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Pending Governance Challenges in the Mexican Oil Industry: A Case for Checks and Balances

By

Armando David Rodríguez

A dissertation submitted in partial satisfaction of the

requirements for the degree of

Doctor of the Science of Law

in the

Graduate Division

of the

University of California, Berkeley

Committee in charge:

Professor Robert D. Cooter, Chair
Professor John C. Yoo
Professor Alison E. Post

Fall 2018

Pending Governance Challenges in the Mexican Oil Industry: A Case for Checks and Balances

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By Armando David Rodríguez

Abstract

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Doctor of the Science of Law

University of California, Berkeley

Professor Robert D. Cooter, Chair

This is a critical account of the regulatory framework governing Mexico's upstream petroleum sector, as a result of the energy reform passed by Congress in 2013 and 2014. Despite the high expectations raised by the opening of the Mexican oil sector towards a market-friendly investment regime, my main argument is that there is set of institutional shortcomings present at the oil regulatory model in force, making the energy reform's liberalization objective far from being complete.

Based upon a political economy approach toward institutions and a comparative analysis of the Norwegian petroleum regime, the present case study applies a concept of checks and balances –as governing standard– to evaluate the new governance model by which the Mexican state has decided to exert control over oil exploration and production activity.

This research identifies sources of excessive administrative discretion and power concentration at the level of 1) the rules governing property rights, 2) the public law contract regime for upstream oil activities, and 3) the administrative state on petroleum in Mexico. The array of failures affecting a balanced oil regime in Mexico lead this critique to put into question whether the government has the capacity to credibly commit to a robust liberalizing policy of its upstream oil business.

More importantly, the institutional design weaknesses stressed by this analysis suggest the persistence of a rentier-state logic shadowing Mexico's upstream oil governance. This rentier function seems to be guaranteed by a full state ownership structure that is much more flexible and permissive than that of the past, but still grants discretionary command and control of this extractive industry to the presidential administration –which ultimately plays against the sector's development.

"I came to realize that one single human being, comprehended in his depth, who gives generously from the treasures of his heart, bestows on us more riches than Caesar or Alexander could ever conquer. Here is our kingdom, the best of monarchies, the best republic.
Here is our garden, our happiness."

ERNST JÜNGER, *Gläserne Bienen* (*The Glass Bees*)

A mis padres, ARMANDO Y ALMA,
por su amor, ejemplo y sacrificio

A mi hermana, ALMA LORENA,
con enorme gratitud

A RACO Y MARTHA,
por creer siempre en mí

Por México y para México

"In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed; and in the next place oblige it to control itself."

Attributed to JAMES MADISON, *The Federalist No. 51*

"The revenue of the state is the state. In effect all depends upon it, whether for support or for reformation…"

EDMUND BURKE, *Reflections on the French Revolution*

"The science of constructing a commonwealth, or renovating it, or reforming it, is, like every other experimental science, not to be taught à priori. Nor is it a short experience that can instruct us in that practical science: because the real effects of moral causes are not always immediate […]

The science of government being therefore so practical in itself, and intended for such practical purposes, a matter which requires experience, and even more experience than any person can gain in his whole life, however sagacious and observing he may be, it is with infinite caution that any man ought to venture upon pulling down an edifice, which has answered in any tolerable degree for ages the common purposes of society, or on building it up again, without having models and patterns of approved utility before his eyes."

EDMUND BURKE, *Reflections on the French Revolution*

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I. INTRODUCTION

The purpose of this work is to frame a critical account of the liberalization process over the regulatory framework governing Mexico's upstream petroleum sector, as a result of the constitutional and legislative amendments passed by Congress in 2013 and 2014. The historical significance of the so-called "energy reform" lies in the opening of Mexico's oil industry, which was nationalized in 1938 and formally transformed into state-owned monopoly since 1958. The main policy goal behind the energy reform proposed by President Peña Nieto's administration was to attract capital investment inside this extractive industry and, thus, stimulate Mexico's growth and economic development. Despite the high expectations raised by the opening of the Mexican oil sector towards a market-friendly investment regime, my main argument is that there is set of institutional shortcomings present at the oil regulatory model in force, making the energy reform's liberalization objective far from being complete.

Drawing upon political economy literature on institutions, credible commitment and the political oil curse theory, the present case study applies a concept of checks and balances as a qualitative standard to evaluate the new governance model by which the Mexican state has decided to exert control over its oil exploration and exploitation activities after the reform. In so doing, this research identifies sources of excessive discretion and power centralization at the level of 1) the rules governing property rights, 2) the public law contract regime for upstream oil activities, and 3) the formal administrative design chosen by the framers to regulate the Mexican upstream oil sector.

The array of failures affecting the Mexican legal institutions on hydrocarbons lead this critique to put into question whether the government has the capacity to credibly commit to a robust liberalization policy along market-driven lines.

My claim about weak checks and balances in Mexico's legal framework on the upstream petroleum industry is reinforced by taking a brief comparative look at oil governing institutions of Norway – a benchmark case whose 'third-way' regulatory design served as model for the Mexican hydrocarbon reform, given their commonality of an ownership structure where the state controls the domestic upstream market and participates by means of a national oil champion. At first glance, the new regulatory organization of Mexico's upstream petroleum sector seems to mimic the 'Norwegian model'; however, a deeper examination of the former's legal architecture sheds light on relevant institutional omissions contrasting the latter's.

The institutional design weaknesses stressed by this law and policy analysis suggest the persistence of a rentier-state logic shadowing Mexico's regulatory governance on upstream oil activities, despite the objectives of growth and economic development nominally pursued by its latest reform. The rentier function of the newborn regulatory framework on crude production seems to be guaranteed by a state ownership arrangement that is much more permissive than that of the past in terms of private investment participation, but still

grants discretionary control of the upstream sector to the Executive branch of government – particularly to the Ministry of Energy and to the Ministry of Finance. The Mexican case illustrates that full state ownership over the petroleum sector served in the past to legalize a rent extraction monopoly –whether for covering the state budget gaps, for patronage purposes, or for private gain itself– into the hands of a ruling elite, considering the absence of checks and balances in the surrounding institutional complex under which such regulatory model was put in motion.

Instead of insisting on institutional façades, this work advocates for a more aggressive liberalization of the Mexican hydrocarbons industry, meaning among other measures: 1) first, an amendment of the rentier policy prevailing on hydrocarbons towards a petroleum resource management that considers other sectorial development strategies from an arm's-length perspective; 2) second, the reinforcement of checks and balances –in the sense of stronger judicial or international law guarantees– to protect the property rights of private investors in the upstream oil industry as a result of the exorbitant command and control powers possessed by the Mexican state in this realm; 3) third, the empowerment of the sectorial regulator in terms of functional autonomy vis–à–vis the Executive branch – particularly from the ministries of Energy and Finance; 4) fourth, the reform of the full state ownership structure that currently prevails on Pemex to a hybrid equity regime that guarantees government corporate control over this national oil champion – as in Norway, Brazil and Colombia.

Although a privatization strategy upon the upstream petroleum industry is not immune to poor implementation or corruption risks, a greater concession of private property rights on oil wealth to agents other than the state is conceived here as an effective institutional means, rather than an economic end per se, in order to check and control rentier voracity on the part of the government, forcing the latter to focus on building its regulatory and policing roles.

Methodology

I want to outline some notes about the methodology on which this dissertation is structured. In general terms, this is a case study on the upstream oil governance system resulting from the Mexican energy reform. In particular, the present case study takes the shape of a law and policy analysis of the regulatory design of Mexico's new oil governance. Rather than consisting in a retrospective evaluation of the oil legal institutions set forth by the energy reform, this work develops a critical stance of prospective approach in addressing the oil industry liberalization pursued by the Mexican energy reform.

Taking into account the difficulty of evaluating at this point the outcomes of the Mexican energy reform retrospectively, since only three years have passed after the approval of Mexico's new laws on hydrocarbons and the correspondent contract regime is at the very early stage of its implementation, this research proceeds to use theoretical and comparative institutional analysis as a feasible way to build a normative standard against to

which assess the Mexico's regulatory framework on crude oil activities. It is in such sense that this work has a prospective orientation.

To structure such law and policy critique and thus reduce its anecdotal orientation, **Chapter II** unfolds an analytical framework with the historical background, economic drivers, preliminary assumptions, and conceptual constructions through which this research's central claims are systematized and thereafter supported in detail across its content. In other words, this is the conceptual backbone of the present work. As stated above and in Chapter II, some of my claims on checks and balances and their correlation with capital investment and economic growth are based on theory developed by political economy literature, which in turn is empirically-supported to the point that today is considered 'conventional wisdom'. I clarify this point because the present enterprise has no purpose in generating first-hand empirical data on the correlations between two or more variables. Moreover, these empirically supported theses imported from political economy are taken as benchmark to articulate its judgments of prospective scope.

Although it could have been part of this work's analytical framework, for the sake of explanatory accuracy, **Chapter III** displays in detail the conceptual pillars supporting the political economy theory on ownership my critique of the Mexican energy reform draws upon. In short, this approach obeys the purpose of making easier for readers without an economics or political science background to understand the rationale behind the policy arguments I make while going through a examination of Mexico's ownership regime on upstream oil operations and its linkage to fiscal institutions.

The aim of **Chapter IV** is to introduce the foundations articulating Mexico's constitutional law system on hydrocarbons in the recent past, so that there is a comprehensive understanding of the legal changes and the institutional narrative the mentioned energy reform entailed for the upstream oil governance. Hence, I go through several constitutional amendments, explaining both the legal notions and drafting technique that were gradually introduced as well as their implications in shaping of the regulatory governance of the Mexican petroleum industry before the energy reform of 2013.

By means of **Chapters V** and **VI**, respectively, this research applies its checks and balances standard to evaluate Mexico's regulatory regime on hydrocarbons and administrative organization of the sector. It is worth noting that this public law and policy assessment imports it normative grip from political economy insights on institutions and commitment, constitutional theory, literature on regulation and government studies. For the sake of organizing such regulatory law and policy analysis, this work focuses on two main components.

On the one hand, **Chapter V** addresses the public law provisions governing: 1) the property rights on crude oil resources; 2) the public law contract regime on upstream petroleum operations; 3) key regulatory aspects regarding the functional intervention of those government agencies entrusted with policy, regulatory, and fiscal powers over the upstream oil industry; and, 4) both the judicial and alternative dispute resolution instruments to keep administrative intervention within rule of law boundaries.

On the other, **Chapter VI** reviews the administrative organization model that was chosen to regulate and intervene in the Mexican upstream oil sector. Based upon a checks and controls perspective, I frame an institutional design critique over the triangle structure of government actors in charge of the policymaking, regulatory, and commercial roles in such extractive industry – namely, the Executive branch (represented by the Energy Ministry and the Finance Ministry), the upstream oil regulator (the National Hydrocarbons Commission), and Mexico's national oil company ("Petróleos Mexicanos").

For the purpose of laying out the juridical analysis above, it was imperative to consult the following Mexican positive law: (a) Articles 25, 27, 28 of Mexico's Federal Constitution; (b) The Transitory provisions of the Energy Constitutional Reform of 2013; (c) the Hydrocarbons Act; (d) the Hydrocarbon Revenue Act; (e) the Coordinated Regulatory Organs on Energy Act; (f) the Federal Administration Organic Act, and (g) the Petróleos Mexicanos Organic Act, among other legislation.

Chapter VII articulates a comparative analysis of Mexico's oil governance with the institutions governing the petroleum industry in Norway – and to a lesser extent with the implantations of the Norwegian model in Latin American jurisdictions, such as Brazil and Colombia. Basically, I take Norway as the best institutional practice of what an arm's-length regime on petroleum should be in order to identify substantive differences that might affect the functioning of the Mexico's oil governance – targeting checks and balances in particular. The relevance of the Norwegian triangle model as a successful regulatory experience comes from the fact that this Nordic nation shares with Mexico the combination of strong state control of the upstream oil sector with the aim for arm's-length governance that fosters market efficiency and growth of the industry.

Finally, **Chapter VIII** summarizes why the Mexican upstream oil sector should be submitted to further liberalization efforts –in terms of checks and balances– than those of the 2013 energy reform, given the rentier rationale that still seems to rule over the newborn regulatory governance in Mexico. To that end, this chapter briefly articulates a narrative of the institutional shortcomings revealed in each of the layers and components of the Mexican upstream oil regime – where all and each of these conclusions is reinforced by means of the comparative analysis done in light of the Norwegian oil regulatory design. Likewise, this chapter provides a set of policy recommendations concerning the institution of private property rights within the ownership regime of the oil sector and a redefinition of functions among the actors of the petroleum administrative state with the aim at restraining the discretion of the Executive branch.

II. Analytical Premises

1. Historical Significance of the Energy Reform

Seventy-five years took domestic political actors and institutional conditions to be aligned for the passage of a legal reform –also known as the '*energy reform*'— with the purpose to open up again Mexico's petroleum upstream sector, which had been nationalized by President Lázaro Cárdenas since 1938.[1] From the 1940s through the 1970s, Mexico's state-owned oil company "Petróleos Mexicanos" (Pemex) became a benchmark for all those mineral-rich states pursuing to regain the control of their hydrocarbons industry through aggressive expropriations over the then-dominant international oil companies –the so-called "majors".[2]

What used to be an oil market operating under an oligopolistic structure dominated by American, British, and Dutch commercial interests, became a state monopoly as a result of a presidential expropriation decree of 1938, which was shielded later on by the passage of a federal law forbidding any type contracts on upstream activities in 1958, and a constitutional amendment in 1960.[3]

The liberalization of the oil industry constitutes a turning point in Mexico's political history because it puts an end to an ossified understanding of energy sovereignty, which for most part of the XX century was the crown jewel of the nationalistic ideology at the service of the Mexican post-revolutionary one-party regime.[4] Yet the public ownership of natural resources in Mexico still is a sacred mantra recognized at the federal constitution.

This maxim has been put in practice by equating the national interest of the people to that of the Mexican state.[5] By means of this legal fiction applicable to the ownership and management of Mexico's oil and gas, the boundaries defining the principal-agent relationship between the people and the state have been confounded and, therefore, encroached by the ruling political elite. This state-controlled framework of property rights on oil resources was instrumented by the Institutional Revolutionary Party's (PRI)

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[1] *See* David G. Victor, David R. Hults, and Mark C. Thurber, Introduction and overview, at 5; Peter A. Nolan and Mark C. Thurber, "On the state's choice of oil company: Risk management and the frontier of the petroleum industry", at 145, and Ognen Stojanovski, "Handcuffed: An assessment of Pemex's performance and strategy", at 285, in David G. Victor, David R. Hults, and Mark C. Thurber (eds.), *Oil and Governance: State-owned Enterprises and the World Energy Supply*, Cambridge University Press, 2012. *See,* also, Tim R. Samples, "A New Era for Energy Reform in Mexico? The 2013-14 Energy Reform", *Texas International Law Journal,* Vol. 50, 2016, at 605-607, 620-622.

[2] *See* Pauline Jones Luong and Erika Weinthal, *Oil is not a curse. Ownership Structure and Institutions in Soviet Successor States,* Cambridge University Press, New York, 2010, at 14, 300.

[3] *See* Victor et al, *supra note* 1, at 5.

[4] *See* Claudio Lomnitz, *La nación desdibujada: México en trece ensayos* [Blurred nation: Mexico in thirteen essays], Malpaso Ediciones, Barcelona, 2016, at 93.

[5] *See* Articles 25, paragraph fifth; 27, paragraph seventh, and 28, paragraph fourth, of the federal Constitution of Mexico.

governments, which were initially driven by a legitimacy concern before the population through the satisfaction of welfare expectations in the form of subsidies, full employment, and public services.[6] The success of natural resource nationalism as domestic energy policy seemed fit during the golden age of import substitution industrialization (ISI) in Latin America.[7]

However, the ISI-based strategy crumbled down when the rapid growth rates of the Mexican economy were achieved thanks to the unexpected finding of oil wealth, suddenly transforming Mexico into a net oil exporter. The oil boom of the mid-1970s and the discovery of huge petroleum reserves of 1976 pushed a leftist government to get indebted at the international lending markets in order to fund high-scale public infrastructure. Once oil prices plummeted in the early 1980s after the peaks provoked by the Iranian Revolution of 1979, Mexico's financial standing to pay the service of its external debt was severely weakened and fiscal deficits increased to keep functioning an economy, whose high growth rates were highly dependent on government money.

When this fiscal crisis spread and became a monetary turmoil in the sense of capital flight, successive currency devaluations and hyperinflation rates, the Mexican government was forced to call a payment default in 1982. The long-term effects triggered by these macroeconomic crises –in which oil wealth mismanagement was a key factor– would cripple the Mexican economy to such extent that the 1980s are referred by historians as the "lost decade"[8]: a period characterized by hyperinflation spiral and low, or even negative[9], growth rates that followed the stop of international credit flow after the payment moratorium declared by several Latin American countries.

To manage the stabilization of the macroeconomic variables, particularly those of fiscal nature, the Mexican government resorted to structural reform through of liberalization and privatization policies of drastic scope along market-oriented lines –also known as 'neoliberal' reform. Both the presidential administrations of the PRI reformists[10]in the 1990s and the first alternation governments of the center-right National Action Party

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[6] *See* Jones Luong and Weinthal, *supra note* 2, at 14, 57—73. The authors of this text encompass this type of economic and social policy objectives within the notion of "societal expectations", whose satisfaction the population demands from the oil-rich states.

[7] *See* Jones Luong and Weinthal, *supra note* 2, at 63. The ISI strategy is based on the principle that the government should dominate the economy. For the authors, "governing elites who opt to develop the petroleum sector for internal consumption, […] have a strong temptation to adopt ISI. According this source, this was the case for Mexico after the nationalization of its oil industry. Jones Luong and Weinthal support this remark on Esperanza Durán's study on Pemex, for whom "[b]etween 1938 and 1976, the prime objective [of the oil industry] was to satisfy internal demand and to support [ISI] through very low, subsidized prices. Oil was regarded as a tool for inward-looking development". *See* Esperanza Durán, "Pemex: The trajectory of a national oil policy", *The Oil Business in Latin America,* J.D. Wirth (ed.), Beard Books, Washington D.C., 1985, at 147.

[8] Stojanovski, *supra note* 1, at 287.

[9] -O.6% in 1982, -4.2% in 1983, and -3.7% in 1986, according to The World Bank, "GDP Growth (% Annual) in Mexico", World Bank national accounts data, and OECD National Accounts data files, consulted on April 1, 2017, at http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=MX

[10] That is, the governments of presidents Miguel de la Madrid (1982—1988), Carlos Salinas (1988—1994), and Ernesto Zedillo (1994—2000).

(PAN)[11] managed to embark on structural reform by signing international free-trade agreements, privatizing state-owned companies, and deregulating the provision of goods and services.

Surprisingly, the petroleum upstream sector of Mexico remained immune to the neoliberal, market-oriented reform agenda. Not even the liberalization winds coming out from the North American Free Trade Agreement (NAFTA) signed by Canada, Mexico, and the United States, and in force since 1994, could permeate the statist policy –a position typically defended by the left wing parties and the PRI establishment— on keeping the national oil sector shielded from foreign investment.

Mexico's state monopoly on oil exploration and exploitation activities was exceptional even among its Latin American peers such as Brazil, Venezuela, and Colombia, whose political elites were less reluctant –or probably faced stronger incentives– to harness the trend of injecting fresh private capital on their natural resource industries throughout the 1980s and 1990s.

The liberalization of the hydrocarbons industry achieved through the energy reform of 2013-2014 symbolizes a long awaited break up with Mexico's economic and political taboos of the past.[12] In words of Mexico's incumbent President, Enrique Peña Nieto, the energy reform has been considered as "the most important economic change in Mexico in the last 50 years".[13]

According to the Executive branch legislation bill proposal of 2013, the main purpose of this energy overhaul was to trigger capital investment in Mexico's hydrocarbons industry and to stimulate economic development. As this work shows, however, the approved petroleum legislation has a *fiscal-oriented* conception of economic development as its main provisions seem to be commanding oil governing institutions to secure the maximum of rents for the state rather than appealing evenly to other equally important policy goals, such as the competitiveness of the sector per se. In any case, aside from its political implications, the 2013-2014 energy reform is the 'blue ribbon' of a cycle of economic liberalization policies implemented by Mexican presidential administrations of the neoliberal era.

2. Drivers of the Energy Reform

Many factors led to the transformation of the rules governing Mexico's crude industry. First of all, the *financial constraints* faced by the Mexican government for increasing its productive investment in petroleum upstream operations are extremely tight, considering

[11] The administrations of presidents Vicente Fox (2000—2006) and Felipe Calderón (2006—2012).

[12] *See* Samples, *supra note* 1, at 607.

[13] *See* Enrique Peña Nieto, "Energy Reform is the Most Important Structural Change in Mexico in the Past Fifty Years: EPN", Presidencia de la República, Mexico City, March 19, 2014, at http://en.presidencia.gob.mx/articlespress/energy-reform-is-the-most-important-structural-change-in-mexico-in-the-past-fifty-years-epn/, cited by Samples, *supra note* 1, at 605.

the fiscal fragility of the state. For instance, governance quality in Mexico seems weak when measured in terms of its taxation capacity. According to the Organisation for Economic Co-operation and Development (OECD), the tax-to-Gross Domestic Product (GDP) ratio in Mexico has increased from 13.59% in 2000 to 17.44% in 2015, whereas the average collection rate of this international organization was 34.4% in 2015.[14] In the same way, approximately 50% of the government revenues come out from non-oil related taxes, while petroleum rents cover more than one third of this governance indicator.[15] In a nutshell, the Mexican government seems handcuffed between a feeble tax collection capacity and a fiscal dependency on oil-related revenue.

It is not coincidence that, as of the new petroleum discoveries in the mid-1970s, Pemex started to be dubbed as the "cash cow"[16] of both post-revolutionary and alternation governments. The political economy arising from this scenario, consequently, fosters fiscal conservatism on the part of the Mexican government by subordinating the use of the domestic oil industry as a potential engine for economic growth to the task of a short-term budgetary patch instead.[17] As a result, the Mexican government's budgetary dependence on its oil monopoly has taken the shape of a paralyzing tax burden for Pemex.[18] This is an illustration of the "rentier"[19] logic guiding the energy policy of Mexico – particularly among decision-makers of the Finance Ministry, whose macroeconomic approach leads to

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[14] *See* OECD, "Revenue Statistics – OECD Countries – Comparative Tables", OECD.stat, at https://stats.oecd.org/Index.aspx?DataSetCode=REV, https://www.oecd.org/tax/revenue-statistics-mexico.pdf.

[15] *See* Carlos Elizondo Mayer-Serra, "Stuck in the Mud: The Politics of Constitutional Reform in the Oil Sector in Mexico", 14, James A. Baker III Institute, Rice University, April 29, 2011, at at 6, 15—16, http://bakerinstitute.org/publications/stuck-inthe-mud-the-politics-of-constitutional-reform-in-the-oil-sector-in-mexico. *See,* also, Manuel Lorenzo Reyes-Loya and Lorenzo Blanco, "Measuring the importance of oil-related revenues in total discal income for Mexico", *Energy Economics* 30 (2008), 2552—2568, at http://eprints.uanl.mx/7524/1/Measuring%20the%20importance%20of%20oil-related%20revenues%20for%20total%20fiscal%20income%20in%20Mexico.pdf

[16] *See* Samples, *supra note* 1, at 614.

[17] *See* Reyes-Loya and Blanco, *supra note* 15, at 2567.

[18] *See* Samples, *supra note* 1, at 615.

[19] According to Beblawi, a *rentier state* is one in which "the government is the principal recipient of the external rent in the economy". *See* H. Beblawi, "The rentier state in the Arab world", in *Nation, State and Integration in the Arab World, Vol. 2, The Rentier State,* ed. H. Beblawi and G. Luciani, Croom Helm, London, 1987, at 52. Michael Ross defines the *rentier effect* as the scenario in which "[a]n abundant flow of oil revenues enables [ruling] incumbents to both reduce taxes and increase patronage and public goods, making it possible for them to buy off a larger set of potential challengers and reduce dissent". *See* Ross, *infra note* 49, at 246. The type of polity depicted by this definition fits in with the Mexican case during the era of the PRI governments, as will as with the administrations of the democratic transition since 2000. Furthermore, it is the fiscal treatment of Pemex as the Mexican government's "cash cow" what has allowed Mexico to have the lowest tax collection rate among the OECD members and to be below average when compared to other Latin American nations. According to the OECD statistics, for 2015 the average tax collection ratio as percentage of the GDP among OECD countries was 34.3%, whilst the Mexico's was 17.4%. Within the Latin American context, in 2014 the average tax collection rate was 21.7%, whilst in Mexico's was 15.2%. The taxing capacity of the Mexican state has weakened consistently to lower levels than the average in Latin America since 1994. *See* OECD, "Revenue Statistics – OECD Countries – Comparative Tables", OECD.stat, at https://stats.oecd.org/Index.aspx?DataSetCode=REV, https://www.oecd.org/tax/revenue-statistics-mexico.pdf. *See*, also, OECD, "Revenue Statistics – OECD Countries – Comparative Tables", OECD.stat, at https://stats.oecd.org/Index.aspx?DataSetCode=RSLACT.

the sacrifice of both the NOC's efficient performance and long-term investments in the sector for the sake of turning it into an "instrument of the state's financial engineering".[20]

In fact, the use of fiscal policy over the domestic energy market for rentier purposes was recently witnessed when the Peña Nieto administration –via its Finance Ministry– decided to anticipate the liberalization of the oil fuels market for 2017 rather than 2018. This liberalization process meant that, as of 2017, petroleum fuels in Mexico began to be gradually regulated by the Energy Regulatory Commission (midstream and downstream regulator).

Taking international markets as baseline for the new price structure, the price amount is now determined by the currency exchange costs given Mexico's *net importer* status, instead of the price control formerly administered by the Finance Ministry – a mechanism centered on the grant of cross-subsidies aimed at selling gasoline to the population below importation costs. But what the administration concealed –or did not communicate in a transparent manner– to taxpayers, was that the subsidies removal would be coupled with a special sales tax of fix rate on oil fuels, regardless of the latter's market price level, in terms of the congressional authorization passed in the Federal Revenue Act for the Fiscal Year of 2017.

Nonetheless, the government judged this tax as imperative to compensate the oil revenue downfall occurred since 2014 and to reduce both the increasing budgetary deficits and the external debt contracted since the incumbent President took office in 2012. Considering the unpopularity that such financial decision would have, and actually had, on domestic consumers, it seems that the Finance Ministry was instructed to advance its execution one year before to that in which presidential elections will take place in Mexico in order to blur its political costs for the President's party.[21]

Second, but related to the first point above, Mexico urgently needs to offset the accelerated pace of its *oil production decline*.[22] By way of illustration, between 2004 and 2011, the Mexican petroleum production dropped from 3.4 million to 2.5 million barrels per-day[23]; that is, a loss of approximately a quarter of the production since the beginning of that period of time.[24] This significant downfall of crude production is the outcome of an exploitation strategy based on 'mature fields' discovered more than twenty years ago. Particularly the supergiant field of Cantarell in shallow waters of the Bay of Campeche, which was discovered in 1976 and whose aging process has come to a point in which it

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[20] *See* Stojanovski, *supra note* 1, at 282.

[21] *See* Hernández Borbolla, Manuel, "¿Peña Nieto adelantó la liberación de precios de la gasolina para evitar la derrota en 2018?" [Did Peña Nieto advanced the liberalization of gasoline price to avoid defeat in 2018?], The Huffington Post – Mexico Edition, January 13, 2017, at http://www.huffingtonpost.com.mx/2017/01/13/por-que-se-adelanto-la-liberalizacion-de-los-precios-de-la-gaso_a_21654031/ , consulted on August 8, 2017.

[22] *See* Samples, *supra note* 1, at 612.

[23] Eric Martin and Carlos Manuel Rodríguez, "Mexico May Finally Get a Modern Oil Industry", *Bloomberg,* July 12, 2012, at http://www.bloomberg.com/news/articles/2012-07-12/mexico-may-finally-get-a-modern-oil-industry, cited by Samples, *supra note* 1, at 612.

[24] *See* Tim R. Samples and José Luis Vittor, "The Past, Present, and Future of Energy in Mexico: Prospects for Reform under Peña Nieto Administration", *Texas International Law Journal*, Vol. 50, 2016, at 702—703.

represented a 17% of Mexico's crude production in 2013 vis-à-vis the 63% it reached in 2004.[25] According to the Mexican Ministry of Energy, about 80% of Mexico's crude fields are now in declining phases of their production life cycle.[26] This concern is critical for the government because, according to some experts, Mexico might become into a net importer of petroleum.[27] In fact, Mexico does import 60% of its oil derivatives like diesel and gasoline and this trend has come to be more pronounced since the fuels market's liberalization in 2017.[28]

Third, by 2013 –the year in which the energy reform was approved at the constitutional level— Mexico was decades behind the contemporary trend consisting in market-friendly legal frameworks fostering foreign investment in the sector.[29] The entrance of *private capital* into the sector seems like a necessary condition to turn this industry into an economic growth engine of the Mexican economy by surrogating the absence of public investment in this industry.

Fourth, *full state ownership and control* of hydrocarbons for nearly eight decades took its toll in the form of an outdated infrastructure –both upstream and downstream— with poor technological capacity to obtain streamlined flows of crude oil production. The presence of such an old-fashioned oil industry partially contributed to the continuous production decline faced by Pemex in the last twenty years. The logic behind this phenomenon is quite simple: When the state – via its NOC — is the exclusive operator of the oil supply chain domestically, the incentives to reinvest Pemex's profits in long-term, capital-intensive, risky projects are very low in the context of an aggressive depletion policy upon existing mature oil fields, provided that both politicians and public officials in the sector respond to short-term concerns –particularly, the contribution of oil sales to cover government budget gaps.

Thereupon, the energy reform of 2013-2014 was aimed at responding to fiscal, sectorial, and regulatory challenges strangling the efficient performance of the Mexican upstream sector. Nevertheless, this dissertation illustrates why the main driver of the Mexican energy reform seems to be a fiscally oriented policy. Considering the environment of price volatility surrounding global energy markets, a feature that has taken the form of a pronounced plunge of oil prices since 2014[30], today Mexico requires to trigger an ambitious investment strategy in technology, human capital, and institutions in order to improve its old-fashioned petroleum upstream infrastructure.

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[25] *Ib.* at 702—703. *See*, also, Samples, *supra note* 1, at 612.
[26] *See* Secretaría de Energía [Ministry of Energy of Mexico], *Estrategia Nacional de Energía 2013-2017* [Energy National Strategy], Gobierno de la República, 2013, at http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=37957550, cited by Samples, *supra note* 1, at 612.
[27] *See* Kennet B. Medlock III and Ronald Soligo, "Scenarios for Oil Supply, Demand, and Net Exports", from James A. Baker III Institute for Public Policy, Rice University, vol. 25, 2011, at http://bakerinstitute.org/publications/EF-pub-MedlockSoligoScenar, cited by Samples and Vittor, *supra note* 24, at 702—703.
[28] Érika Hernández, "Adelantan importación de combustibles" [Fuels importation gets approved in advance], *Reforma,* February 22, 2016, at http://www.reforma.com/aplicaciones/articulo/default.aspx?id=774398
[29] *See* Samples, *supra note* 1, at 606.
[30] *Id.*

3. Governance Challenges after the Energy Reform

The purpose of this dissertation is to evaluate whether the institutional response chosen by the Mexican state –through the energy reform– seems fit to achieve the economic liberalization of this industry. Despite the economic expectations raised by President Peña Nieto's administration on the energy reform of 2013-2014, both domestically and internationally, Mexico's new hydrocarbon laws seem like a pale liberalization effort of the upstream sector.

The present case study takes the energy reform of 2013-2014 as its main object of study; namely, the new *legal institutions* and *regulatory arrangement* applicable to petroleum upstream activities in Mexico. In so doing, this work applies the normative rationale of some concepts framed by both the theory on 'institutions and commitment' and the critics of the traditional oil curse narrative, with the aim at analyzing the ways in which these play out in light of the specific oil regulatory framework resulting from the energy reform.

My central claim is, therefore, that the oil legal regime incorporated through the energy reform of 2013 is far from having a robust structure of *checks and balances*, putting into question whether this institutional change is guided by a genuine liberalization objective.[31] Basically, this research identifies sources of administrative discretion on the level of the rules governing the ownership structure as well as on the institutions organizing the policymaking, regulatory, and commercial functions of the petroleum upstream segment. Mexico's new legal system on hydrocarbons still reserves highly discretionary prerogatives in favor of the Mexican government, casting doubt on the state's capacity to credibly commit to a robust liberalization policy along market-oriented guidelines.

My account is that the exorbitant authority granted to Mexico's ministries of Energy and of Finance, under a policy mandate particularly aimed at maximizing oil rents, could be an obstacle for improving the performance of this industry itself. The still encroaching presence of the Finance Ministry over Mexico's petroleum upstream governance somehow reflects a property rights framework in which the interest of the state apparatus –and its incumbent governing elite, regardless of its political ideology– is misinterpreted as "national interest" at the expense of effective constitutional protection of real checks and balances just as private property rights as well as an enabling, but accountable, fiscal system. Such structural shortcomings convey, in my view, the wrong incentives to private investors and might frustrate the policy fueling the energy reform: that is, to attract the flows of capital investment needed to modernize the Mexican petroleum sector and turn it into an engine for growth and development of the nation.

[31] In the context of this paper, my understanding of *economic liberalization* is simply the relaxation of legal norms governing property rights, investment, and competition at any given industry or market. Hence, any *economic liberalization* process entails the evolution from a public ownership regime with full state control towards a more flexible regulatory environment that allows the presence of private investors, assigns private property rights, and guarantees competition among market agents.

4. Checks and Balances in the Oil Industry

A. Checks and Balances as Principle

This work's singularity lies in using a notion of *checks and balances* that appeals neither to domestic positive law nor to any judicial doctrine on constitutional separation of powers; instead, I hereby employ a broad concept of checks and balances consisting in a governance system in which each branch of the government has been granted with a defined sphere of legal authority and has the mechanisms to limit any power encroachment, or functional aggrandizement, from the other state departments. Two are the dimensions I attach to the idea of checks and balances.

On the one hand, the concept of checks and balances I use here is a *normative* one because it works as a standard to evaluate the new governance model by which the Mexican state has decided to exert control over its oil exploration and exploitation activities after the energy reform of 2013-2014. Rather than sticking its meaning to domestic constitutional law, this research uses checks and balances as a *rule-of-law standard* rooted in the tradition of classical liberalism: a political philosophy whose ultimate goal is the deterrence of pervasive concentration of political power on one state institution –whether an individual, an assembly, a judge, or an administrative agency— at the expense of the others, as necessary means to secure political freedom.

Consequently, the prescriptive nature of the present category means that any institutional design allowing the expansion of one government department in detriment of the rest authoritative branches is in violation of this checking standard and needs to be counterbalanced according to rule of law parameters.

On the other hand, this paper resorts to a *functional* conception of checks and balances that places political institutions at a central position by shaping the incentives and constraints faced by the state officials and other strategic actors when it comes to the policymaking, regulatory, and business decisions in the Mexican oil sector. It is not constitutional law theory or jurisprudence the touchstone of this work's notion of checks and balances, but rather the language of positive political theory; namely, the structure of incentives, interests, and motives from different actors checking one another in such a competitive fashion that discretion is limited and, therefore, the regulatory environment enables a workable balance of the government system.

The *balanced* performance of an institutional arrangement is synonym of two qualities that go hand-in-hand: *stability* and *predictability*. The first attribute is fostered by a system of checks and balances when one institutional actor cannot unilaterally make a binding decision for the whole body politic without the others branches of government having a controlling role in such decision-making process by means of review or veto powers. Consequently, checks and balances are a tool against the arbitrary and capricious change of rules and policies in force (status quo equilibrium), whose creation, reform or

implementation to be both valid and effective can only result from rule-based cooperation among different authoritative decision-makers –whether legislative, judicial, or executive.

Predictability, on the other hand, refers to the degree of certainty on the outcome that institutional agents in interaction can reasonably expect from others' behavior in order to rationally guide their conduct in their best interest, in light of a previously known set of legal institutions regulating such competitive environment.[32] Thus, predictability is enhanced where institutional actors check one another because these power interactions are rule-bound themselves, so they must be processed in an orderly way through specific institutional channels where no institutional actor has an absolute say.

All things considered, this commitment to stability and predictability of the regulatory environment results from a power-diffusion rationale anchored at the concept of checks and balances. By way of explanation, checks and balances perform a *disaggregation* function that appeals to deterring –or neutralizing– arbitrary and discretionary concentrations of power by means of institutional mechanisms aimed at controlling, limiting, and even breaking unlawful authority encroachment of dominant agents against other institutional actor's space of legal prerogatives. This *power-dispersion* logic of checks and balances is neither trivial nor morally neutral, but mainly defensive, since its ultimate purpose lies in protecting the limited sphere of freedom the legal system grants to individuals from the whims of political power.

However, I want to add a remark that might counter the argument above. Although the notion of checks and balances reveals a *power-diffusion* rationale rather a centralization of authority, it should be stressed that such functional separation must not be conceived in absolute terms as a permanent gridlock to the procurement of the governance system's social goals –for instance, economic growth and development, social fairness, national security, etcetera. Most policy objectives require a positive consensus –or at least a qualified majority of approval– among decision makers so as to overcome the ordinary vetoes structure and, therefore, amend a given regulatory framework from a status quo default scenario toward a new situation where the relevant community is better off in net terms. In fact, the successful implementation of policy goals demands active and concerted intervention from different branches of government.

On that account, it should be highlighted that checks and controls are prone to *fragmentation* pressures acting upon the relevant policymaking institutions, increasing not only the likelihood of government paralysis, but also the possibility of conflicting and unstable policies. When excessive or badly engineered, separation of functions regimes can obstruct *coordination* among the different government entities with the legal capacity to regulate several portions of the same subject –in our case, the Mexican upstream petroleum industry–.

[32] *See* Joseph Raz, "The Rule of Law and its Virtue", in *The Authority of Law: Essays on Law and Morality,* Oxford, Clarendon Press, Oxford Scholarship Online, 1979, at: http://www.oxfordscholarship.com/view/10.1093/acprof:oso/9780198253457.001.0001/acprof-9780198253457-chapter-11

The lack of coordination channels caused by the misalignment of checks and balances leads to overlapping roles, information asymmetries, and high transaction costs which usually crystallize in conflicting regulatory policies, jurisdictional disputes, legal uncertainty and excessive bureaucracy, hurting what was the original target of protection: the stability and predictability of the institutional environment demanded by private investors.

Thus, government's workable performance demands that checks and balances are carefully *aligned*, so their functional separation rationale is compatible with the pursuit of the regime's policy objectives through a cohesive and stable regulatory environment. For that purpose, checks and balances are to be understood as instrumental components at the service of a given governance regime that is aimed at pursuing certain social goals, whose effective delivery justifies the regulatory power exercised by such system over its agents. Echoing Michael Walzer's political philosophy, the core purpose of checks and controls is to deal precisely with the paradox embedded at the heart of state power: It is a necessary means to materialize different social goods and ordain its distribution, including the sphere of political power itself. [33]

Paraphrasing Ferdinand Lassalle, a German jurist and social-democrat politician of the XIX century, who defined a national constitution as the group of real power factors in force at a given country's territory[34], this research portrays a version of checks and balances supported on a realistic picture of the politics surrounding petroleum upstream sector. Put differently, it is the acknowledgment of this political economy characterized by a fierce competition among a plurality of interests trying to benefit from the oil industry what allows policymakers to design a legal regime with an aligned structure of checks and balances among its institutional components that actually works for the public interest –say, national economic growth and social development— instead of being captured by private interests –such as, corruption and rent-seeking practices.

Yet my aim at taking into account Mexican oil *realpolitik* –that is, politics as it is– as the core foundation for my legal design and policy proposals is to neither conserve nor reinforce the status quo from which political elites benefit today, but to effectively regulate and shape those political dynamics in a compatible way with a robust liberalization. Any institutional change attempt that turns a blind eye to the existing oil politics is doomed to be a mere legal façade without the normative force to regulate struggles of political and economic power.[35]

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[33] For Walzer, *sovereignty* is the most significant and dangerous form power can take. *Political power* protects us from tyranny and itself becomes tyrannical. *See* Michael Walzer, *Spheres of Justice: A Defense of Pluralism and Equality,* New York, Basic Books, 1983, at 281.

[34] *See* Ferdinand Lassalle, *¿Qué es una Constitución?* [What is a Constitution?], Ediciones Coyoacán – Política, Mexico City, 2005, at 42—52.

[35] Some critics, especially those legal scholars educated in the rigors of logical positivism, could raise the counter-argument that the two-fold dimension of checks and balances presented here is mistaken, or incurs into a fallacy, by framing legal reform and policy proposals, which pertain to the normative realm (the "ought to be"), based on factual world observations (the "is") relative to political economy studies. In accordance to the so-called Hume's rule, it is logically invalid to get an "ought" from an "is" and vice versa. Those who try to get an "ought" from an "is" incur in the *naturalistic fallacy.* My reply to such challenge would be that, first of all, public law and policy analyses are not 'science' –or 'hard science'— strictly speaking, but disciplines

B. THE CREDIBILITY OF PETROLEUM INSTITUTIONS

My interest in checks and balances within the Mexican oil governance is inspired in political economy theory on *institutions and commitment* because of its robust empirical findings at the level of cross-sectional studies. Even though this dissertation has no purpose in generating and organizing first-hand empirical data on the correlation between two or more variables, my aim at borrowing both concepts and insights from the literature on institutions and commitment is to apply their political economy rationale to my critique of Mexico's new legal regime on petroleum upstream. Thus, this work develops further the concept of checks and balances at the level of a case study on the governing public law institutions of the Mexican oil sector, as result of the 2013-2014 reform.

Taking Brian Levy and Pablo T. Spiller's work "*Regulation, Institutions, and Commitment*" as model for the work I want to do through this book, in order to analyze whether Mexico's new regulatory system on oil upstream is a credible and effective liberalization, and so its capacity to boost private investment and efficiency, it is convenient to clarify that any regulation "design" problem[36] integrates two main components: *regulatory governance* and *regulatory incentives*.[37] In our specific context, the first component refers to the legal mechanisms aimed at both guiding the authoritative behavior and restraining the discretionary behavior on the part of the government agents and other public entities involved in the policymaking, administrative, and contracting roles of the Mexican upstream oil activities.[38] On the other hand, the incentives structure consists in the norms ruling the microeconomic aspects of the specific industry at hand, such as the fiscal terms of Mexico's new contracting regime for the performance of crude oil exploration and extraction tasks; applicable competition regulation (i.e. barriers of entry, interconnection, etcetera); pricing regulation, and so forth.[39]

The present work emphasizes the evaluation of the *regulatory governance* enacted by means of the energy reform of 2013-2014. Even though at some point of this book I briefly address the oil contract regime established by the energy reform, such exploration is

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for which the subject matter of study is human behavior and institutional vehicles created to reach binding collective decisions. In this sense, the scholarly study of the law and political institutions requires a high deal of interpretation on the observer's part, as well as a thorough understanding of the specific historical context. On the contrary, natural sciences target their analytic tools to objects of study that may be easily addressed by the orthodoxy of the empiricist scientific method, in terms of objectivity and precision. This is not to say, however, that public law and policy analysis are totally void of empirical evidence. My goal here is just to underscore that even those factual observations supporting institutional reform are at the service of a complex heuristic process that implies a larger amount of speculative thinking than hard sciences do. Second, although this paper's legal reform recommendations suppose a contingent nexus between the empirical sphere and the normative field, given that part of their justification draws upon positive political theory, this course of action is motivated by a more important concern regarding the discovery of the possibility conditions for these overhaul proposals to be effective in Mexico's upstream petroleum sector.

[36] *See* Brian Levy and Pablo T. Spiller, *Regulations, Institutions, and Commitment. Comparative Studies of Telecommunications,* Political Economy of Institutions and Decisions, Cambridge University Press, Cambridge, 1996, at 4.

[37] *Id.*

[38] *Id.*

[39] *Id.*

tangential and collateral to the analysis of the Mexican oil governance structure. This methodological path is far from being an arbitrary choice in light of the following arguments.

Firstly, the new contractual framework of Mexico's crude industry is at an early implementation stage –a circumstance that makes difficult a retrospective evaluation of its outcomes in terms of the incentives structure covered by each kind of ideal-type agreement (i.e. production-sharing agreements, profit-sharing agreements, licenses, services contracts). Secondly, according to Levy and Spiller, regulatory incentives have been the main concern of theoretical works on regulation, which may be inadequate because incentives only produce their full consequences when clothed by the proper governance arrangements. Hence, my purpose is to fill the gap identified by the aforementioned scholars regarding the lack of case studies on governance regimes. Thirdly, even when Mexico's upstream contracting regime was fully regulated and operational to be properly reviewed, a thorough assessment of its microeconomic grounds surpasses the scope of this legal and policy study.

In consonance with the remarks made by Witold J. Henisz and Bennet A. Zelner, the theoretical foundations for the economic effects of political institutions have evolved exponentially since the work of North and Thomas, who were the first economists to lay out the so-called "transaction cost theory of economic history".[40] Studies on the economic role played by government and other political factors –which can actually reduce the private costs of bargaining, contracting, monitoring and enforcement— have reached the degree of "conventional wisdom"[41] among scholars and policy experts. This consensus has emphasized that government's credible commitment neither to interfere private property rights, nor to perform frequent and arbitrary changes in taxation, regulatory or other economic policies, turns out a critical instrument in achieving long-term capital investments required for developing nations to have rapid economic growth.[42]

The upstream petroleum sector is a *capital-intensive* industry where large sunk investments are essential for keeping up with infrastructure and other technological needs. In such case, the absence of credible commitment by state actors on not expropriating capital assets or returns –or on refraining from capricious regulatory changes—increases both the uncertainty and the cost for private investment.[43]

[40] *See* Witold J. Henisz (2000), "The Institutional Environment for Economic Growth", *Economics and Politics,* Volume 12, No.1, Blackwell Publishers, Massachussets, March 2000, at 2—3. *See*, also, Witold J. Henisz and Bennet A. Zelner (2001), "The Institutional Environment for Telecommunications Investment", *Journal of Economics and Management Strategy,* Volume 10, No. 1, Spring 2001, at 124—128. *See*, also, Witold J. Henisz (2002), "The Institutional Environment for Infrastructure Investment", *Industrial and Corporate Change,* Volume 11, Number 2, ICC Association, at 356—362.

[41] *See* Henisz (2000), *supra note* 40, at 2. *See*, also, Henisz (2002), *supra note* 40, at 357.

[42] *See* Levy and Spiller, *supra note* 36, at 1—7. *See,* also, Henisz (2000), *supra note* 40, at 2; Henisz and Zelner (2001), *supra note* 40, at 127—128; Henisz (2002), *supra note* 40, at 357, 362.

[43] *Id.*

This political economy phenomenon is what Professor Raymond Vernon described in 1971 as the "*obsolescing bargain*"[44] with its correspondent hold-up effect on the economy: as soon as foreign oil companies have deployed their sunk investments in the form capital assets (i.e. exploration infrastructure, strategic information about proven reserves beneath the licensed oilfields, or when projects have achieve a productive stage) and prices reach a peak cycle, government elites experience strong incentives to renege on previous contractual agreements and policy commitments –whether through the unilateral increase of foreign investors' tax burden or via expropriation measures aimed at increasing the state's share in oil production activities. Once the original oil contracts are rendered obsolete, foreign oil corporations face a contracting problem they respond either by investing in legal safeguards against arbitrary policy changes, or by demanding host-governments higher and more immediate returns, or by rolling back planned future investments.

A second effect of the petroleum political economy relates to *rent seeking*; namely, the capture of economic returns through the control of political channels by elites in weak institutional environments, changing the incentives to the point of reallocating resources from economic to political activity. Considering the *ex ante* problems of grand corruption corroding the Mexican state-owned oil monopoly before the energy reform, it is foreseeable that, as a result of its liberalization, political opportunism for rent-seeking activities on the oil sector might experience a ripe atmosphere to spread and, thus, frustrate the expected capital investment –which is the policy goal itself of the energy reform.

The likelihood of corrosive rent-seeking in the oil industry is high, since Mexico's new legal framework has regulated the possibility for the state to assign contracts –in the form of licenses, production-sharing agreements, profit-sharing agreements, and services contracts— to private investors to enter into upstream activities. Given the fragility of both the rule of law and government capacities in Mexico, an economic liberalization might amplify the risks for rent seeking and other predatory practices (e.g. illegal collusive deals, extra-contractual kickbacks, insider information related to exploration and development of oil reserves, etcetera) involving the collusion between public officials and the private sector as the new actor of the Mexican upstream industry.

For these reasons, rent-seeking activities understood as grand corruption –that is, the use of public entrusted power for private gain by high-ranking officials[45]—represent a significant governance risk for implementing the new hydrocarbon law in Mexico.

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[44] *See* Raymond Vernon, *Sovereignty at Bay,* Basic Books, New York, 1971, at 47, cited by Jones Luong and Weinthal, *supra note* 2, at 14, 208—209.

[45] Drawing upon the writings of the academic Leslie Holmes, I add the *elitist* character to the most common definition of corruption. *See* Leslie Holmes, *Corruption: A Very Short Introduction,* Oxford, Oxford University Press, 2015, at 1—7.

C. Fiscal Dependency on Petroleum: Is Mexico "Oil-Cursed"?

For oil liberalization to succeed *political risks* concerning the above contracting problems, then Mexico requires legal institutions rooted in a robust foundation of checks and balances. Yet the implementation of the Mexico's new regulatory arrangement on crude oil is not an institution-building process that runs independently from the prior institutional environment. During the past fifteen years, the Mexican government has experienced increasingly budgetary pressures on the oil revenues captured by Pemex. Oil-based income has covered approximately 30-40% of the country's *fiscal backbone*.[46] In other words, the oil rents dependency affecting the Mexican state posits an important economic and political constraint for a successful implementation of the energy reform.[47] A more accurate question, then, is how autonomous the impact resulting from the energy reform's oil governance model can be in the face of the fiscal dependency the Mexican government has on oil revenues.

Based upon the findings of Pauline Jones Luong and Erika Weinthal's comparative work on some states of the former Soviet Union, this research takes as premise that the institutional structure checks and balances in the Mexican upstream oil sector is, also, a function of the existing connections –in terms of incentives and constraints– between the *tax and spending regime* of that polity, on the one hand, and the *ownership structure* protected by such laws, on the other.[48] In this regard, this work attempts to fill a gap in the legal and policy literature of Mexico by underscoring the role played by specific legal institutions –such as property rights and its relation to the fiscal regime—in regulating and conditioning the adverse effects of petroleum wealth. It is exactly this countervailing function what bestows both the ownership structure and the tax system the character of checks and balances in the case of the Mexican oil sector. In other words, this analytical assumption points out to the need of asking ourselves whether the Mexican energy reform put in motion a new framework of property rights with an effective capacity to dismantle the monopolistic nature of the public ownership scheme that fostered the weakening of Mexico's fiscal system.

[46] My estimations result in 29.19% as the average share that oil revenues have in Mexico's federal government budget from 2000 to 2015. This percentage increases from 30 to 40% when other direct payments and oil-related taxes from Pemex are considered. Source: elaborated with data publicized by the Secretaría de Hacienda y Crédito Público [Ministry of Finance of Mexico], *Estadísticas Oportunas de Finanzas Públicas* [Public Finance Statistics], consulted on November 15, 2016, available at http://www.shcp.gob.mx/POLITICAFINANCIERA/FINANZASPUBLICAS/Estadisticas_Oportunas_Finanzas_Publicas/Paginas/unica2.aspx. *See* also Elizondo Mayer-Serra, *supra note* 15, at at 6, 15—16. *See* also International Monetary Fund (IMF), "Mexico in a Globalized World", 2008, cited at Rehman, Scheherazade and Frederick V. Perry, "Corruption, Constitutions, and Crude in Latin America", *Law & Business Review of the Americas,* Vol. 20 Issue 2, at 163-207, Spring 2014, at 183. According to Rehman and Perry, from 2002 to 2007 an average of 36.39% of the Mexican government's revenue came from oil and gas exportations. *See,* also, Stojanovski, *supra note* 1, at 281-282. For this author, Pemex is treated as a cash cow because it alone finances almost 40% of Mexico's entire federal budget. *See* Samples, *supra note* 1, at 606, who in turn cites Clifford Krauss & Elisabeth Malkin, "Mexico Oil Politics Keeps Riches Just out of Reach", N.Y. Times, Mar. 8, 2010, at http://www.nytimes.com/2010/03/09/business/global/09Pemex.html.

[47] *See* Stojanovski, *supra note* 1, at 280-282, 318-319.

[48] *See* Jones Luong and Weinthal, *supra note* 2, at 11-27.

By the same token, I have been asked several times whether the so-called "*resource curse*" theory provides a suitable explanation of Mexico's fiscal dependency on oil revenues; and, if so, whether it could offer potential policy proposals to fix such institutional problem. To the end of responding that query, I first unpack certain concepts and preliminary assumptions to clarify the way in which the resource curse literature is linked to the present analytical enterprise.

According to Michael L. Ross, one of the most renowned experts in the political economy of the oil sector, the *resource curse* narrative refers to the "adverse effects of a country's natural resource wealth on its economic, social, or political well-being".[49] Within this theoretical landscape, there is a branch of studies grouped around what is known as the "*political oil curse*", which has as its main claim "that natural resource wealth tends to adversely affect a country's governance".[50]

Considering that the *political oil curse* is an ample body of research whose boundaries extend from conceptual to empirical correlations that natural resource wealth has with democracy, governance quality, or civil conflict, my purpose here is to both focus and apply the empirically-supported theses about the complex relation between oil wealth and the qualitative performance of government institutions, in order to articulate a critique of the energy reform from a legal and policy perspective. By '*governance quality*'[51], I borrow Michael Ross's broad notion encompassing the effectiveness of governmental authority; the executive branch and its modern bureaucratic apparatus in the Weberian sense[52]; a robust compliance to the rule of law, and the state's capacity to boost economic growth and development.[53]

The relationship between petroleum and institutional quality is complex enough to the point that most of the political oil curse falls in two main categories. The first approach usually takes institutions an independent variable that interacts with the oil wealth. Basically, this means the effects of oil wealth on governance –whether harmful or beneficial– depend on the institutional environment. For Mehlum *et al*, natural resources either favor economic growth or foster corruption depending on whether governmental institutions are "producer-friendly" or "grabber-friendly".[54]

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[49] Michael L. Ross, "What Have We Learned about the Resource Curse?", Annual Review of Political Science, 2015, 18:239—59, at 240.
[50] *Ib.* at 239.
[51] The historian Francis Fukuyama describes *governance* as "government's ability to enforce rules, to deliver services […] regardles of whether that government is democratic or not". *See* Francis Fukuyama, "What is governance?" (commentary), *Governance: An International Journal of Policy, Administration, and Institutions*, Vol. 26, No. 3, Stanford University, Wiley Periodicals, July 2013, 347–368, at 347.
[52] The political sociologist Max Weber defined the *state* as the "human community that successfully claims the monopoly of the legitimate use of physical force [as means of domination] within a given territory"– whether that legitimacy results from tradition, charisma, or legal-rationality, or complex combination of those ideal types. *See* Max Weber, "La política como vocación" [Politics as a Vocation], in *El Político y el Científico* [The Politician and the Scientist], Ediciones Coyoacán Sociología, Mexico City, 1994, at 8, 13-14.
[53] *Ib.* at 248—250.
[54] Halvor Mehlum, Karl Moene, and Ragnar Torvik, "Institutions and the resource curse", *Econ. J.* 116(1):1—20, 2006, cited by Ross, *supra note* 49, at 248.

On the other hand, the second field of research evaluates how petroleum wealth hurts the quality of state institutions quality, treating the latter as an *endogenous* variable dependent on resource endowments. Paraphrasing Michael Ross, the connections between resource wealth and government quality is extremely difficult to disentangle. It could be –Ross sustains– that institutions impact and are affected at the same time by petroleum revenues. Either way, there is compelling evidence supporting the consensus among scholars and policy experts that strong institutions configure a necessary condition so that developing nations may turn their natural resource wealth into a sustainable growth mechanism of their economies.[55] Nonetheless, what the evolution of the political oil curse literature has taught us is that "mediating institutions themselves"[56] –that is, regulatory governance structures in the present case study– are subject to the damaging effects of oil booms, making harder to successfully escape from petroleum windfall trap.

In this light, this law and policy critique of the Mexican energy reform follows the orientation of the first class of surveys described above –in consonance with the treatment that Mehlum *et al* gives to the institutional factor.

Yet when Mexico's *oil rents dependence* emerges in the institutional map, there could some temptation among the readership to focus on how the government's fiscal fragility or other phenomena can be explained in terms of the political oil curse– actually, this is a commonplace many social scientists have taken in the past for empirical explanatory reasons, but which has rarely transform into corrective policy action.

Although the *political resource curse* thesis has been used to explain the poor institutional development of Mexico as a result of an incomplete democratic transition characterized by a fragile rule of law; high levels of rent-seeking and corruption eroding the state, and by a poor fiscal federalism, this narrative has proven unfruitful to get an answer on how get out of this presumptive "trap" –which of course has a flavor of *fatalism*.

To support the generalization that petroleum abundance always damages the regulatory capacities of the state, or prevents them from being built, condemns any proposal of institutional solution to a non-starter scenario. Somehow, there is an absence of an in-depth evaluation of legal institutions at the core of the traditional resource curse literature. This criticism gets reinforced with the oil curse thesis' failure –described by Jones Luong and Weinthal–to explain the cases of those developing countries that have been successful in escaping the vicious-cycle resulting from mineral wealth –for instance, the cases of Botswana, Chile, and Russia for the period of time it had private domestic ownership in its oil sector.[57]

So instead of deviating this assessment of Mexico's oil governance toward an endless quest aimed at responding whether or not the Mexican oil rents dependency is an illustration of the oil curse, I adopt a more productive method by taking Jones Luong and Weinthal's conclusions as benchmark to evaluate: 1) first, if the Mexican energy reform did

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[55] *See* Ross, *supra note* 49, at 250.
[56] *Id.*
[57] *See* Jones Luong and Weinthal, *supra note* 2, at 3, 7, 11, 24, 121-134, 177-180.

change, in fact, the oil ownership regime, and 2) second, what potential consequences this institutional diagnosis could trigger for Mexico's fiscal system.

My appeal to Jones Luong and Weinthal's critical reviews of the political oil curse –as part of this paper's theoretical framework— obeys to the following reasons. First of all, their remarks on the function of *oil ownership* structure are helpful to have a better understanding of the incentives, interests, and constraints conditioning the actual performance of Mexico's new oil upstream institutional model.[58]

Jones Luong and Weinthal's critique has allowed this work to focus on the political oil curse arguments that are both empirically relevant and policy-substantive for the Mexican case; namely, an upstream oil industry serving the government's budget at the expense of an enabling and accountable tax system. So, as stated earlier, this essay aims not to enter into an empirical research so as to determine whether or not petroleum wealth is an inevitable trap for the Mexican economy; rather, it attempts to give lawyers and policymakers in Mexico a sense of the incentives structure surrounding the institutional actors and rules governing the hydrocarbon sector so as to contribute with some institutional design solutions that are relatively resistant to political reality.

Second, Jones Luong and Weinthal's findings serve this work to rebut the claim that reliance on Pemex's tax burden is sufficient and unequivocal evidence either to diagnose an "oil curse" in the Mexican institutional environment, or to say that Mexico is a "petro-state"[59]. To say otherwise and agree with the inaccuracy of the rejected claim amounts to an argumentative *fallacy*, meaning the conflation of mineral wealth with the notion of fiscal dependence.[60]

This work is very careful of that conceptual distinction, so when it comes to Mexican oil institutions I mean the latter. Furthermore, there are relevant indicators to reject the claim that Mexico is a cursed petroleum-based economy. For instance, according to empirical data of the World Bank, from 2004 to 2014 oil revenues reached an average of 6.45% of Mexico's GDP[61], in comparison to the 47.31% of Saudi Arabia[62] for the same period, or to the 28.37% registered by Venezuela in a similar time lapse (2004-2012).[63] This information is consistent when comparing the percentage of fuel exportations in merchandise exports among the same countries: the average ratio for Mexico is approximately 13.66% from 2004 to 2015[64], whereas in Saudi Arabia it is 87.88%[65] for an identical period and for Venezuela the share is 90.1% (2004-2013).[66] Thanks to NAFTA

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[58] *See* Ross, *supra note* 49, at 248-249.

[59] By "*petro-state*", I understand a nation whose wealth and economic growth stem predominantly from its oil sector activities.

[60] *See* Jones Luong and Weinthal, *supra note* 2, at 327—330. These authors illustrate the reasons why it is so important to distinguish between wealth and dependence.

[61] Source: elaborated with data of The World Bank, consulted on November 14, 2016, at http://data.worldbank.org/indicator/NY.GDP.PETR.RT.ZS?locations=MX

[62] *Ib.* at http://data.worldbank.org/indicator/NY.GDP.PETR.RT.ZS?locations=SA

[63] *Ib.* at http://data.worldbank.org/indicator/NY.GDP.PETR.RT.ZS?locations=VE

[64] *Ib.* http://data.worldbank.org/indicator/TX.VAL.FUEL.ZS.UN?end=2015&locations=MX&start=1962&view=chart

[65] *Ib.* at http://data.worldbank.org/indicator/TX.VAL.FUEL.ZS.UN?locations=SA

[66] *Ib.* at http://data.worldbank.org/indicator/TX.VAL.FUEL.ZS.UN?locations=VE

and other free market policies, it is clear that the Mexican economy is much more diversified[67] than its Latin American or Middle-Eastern counterparts such as Venezuela and Saudi Arabia, which could actually be considered as petro-states in terms of the aforementioned evidence.

For these fundamental reasons, this dissertation targets its analytical efforts on the *legal* and *regulatory* institutions of Mexico's oil industry, leaving aside many otherwise interesting questions concerning the microeconomics of this extractive industry, or its technological challenges, or the international best practices for petroleum transactions.

This research is, then, an interdisciplinary analysis of Mexico's oil governing institutions understood as the fundamental intervening variable in the administration of petroleum production.[68] Basically, this means that this case study of the Mexican energy reform endorses a view in which legal institutions have a *functional effect* on human behavior by modifying and, to some degree, shaping the reality subject to its regulation.[69] Otherwise, the assessment of any legal reform would be meaningless. At the same time, I am aware that the regulatory power of the law is not absolute but relative, given its dynamic interaction with a set of *ex ante* norms, practices, customs, as well as with preexistent struggles of wealth and power.

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[67] *See* Clifford Krauss & Elisabeth Malkin, *supra note* 46, at http://www.nytimes.com/2010/03/09/business/global/09Pemex.html

[68] *See* Mark C. Thurber, David R. Hults, and Patrick R.P. Heller, "Exporting the 'Norwegian Model': The effect of administrative design on oil sector performance", *Energy Policy,* Elsevier, Research Program on Energy and Sustainable Development, Stanford University, May 2011, at 3.

[69] *See* Jones Luong and Weinthal, *supra note* 2, at 1—4. For these political scientists, the traditional *resource curse* theory encompasses all those claims pointing to the "[…] negative consequences of mineral abundance in developing countries –poor economic performance, unbalanced growth, impoverished populations, weak states, and authoritarian regimes […]"—, and tends to be widely accepted among highly respected academics, international nongovernmental organizations, and international financial institutions. However, since the beginning of their book, the authors recognize that most of the resource curse explanations mask "the fact that underlying all of them are institutions". That is, "weak (or nonexistent) institutions are the key intervening variable between mineral abundance and the negative economic and political outcomes associated with this wealth. In Luong and Weinthal's view, for the resource curse thesis's proponents, mineral-rich countries are "cursed" because they do not possess the "right" set of institutions. This is because either such institutions did not exist prior to an export boom, and state elites have no incentive to build them once they start to reap the benefits of their wealth, or if such institutions did exist before an export boom, state elites would have an strong incentive to dismantle or undermine them". Hence, Luong and Weinthal suggest in reference to the resource curse's theorists, weak institutions are endogenous to mineral wealth and turn out inevitably doomed in mineral-rich states. In sum, "weak institutions are both a direct consequence of mineral wealth and the primary reason that this wealth inevitably becomes a curse". By looking at the institutional experience of five former Soviet republics, Luong and Weinthal conclude not only that weak institutions are not endogenous to mineral wealth but also that even those petroleum-rich states that do not have *ex ante* strong institutions can nonetheless build them. Moreover, these critics of the classical oil curse theory underline how the original thesis has taken for granted the critical role played by ownership structure states choose to manage their petroleum wealth.

III. A POLITICAL ECONOMY THEORY OF OWNERSHIP

1. Ownership Regime: The Fundamental Institution

This critique takes *ownership structure* as the main variable when analyzing the legal rules governing the Mexican upstream oil sector after the energy reform. In so doing, this work follows the policy implications of Jones Luong and Weinthal's findings about institutions in mineral-rich states and applies them to this case study. For these critics, the property regime chosen by the state to manage its hydrocarbons reserves has been largely neglected by the traditional resource curse literature, which has treated it as a constant rather than a variable.

Although the underlying thesis of the conventional resource curse literature is that weak –or nonexistent– institutions are the conditioning factor between oil wealth and the poor economic and political outcomes related to that abundance, their proponents have refrained from making explicit what those institutions are. Instead, exponents of the traditional oil curse theory either incur in the circular argument that mineral-rich countries are cursed when they don't have the right type of institutional apparatus to manage this wealth[70], or have started to focus on retrospective explanations as for why predatory elites do not have incentives to build strong institutions to administer petroleum affluence. Thus, the explanatory scope of the traditional resource curse narrative has proved deterministic and unproductive for developing countries lacking the appropriate institutional conditions, leaving them with none answers to fix their ex ante shortcomings.

According to Jones Luong and Weinthal, the *ownership regime* has been ignored as an essential intervening variable, because the conventional literature on the oil curse has centered its analysis on the same historical period: namely, from the 1960s to the mid-1990s. For these two scholars, this temporal window was an interesting piece of study in order to test theories seeking to explain the associations between "resource endowments, economic growth, and state building"[71] in the developing world.

Two research lines attracted the attention of political economists: on the one hand, why mineral-rich nations in the developing world were growing slower than resource-poor countries, controverting the expectations raised by developmental economists during the 1950s and 1960s; and, on the other hand, why oil-rich nations were having negative economic and political outcomes despite the boom the enjoyed for most of the 1970s decade.[72]

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[70] *See supra* note 69.
[71] *See* Jones Luong and Weinthal, *supra note* 2, at 6.
[72] *Ib.* at 7. Jones Luong and Weinthal cite the works of R.M. Auty, *Sustaining Development in Mineral Economies: The Resource Curse Thesis,* Routledge, London / New York, 1993; Alan H. Gelb and Associates, *Oil Windfalls: Blessing or Curse?,* Oxford University Press, New York / Oxford, 1988, and Terry L. Karl, "Crude calculations: OPEC lessons for the Caspian region", in *Energy and Conflict in Central Assia and the Caucasus,* ed. R. Ebel and R. Menon, Rowman & Littlefield, Lahnam, MD, 1997.

As a result, Jones Luong and Weinthal argue, the focus on this lapse of time has produced a biased diagnose of empirical reality, since most of resource-rich nations did, in fact, have state ownership over their mineral assets.[73] Yet, as Jones Luong and Weinthal illustrate through their comparative assessment of former Soviet states, public property is not an immutable factor, since it changes over time and, above all, has a varying degree scale of state control.[74]

Moreover, the empirical data screening of Jones Luong and Weinthal's survey allows them to measure the relative impact –whether positive or negative– that different ownership structures have had on the oil industry, the economy, and on the fiscal institutions of each of these countries after seceding the Soviet Union. In summary, their findings suggest that the *ownership* system adopted by the state is:

> "[…] The *first* and the *most important choice* that mineral-rich states make because it shapes incentives for *subsequent* institutional building". In particular, it affects "the type of *fiscal regime* that emerges and hence the prospects for building state capacity and achieving long-term economic growth".[75]

For conceptual purposes, Jones Luong and Weinthal propose four ideal types of ownership and control schemes that countries may choose as petroleum development strategies, which are characterized as follows:

A. STATE OWNERSHIP WITH CONTROL (S_1).

In this regime the state is entrusted with the rights to explore and extract the majority of hydrocarbon reservoirs. Although Jones Luong and Weinthal characterize this model with the state having the majority of shares (> 50%) in the oil and gas sector, they omit to specify whether this ownership status also applies to the capital structure of the national oil company (NOC) itself. For the sake of clarity, this dissertation considers S_1 a regime in which the relevant NOC is fully owned and controlled by the government, being part of the public administration for every legal and practical purpose. According to Jones Luong and Weinthal, under S_1, private investment –foreign conglomerates in particular– in the hydrocarbon industry is constrained either to participating in heavily regulated, public law contracts that restrict the managerial and operational control of private companies –such as, carried interest or joint ventures agreements–, or to operating services of technological, labor, or financial type as subcontractors.[76]

B. STATE OWNERSHIP WITHOUT CONTROL (S_2).

Just as in S_1, the legal system grants the state the rights to develop the majority of petroleum deposits and to act as major shareholder (> 50%) of the oil and gas sector. Even though Jones Luong and Weinthal are silent on whether this financial stake

[73] *Id.*
[74] *Id.*
[75] *Ib.* at 9. The italics are mine.
[76] *Ib.* at 7.

parameter refers to market share control or to the NOC's ownership structure, I understand it as applicable to both situations. Unlike S_1, I complement Jones Luong and Weinthal's description of S_2 as an institutional mode where the NOC's stock composition can be privatized in a range from 1 up to 49%, though leaving the company under the state ownership and control. In order to develop further the definition given by Jones Luong and Weinthal, I characterize S_2 with a regulatory framework that encourages the presence of private investment –foreign corporations in particular– via more permissive contract regimes such as production-sharing and profit sharing agreements to perform upstream activities.[77] Under S_2, contractors are entitled with greater managerial and operational than in S_1.[78]

C. PRIVATE DOMESTIC OWNERSHIP (P_1).

Under this regulatory framework, the private domestic sector is authorized to have the rights to develop the majority of hydrocarbon reservoirs and carry the majority of shares (> 50%) in the petroleum sector.[79] In other words, the legal regime discriminates between domestic and international private corporations by conceding the former, and thus forbidding the latter from, the exclusive privilege to be the only type of private actor that can participate in the upstream oil industry besides the state. For Jones Luong and Weinthal, this is an exceptional scheme that has only taken place in the Russian Federation during the period examined in their book – the lapse starting from 1992 to 2005.[80]

D. PRIVATE FOREIGN OWNERSHIP (P_2).

This institutional structure is in place when private foreign corporations, and not just domestic, can have the rights to develop the majority of petroleum deposits and carry the majority of shares (> 50%) in the petroleum sector. Under P_2, the regulatory framework authorizes private investment participation in the upstream oil sector through a concession regime.[81]

In the context of this work, the notion of *administrative concession* in Mexico is heir of the French public law doctrine, according to which this title is discretionally granted by the administration and grants its holder –also known as 'concessionaire'– the exclusive rights to operate, use and commercially exploit a public domain asset or a public interest service, which in turn remains property or jurisdiction of the state and can be unilaterally disposed –taken back or sold, for example– by the latter in its owner capacity. Although subject to an *administrative law* regime as well, in a capital intensive, highly risky environment such as the petroleum industry, my view is that concessions may be a more flexible and investment friendly instrument than exploration and extraction contracts regulated by the new hydrocarbon laws in Mexico, since the

[77] *Id.*
[78] *Id.*
[79] *Id.*
[80] *Ib.* at 124-134.
[81] *Ib.* at 7.

former normally grant the concessionaire a wider sphere of *private property rights* for longer periods of time than public contracts do.

Save for one detail in the operation of license agreements[82], the new contract regime on upstream petroleum activities in Mexico absolutely forbids the property transfer of subsoil hydrocarbons from public to private domain, so private contractors can only recover and benefit from investment costs and risks they incur in the development of crude oil resources through consideration payments. In exchange of those gains, contractors commit to satisfy a bundle of counter-payments in the state's interest at the prior bidding proceedings.

In sum, upstream *contractors* are never owners of the crude oil resources they develop in terms of the hydrocarbon laws of Mexico. Instead, they perform a strategic service on behalf of the state that could be described as a 'partnership' in which the government is the principal and private sector is the agent. In contrast, at least from a legal doctrine perspective, *concessions* confer their holders the exclusive right to commercialize directly the public asset or service they have been authorized to use or perform, respectively.

Although a concession regime is itself normed by legislation and regulation and is patrolled by the government too, its difference with public contracts is not trivial because it implies greater freedom for the investor to make plans regarding the scope of its their right to profit or enjoy the fruits or products from the use or performance of the good or service ruled by the concession at issue.

In light of the catalogue above, which I refine further for the purpose of this research, to determine Mexico's ownership structure on its upstream petroleum industry, it is necessary to address and respond the following queries: 1) First, whether the Mexican hydrocarbon laws resulting from the energy reform grant to either the state or the private companies with the rights to develop the majority hydrocarbon reserves and hold the majority of financial shares of the oil industry; 2) second, whether the Mexican legal system permits private capital within Pemex's ownership structure; 3) third, what type of contract regime on upstream oil activities is established by the Mexican energy law in order to identify whether state ownership remains with or without control, depending on the participation degree of private investment permitted.

As Chapter V of this research illustrates, legislation is the device I use to assess whether the Mexican case fits in S_1, S_2 or even has some aspects of P_2. Although this part involves a great deal of legal interpretation, its nature is mainly descriptive. Once the legal premises are spelled out, I shall draw upon Jones Luong and Weinthal's policy implications to frame

[82] According to article 6, clause B of the Hydrocarbon Revenue Act, licenses contracts shall guarantee the contractor a compensation consisting in the right to purchase the oil and gas resources extracted from the petroleum deposits for as long as the contractor up-to-date with the payment of his obligations toward the state. Hence, the extracted petroleum gets transferred from state to private domain as a result of this sale of the production to the contractor itself – that is, after an onerous transmission of the public asset.

a critique of Mexican ownership structure on the upstream oil industry, considering the political economy existing among fundamental actors of its governance network –such as, government elites, foreign private investors, civil society, and international organizations–, so as to outline the potential effects such framework of property rights might have for subsequent institution-building process in Mexico –in particular, to its fiscal system.

It is worth advancing that, for Jones Luong and Weinthal, P_2 is the best choice of ownership structure a country can have to trigger a virtuous circle of incentives and thus prevent the risks of getting trapped into the so-called "oil curse". Although it is not my intention here to get into the detailed reasoning these authors articulate throughout their book to arrive that conclusion[83], I would rather use the rest of this chapter to describe the three pillars on which their theory is built upon: a) the *relational dimension* of property rights; b) the set of *incentives* at stake, and c) the *historical* variable.

2. <u>Ownership as a Relational Concept</u>

The starting point for Jones Luong and Weinthal's theory is their notion of *ownership*, which they conceive as an array of social relations among a plurality of claimants to the gains resulting from the possession, use, and exploitation of the correspondent asset.[84] Albeit these authors acknowledge that property –whether public or private– is a legal institution conferring the owner –whether an individual or an entity– the *erga omnes* right to exclude everyone else from exploiting the good in question and, thus, imposing the correlate duty on society to not transgress those ownership prerogatives, their conception of this right is not longer understood in absolute terms since there are always multiple agents with claims of redistributive character to the asset proceeds – in particular when it comes to natural resources owned by the state.[85]

In this context, the role of the modern state has normally been that of a *guarantor* of property rights and of *regulator* on behalf of the public interest; namely, a mediator between the owners' property rights and non-owners' indirect claims.[86] Such police and enforcement powers have crystallized either in the building of *tax* and *regulatory* systems or in the vindication of *public* ownership.[87] Naturally, this involvement of the state loads the institutional environment surrounding property rights with a relevant dose of political content, which reaches its apex because the asset at issue is petroleum – a natural resource commodity commonly seen as having high economic value and perceived as being part of the nation's wealth and property accordingly.[88]

[83] *See* Jones Luong and Weinthal, *supra note* 2, at 9-13.
[84] *Ib.* at 9-10
[85] *Ib.* at 10.
[86] *Id.*
[87] *Id.*
[88] *Id.*

Following the work of Daniel Bromley, the theory framed by Jones Luong and Weinthal portrays property rights as a *triadic* set of "social relations among member of a collectivity with respect an array of items of social worth [that] link not merely a person to an object, but rather a person to an object against other persons".[89] As indicated above, it is the *high involvement of the state* what gives the property rights arena its *tripartite* aspect. If applied to the oil sector context, therefore, ownership structure may be defined as a set of relations between direct and indirect claimants to the rents obtained from the exploitation of hydrocarbon deposits.[90] In this way, Jones Luong and Weinthal use Table I below to identify the type claimants in accordance to each of the ownership structures described through this chapter.

TABLE I. CLAIMANTS TYPE BY OWNERSHIP REGIME		
Ownership regime	**Direct Claimants**	**Indirect Claimants**
S_1	Ruling elites + NOC's bureaucracy	Domestic population
S_2	Ruling elites + Private investors –both foreign and domestic	Ruling elites + Domestic population
P_1	Domestic private investors	Ruling elites + Domestic population
P_2	Private investors –both foreign and domestic	Ruling elites + Domestic population

Source: See Jones Luong and Weinthal, *supra* note 2, at 11.

As underlined by the chart above, under S_1, the 'tripartite' relationship is characterized by the tension between government elites and the NOC's top managers, on the direct claimants' side, and domestic population acting as non-owners with indirect claims, on the other side. In contrast, under S_2, the regime allows the partnership of the NOC with private contractors in exchange for a direct entitlement to the proceeds from crude oil wealth, leaving both governing elites and domestic population as indirect claimants. Thus, S_2 stands out because of the *dual status* government elites play both as 'owners' with a direct claim on oil rents resulting from their control of the NOC, and as 'regulators' representing the domestic population's general interest given their dominion of the most important government offices.

As we shall see in Chapter V, this *hybrid* position, which is relevant for the Mexican case after the energy reform, may have some implications for the relation between the ruling elites and the national population and for the subsequent institution-building process. Although the triadic context in P_1 is clear, this dissertation is not devoted to the analysis of that ownership structure due to its exceptionality and inapplicability to our case study. On the contrary, this work portrays P_2 as the ideal ownership structure to which the Mexican upstream oil industry should point at for the near future; that is, a regime where governing elites have an indirect claimant role that confines them to their taxing and regulatory

[89] *Id.* Jones Luong and Weinthal cite Daniel Bromley, *Sufficient Reason: Volitional Pragmatism and the Meaning of Economic Institutions,* Princeton University Press, Priceton NJ, 2006.
[90] *Ib.* at 11.

authority with an eye on domestic population's public interest, hence leaving most of the ownership rights to the private sector –both foreign and domestic.[91]

Yet my view is that Jones Luong and Weinthal's characterization of ownership models where the state has abdicated its *owner* role should be nuanced, because when lawmaking and regulatory authority is at the fully disposal of the ruling elites, if not counterweighed by *effective checks and balances*, that concentration of power translates into majoritarian, or even unanimous, legislative capacity that might pose a threat existing private property rights –which in turn cannot be opposed against the state as a completely autonomous institution, but rather a creation of the law through which such state formalizes its acts.

This attitude of *political realism* gets traction when the good at stake is petroleum wealth: a scarce energy asset whose demand still is fundamental both for the proper performance of a dynamic economy and for a streamlined flow of government revenue. If necessary, my point here is that elites ruling the state will be likely reclaim oil ownership in case a national security crisis takes place. Incentives driving the rentier behavior on the part of the governing elites, however, must be aligned – in the sense of balanced– with those factors spurring the oil industry and the economy working efficiently under private hands; otherwise, an exorbitant thirst for oil rents might play out against the economic source providing those proceeds, ending up in the worst case scenario.

3. Ownership Regime: An Incentives Supplier for Institutions

If, according to Jones Luong and Weinthal, ownership structure is the most important institutional choice to shape incentives for subsequent institutional building, then each property rights framework is likely to generate a different type of government institutions, considering the peculiarities of the political and economic power struggles existing amongst the relevant players in each regime. In terms of Jones Luong and Weinthal's theory, there are three classes of incentives interacting in the oil sector: 1) *transaction costs*, 2) *social expectations*, and 3) *power relations*.

Simply put, an ownership regime triggers a certain group of transaction costs and social expectations that may, or may not, prompt the incentives of –direct and indirect– oil rents' claimants to demand a fiscal system that "can effectively constrain and enable the state"[92], as well as the power relations that induce the emergence of those *subsequent institutions* by reinforcing the correspondent incentives structure. As indicated above, along with Jones Luong and Weinthal's work, the present critique takes *fiscal systems* as that institutional variable of *dependent* character, but this could be other, such as the political system, the type of federalist arrangement, and so forth.

But before addressing incentives, it is worth clarifying that this research qualifies fiscal systems depending on their capacity to constrain and enable the state, meaning by that

[91] *Id.*
[92] *Ib.* at 12.

feature a workable balance of taxing and spending institutions – that is, a functional structure of checks and controls. In this way, a *strong fiscal system* is one integrated by a stable, broad-based tax framework that relies mainly on direct and explicit taxation, on the one hand, and by a stable and transparent budget regime, on the other.[93] On the contrary, a *weak fiscal system* tends to be equipped with both an unstable tax framework that is mainly supported on the mineral sector and on indirect and implicit taxes across sectors, and an expenditures regime lacking of budgetary stability and transparency.[94]

Despite that Chapter V unfolds a law and policy analysis primarily focused on the Mexican ownership regime on hydrocarbons, I articulate some associations pointing to the *fiscal rules* of this industry in order to justify my claim that there is still a *rentier* logic guiding Mexico's new regulatory arrangement on upstream oil operations. Nonetheless, my remarks on the fiscal policy underlying the Mexican hydrocarbon reform are far from being a study of the stability, scope, composition, transparency of the Mexican fiscal regime applicable to the upstream petroleum sector, but rather an indicator to bridge the claim that a state-controlled ownership regime –lacking of checks and balances– facilitates an energy policy subordinated to short-term budgetary goals, damaging both the upstream oil sector and the state's fiscal capacity in the long run.

A. TRANSACTION COSTS

After being originally developed by Ronald Coase in his theory of the firm[95], the notion of transaction costs has been ever since applied to the economic analysis of legal institutions. This work is interested in the concept of *transaction costs as incentives* for relevant actors to build institutions.

According to Robert Cooter and Thomas Ulen, Professor Coase used transaction costs to describe "all of the impediments" to negotiating a market exchange[96], being of three types depending on the stage of the transaction – search costs, bargaining costs, and enforcement costs.[97] These bargaining obstacles are the resulting function of *information asymmetries* regarding the preferences of relevant actors and thus the translation of such interests in a certain behavior. If these information asymmetries are high, transaction costs increase accordingly and thus prompt actors' willingness to design *institutions* for the purpose of reducing these bargaining barriers.[98] In the context of organization theory, the upshot is that firms have propagated precisely because of their effectiveness as an instrument to cut down transaction costs affecting pure market bargaining.[99] Consequently,

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[93] *Id.*
[94] *Id.*
[95] Ronald H. Coase, "The nature of the firm", in *Economica,* November, 1937, at 86—405.
[96] Robert D. Cooter and Thomas Ulen, *Law and Economics, 6th edition*, Berkeley Law Books, 2016, at 85.
[97] *See* Cooter, *supra note* 96, at 90.
[98] *See* Douglass North, *Structure and Change in Economic History,* W.W. Norton & Company, New York, 1981, cited by Jones Luong and Weinthal, *supra note* 2, at 50.
[99] *See* Oliver E. Williamson, "The economics of organization: The transaction cost approach", *Amer. J Sociology* 87(3), 1981 548—77, cited by Jones Luong and Weinthal, *supra note* 2, at 50.

institutions emerge as mechanisms aimed at supplying information helpful to minimize uncertainty about the relevant parties involved in a given market transaction.[100]

It should be mentioned, though, that rather than centering on incentives to explain why Mexican reformers have chosen a particular form of fiscal regime on the hydrocarbon sector, my purpose here is to make sense of incentives as material stakes that influence a plurality of institutional actors to build either strong or weak fiscal systems, irrespective of their particular formal design.

Moreover, the present work not only owes Jones Luong and Weinthal the argumentative linkage between ownership structure and fiscal regimes, but also an idea of transaction costs that results from an institutional dynamic that goes beyond the interests of government elites by taking into account the incentives of a plurality of actors, such as private investors, the civil society, and the international community. From this perspective, Jones Luong and Weinthal's work upon oil ownership regimes and their impact on institution building is far away from being state-centered theory precisely due to its pluralistic approach, which happens to be more attached to our reality these days.

Considering that ownership structures mold the preferences of main claimants to petroleum wealth as for how the industry should be managed and regulated, then, we have at least two possibilities. On the one hand, when interests of both direct and indirect claimants are aligned in the sense of being pushed by *coincident* interests, they face no incentive to constrain each other's conduct regarding access, regulation, and exploitation of oil wealth, because information asymmetries to find out what to expect from others' behavior, and therefore transactions costs, are low.[101] On the other hand, in the case of *non-aligned preferences* amongst main claimants to mineral wealth, they will have an incentive to restrain each other's behavior in terms of access, benefits, and exploitation of the proceeds resulting from oil wealth, since information asymmetries about what to expect from others' conduct, and thus transactions costs, are high.[102]

Having explained the rationale behind the impact of transactions costs on state building efforts, fiscal capacity in particular, we should look at their interaction with our original *independent* variable: *ownership structures*. In a simple world of pure models, we have that, under $S_{1,}$ transaction costs are low because direct claimants to oil proceeds – government elites and the NOC's high bureaucracy– have a mutual stake in maximizing their discretionary control over the regulation and management of this extractive industry.

Taking into account neither of these direct claimants has an exclusive right to the gains produced by the state monopoly via the NOC, but rather represent the government elites' side if taken together, it can be said there is not residual claimant under S_1.[103] Even though ruling elites and NOC managers have the character of direct claimants pursuant the

[100] *See* Robert O. Keohane, "International institutions: two approaches, *Int. Stud. Quart.* 32 (4), 1988, 379—96, cited by Jones Luong and Weinthal, *supra note* 2, at 50.
[101] *See* Jones Luong and Weinthal, *supra note* 2, at 51.
[102] *Id.*
[103] *Id.*

characterization of S_1, from a legal standpoint, they formally are 'agents' subordinated with the obligation of serving the interest of the nominal 'principal', which is the domestic population to which the mineral wealth belongs in accordance to most of these countries' legal order.[104] Their role as direct claimants turns out from its privileged position in the policy, regulatory, or managerial decision-making process, whether in the executive branch, in the independent agencies, or in the NOC.

As a result of their interests' alignment, direct claimants under S_1 have incentives to take advantage of their official role to maximize their share of oil rents for their "own personal and political ends".[105] This situation on the part of political elites translates into a low interest in developing a strong fiscal regime that effectively constrains and enables the state apparatus. Rather, government elites opt for an easy taxation scheme on the population and large subsidies programs to clienteles, i.e. an energy sector appears dominated by 'quasi-fiscal' activities[106], in exchange for some sort of legitimacy of their non-transparent rent seeking agenda.[107]

In this context, Venezuela and Mexico[108] exemplify two traditional cases of oil-related rent seeking and corruption where NOC bureaucrats and high-ranking officials, under $S_{1,}$ have largely used their authority for private gain, either by directly diverting public funds or by committing the scarce NOC's capital to large infrastructure projects –commonly referred as "white elephants"– which have never paid off the expected investment returns.[109] Obviously, this outcome of institutional underdevelopment is only possible when the tax system is mainly supported on indirect taxation and, above all, when the budget system is affected by the lack of accountability and transparency – that is, the absence of checks and balances opposable to the government elites both through the political process and other state institutions. In sum, petroleum-rich nations that adopt S_1 are likely to build *weak fiscal systems*, which are likely to be reinforced with the subsequent boom and decline cycles.

There is, however, a criticism applicable to Jones Luong and Weinthal's view of how transaction costs interact with the relevant players in a state ownership regime with government control. The mutuality of interests ascribed by Jones Luong and Weinthal to direct claimants in $S_{1,}$ parts from a premise these authors fail to unpack clearly –the assumption about the absence of effective *checks and balances* within the state apparatus itself to control the ruling elite. Put differently, for Jones Luong and Weithal's theory, ownership structure is the only system of check and controls worthy of analytical consideration, leaving aside the possibility that the state apparatus might be itself a competitive arena among different political elites where no one has absolute control of the

[104] *Id.*
[105] *Id.*
[106] *Ib.* at 54.
[107] *Ib.* at 52.
[108] This critical remark on Mexico must be understood for that period of time in which oil sector was managed and controlled through the state monopoly of Pemex, which basically goes from the 1958 until December 2013 when the Mexican energy reform was approved.
[109] *Id.*

others.[110] This *analytical bias* towards an explanation based on property rights and on the tension among their claimants is the reason why I devout Chapter VI to frame a complementary analysis of the checks and balances structure within Mexico's 'administrative state' on the upstream oil industry.

Conversely, under private domestic ownership (P_1), transaction costs are at a high level because direct and indirect claimants to gains of hydrocarbon wealth have conflicting interests regarding the management and regulation of these resources.[111] Domestic private investors are the sole principal both legally and materially, so they are the only who benefiting directly from the profits that their companies can make out of upstream petroleum activities. The divergence of interests between domestic private investors as direct claimants, on the one hand, and government elites and national population in their character as indirect claimants, on the other, is that the former are motivated to maximize their profit from oil production activities –which also means reducing their tax burden at the most–, whereas the latter are interested in maximizing their share of oil rents –in the form of taxes– in order to fund the government's budget and hence launch larger programs of subsidies for the population. In light of this competitive scheme, there are incentives on each side to check and control the other by means of strong institutions.

Given that ownership rights on oil production lie in private hands under P_1, the government has less control of the industry than in S_1, being exclusively in charge of the sector's regulation and taxation. For Jones Luong and Weinthal, government officials may face strong incentives to defect the public sector to enjoy greater benefits in terms of salary in the private sector.[112] As opposed to the rent seeking deployed by the NOC's managers and the central government in S_1, market incentives in P_1 foster domestic private owners to maximize internal control and to screen the managers of their companies through an incentives scheme that is attached to the firm's performance.[113] Considering that the profitability of a private oil company depends primarily on reinvestment, and that government budget is not an available option for financing purposes, domestic private owners are likely to introduce international accounting standards as an accountability tool through which the companies can assure commercial lending from the banking sector.[114] According to Jones Luong and Weinthal, the virtuous circle of incentives in P_1 is boosted

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[110] Jones Luong and Weinthal underline that ordinary interactions between the NOC and government in S_1 are designed in such a way that they not only reinforce their mutual interests for management and fiscal discretion, "but also perpetuate low [transaction costs] and hence mutual incentives for weak fiscal regimes". The only remark on checks and balances these political economists make in terms of corporate governance is that, under S_1, "government officials tend to chair the NOC's board of directs, appoints its other members, and are periodically rotated with the NOC's top management", so institutional boundaries among policy, regulatory, and entrepeneurial functions become blurred at the service of the ruling elite. The so-called "*revolving door*" problem is the practice of government officials leaving their decision-making positions at the the government, or at the NOC in this context, for lucrative work opportunities in the business sector that was formerly subject to their regulation, as well as the reciprocal high-ranking personnel migration from the private sector to the government agencies in charge of the former's regulation. *See* Jones Luong and Weinthal, *supra note* 2, at 53.

[111] *Ib.* at 55.

[112] *Id.*

[113] *Id.*

[114] *Ib.* at 56.

when companies are held accountable to shareholders, who in turn expect the return of their investment as agreed. To achieve such level of accountability and transparency between principals and agents within the organization, private oil firms are likely to have robust *checks and balances* in the form of a corporate governance that allows for an efficient separation of functions as well as a managerial apparatus aligned to objectives of market performance rather than political and regulatory roles such as those common in a NOC under S_1.

Having explained the argument underlying the institutional outcome emerging from low transaction costs among the main claimants to the benefits of oil wealth, I want now to examine further the specific reasons behind the mutual interest of both domestic private investors and government elites have to build *strong fiscal system*s, despite their competing stake to maximize their respective share of oil rents.

For Jones Luong and Weinthal, *strong fiscal rules* emerge under P_1 because, in the absence of controls on each of the main claimants' parcel of discretionary power, both sides would be worse off after a costly tug-of-war negotiation, whose unpredictable outcome is likely to hurt the stability in two correlated ways: By altering the contractual terms under which private companies expect to retrieve their investment and disrupting the revenue streams earmarked for the government's purse accordingly.[115]

Once subsumed in the vicious cycle triggered by the lack of a stable, broad-based tax regime that primarily relies on direct levies and not just on indirect taxation on the petroleum industry, the government short-term incentives are to increase the tax rates to exorbitant levels, which in turn foster tax evasion on the part of domestic private oil owners and, then, ruling elites could retaliate with higher tax rates, regulatory takings, the use of the criminal code, and expropriation threats, inducing again private investors to come up with "more elaborate, and time-consuming schemes to hide their profits" from the government's treasury.[116]

In the end, high transaction costs without the certainty provided by solid fiscal institutions lead both direct and indirect claimants to divert resources to unproductive activities rather than center on what they are most efficient – namely, the government targets significant policy and legal efforts to collect a smaller share of the revenues it was originally expecting to get via taxes with a corresponding impact on its budget, while domestic private oil owners divert part of the funds they original expected to invest in oil projects for the payroll of accountants and attorneys, impairing their prospect returns consequently.

Hence, both domestic private oil owners and government elites benefit more from a stable tax regime, because it provides institutional certainty that reverberates in the form of budgetary stability claimed by the government and of the contractual stability needed by private investors to meet their investment commitments and expected returns. Still, this answer pointing to the benefits of such scenario does not tell exactly where the

[115] *Id.*
[116] *Id.*

effectiveness –or strength– of fiscal institutions comes from. The simplest response to this query, though, has already been hinted above: It is the *high* transactions costs resulting from the opposing and *competitive* nature of domestic private owners' goal of maximizing their profits with the government's incentive to extract the greatest share of oil revenues as possible, what induces a high degree of accountability among main claimants. And this is exactly how ownership rights and indirect benefits to oil proceeds work as the bedrock that infuses a sense of materiality, of political economy, to our concept *checks and balances* instead of a pure juridical notion.

The example of Russia after the Soviet Union fall serves Jones Luong and Weinthal to conclude that just as a NOC can behave as a quasi-private oil company with the right market incentives and institutions, so can a domestic private oil owner behave as if it were a NOC in the fashion of a state monopoly.[117] This was the case of the Russian oligarchs who took advantage of their close ties with government elite in the Kremlin through a "*revolving door*"[118] mechanism that allowed them to pull the strings simultaneously both in the private and public sectors, so as to capture the privatization reform of the gas sector in favor of this group of interest – namely, a state monopoly was converted into a private monopoly sponsored by the ruling elite, frustrating then competition incentives that private property rights spur vis-à-vis the government when assigned in a balanced fashion[119] among a plurality of agents rather than concentrated in one or few hands.

Once explored the contrasting force that transaction costs generate depending on whether they are interacting in S_1 or P_1, in Chapter V of this research I shall assess whether the transaction costs of relevant actors in the Mexican oil institutions still fit in S_1 as in the recent past, or whether Mexico's ownership regime after the energy reform is more likely to trigger the incentives common to S_2.

B. SOCIAL EXPECTATIONS

As of the XX century, the paradigm of a minimal state, whose duties were exclusively limited to guaranteeing private property rights and enforcing public safety, gave way to a pattern where the public sector's functions were not only enlarged in terms of economic regulation, but also in the sense of transforming the state in the leading player of the national economy's development by means of building welfare networks, providing public services, and leveling the field for those worse off in the social ladder. The welfare state of the XX century was then a consequence of societal pressures on the spending capacity of governments.[120] Nonetheless, the implementation of state-sponsored safety nets has experienced much more financial hardship in developing countries than in advanced

[117] *Ib.* at 56—57.
[118] For a detailed explanation of this concept, please *see supra note* 110.
[119] For Jones Luong and Weinthal, both the financial strength and successful discoveries of new oil deposits the Brazilian NOC, *Petrobras,* made in the early twenty-first century was primarily due to the government's decision –during the administration of President Fernando Henrique Cardoso– to terminate *Petrobras's* legal monopoly status in the late 1990s. *See* Jones Luong and Weinthal, *supra note* 2, at 57.
[120] *Ib.* at 58.

economies, since the latter arrived to this historical point when their governments had already built robust fiscal capacities – namely, these industrialized had developed "efficient resource allocation through budgeting and effective […] income taxation".[121] On the contrary, developing nations have dealt with both the inflated expectations on the part of the population, plus the absence of an enabling and accountable fiscal systems that are capable to fund such social demands.

It is reasonable to concede that societal pressures on state expenditures increase notably when there is mineral wealth in the background. However, as Jones Luong and Weinthal explain, hydrocarbon wealth *per se* is not what intensifies social expectations concerning the state's role as orchestrator of socioeconomic development in a given nation, but rather the rules and institutions –i.e. the ownership regime– that establish who owns and controls petroleum production.[122]

Considering Jones Luong and Weinthal's notion of ownership structure as set of social relations, owners with legal right to the exploitation of hydrocarbon wealth must legitimize their direct claim before a set of indirect claimants of which society becomes part and who "relinquish these rights or entrust them to others"[123] in the form of a principal-agent relationship that sometimes happens to be recognized by the constitution and laws of the state in question. Hence, social actors have also *expectations* regarding the *benefits* coming from the petroleum exploitation, whose indirect character obeys to the fact that their social demands are propound before and enforced through the state, which in turn performs the role of society's agent before direct claimant –whether the latter is the state in its owner facet, or private investors, or both– by regulating and taxing the hydrocarbon industry pursuant "society's best interest".[124]

It is important now to characterize and contrast the features present in S_1 with those in P_1, in terms of their *social demands*. First off, social expectations are high under S_1 precisely because the state appears to perform a dual function –both as owner and as society's representative. Put differently, the collective perception is that the state is in the best position for generating and distributing oil rents to the population, since the owner and the public interest agent functions are posited on the same actor for every practical purpose.

In accordance to Jones Luong and Weinthal, there are three "mutually reinforcing"[125] features that shape the impact of social expectations on the – weak – fiscal system that is likely to emerge in the context of S_1. The first aspect has to do with the question of how the state *distributes* the gains of petroleum production, how much is spent and saved, and on what concepts these oil rents are spent. Given that government's interest to make visible that ownership rights conferred by the population are being properly exercised and that domestic population as nominal principal feels authorized to enjoy the benefits coming from the oil industry, both direct and indirect claimants have no incentive in keeping

[121] Carolyn Webber and Aaron Wildavsky, *A History of Taxation and Expenditure in the Western World,* Simon and Schuster, New York, 1986, cited by Jones Luong and Weinthal, *supra note* 2, at. 58.
[122] *Ib.* at 59.
[123] *Id*
[124] *Id.*
[125] *Id.*

checks and controls on state's spending power discretion.[126] As a result, the combination of low transaction costs and high social expectations fosters, on the one hand, the ample distribution of *universal subsidies* (e.g. fuel, food, and housing) and, on the other hand, *politically oriented* rather than business-based infrastructure projects at the expense of the NOC's financial stability. This spending dynamic is reinforced during boom and lump cycles, according to Jones Luong and Weinthal's theory.[127]

The second feature of societal expectations in S_1 relates to the *state* as the *primary source* to pay for goods and services. In this way, the collective perception that oil revenue should be enough to finance the state limits the latter's legitimacy to extract additional sources of income from the population, making taxation a highly sensitive issue for the ruling elites. Thus, the incentives for the government are to back up their fiscal system on indirect, less visible forms of taxation outside the hydrocarbon sector, direct taxes on state-owned companies, as well as on external and internal debt in order to either enlarge the scope of government economic activities or compensate budgetary gaps.[128]

The third way by which societal expectations mold the emerging the fiscal system under state ownership (S_1) is that *government* is conceived as the *leading actor* conducing the national economy of the country at issue, which in turn has two effects. On the one side, state-based economic development leads to the expansion of the public sector, thereby constraining the fiscal system's tax base to levies on state-owned companies and public employees – which in Jones Luong and Weinthal's perspective is a direct form of taxation that "does not contribute to either state building capacity or promoting economic growth".[129] On the other hand, state ownership on oil revenues fosters endemic rent seeking carried out by both government elites and the population. As a result of the enlarged role of the state in the economy, domestic business and industry grow under the shadow of the government, setting up the roots of a protectionist relationship based on the cronyism and rent seeking between the ruling elite and capitalists.[130]

In summary, under a state ownership regime, the blend of *low transaction costs* among main claimants to the proceeds of oil production and *high societal expectations* produce an institutional environment where ruling elites are discouraged to build strong fiscal institutions and civil society have no incentives to demand them. The danger of this vicious circle of incentives is the population's internalization of the practice of being detached from the most fundamental political process there is in any polity that claims to have minimum level of representative government – namely, checks and balances on the state's power to impose taxes and assign the correspondent budget, holding both Congress and the Executive accountable to the population at some extent. State ownership, therefore, ends up creating a "fiscal illusion": the addictive attitude on the part of the collectivity that because someone or something else (i.e. oil revenue) is absorbing the nation's tax burden, state spending should always follow an expansive pattern.[131] Tragically, sometimes external

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[126] *Ib.* at 60.
[127] *Id.*
[128] *Ib.* at 61.
[129] *Ib.* at 63.
[130] *Ib.* at 64.
[131] *Ib.* at 65.

shocks hit a rentier state's mineral sector in the form of a prolonged decline of prices or production, or as debt crisis, so an ownership regime reform seems imperative for economic recovery and society's self-inflicted veil of ignorance gives way to a hangover condition that reveals the absence of state institutions healthy enough to even launch this amendment process.

By contrast, Jones Luong and Weinthal sustain that social expectations tend to be low under a private domestic ownership structure (P_1), by virtue of a third party acting as direct claimant to ownership rights on petroleum production – that is, domestic private investors of the upstream industry–, which in turn relieves the state from the political pressure exerted by domestic population under S_1, leaving thus the state with an indirect claimant role, whose primary task is to guarantee that owners legitimize their property rights by paying their respective share of tax revenue. In other words, *private property rights* constitute a *buffer zone* between society and the state, diffusing even more the former's indirect claims to the latter than in S_1, given the privileged legal status of domestic private owners' claim to oil rents.

In the same fashion as with weak fiscal institutions under S_1, three are the ways by which P_1 shapes social expectations that contribute to the construction of strong fiscal systems. First of all, the filtering of society's indirect claims to the benefits coming from petroleum exploitation, which is achieved through the settlement of private ownership rights, generates the perception among the population to not feel entitled to receive the bulk petroleum gains through *distribution* schemes, but rather a fraction of them via *redistribution* mechanisms.[132] This institutional environment, therefore, fosters the state to develop a *robust tax system* –that is, the extractive rather than spending capacities– as this will be the only tool to provide the population a residual portion of the profits produced by the oil industry.[133] In this sense, government elites have the incentive to make the tax regime on domestic private oil owners as visible and transparent as possible, so that society has a credible channel to judge how the state is representing their best interest. At the same time, society has an interest in strengthening the state's taxing capacity for the purpose of maximizing their residual benefits resulting from oil proceeds.

As for the *expenditures* dimension of the fiscal system, the "inequality expectation"[134] in the distribution of the oil industry's gains makes the government elites less willing to deploy grandiose public works in a populist fashion, thereby preferring to "save and invest its share of mineral rents".[135] So implicit forms of taxation, such as consumer subsidies for fuel and electricity, exist in P_1 but in a minimal proportion compared to those present in S_1, because, under private domestic ownership, for this type of taxation to be financially viable the state needs to rely *either* on the domestic oil owner's tax revenue or on its budget. Both possibilities, according to Jones Luong and Weinthal, imply significant obstacles since, unlike NOCs in S_1, domestic private oil owners will demand a reduction of their tax burden in exchange for their losses resulting from the implementation of energy subsidies, having

[132] *Id.*
[133] *Id.*
[134] *Ib.* at 66.
[135] *Id.*

this the effect of a smaller portion of oil-related tax revenue for the state – a consequence that runs against the ruling elite's interest in making the state's extractive power highly visible for the nation.

Second, while a state ownership regime (S_1) fosters the confusion of the central government's budget with the oil proceeds captured by the NOC because of the state's intervention both as direct and indirect claimant, private domestic ownership (P_1) avoids such conflation by conferring private property rights to a third party, whose profit maximization goal competes against the regulatory and taxing role of the state and correspondingly with social pressures.[136] As indicated above, the material character of the stakes in question gives institutional *checks and balances* a solid foundation that leads towards the lowering of social expectations. Thereupon, the margin governing elites have for taxing the population alongside private investors in the oil sector is greater and less politically risky in P_1 than in S_1. This greater legitimacy buttressing an enabling and accountable taxing power emerges both because under the former regime society internalizes that its access to the benefits of petroleum wealth depends on government's ability to extract revenue, and because oil private companies are incentivized to demand stable tax rules on them, leading the state to broad its tax base across different sectors of the economy –via direct and indirect taxation– in order to compensate the revenue source it has with a NOC under S_1 but that is not available in P_1.[137]

Third, private domestic ownership regime (P_1) encourages the perception that "the state is neither the sole nor the chief source of economic activity"[138], which in turn deploys three positive effects for the empowerment of the business sector and thus a long-term growth of the economy.[139] As underlined above, the first positive consequence of the state's moderate intervention in the economy is that government has room for expanding the tax system's base beyond state-owned enterprises and public sector employees. Simultaneously, the government has the incentive to behave not as a competitor, but rather as a promoter of the private sector's industrialization efforts across the economy. The second positive effect is that incentives for rent seeking activities in detriment of the state get lowered, because *competition* pressures resulting from the *dispersion* of ownership rights on oil production among third party actors increase the costs and reduce the benefits of trying to capture the favor of governing elites. Rather, under P_1, capitalists are motivated to build a competitive business, given the absence of a state monopolistic structure over the oil industry that is typical of S_1.[140] The third positive consequence is that the state will be willing to build welfare systems in partnership or cooperation with the private sector through market mechanisms instead of relying on its own budget to fund the provision of goods and services for this purpose.[141]

All things considered, private domestic ownership (P_1) shapes a combination of *low societal expectations* and *high transaction costs* affecting the ruling elite's incentives,

[136] *Ib.* at 66-67.
[137] *Ib.* at 67.
[138] *Id*.
[139] *Id.*
[140] *Id.*
[141] *Id.*

which favors the building of a fiscal system that is effectively capable of both checking government spending discretion and enabling state taxing power to balance its public finances – that is, a stable, broad-based tax regime with disciplined expenditures system.

This synergy of positive incentives gets strengthened with booms and busts cycles. When it comes to oil booms, Jones Luong and Weinthal argue that, under P_1, government's incentives are to rise the tax burden imposed on the private oil owners, as opposed to the pressure to increase social spending as under S_1. To that end, governments usually resort to a flexible tax imposed directly on the amount of oil gains exceeding the law bracket established for the purpose of identifying this extraordinary income –also known as windfall tax.[142] Private oil companies, for their part, might choose to avoid the payment of the windfall tax by allocating their profits for reinvestment projects in the company's domestic projects, for operations abroad, or for philanthropic activities in direct benefit of society.[143] As for decline periods, Jones Luong and Weinthal observe that, under P_1, government will face greater incentives to implement a countercyclical fiscal policy aimed at helping the recovery of the oil industry in a moderate fashion, such as a temporary reduction of the private oil owners' tax burden.[144]

Whereas, under S_1, the government is prompted to increase the social spending either by getting more debt, or by unilaterally appropriating oil stabilization funds aimed at making up revenue shortfalls during busts, under P_1, government is leaned to relieve private oil companies from their tax burden in balanced fashion that pursues budgetary stability for both the taxpayer and the state.[145] On their part, private oil companies are better capable of adjusting to negative shocks as they face neither the high societal expectations for distribution of goods and services the state has to administer under S_1, nor the state's regulatory and taxing functions under S_1 and P_1, so private enterprises are more likely than NOCs to undergo through restructuring measures –for instance, lowering production, reducing costs, amending prospect investment portfolio, amending corporate governance, looking up for partnerships with foreign investors, and performing merges with other domestic private enterprises.[146]

Finally, it deserves special consideration that Jones Luong and Weinthal depart from mainstream economists who see in the state's redistribution mechanisms the main fear acting against private investors' sphere of interests.[147] Instead, their critique conceives *taxation* as a channel private oil companies make use of for legitimacy purposes vis-à-vis the state and society accordingly.[148] This conception of taxation, however, does not mean that domestic private oil companies are willing to tolerate their taxes are used to cover a

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[142] *Id.*
[143] *Ib.* at 70.
[144] *Ib.* at 68.
[145] *Id.*
[146] *Ib.* at 70.
[147] Daron Acemoglu, Simon Johnson, and James Robinson, "An African success story: Botswana", in *In Search of Prosperity: Analytic Narratives on Economic Growth,* Dani Rodrik (ed.), Princeton University Press, Princeton NJ, 80—119, cited by Jones Luong and Weinthal, *supra note* 2, at 68, who attribute the original argument to Charles Beard in 1913.
[148] *Ib.* at 68.

limitless expansion of government's social spending over bust periods, but rather it is a reason for the domestic business sector to demand checks on public expenditures. Otherwise, if government's social spending becomes unconstrained despite these demands for checks and balances, domestic private oil companies are likely to retaliate by hiding or diverting profits from the state, hurting the government's interest in making its taxation efforts highly visible. The possibility of such risk leads both the state and domestic private investors to prefer a stable fiscal system.

Though *taxes* may be thought as the vehicle through which domestic private investors justify the ownership rights on oil production they have been entrusted by the legal order, since the 1990s these actors have been progressively adopting practices of *corporate social responsibility*. Unlike taxation, the philanthropic nature of corporate social responsibility activities implies the direct and voluntary provision of public interest goods and services by domestic private oil companies in favor of society. This form of distribution of the residual profits resulting from petroleum wealth has been deployed by private companies for socioeconomic development and environmental purposes, as well as to gain legitimacy on the international level with both governmental and non-governmental organizations.[149]

Having explained how ownership regimes shape divergent levels of societal expectations which, combined with the correspondent transaction costs, pave the way for either strong or weak fiscal institutions, in Chapter V I shall evaluate whether Mexico's ownership regime after the energy reform is more likely to produce the societal expectations of S_1 as in the recent past, or those indirect claims typical of S_2.

C. POWER RELATIONS

Both transaction costs and social expectations constitute forces that induce whether main claimants to the profits from oil wealth have an incentive to supply or demand strong fiscal institutions, whereas *power relations* between these actors impact how these institutions subsequent to ownership rules come forth and thus the form they take and whether they are likely to be resilient over time.[150]

Given their criticism to the 'contractarian approach', whose explanation of institutional outcomes is that they result from individual efforts to overcome collective action problems, but fails to respond why one particular institutional form is preferred over other possibilities, Jones Luong and Weinthal highlight a couple of alternatives they consider more effective to address such query: 1) *bargaining*, which relates to an interdependent relationship that can be either explicit or implicit; and 2) *coercion*, that is, the unilateral use of force of one actor to impose its will against others.[151]

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[149] *Ib.* at 68-69.
[150] *Ib.* at 70.
[151] *Ib.* at 50 and 70.

The distinction between these two mechanisms is that *bargaining* leads to distributional results whereby every claimant has both gains and losses, besides that institutions are more resistant to change, whereas *coercion* gives rise to asymmetrical results –also known as 'zero-sum' outcomes– that are less resilient and then vulnerable to changes in the balance of power.

Based upon their notion of ownership structure as an array social relations among relevant claimants to profits resulting from mineral wealth, Jones Luong and Weinthal opt for *relational* perspective to apply a concept of power, whose key element is the degree of mutual dependency of one claimant over the others for maximizing their ownership and control rights –or claims– in terms of oil profits. In short, Jones Luong and Weinthal's core point is that each ownership regime generates distinctive power relations that impact on whether fiscal institutions are the product either of bargaining or of coercion.[152]

For Jones Luong and Weinthal, in a simple world of state ownership (S_1) or private domestic ownership (P_1), claimants tend to keep an *interdependent, symmetrical relation* on one another to enforce their property rights or to materialize its expectations, making subsequent institutions more likely to come up through a bargaining.[153] On the other hand, in the more complex, but realistic, landscape of state ownership without control (S_2) or private foreign ownership (P_2), subsequent institutional building is more likely to emerge via coercion because power interactions among claimants tend to be *asymmetrical, dependent* on the actor who has the upper hand to facilitate the enforcement of others' rights or expectations.[154] But, as indicated earlier, in Chapter V of this work I will address this analysis on incentives interacting under S_2 and P_2.

Before, it is worth examining how power relations interact in a simple world of ownership structures. Although *interdependent* power relations is a common feature for both S_1 and P_1, these economists articulate a distinction concerning the *implicit* form that bargaining takes under S_1 due to the mutual interest of direct claimants to hide information, whereas under P_1, the mutual inclination of both owners and indirect claimants to go public on information fosters an *explicit* mode of bargaining. Given these premises regarding the negotiation pattern that gives birth to fiscal institutions subsequent to the respective ownership regime, Jones Luong and Weinthal conclude that implicit bargaining, under S_1, reinforces the chances of building *weak fiscal institutions*, while explicit bargaining under P_1 leans the scales toward the emergence of strong fiscal systems.[155]

As for the specific reasons that make power relations interdependent in the context of S_1, we have that ruling elites and NOC high bureaucracy – in their capacity as agents – need to coordinate with each other to enforce their ownership and control rights over petroleum production that have been entrusted by society as the principal, whose public interest the former are legally commanded to serve.[156] As a result, both agents in S_1 are

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[152] *Ib.* at 70-71.
[153] *Ib.* at 71.
[154] *Ib.* at 71, 204-205.
[155] *Ib.* at 71.
[156] *Id.*

locked in a "*mutual hostage-taking*" in which a change of one party's strategy with regard to its direct claims has a symmetrical mirror effect on the other's direct claimant plans to maximize its profits.[157]

Considering that state ownership (S_1) spurs both low transaction costs among main claimants to oil profits as well as social expectations for ample distribution of goods and services, then hiding away information from the population on the accurate level of petroleum reserves, oil production, and the amount of these mineral rents that remain within the NOC or flow to the central government, and how they are distributed and spent, seems like an optimal way to supply the fiscal institutions demanded by these actors' needs. This is another argument that strengthens ruling elites' interest in building a fiscal system, whose direct taxation relies primarily on the mineral sector, but avoiding as much as possible to impose direct levies on the population, so the latter has no interest in lifting the secrecy curtain of such tax arrangement.

The implications of the power relations described above is that, on the one hand, the *implicit bargaining* typical of S_1 ends up reinforcing weak fiscal systems, institutional informality, rent seeking, and corruption, by rooting in state institutions the absence of fiscal accountability and transparency as the norm. On the other hand, *implicit bargaining* within S_1 compromises the NOC's autonomy by blurring the boundaries of its financial sphere and business stability with the government's political objectives.[158]

Likewise, under $P_{1,}$ both domestic private companies –as oil owners– and government elites –as indirect claimants– depend on each other's assistance to materialize their claims in terms of petroleum gains. To maximize its oil revenue, government's expected revenue collection hinges upon the ability of private domestic oil owners to pay their tax burden, while owners' desire to maximize their oil profits is ultimately linked to the state's commitment to protect their private property rights and to guarantee a stable legal climate – in particular, the regulation and taxation of the sector.

The reciprocal understanding between direct and indirect claimants, under P_1, consists then: 1) first, in the state's guarantee to refrain itself from expropriating and to enforce private ownership rights for as long as it collects an optimal amount of oil revenues from domestic owners; and 2) second, in domestic private companies' promise to contribute their fair share to the state budget, provided that they can operate in a stable regulatory environment that allows them to maximize their oil gains. The non-compliance of any of these duties is likely to induce the affected party to renege on its bilateral promise and hence affect the prospect gains for both claimants.[159]

Taking into account that, under private domestic ownership (P_1), main claimants face both high transaction costs as well as social expectations for redistribution, the "*mutual hostage-taking*"[160] scenario here implies that fiscal institutions are supplied and operated by

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[157] *Ib.* at 72.
[158] *Id.*
[159] *Ib.* at 73.
[160] *Id.*

state elites through high standards of accountability and transparency in the face of the private sector and the population; simultaneously, owners must convey reciprocally to ruling elites and society how much oil production has been generated as well as the tax rate they see fair to pay before incurring into tax evasion planning.[161] For these reasons, the implications of having the type of power relations of P_1 is that explicit bargaining turns out the best way to enforce this bilateral commitment among main claimants, fostering thereby the emergence and resilience of strong fiscal systems, a culture of institutional formality, and checks and balances.[162]

4. Ownership Regimes through History

The third pillar buttressing Jones Luong and Weinthal's theory of ownership structures over the hydrocarbon sector is the *international context*. For these political economists, the economic and geopolitical trends of the international context configure a *pivotal force* buffering –whether intensifying or counterbalancing– the impact of ownership structure on institutional actors' incentives –that is, transactions costs, social expectations, and power relations– for building subsequent institutions, provided there are foreign investors with interests in the oil industry at hand. For this reason, the international context is not a factor to consider when analyzing the ownership structures of a simplistic, domestic institutional scenario, such as S_1 or P_1, in which foreign investment has no capital interest whatsoever. Moreover, the institutional landscape applicable to S_1 or P_1 seems highly unrealistic even to Mexico these days; in particular after the energy reform which, as I sustain in Chapter V, has incorporated an ownership regime that resembles more to what Jones Luong and Weinthal define as typical of S_2.[163]

According to Jones Luong and Weinthal, by combining varying degrees of ownership and control among the foreign investment and state elites, S_2 and P_2 constitute *hybrid* regimes of property rights that differ from the pure domestic models, represented by S_1 and S_1, in two relevant ways.[164]

First, their modulating effect on fiscal institutions is dynamic, in the sense that they can modify in different ways how the same ownership regime impacts their institutional actors, depending on which of these parties has a more prominent at the international sphere in a given period of time. Second, their benefits on fiscal systems are partial since they lead to second-best outcomes –that is, fiscal institutions that "are partially constraining and enabling"[165] because their impact is produced mainly within the oil sector, but not the other sectors across the economy.[166]According to Jones Luong and Weinthal, the main shifts

[161] *Id.*
[162] *Id.*
[163] *Ib.* at 13.
[164] *Id.*
[165] *Id.*
[166] *Ib.* at 13-14, 16.

concerning the dominance of some institutional actors over others and the regulatory trends of the upstream oil industry at the international sphere can be divided in three different periods, each of them has altered the so-called ‘hybrid’ fiscal institutions under S_2 or P_2 in different directions.

The first time period goes from 1900 through 1960, an era featured by an oligopolistic structure given the financial, technological, and ideological dominance exerted by a small number of foreign oil companies –also known as “the majors”. Since the impact of either of the hybrid ownership structures on the incentives at stake is almost identical, the resulting fiscal systems from S_2 and P_2 are very similar. For Jones Luong and Weinthal, this outcome obeys the fact that transaction costs are insignificant due the widespread use of a “model contract” to norm the commercial relationship between host governments and foreign oil enterprises.[167]

Likewise, under S_2 and P_2, social expectations on both the state and foreign investors tend to be low because of the secrecy and low accountability surrounding the institutional environment in which international oil companies subscribe upstream oil agreements with host governments.[168] By virtue of their financial capacity, the political support they can get from their national governments, and their oligopolistic market power, *foreign oil companies* dominate the arena of power relations, thereby having enough leverage to dictate the state the terms of their oil production contracts.[169]

From a geopolitical perspective, this time period was heavily influenced by a capitalist ideology, which was dominant among the business and governmental elites of Western superpowers and used to favor a minimal presence of the state in socioeconomic life, except for the purpose of guaranteeing private property rights. In fact, the protection of private property rights was something that at some point reached the level of foreign policy –in particular, for developed states with strong military and naval capacities directed at protecting the commercial interests of their national elites around the globe. In the context of international politics, this partnership between business and governmental elites with the aim to use warfare instruments overseas, if the protection of private property demanded so, is commonly referred as “gunboat diplomacy”.[170]

In short, there was not substantial difference between having S_2 or P_2 during this time period, since both ownership regimes shaped identical incentives in light of the international context encompassing such era. Consequently, the tendency was that the fiscal system produced by those institutional conditions reflected the preferences of foreign oil investors: “a *minimal* and *stable fiscal burden*”.[171] Jones Luong and Weinthal describe that the contract template in this period used to grant the host government a fixed royalty on the amount of hydrocarbons extracted, regardless of the production levels and the profits the oil companies could get out of their oil and gas sales. Additionally, foreign oil companies did

[167] *Ib.* at 14.
[168] *Id.*
[169] *Id.*
[170] *See* James Cable, *Gunboat Diplomacy: Political Applications of Limited Naval Force*, Chatto and Windus for the Institute for Strategic Studies, 1971.
[171] *Id.* The italics are mine.

not have the obligation get involved in social spending, save for paying higher salaries and "occasionally housing and medical clinics for their own workers".[172] In the same guise, state elites did not face high societal pressures to launch social spending programs of universal scopes or to engage in high-scale public infrastructure projects.[173]

The second time period canvassed by Jones Luong and Weinthal encompasses a time span between 1960 and 1990. In terms of the market structure under which the hydrocarbon industry operated during this lapse of time, these authors point out to the emergence of an array of small foreign oil companies –commonly known in the specialized literature as the "independents"– who contributed to break up the oligopoly then controlled by the Majors and fostered the rise of the Organization of Petroleum Exporting Countries (OPEP) – an international cartel of developing petroleum-rich countries, most of them located on the Middle East and Africa[174], with the aim at competing against the dominance the majors had over the world oil supply back then, and countering the geopolitical influence of Western superpowers –i.e. the United States and Great Britain– in which these enterprises were incorporated. As a result, this phase was a turning point at which the fiscal systems resulting from S_2 or P_2 began to diverge on each other.

Although transaction costs remained insignificant thanks to the widespread use of the model contract during this second time period, there was a *shift* in *power balance* favoring the *state* as a result of this higher degree of economic competition in the hydrocarbons industry. But how exactly did this shift in power relations reflect at the level of the fiscal institutions shaped by both of these hybrid ownership regimes? First off, the tax burden on foreign oil companies became highly unstable and aggrandized to cover not just oil production, but the resulting profits as well.

As matter of fact, Jones Luong and Weinthal conclude, this is an illustration of the "*obsolescing bargain*" thesis depicted by Raymond Vernon: the phenomenon by which government elites are willing not just to collect a greater share of oil gains upfront when their contractual relationship with foreign oil investors even starts, but to unilaterally modify the terms of those agreements, via regulatory and tax amendments with clear rent seeking goals.[175]

Second, S_2 and P_2 start to differ from each other in terms of *social spending*, considering that the former presented high social expectations vis-à-vis both the state and foreign enterprises, inducing the launch of populist and highly visible social spending on the part of the government and some forms of philanthropy on the part of the foreign private sector; whereas under the latter regime, social pressures were high on foreign oil companies, but low on the state because of the government's abdication to control the oil industry's

[172] *Id.*
[173] *Id.*
[174] Venezuela and Ecuador are the two South American states with membership at OPEC. *See* Organization of Petroleum Exporting Countries (OPEC), "Member Countries", OPEC, electronically available at http://www.opec.org/opec_web/en/about_us/25.htm, consulted on October 23, 2017.
[175] *See* Jones Luong and Weinthal, *supra note* 2, at 14.

ownership structure, thereby creating incentives for stronger fiscal institutions than those under S_2, but with the same social spending levels provided by foreign oil companies.[176]

The third historical period referred by Jones Luong and Weintal goes from 1990 through 2005, with a tendency to increase the differences of the preceding stage between the fiscal systems generated by S_2 and P_2, respectively.[177] This is a phase characterized by the spread out of new *international rules* regarding the obligations of foreign oil companies to host governments, international financial institutions (IFIs), and international non-governmental organizations (INGOs) interested in assuring the compliance of these norms.

As in the two prior time periods, transactions costs remain low given the standardized adoption of the model contract.[178] However, it should be noted that at this point the global template to regulate contractual relations between the host governments and foreign oil investors had been amended in accordance to the shifts in the balance of power that took place at the preceding time period and the pressures exerted by institutional actors –i.e. IFIS and NGOs– to impose duties of *corporate social responsibility* on foreign enterprises.[179]

In light of this pattern of additional obligations at the expense of foreign investors, the latters' contribution to the state budget tends to go beyond the levels of the two previous stages, is not limited to a tax-type classification, and begins to be recognized by contract. Therefore, while social expectations on foreign oil companies are still high under both S_2 and P_2, as in the preceding historical period, there is an expansion of the substantive requirements to meet such demands; for instance, the indirect claims coming from host governments, domestic population, INGOs, and IFIS are not limited to social spending, but they even cover some type of direct financial support which many times turns out more burdensome than the contractual obligations concerning social spending.[180]

Considering the impact of the aforementioned incentives on foreign companies' fiscal burden, then the building of *strong fiscal institutions* becomes a matter of interest for the international oil business sector. In this way, foreign investors seek to influence the emergence of a stable, broad-based, and transparent tax regime as well as an accountable, disciplined expenditures system that does not waste their fiscal contribution which, despite being earmarked to social spending, most time is channeled through the state's coffers.

Oil companies, moreover, develop an interest in coordinating with the state and making that relation as public as possible, so their social spending contributions are used to satisfy a collective need for goods and service instead of a politically motivated public works in a populist fashion or a redundant expenditure the government elites might want to make it look as coming from them. Thereby, this incentives structure fosters foreign investors to support the efforts of IFIs and INGOs for increasing the adoption of transparency and

[176] *Ib*. at 15.
[177] *Id*.
[178] *Id*.
[179] *Id*.
[180] *Id*.

accountability best practices on the oil revenues extracted by the state via taxes and on how these gains are spent by the government.[181]

Even though the state's reliance on the petroleum sector is the key feature of the third historical stage, it does not follow that power relations have shifted in favor of the state *per se*. According Jones Luong and Weinthal, despite that it is clear who was the institutional actor favored by the balance of power in each of the preceding time periods, this is not clear *a priori* for the fiscal systems resulting under S_2 and P_2 in the last period.

For Jones Luong and Weinthal, the *uncertainty* –or *contingency*– of who dominates the arena of power relations, results from two factors. On the one hand, international organizations are not longer providing unconditional support to host governments over foreign oil companies. On the other hand, foreign oil business has found effective ways to protect their contractual rights to oil profits against the risk of the obsolescing bargain, by seconding the pressures of civil society, IFIs and INGOs on government elites to increase the degree of accountability and transparency over their fiscal systems, in exchange of their corporate social responsibility commitments.[182] If not taken into account, foreign investors' threat consists in unilaterally cutting off the social spending duties, affecting then the state's budget, since the government will need to offset such downfall of resources targeted for social spending and might be incapable to get this revenue through taxes imposed on economic sectors outside the hydrocarbons industry.[183]

Jones Luong and Weinthal thus come to terms with the conclusion that, even under the best possible scenarios concerning incentives, *hybrid ownership regimes* –such as, S_2 and P_2– tend to produce *second-best* outcomes compared to those generated under the pure ideal types of their ownership structures catalogue – namely, S_1 and P_1. Their explanation is twofold.

The first argument is that foreign investors' capability to influence the building of strong fiscal institutions outside the hydrocarbons industry is constrained because this possibility depends on whether the ruling elites have other contingent incentives nudging them to check and enable their power.[184] But, if it is a matter of deciding between S_2 or P_2, Jones Luong and Weinthal indicate that the likelihood of having stronger fiscal systems is higher under P_2 than under S_2.

This preference for P_2 over S_2 is supported on the same reasoning draw above with respect to the greater probability of developing more effective fiscal systems under P_1 than under S_1. Simply put, under P_2, social expectations vis-à-vis the state are low, since the government is not longer an actor controlling the ownership rights on oil production, whereas under S_2, ruling elites face more incentives –in the form of high societal pressures for the state– to build fiscal institutions that are more reliant on direct taxation over the oil industry as well as to come up with an unchecked expenditures system.

[181] *Id.*
[182] *Ib.* at 16.
[183] *Id.*
[184] *Id*

The second reason for ranking fiscal institutions produced by hybrid ownership regimes below the P_1 has to do with the risk that the greater intervention of foreign oil investors in the institution building and socioeconomic advancement of a mineral-rich, developing country, may plant the seeds of a potential de facto private power that could capture the state apparatus and pull the strings without being held accountable to the legal rules and oversight mechanisms applicable to any official authority.[185] Paradoxically, this inherent danger resulting from an ill-understood notion of the private sector's autonomy might erode, too, our initial goal of building enabling state institutions based on effective checks and balances.

5. <u>Political Economy Implications</u>

The set of arguments above synthesizes Jones Luong and Weinthal's theory of ownership on the upstream oil industry. Although this chapter mostly addresses the features and contrasting aspects of ownership structures present in a pure simple world, in which the international context is not an acting factor – that is, S_1 and P_1–, the rationale behind each of those institutional arrangements can be replicated *prima facie* for the *hybrid ownership regimes* –S_2 and P_2. Their caveat, though, is that fiscal institutions resulting from hybrid property structures might be either weaker or stronger, depending on the actor that wields greater leverage on this extractive industry –a contingent situation that shall be filtered and ultimately shaped by the *international arena*.

Based on the arguments articulated throughout this chapter, it is clear that Jones Luong and Weinthal's conceptual framework on ownership in the petroleum industry lends strong hold to legal systems where the institution of private property is guaranteed and configures an effective check against the arbitrary discretion of governing elites.

However, although their political economy approach is successful in conveying a sense of *materiality* to the traditionally legalistic notion of *checks and balances*, there are some nuancing observations that worth be putting upfront to not overrate Jones Luong and Weinthal's theory and their policy extensions.

The first remark has to do with the fact that ownership is not the only type of institution to trace and enforce legal boundaries around the ruling elites' abuse of political power at the expense of the population. By asserting this, though, I mean not to downplay the role of ownership rights as probably the most effective mechanism civilized nations have come up with to constitute a private dominion opposable to the discretion of political power, but rather to underline its interaction with *other relevant checks and controls* as well as its limitations.

This consideration leads us to a second remark concerning the need for an independent judiciary that is capable of solving and enforcing, with impartiality, the legal disputes

[185] *Id.*

arising between the state and private parties on ownership rights, regardless of whether or not they imply a judicial mandate against state elites' interests. Hence, private ownership regimes require the intervention of law enforcement officers on an institutional position that allows them to act against the will of the incumbent political elites.

In this way, it could be said that Jones Luong and Weinthal's theory puts most of its hopes in *ownership* structures in order to come up with *reliable checks and balances*. Somehow, these authors take for granted the possibility of having a highly competitive political arena that avoids either the concentration of power on the part of one elite at the expense of other or the cartelization of the political class, creating then room for independent decision-making instances.

The third point is that any understanding of ownership as an *autonomous* tool, whose functioning resembles a containment dam put against the political arena must be modulated because, as any institution framed through legal rules (i.e. legislative, judicial, and administrative norms), its *formal architecture* can be *manipulated* by those wielding political power within the state apparatus –whether in the legislative, the judicial, or in the executive branches of government. Taking as premise the positivist perspective this work has adopted early on, the realms of *law* and *politics* cannot be absolutely disentangled from each other. Even though the former appeals to a relevant degree of autonomy from and against the latter, as if it was an external object in pursuit of the rule of law ideal, either taming or rationalizing the crude reality of power struggles, the case is that both the design and performance of legal institutions are inevitably tied up to the competitive atmosphere of the political game.[186]

At the heart of the dualist approach employed by rule-of-law theories, we found a legitimacy function the law provides the state – namely, the purpose to govern politics through institutional channels guided by certain liberal standards, such as: rationality, predictability, publicity, and the maximization of individual freedom to guide one's self-behavior. This duality between the juridical and the political fields turns to be a fiction that must not be exaggerated in way that confers the former a sort of ontological superiority over the latter, since the political process and its institutional actors' behavior are the elements that ultimately makes operational and gives meaning to any legal regime.

This reasoning can be also extended to the performance of any law enforcement office – such as, courts or independent regulatory agencies–, whose normative acts always end up

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[186] When it comes to the analysis of the law and the state, rule-of-law theories rely on a *dualist* approach to explain the interrelation between those two 'objects' of study. Basically, rule-of-law theories presuppose the preexistence of the state, which is in turn understood as a collective unity resembling a volitional subject with action capacity, in comparison to the emergence of the law. So it is taught –by the rule of law jurists– the historical mission of the state consists in creating its law, so that the former abides by the latter. The state imposes on itself the obligation to be ruled by the law and, therefore, it both regulates and empowers itself by means of its own creation. According to the Austrian jurist Hans Kelsen, this is the theory of the *two faces of the state*, which cloaks many contradictions and circular justification – in particular, the conclusion that the duty of representing the state apparatus as a different agent from that of the law posited by the state itself, which is clearly performing a *legitimacy function* towards the former. *See* Hans Kelsen, "The Dynamic Aspect of Law", from *Pure Theory of Law* (trans. By Max Knight), Berkeley, University of Califrnia Press, 1967, at 290-291.

having political implications or being framed within a certain policy choice, despite the neutrality goal guiding its decision making processes.

Even so, what confers weight to ownership is its institutional construction, which is not exhausted by a system of formal rules, but has as well a *materiality* sense attached to its social meaning. Ownership thus is a complex institution, whose scope goes beyond the sphere of legality, when it is entrenched in daily societal life through the norms governing other spheres as the economy, morality, politics, labor, and social wellbeing. It is this complex social meaning what, if deeply rooted, buttresses ownership with a *thicker normative shield* than just checks and balances covered with the formality of the law.

IV. CONSTITUTIONAL REGULATION OF PETROLEUM BEFORE THE ENERGY REFORM

1. The constitutional system on energy

This section aims to provide some background upon the way the Mexican constitutional order has both addressed and structured the regulation of the Mexican hydrocarbon sector. In this way, I choose to focus on the *constitutional directives* of Mexico's legal system for now, since they convey relevant information regarding the ownership structure applicable to the energy industry and how this sector has been organized and regulated ever since the twentieth century.

Since it became the supreme law of the land in 1917, the federal constitution of Mexico broke up with the Western liberal tradition of framing a juridical instrument with a minimal scope aimed at structuring the organization of government, distributing its public powers amongst different departments, and establishing a catalogue of individual liberties opposable to state authority.[187] Being the result of a revolutionary conflict, the Mexican constitution formalized on black letter many demands of social nature that several collectives (i.e. peasants, teachers, blue-collar workers, and labor unions) had been seeking against the opposition of oligarchic elites.

As stated by José Ramón Cossío Díaz, jurist and justice of the Mexican Supreme Court, during the post-revolutionary era of the Mexican state, the triumphant leaders of this civil war encoded the social goals[188] that inspired their armed movements, so as to materially enforce them by means of new institutions. Rather than the supreme norm of the Mexican legal system, the federal constitution of 1917 was conceived as the political manifesto of the Revolution. For most part of the XX century, Mexican constitutional law was read under Schmittian coordinates, as a code encompassing the 'fundamental political decisions' of the political regime the Revolution gave birth.[189]

During the PRI era, Mexico's presidential regimes developed a lawmaking style characterized by the incorporation of constitutional provisions with huge economic impact that commanded –at least in nominal terms– the building of a expansive a*dministrative*

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[187] *See* José Ramón Cossío Díaz, *Cambio social y cambio jurídico* [Social change and legal change], ITAM, Mexico City, 2001, at 80-142.

[188] Namely, free elementary school; distribution of lands for agricultural use among smallholders; the state protection of workers' labor rights, and so forth.

[189] *See* Cossío Díaz, *supra note* 187, at 77-105, 110-116. In reference to the notion of Constitution and the concept of the 'political' developed by the German jurist Carl Schmitt. *See* Carl Schmitt, *The concept of the political,* Expanded Edition, Translated and with an Introduction by George Schwab, with Foreword by Tracy B. Strong and Notes by Leo Strauss, University of Chicago Press, 2007, at 19-79. This constitutional momentum in the history of Mexico set up the conditions for the establishment of the one-party regime, whose hegemony was centralized on the presidency and on the corporatist and clientelistic machine of the Institutional Revolutionary Party (PRI), and lasted for approximately 71 years in contemporary Mexico.

state where the Executive branch is granted of ample regulatory authority to satisfy the material claims resulting from the social rights indicated above. Nevertheless, the heterodoxy of the post-revolutionary constitutionalism lied in that those provisions of *regulatory* nature were rather understood as policy aspirations than as legal mandates with effective normative force, whose execution was taken care of by the administration in a gradual, programmatic fashion given the state's limited fiscal capacity, emptying thus the possibility of being demanded in a court of law and fostering legal demagoguery on the part of the legislature.[190]

Once the politicized approach to constitutional interpretation was replaced by a positivist philosophy in the context of the democratic transition in the mid-1990s, which in turn implied a judicial reform that entrusted the Mexican Supreme Court of Justice with stronger constitutional review powers over any authoritative act coming from any of the government branches, the constitution began to be interpreted as the *supreme law* of the land – that is, the law source with the highest binding force over both form and substance of every other norm of the Mexican legal order.[191]

Yet the practice of incorporating administrative law–type provisions into the Mexican constitutional text did not vanish after the political and economic liberalization reforms launched in the 1990s, but was in fact increased as the lawmaking technique par excellence. Unlike the authoritarian times of the past, where there was an ideological rationale fueling this *modus operandi* of a legislature subordinated to the President, in the age of 'divided governments'[192] *regulatory constitutionalism* in Mexico was propelled by a different logic – the need to guarantee certainty and predictability demanded by market investors, and to incorporate institutional safeguards for entrenching the economic and political liberalization agenda in light of future political uncertainty.[193] Given its contemporary conception as the instrument with the highest normative force domestically, the constitution became ever since the safest vault to wire up the credible commitment on the part of the ruling elites towards a given policy agenda from the ups and downs of the political process.[194]

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[190] *Ib*. 138-143.

[191] *See* Cossío Díaz, *supra note* 187, at 225-290; José Ramón Cossío Díaz, "La Suprema Corte y la Teoría Constitucional" [The Supreme Court and Constitutional Theory], in *Política y Gobierno,* Vol. VIII, No. 1, Primer Semestre de 2001, at 61-115. *See* also Héctor Fix Fierro, "Poder Judicial" [The Judiciary], in *Transiciones y diseños institucionales* [Transitions and Institutional Designs], Instituto de Investigaciones Jurídicas de la UNAM, Mexico City, 2009.

[192] In a presidential democracy, a *divided government* describes the scenario in which the President´s political party does not have a simple majority in Congress – both in the House of Representatives and in the Senate. *Cfr.* Benito Nacif, "Las relaciones entre los poderes ejecutivo y legislativo tras el fin del presidencialismo en México", from *Política y Gobierno,* Vol. XI, Núm. 1, I Semestre de 2004, CIDE, Mexico City, at 9-38.

[193] *See* Douglass North and Barry Weingast, "Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England", *The Journal of Economics History,* Vol. 49, number 4. (Dec. 1989), at 803–832.

[194] For an in-depth understanding of what *credible committment* means and its relation with institutions and regulated industries, *see* Brian Levy and Pablo T. Spiller, "A framework for resolving the regulatory problem", in Brian Levy and Pablo T. Spiller, *Regulations, Institutions, and Commitment. Comparative Studies of Telecommunications,* Political Economy of Institutions and Decisions, Cambridge University Press, Cambridge, 1996, at 1-35.

The *regulatory* orientation towards constitutional lawmaking has been employed by Mexican Congress to govern the usage of certain key assets for the performance of certain economic activities, on the one hand, as well as the organization and management of such industries and the general interest services related to them, on the other. This is the case of the energy business – both the hydrocarbon and the electricity sectors. In this light, according to Cossío Díaz, asset's ownership / industry / governance regime configure the triad of structural elements governed by the regulatory provisions of Mexico's constitution and, as such, will be our object of analysis through this section with regards to the hydrocarbon sector.[195]

2. Evolution of the constitutional system on petroleum

This section seeks to summarize what I consider as the main amendments performed upon Mexico's constitutional provisions on energy matters as of the entry into force of the 1917 constitutional order. By doing so, my purpose is to give a sense of the juridical background that preceded the enactment of the "energy reform": the set of amendments approved by federal Congress and state legislatures to articles 25, 27 and 28 of the Mexican constitutional text as well as their transitory regime, which were published through a decree on the Federal Official Journal on December 20th, 2013.

Considering the original provisions of the constitutional text in 1917, for Justice Cossío Díaz, the constitutional regulation of the energy industry has gone around three analytical components: 1) the juridical status, and hence the ownership rights, of a certain set of assets; 2) the identification of the industry or economic sector resulting from the usage and exploitation of the constitutionally regulated assets in the first place and its modalities; 3) the governance regime applicable to the industry or business activities, including the regulatory scheme of the services that are being delivered within the regulated industry at hand, if any.[196]

A. Article 27 of the Constitution

The primal text of article 27, first paragraph, of the constitution prescribed – and still does – that ownership of lands and waters located within Mexican territory belongs "*originally* to the *nation*"[197], which has the right to transfer their dominion to private parties, thus

[195] José Ramón Cossío Díaz and José Ramón Cossío Barragán, "El nuevo sistema energético en la constitución mexicana" [The new energy system in the Mexican constitution], in Tony Payan, Stephen P. Zamora, José Ramón Cossío (eds.), *Estado de derecho y Reforma Energética en México* [Rule of Law and the Energy Reform in Mexico], Tirant Lo Blanch, Mexico City, 2016, at 57-58.
[196] *See* Cossío Díaz and Cossío Barragán, *supra note* 195, at 60.
[197] Article 27, first paragraph, of the Political Constitution of the Mexican United States, published on February 5th, 1917 in Mexico's Federal Official Journal, available at
http://www.diputados.gob.mx/LeyesBiblio/ref/cpeum/CPEUM_orig_05feb1917_ima.pdf
The italics are mine.

constituting “private property”.[198] On the second paragraph of article 27, the constitution preserves its original drafting when it states that the nation shall always have the right to impose on private property the *modalities* dictated by *public interest* to each case and to regulate private property the exploitation of those natural resources that are susceptible of appropriation for society’s benefit and with the purpose of achieving an equitable distribution of wealth.[199]

As for hydrocarbons specifically, the original text of the 1917 constitution established – and still does – on its fourth paragraph that the nation has “*direct dominion*” of those natural resources. In this way, on paragraph sixth of article 27, the constitutional norm added up two qualifications that still remain today, by disposing that the nation’s dominion over hydrocarbons is “*inalienable*”, meaning that its title is not susceptible to trading, and “*imprescriptible*”, in the sense of a legal right whose validity is not subject to expiration.[200] Finally, the original text of article 27, paragraph sixth, of the Constitution stated that only federal government has the authority to grant *concessions*[201] either to private individuals or to civil or commercial companies that were incorporated pursuant Mexican laws, provided that potential concessionaires committed to deploy regular work for the exploitation of the natural resources at issue and that there was full compliance with those requirements established by Mexican laws.[202]

In light of the provisions above, article 27 of the constitution is the *touchstone* to understand how ownership in general, and that of natural resources such as petroleum, has been interpreted in the Mexican legal order. First of all, the concept of private property rights is constitutionally subordinated to a public interest represented by an ambiguous and vague concept of the nation – What did the framers of 1917 meant to refer to through such collective subject? Was it the Mexican people, the citizenry, or the state? This *servitude position* under which the *private property rights* are placed in the Mexican constitutional order, mirrors the despise political elites saw in the fundamental institution to protect the creation of wealth resulting from a private person’s own work and industrious efforts. Consequently, when it comes to defining public property, article 27 of the constitution amounts to a criterion that allows to read every other law or regulation of Mexico’s legal system in a discretionary fashion.

Second, article 27, paragraphs fourth and sixth, of the constitution seem to confuse the ‘*political*’ question of sovereignty that any state-nation deploys over lands, waters, and natural resources located within its territory with the ‘*legal*’ question of property. The consequences of this conceptual confusion reproduced at the level of the constitutional text have been tremendously harmful for a reasonable understanding of private ownership

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[198] *Id.*

[199] *See* Article 27, second paragraph, *supra note* 197.

[200] *See* Article 27, fourth paragraph, *supra note* 197.

[201] As explained in Chapter 3 of this dissertation, the notion of *administrative concession* in Mexico is heir of the French public law doctrine, according to which this title is discretionally granted by the administration and grants its holder –also known as ‘concessionaire’– the exclusive rights to operate, use and commercially exploit a public domain asset or a public interest service, which in turn remains property or jurisdiction of the state and can be unilaterally disposed –taken back or sold, for example– by the latter in its owner capacity.

[202] *See* Article 27, sixth paragraph, *supra note* 197.

rights: their role as checks and balances for any polity governed by the rule of law, and their positive impact for rapid economic growth and development.

Third, by entrusting federal government with the power to assign administrative concessions concerning the exploitation of hydrocarbons in Mexican territory, the original text of article 27 of the constitution backed up an interpretation for which federal government – that is, the Executive branch – has the legal capacity to act as the nation's agent with the mandate to protect its public interest in the petroleum industry.

B. THE 1938 EXPROPRIATION AND THE 1940 CONSTITUTIONAL REFORM

Mexico's oil and gas industry was shaken up on March 19th, 1938, in light of the *administrative taking* decreed by President Lázaro Cárdenas over the assets formerly owned by the international oil companies, who on their part had disobeyed a labor court's ruling of December 1937. In order to shield this executive action and the nationalist shift in energy policy from judicial review challenges, the President sent to Congress a constitutional amendment in December 1938, but which for some unclear reason was approved as late as on November 9th, 1940.[203]

By means of this reform, a portion was added up to paragraph sixth of article 27 of the constitution to underline that concessions over petroleum and the rest of hydrocarbons shall not be authorized henceforth and that secondary legislation would specify how those products should be exploited. According to President Cárdenas' statement of purpose for the 1940 constitutional bill, the expropriation of 1938 was aimed at fighting back the legal transgressions of the few international oil companies –also known as "majors"– with *dominance* over the Mexican petroleum market. In this sense, both the 1938 administrative taking and the 1940 constitutional overhaul had the purpose of rescuing a domestic industry from an *oligopolistic* structure that had abused the *concession* regime at the expense of the nation's general interest.[204]

In terms of the statement of purpose signed by President Cárdenas for the 1940 constitutional reform proposal, the concession regime had been misinterpreted against the national interest and the public property of hydrocarbons. In particular, the Executive's criticism targeted a 1918 decree signed by the then-President Carranza, according to which the state had the obligation to assign petroleum concessions, leaving the nation just with the right to receive the payments for taxes, rents, and royalties established for that purpose. In

[203] This delay in processing this constitutional reform bill of 1940 might had to do with the turmoil triggered by the expropriation; the heated demands made by the affected foreign oil investors and their governments; the compensation payment claims by these companies to the Mexican government; the emergency scenario triggered by World War II; or to the fact that the Executive sent to Congress his legislative bill on petroleum till December 1939, so the reformers could approve both the constitutional reform and secondary legislation altogether in package.

[204] *See* Lázaro Cárdenas, "Exposición de motivos a la Iniciativa de Adición al Párrafo Sexto del Artículo 27 de la Constitutción Política de los Estados Unidos Mexicanos" [Statement of Purpose to the Reform Bill of Article 27, Paragraph Sixth, of the Political Constitution of the United Mexican States], Lázaro Cárdenas, Presidente de la República, December 22, 1938, at 1.

short, it was a motive of condemn that this former presidential decree did not allow the legal possibility for the government to deny a concession application on more discretionary grounds. Although the Mexican Supreme Court held the constitutional validity of the administration's prerogative to either adjudicate or reject hydrocarbon concessions, President Cárdenas sustained, this authority was annulled through the Petroleum Law of 1925 – a legislative statute that explicitly ordained the Executive's obligation to assign an administrative concession on oil and gas, provided the respective applicant complied with the other requirements established by Mexican laws.[205]

The Cárdenas' statement also attacked the Secondary Law on Article 27 of the Constitution with regards to Petroleum, approved in 1933, under the argument that this statutory legislation had omitted to grant the Executive with the *administrative law* power to take back an oil and gas concession given its public property status, if according to government agencies in charge of policing and regulating the hydrocarbons industry, such legal title and its assets are not being exploited in benefit of the national interest – in other words, what in Mexican law is ambiguously dubbed as a 'for-cause regime of public utility'. For these reasons, President Cárdenas thought the original purpose of the 1917 constitution's framers in establishing a concession regime had been distorted for the benefit of just a few foreign interests.

For the nation to have a *direct profit* on oil wealth, President Cárdenas statement of purpose highlighted the need for *state-owned* entities to achieve a direct exploitation of the national oil reserves. Had the concession regime on crude oil been amended in advance, President Cárdenas indicated on his exposition of motives, then the 1938 expropriation would not have taken place. In consequence, the constitutional reform bill of 1940 sought to put an end to the interpretive controversies over article 27 provisions on petroleum. Nonetheless, the presidential statement of purpose acknowledged, there were some officials inside the state for whom the framers of the 1917 constitution did not mean to exclude any type of private investment participation in the hydrocarbon sector. As a result, the presidential statement of purpose highlighted, the addition proposed on article 27, paragraph sixth, of the constitution had the objective to leave on the legislature's discretion the authority to decide and regulate the schemes through which private capital could be inserted into the Mexican oil and gas industry.[206]

C. The Secondary Legislation Interregnum: 1940-1958

Before addressing the next constitutional amendment on energy, it is worth noting that the so-called Secondary Law on Article 27 of the Constitution with regard to Petroleum was abrogated, promulgated brand new and reformed three times during the period that goes from 1940 through 1960. The first secondary law of this type was published on November 9th, 1940 to adjust and develop further the principles and provisions established through the constitutional changes pushed forward by the Cárdenas administration earlier that year. The new federal statute provided the possibility of private capital participation through a

[205] *Ib.* at 2.
[206] *Ib.* at 4-5.

contractual regime instead of the former *concessions*, having the private parties the right to recover their investment plus a reasonable profit. Nevertheless, as for the quality of the private parties, this legislative instrument ordered that only national individuals or companies were authorized to participate in the new contracting arrangement on oil industry. Hence, this provision was an early hint of the *nationalistic* trends that would dominate the Mexican energy industry in the years to come.[207]

A second new Secondary Law on Article 27 of the Constitution with regard to Petroleum was published on June 18th, 1941. This time there was no longer a leftist administration in power and Mexico was governed instead by President Manuel Ávila Camacho, whose approach towards the relation between the state and the business sector was at the right wing of the PRI's political spectrum. The purpose of this new version of legislation on crude oil activities had the goal of making more *flexible* – or *market friendly* – the channels through which private capital could be invested in the industry. Unlike the more restrictive legislation piece of 1940, the 1941 statute ordained that private parties were entitled to a payment for their upstream oil operations, consisting in either an economic compensation or a percentage of the oil production. Thus, it was clear the legislation set forth by the Ávila Camacho administration had the objective of launching more aggressive vehicles to attract private investment than those of the Cárdenas era. Moreover, this secondary legislation contemplated the creation of *mixed-capital entities controlled by the state* to perform upstream petroleum activities. In a nutshell, the secondary law on petroleum of 1941 provided greater alternatives for the state to decide how private investment could be integrated to the upstream oil industry – either by investing within the capital structure of a state-controlled enterprise or by assigning a contract on upstream activities to the private agent itself.

The third version of the Secondary Law on Article 27 of the Constitution with regard to Petroleum was published on November 29th, 1958, during the presidential administration of Adolfo Ruiz Cortines – that is, 20 years later than the taking over of property formerly owned by foreign oil companies was decreed by President Lázaro Cárdenas. The aim of this legislative instrument was to consolidate *full state control* on hydrocarbons to its maximum through a *state monopoly* – precisely, the state ownership arrangement (S_1) that would characterize the Mexican oil and gas industry for the future decades until the passage of the energy reform of 2013.

In light of the structural components of analysis suggested by Cossío Díaz, this legislative body is the first one in specifying the activities of the hydrocarbons industry that would be *exclusively reserved* to the *state* and its public instrumentalities, amongst which Pemex[208] assumed a central role. For that purpose, the legislature used the supply chain of the oil industry to define these activities and services, whose performance would be taken

[207] Even though the present research ignores how the contract framework of 1940 worked in practice, we know it only lasted one year when new secondary legislation was promulgated and abrogated the past one accordingly. Furthermore, this is a perfect illustration of the *private domestic ownership* regime (P_1) that was described in Jones Luong and Weinthal's theory of ownership in the petroleum industry.

[208] Petróleos Mexicanos (Pemex) was created by decree of President Lázaro Cárdenas on July 20th, 1938, as a government entity in order to take over possession and administration of the assets expropriated to foreign oil companies in March 1938.

over by the state under the cover of a *legal monopoly*.[209] Nevertheless, the secondary legislation of 1958 nuanced its exclusionary character by permitting the possibility for Pemex to suscribe service agreements with any private party or company, for as long as the contractor's consideration payment consist in cash, forbidding thus the instance of a compensation that might consider the amount of extracted oil or a participation in the oil profits once the production had been sold in the markets.[210]

According to President Ruiz Cortines' statement of purpose for this legislation bill, the main argument behind the consolidation of a state monopoly for Mexico's oil industry was that, considering the non-renewable nature of hydrocarbons and its role as key lever for the economic progress of Mexico, it was not for the business sector to decide the terms of its commercial exploitation, so a stronger intervention of the state was necessary to keep the extractive industry functioning in accordance to the nation's general interest.[211] Second, the Ruiz Cortines administration argued that the state-controlled scheme of mixed-capital entities would cause a duplicity of functions with Pemex, as the head of public organisms that had been created by the Executive since 1938 to manage and operate the oil industry on the state's behalf, echoing into a waste of budget resources accordingly.[212] Third, the Ruiz Cortines' letter of motives to his legislative proposal underlined that there was not need to maintain the contractual regime implanted by the petroleum legislation of 1941, because it had proved ineffective in attracting capital investment into the sector: only 1 (one) upstream agreement was signed off in 1948, but never became operational whatsoever.[213]

Last, it should be underscored that the Ruiz Cortines's statement of purpose made clear that 450 concession titles had not been put yet at the state's disposal by 1958, so in order to comply with the mandate of the 1940 constitutional reform, which supressed the concession regime on upstream oil operations, the proposed legislation had also the aim to incorporate them to the state's dominion, paying the corresponding compensation either through a covenant or through a compulsory sale in favor of the nation. Put differently, after the 1940 reform, the remainder of upstream oil concessions were void of constitutional support, leaving the economic rights resulting from these titles just protected by the secondary law of 1941. Thus, it was clear why, from a legal standpoint, the Ruiz Cortines administration saw this as an opportunity to reinforce the construction of a full state monopoly upon the oil industry by setting forth the federal statute of 1958.[214]

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[209] These sectorial economic activities and services were "exploration, exploitation, production, refination, storage, distribution, and first-hand hydrocarbon sales". *See* Francisco Javier Zenteno Barrios, "La regulación de los hidrocarburos en México" [The regulation of hydrocarbons in Mexico], en *Regulación del sector energético* [Regulation of the energy sector], Instituto de Investigaciones Jurídicas – UNAM, Mexico City, 1997, at 94.
[210] *See* article 6 of the Secondary Legislation on Article 27 of the Constitution with regard to Petroleum, published on November 29, 1958, in Mexico's Federal Official Journal.
[211] *See* Francisco Javier Zenteno Barrios, *supra note* 209, at 95.
[212] *See* Adolfo Ruiz Cortines, "Exposición de motivos a la Iniciativa de Ley Reglamentaria del Artículo 27 Constitucional en el Ramo del Petróleo" [Statement of Purpose to the Bill of Secondary Legislation on Article 27 of the Constitution with regard to Petroleum], Adolfo Ruiz Cortines, Presidente de la República, November 25, 1958, at 2.
[213] *See* Ruiz Cortines, *supra note* 212, at 3.
[214] *Ib.* at 4-6.

D. The Constitutional Reform of 1960

Legally speaking, the adjustments approved on article 27, paragraph sixth of the Mexican constitution in 1960, by initiative of President Adolfo López Mateos, came up late in time just as the constitutional reform of 1940 did with the expropriation of 1938. Basically, the purpose of the constitutional amendment of 1960 was to harmonize the content of the supreme law provisions on the oil industry with that of the secondary law on petroleum passed in 1958, so alternative interpretations from the constitutional text could not stop the dismantling of the 1941 contracting regime.

In this context, the overhaul consisted of *forbidding* both concession titles and contractual agreements, stating explicitly that those still in force would not longer subsist from that point on and that the nation –that is, the state– would be in charge of the upstream oil activities pursuant the corresponding legislation. This reform, therefore, came to fully crystalize a *state ownership* structure over the hydrocarbons industry from the constitutional norm itself.

However, a literal reading of article 27, paragraph sixth, of the constitution after the 1960 reform would have lead to an absurd interpretation, in the sense that only the state and its instrumentalities would have legal capacity to participate in the hydrocarbons industry without any type of *assistance* from a *private third party* – including the execution of accessory, but still important, activities such as the construction extracting platforms; the installation, use, and maintenance of infrastructure for the drilling and production of oil wells; secondary services to fulfill transport, medical, housing, and safety needs for the personnel carrying out oil production activities, etcetera. Considering the great financial impact a narrow interpretation of the 1960 constitutional amendment would have meant for the government's budget, the authoritative consensus was that the ban on contracts was exclusively targeted at what is known as risk contracts, excluding *services agreements*, which in turn were essential for the Mexican state to conduct the direct exploitation of hydrocarbons.[215]

E. The Constitution's Economic Chapter

The next amendment to the constitutional provisions regulating the management of Mexican oil wealth occurred in 1983, under the government of President Miguel de la Madrid.[216] This reform was passed in the midst of economic and political turmoil in Mexico. The complexity of this national financial crisis had resulted from Mexico's default

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[215] *See* Cossío Díaz and Cossío Barragán, *supra note* 195, at 63-64. Nonetheless, as Cossío Díaz sustains, the possibility that Pemex, or other state-owned company of the upstream oil sector, could suscribe service contracts with a private third party was permitted, for as long as a pair two legal constraints were observed: First, the prohibition to compensate contractors with any proporportion based on the oil produced. Second, the prohibition to compensate contractors through a participation linked to the exploitation of the oil produced.

[216] Two decades had passed without relevant legal changes to the regulatory framework on crude oil since 1960, except for an organic statute that was passed by Congress in 1971 to structure Pemex's corporate governance and to subordinate it to the Executive branch – particularly, to the financial dictates of the Finance Ministry and the political authority of the Presidency.

on its external debt payment; the 1982 failed expropriation of the banking industry, which was decreed by the former President José López Portillo; the bad situation of public finance and macroeconomic variables' poor performance – such as hyperinflation, high interest rates, and high volatility of the currency exchange rates – made evident the need to launch stabilization measures to tackle this critical conjuncture. In exchange of these structural adjustments, the Mexican economy was rescued by means of restructured lending lines with its foreign creditors – mainly, the International Monetary Fund and the World Bank.

In 1983, the presidential administration of de la Madrid lobbied before Congress for the approval of a reform that is known for introducing what is commonly referred among Mexican jurisprudence as the "*Constitution's economic chapter*". According to the President's statement of purpose, the 1983 amendment to articles 25 and 28 of the constitution had three primary goals or vectors. First, it established the constitutional principles and standards of the national development strategy within the framework of a mixed economy model. To that end, it was imperative to provide the state with greater institutional capacities and thus oppose more legal predictability to the environment of uncertainty and low productivity that had characterized the Mexican economy from the 1970s through the early 1980s, setting up the conditions for Mexico's socioeconomic modernization.[217]

The framers placed *state-directed governance* ("rectoría económica del Estado") as the constitutional directive on which the mixed economy system should be ruled henceforth. In accordance to President de la Madrid motives exposition, this principle would serve as the normative justification to expand the state's function and instruments to intervene directly, and more effectively, in the conduction of national economic development, encompassing as well the collaboration of both the private sector and the social sectors in achieving such constitutional objective. Unlike the recent past, according to President de la Madrid's statement of purpose, the general interest pursued by a state-commanded governance of the economy demanded that every government action should be harmonic with and respectful of the individual liberties that were also guaranteed by the constitution.[218]

For the reasons above, the presidency persuaded the framers to introduce a legal distinction between '*strategic areas*' ("áreas estratégicas") and '*priority areas*' ("áreas prioritarias"), on articles 25 and 28 of the constitution. This constitutional typology had the purpose of structuring government management of the national economy through a set of planning, command-and-control, coordination, and foment regulatory tools, as well as the organic vehicles to carry out those actions.[219] By means of the *strategic areas*, the constitutional legislature chose to group all those economic activities and services, whose performance should be within the exclusive purview of the state under a *legally protected monopoly*. In short, the 1983 reform on article 25 of the constitution made clear that economic activities and services classified as strategic should be managed by the public

[217] *See* Miguel de la Madrid Hurtado, "Exposición de motivos a la Iniciativa de Reformas y Adiciones a los artículos 16, 25, 26, 27, 28 y 73 de la Constitución Políticade los Estados Unidos Mexicanos", [Statement of Purpose to the Reform Bill of articles 25, 26, 27, 28, and 73 of the Political Constitution of the Mexican United States], Miguel de la Madrid Hurtado, Presidente de la República, January 19, 1983, pp. 3-4.
[218] *Ib.* at 4-6.
[219] *Ib.* at p. 6.

sector in an exclusive and exclusionary manner. As a result of the 1983 amendment, the constitutional legislature started to employ article 28 of the constitution hereafter to enunciate the catalogue of economic activities qualified as strategic.

Despite their explicit regulation in article 27 of the constitution, the hydrocarbon sector was explicitly added up to article 28's list of strategic areas, along with other branches of the energy industry –such as electricity, basic petro-chemistry, radioactive minerals and nuclear energy–, among other economic activities or services.[220] It is worth noting that this *numerus clausus*[221] inventory of strategic areas has been changed over time; however, it should be highlighted that hydrocarbon exploration and exploitation has remained a part of it to these days.

On the other hand, the notion of *priority areas* was reserved to regulate ever since either the exploitation of public dominion assets, or the delivery of general interest services, for which the ordinary legislature has the discretion to entrust their operation to the administration all alone, or to rely whether on the private or the social sector through an administrative law regime – a 'concession' arrangement in case of a business or industry contractor, whereas a 'permit' scheme if these activities will be deployed by a non-governmental organization.

The second axis of the 1983 constitutional reform lied in the *mixed nature* of the economic model that the public sector had to put in motion forward with the collaboration of both the social and private sectors. Despite the state's preservation of central planning, regulation and foment functions, the nuance of this constitutional shift consisted in the acknowledgement that national economic development should be the result from the tripartite concurrence of the state, the private sector, and civil society – in particular when it comes to the carrying out of the so-called priority activities. This cooperation principle is still carved out in the Mexican constitution, when it comes to national economic development.

The third feature of the 1983 constitutional modifications refers to the *organic entities* by which the public sector would enforce its exclusive mandate to manage and operate the 'strategic areas' of national development, on the one hand, as well as its – full or partial – participation in those 'priority areas' designated by the ordinary legislature, on the other (article 28 of the constitution). But, as far as '*strategic areas*' are concerned, the reformers specified that the federal government should maintain both the *ownership* and *control* over the "organisms and companies" – Pemex included – that are created therein (article 25 of the constitution).

Although it was not part of this amendment, it is important to highlight that all references to the organic dimension through which the public sector would execute the tasks ordained by the supreme norm's economic chapter, should be read systematically

[220] *See* Cossío Díaz and Cossío Barragán, *supra note* 195, at 64.
[221] In Latin, this expression means a closed number. When applied to the interpretation of the law, this Latin technique designates a catalogue, classification, or typology of elements, features or behavior whose extension is as limited as the number of elements, features or behavior types that it explicitly enunciates.

with article 90 of the constitution, whereby the federal public administration is divided in two branches: the '*central*' administration, which is the bureaucratic complex at the service of the Executive for the management and dispatch of administrative matters, and the '*parastatal*' entities system, by which the government carries out a public interest activity or service that is legally qualified either as an strategic or as a priority area.

In summary, the aforementioned reform systematized the triad of structural components to construe the constitutional understanding of the hydrocarbons industry that was in force from 1983 until the 2013 energy reform.[222] These elements can be illustrated as it follows:

1) <u>Asset's ownership</u>. The legal status of oil wealth located in Mexican territory, as a natural resource that is subject to the nation's direct, inalienable, and imprescriptible dominion (article 27 of the constitution).

2) <u>Industry</u>. The identification of the hydrocarbon sector as one type of activity that can be subject to economic exploitation among several other branches of the energy industry – such as electricity, nuclear energy, etcetera (article 27 and 28 of the constitution).

3) <u>Governance regime</u>. The qualification of the hydrocarbons as an strategic sector, whose management, operation, and exploitation is within the exclusive orbit of the state, forbidding the possibility of assigning concessions, licenses, or risk contracts to private companies – except for those service agreements needed by Pemex (articles 25, 27, and 28 of the constitution).

Yet it is still paradoxical that the constitutional economic chapter, whose incorporation into the Mexican supreme norm was set forth by a reformist administration that would inaugurate a policy consensus aimed at shrinking the size and responsibilities of the state on the economy, was built upon a legal design that concentrated an enormous amount of regulatory power and discretion in the hands of the Executive branch. Put differently, there was a need for a strong presidency to redefine the role of the Mexican state towards a *market-friendly* development strategy with the target of *liberalizing* and *deregulating* the national economy.

F. Legislative Reforms between 1983 – 2013

After the incorporation of 1983 regulatory provisions into the constitutional system on energy, the Mexican hydrocarbon regime would hereafter have only legislative amendments of organic and administrative nature. In other words, there was not a structural change of Mexico's oil institutional framework until the approval of the 2013-2014 energy reform. In between, both the Secondary Law on Article 27 of the Constitution with regard to Petroleum and the Petróleos Mexicanos Organic Act were the legislation that suffered most changes.

[222] *See* Cossío Díaz and Cossío Barragán, *supra note* 195, at 64-65.

If there is something worthy of a remark regarding the evolution of rules governing the Mexican energy industry in this lapse of time, this could be the legislature's decision to exclude from the strategic areas catalogue, some specific activities from hydrocarbons industry[223], as well as to update Pemex's corporate governance for division of labor purposes[224] and its financial regime, for as long as it would still fueling 40 to 30 percent of the government's budget –an essential fiscal function that implied to keep this

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[223] First, according to the Petróleos Mexicanos Organic Act of 1992, the petro-chemistry industry ("petroquímica") was the only segment of the hydrocarbon supply chain that did not constitute a *strategic* area, so it has been subject to a *priority* area regime ever since, meaning that private sector's investment was allowed.

Second, the Secondary Law on Article 27 of the Constitution with regard to Petroleum was reformed on May 11, 1995 (published in Mexico's Federal Official Journal), so as to qualify the storage, transportation and distribution of natural gas –namely, some midstream and downstream activities of the hydrocarbon supply chain– as a *priority* area, and therefore authorize the financial assistance of the *social* and *private* sectors, via an administrative law regime based on 'permits'. Since the government of President Zedillo did not have the funds to cover the cost of the expansion and operation of the gas pipelines network needed by the Mexican economy, it was imperative for the administration to call on private investors. However, the political environment was not suitable for bargaining and approval of a constitutional reform on the oil and gas sector. Thus, the juridical strategy followed to achieve this reform was based on the formalist *a contrario sensu* interpretation that the constitution just forbade the use of concessions on hydrocarbons, but not of permits. This legislative change went up to the point of guaranteeing private property rights on the new infrastructure, for as long as this would be subject to the Energy Ministry's regulatory and adjudicative authority.

Third, the secondary law above was amended again in June 26, 2006 (published in Mexico's Federal Official Journal), in order to explicitly regulate the exploitation of gas associated to mineral coal as mining activity, which allowed for a concession regime according to the Mining Act, and thus avoid the temptation to rule it as an *strategic* activity within the rest of the hydrocarbon supply chain.

[224] First, the Petróleos Mexicanos Organic Act of 1992, which gave Pemex the character of a *public descentralized organism*, as part of the 'paragovernmental' federal administration accountable to the Executive, with legal capacity and patrimony to respond for its own legal acts, and with an organizational structure integrated by *subsidiary organs,* each of which was in charge of a specific segment of the hydrocarbon industry's supply chain.

Second, the energy reform of 2008 was passed during the presidential administration of Felipe Calderón Hinojosa from the right-wing National Action Party (PAN), who originally attempted a radical constitutional overhaul aimed at liberalizing both the petroleum and the electricity sectors, but whose reformist efforts were opposed in Congress by the Institutional Revolutionary Party (PRI) and Democratic Revolution Party (PRD). At the end, President Calderón's party just got the support of the PRI to pass a legislation package which included 1) the creation of a hydrocarbon *quasi*-regulator with the objective of supporting the Energy Ministry exclusively for technical regulatory matters –the National Hydrocarbons Commission (CNH); 2) the incorporation of "professional advisors" within Pemex's administrationboard, in order to gain more decisional independence for this entity vis-à-vis the central government; 3) a new financial and budgetary regime for Pemex to contract debt aimed at productive infrastructure with less obstacles from the Finance Ministry; 4) a new contracting scheme for technology and infrastructure services required by Pemex to carry out upstream activities in deep waters, in which incentives were more aggressive than in the past since compensation payments for contractors were based on results and efficiency standards.

It is worth noting that the validity of this contracting framework was challenged before the Mexican Supreme Court, by a minority of legislators, for allegedly being against the letter of the constitution. As we know, the constitution reserved at this point the exploitation of hydrocarbons to the state and used to have a ban on any type of private investment participation in this regard, whether through concessions or contracts, except for those agreements with the purpose of delivering a secondary service. *See* "Sentencia dictada por el Tribunal Pleno de la SCJN en la Controversia Constitucional 97/2009", el 6 de diciembre de 2010. Publicada en el Diario Oficial de la Federación el 10 de marzo de 2011 [Mexican Supreme Court of Justice Ruling on the Constitutional Controversy 97/2009, December 6, 2010, published in Mexico's Federal Official Journal on March 10, 2011]. Nevertheless, this contractual scheme was scarcely implemented due to its weak economic incentives for private companies and the straitjacket regulation imposed over them.

paragovernmental entity subordinated to the Finance Ministry and therefore to the President, regardless of the many "cosmetic" changes that were tried out to achieve some degree of independence through its formal design.

V. OIL RESOURCE MANAGEMENT REGIME IN MEXICO

1. The Political Process of the 2013 Energy Reform

A. THE SURROUNDING POLICY NARRATIVE

The 2013 constitutional overhaul on the energy industry was packed among the so-called "*structural reforms*" passed by Congress during President Peña Nieto's administration. The purpose of these constitutional and legislative adjustments was to modernize the legal architecture and institutions governing different areas or industries with the capacity to boost Mexico's economic growth and development, but whose efficient performance had largely been captured by interest groups with structures of concentrated power aimed at protecting their rent seeking goals – namely, antitrust laws, education laws, labor laws, telecommunications laws, taxation laws, among other fields.

There was a microeconomic logic inspiring the structural reforms, in the sense that their touchstone was the argument that '*institutions matter*' for the efficient performance of markets. Hence, the rule of law and its enforcement perform a key role in providing a predictable and safe environment that, in turn, encourages rapid economic growth, development, and innovation. For the last twenty years, economists had been underscoring the need for inclusive legal regimes in Mexico to create aligned incentives structures to promote market efficiency in the areas and industries above.

However, since political alternation took place in Mexico's presidency as consequence of the 2000 elections, governments headed by the center-right National Action Party (PAN) were unsuccessful in getting the legislative approval of some of these legal amendments – for instance, the originally ambitious energy reform of 2008 that ended up being a bunch of 'decaf' legislation changes. The reason for this outcome was the congressional *gridlock* brought up by a 'divided government' scenario in which the President's party lacked of a majoritarian legislative presence to approve the administration's first-choice of policy reforms.

Since the beginning of our democratic transition in the 1990s, the formal arrangement of checks and balances established on the federal Constitution started to effectively work. In this way, the meta-constitutional authority the President used to have during the hegemonic party regime of the PRI, had been transformed into a congressional bottleneck unable to pass structural policy reforms.

B. "THE PACT FOR MEXICO"

It was until President Peña Nieto took office in December 2012, when this congressional paralysis obstructing the approval of structural reforms was overcome. Paradoxically, the

victory of Peña Nieto in the 2012 election –based upon a political campaign appealing on the need for an effective state ("estado eficaz") –also meant the return of the PRI to presidential power after twelve years of being in the opposition, during the PAN's alternation governments (2000-2012). On December 2, 2012, just one day after having being sworn into office, President Peña Nieto publicly released a policy reform platform known as the *Pact for Mexico* ("Pacto por México"), which encompassed an ambitious package of constitutional amendments and legislation bills of huge economic impact, for whose passage the presidency was requesting a *legislative coalition* among the then main forces of the Mexican political spectrum: the PRI, the PAN, and the PRD.[225]

There is no doubt that the 2013-2014 energy reform was the crown jewel pursued by the Peña Nieto administration. For its part, although the PAN had tried a similar overhaul of the energy industry in 2008, which definitely did not get the ambitious scope it pretended precisely because of the PRI's hijacking politicking back then, the center-right party negotiated giving its legislative support to President Peña, in exchange for a large-scale reform over the country's electoral rules, the political system's institutions[226], and the institutional design of the attorney general office[227], that would be approved in 2014.[228]

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[225] It is worth noting that until 2012, the party that used to aggregate most of the left-wing 'tribes' in Mexico was the Democratic Revolution Party (PRD). After the presidential elections, Andrés Manuel López Obrador – former Mayor of Mexico City (2000-2005), two times presidential candidate for the PRD, both in 2006 and 2012 – decided to constitute the "National Regeneration Movement" (MORENA), as a cross-party organization that finally became an official political party in 2014, co-opting most of the PRD's political base and taking the lead as the most important left-wing party in Mexico after such split-off. This scission process was mainly motivated, among other reasons, because in López Obrador's perception he has been victim of electoral fraud orchestrated twice by a collusive partnership between the PRI and the PRI. Therefore, when the PRD leadership was invited to support the policy reform agenda of the so-called *Pact for Mexico,* there was twofold reaction among the Mexican political left. López Obrador, for his part, rejected this program due to its 'neoliberal' character and because it was being launched by an political elite lacking of democratic legitimacy. On the other hand, it is very likely that the PRD leadership, which was then controlled by its more liberal and moderate segments, saw this temporary legislative partnership with the PRI government – via the *Pact for Mexico* – as an opportunity to disguish themselves and thus break up with the anti-systemic, radical style of López Obrador. In 2018, Mr. López Obrador ran for president of Mexico for a third time in life, through MORENA, winning by a 53% of the popular vote – 30 points ahead of the second place, the PAN candidate, and 37 points above the incumbent PRI.

[226] For instance, coalition governments; consecutive reelection for both federal and local legislators and city mayors; the Senate's ratification of the Finance and Foreign Affairs ministers appointed by the President; the Senate's ratification of the Executive's six-year national development program and public safety strategy. *See* Gobierno de la República, "Explicación Ampliada de la Reforma Política-Electoral", [Extended Explanation of the Political-Electoral Reform], Presidencia de la República, Mexico City, 2014, at 3-20, available at https://www.gob.mx/cms/uploads/attachment/file/3080/EXPLICACION_AMPLIADA_REFORMA_POLITICA_ELECTORAL.pdf, consulted on January 14, 2018.

[227] *Id.* The purpose was to set up an institutional design, supported on the Senate's collaboration in the appointing and removal mechanism, through which the Attorney General Office could become into a law enforcement body with enough independence from the President and the Executive branch; particularly with regard to the authority to conduct investigations and prosecute both electoral and political corruption crimes.

[228] In the same way as the PRD, the PAN's leader, Gustavo Madero, saw this cooperation with the government, via the Pact for Mexico, as a way to get rid of the control that former President Felipe Calderón Hinojosa had over the party during his whole administration and whom many cadres identify as the main responsible for the loss in the 2012 presidential elections.

On the other hand, the PRD –for mostly ideological reasons fueled by the risk of losing its remaining political base after Andrés Manuel López Obrador quit the party – played the card of being publicly against the liberalizing policy orientation on which the reform would be launched by the other two members of the Pact's coalition –namely, the PRI and the PAN. Yet the opposition deployed by the PRD in this regard was rather symbolic compared to hostility showed by López Obrador. This absence of left-wing sabotage resulting from a sort implicit agreement was critical for the PRI government to work out not just the passage the energy reform, but the PRD's backing for the rest of the Pact's reform agenda.

The energy reform was framed within the "Agreements on Economic Growth, Employment, and Competitiveness" of the Pact for Mexico. According to the Pact's charter of commitments, objective 2.5 was to "advance an energy reform to transform this sector into one of the most powerful engines of economic growth through the attraction of investment, technology development, and by the creation of value chains".[229]

Concerning the oil and gas industry[230], the agreement stated the pursuance of several actions among which it stands out the following:

First, that hydrocarbons shall still be subject to the nation's public dominion and control, "*through* the *state*"[231], and that in every case the nation shall receive the total of petroleum proceeds. Likewise, the parties agreed on keeping Pemex as a public enterprise under full state ownership.[232]

Second, the imperative to make reforms on the regulatory framework of the decentralized public entities, the energy sector, and the fiscal regime, in order to transform Pemex into a "*public enterprise of productive character*"[233] that remains state-owned, but with the capacity to compete in the industry –both domestically and internationally. To that end, the coalition saw it necessary to grant Pemex new rules of corporate governance and transparency.[234]

Third, the Pact contemplated the need for boosting the execution capacity of the Mexican upstream petroleum industry, meaning both the exploration and exploitation of crude oil reserves with the "purpose of *maximizing* oil rents for the Mexican *state*".[235]

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[229] *See* Enrique Peña Nieto, Presidente de la República, Grupo Parlamentario del Partido Revolucionario Institucional (PRI), Grupo Parlamentario del Partido Acción Nacional (PAN), y Grupo Parlamentario del Partido de la Revolución Democrática (PRD), "Acuerdos para el crecimiento económico, empleo y competitividad" [Agreements on economic growth, employment, and competitiveness], *Pacto por México* [Pact for Mexico], Mexico City, December 2, 2012, available at http://pactopormexico.org/acuerdos/, consulted on January 14, 2018.

[230] For the sake of analytical clarity, I just mention below those policy goals that are directly connected to object and purpose of the present work. However, it is worth noting that concerning the oil and gas industry, the Pact for Mexico also addressed the need to reform downstream and midstream networks and to tackle the question of climate change, among many other policy objectives.

[231] *Id.* Commitment 54 of the Pact for Mexico. The italics are mine.

[232] *Id.*

[233] *Id.* Commitment 55 of the Pact for Mexico. The italics are mine.

[234] *Id.*

[235] *Id.* Commitment 56 of the Pact for Mexico. The italics are mine.

Fourth, the amendment of secondary legislation aimed at reinforcing and expanding the authority of the regulatory agency responsible for overseeing the development of the upstream petroleum activities – that is, the National Hydrocarbons Commission (CNH)–, as well as imposing on Pemex duties that force it to meet efficiency and transparency standards faced by worldwide oil companies.[236] Finally, the parties concurred in assigning Pemex the additional role of developing a national suppliers chain of goods and services for the domestic petroleum industry.[237]

It should be noted that the language employed by the negotiators of the Pact was purposefully ambiguous and vague, considering that both the administration and the PAN were sympathetic to the possibility of a large-scale energy reform that this time was able to grant private investment a real participation in the oil industry. To that end, the wording used could not raise any concerns for the *nationalist* taboos of the PRD from the very beginning of the Pact's coalition. Whether or not this PRI-PAN agenda was kept secret from the PRD leadership remains unknown.[238]

However, the fact that the *political bargaining* leading to the energy reform agreed on the Pact involved only party and government elites and was conducted on the highest level of *secrecy*, weakened the democratic legitimacy and transparency of this part of the political process, raising high suspicions on the content of the non-written political agreements.[239] The main reason for this course of action was to guarantee a safe place of frank, constructive and good faith dialogue among the party elites. Then, as suggested above, it is likely that the PRD leadership had agreed on refraining from actively obstructing an energy reform of constitutional scope, despite the leap service paid to its leftist dogmas when its legislators voted against the constitutional and legislative bills of reform once they were processed in Congress.[240] According to the political analysts José del Tronco and Mara Hernández, mutual concessions were negotiated for those hot-button questions of the Pact that were source of policy disagreements, but which were considered a top priority to address for at least two of the three parties.[241]

A second illustration of this bargaining pattern among the Pact's subscribers was the passage of the fiscal reform in 2013, which the PAN publicly opposed and voted against due to its purpose of placing most of the tax burden and rates increases both on the high-medium taxpayer and on corporations (i.e. sources of formal employment, social security and economic growth), rather than increasing the tax base more fairly distributed across all the segments of society (i.e. the informal sector). So when this legislative battle took place,

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[236] *Id.* Commitment 58 of the Pact for Mexico.
[237] *Id.* Commitment 59 of the Pact for Mexico.
[238] José del Tronco and Mara Hernández, "Reforma energética y ¿representación política? La importancia de la negociación y la deliberación pública" [Energy reform and political representation? The importance of bargaining and public deliberation], in Tony Payan, Stephen P. Zamora, José Ramón Cossío (eds.), *Estado de derecho y Reforma Energética en México* [Rule of Law and the Energy Reform in Mexico], Tirant Lo Blanch, Mexico City, 2016, at 112-113.
[239] *Ib.* at 111.
[240] *Ib.* at 113.
[241] *Id.*

the PRI and the PRD were on the same wining legislative coalition. In exchange for this defeat, the PAN would receive the PRI's and the PRD assistance to approve the electoral-political reform.

In the context of Pact for Mexico, it is fair to say that for the purpose of securing an effective negotiation, *secrecy* became the rule in detriment of public deliberation within both houses of Congress.[242] Legislators, in particular those from the political opposition to the party holding the presidency, abdicated their constitutional authority to check and balance the discretion of the Executive, not to mention their duty to represent the common citizen. Most of the constitutional and legislative reform bills resulting from the Pact arrived to Congress when they had been already negotiated and given clearance by the party elites and the administration behind-the-scenes.

As to the strategy orchestrated by President Peña Nieto and his former Minister of Finance, Luis Videgaray, whom many commentators point out as the *technocratic brain* behind the Pact's policy reform agenda and its clockwork political operation, this was a mixture of the so-called 'Blitzkrieg' and 'Fabian' approaches. Paraphrasing Samuel Huntington, on the one hand, the Blitzkrieg method is that one in which "the reformer makes known all his goal at an early time of his rule and to press for as many of them as he could in the hope of obtaining as much as possible".[243] This comprehensive perspective is effective for as long as the political parties and the bargaining structure are relatively stable. It is clear this was the political plan used by the administration to process those structural overhauls that had a relative consensus by the Pact's tripartite coalition –such as the telecommunications reform, the antitrust reform, and the education reform, among others. On the other hand, the Fabian strategy is characterized by its incremental scope, in which the reformer conceals his aims, "separating the reforms from each other, and pushing for only one change at a time".[244]

Definitely, Peña Nieto's tactics tilted more to a comprehensive and accelerated approach for most of the Pact's agenda, when he made public since the second day of his term, alongside the leadership of the main opposition parties the set of concrete policy reform goals that would be actively pursue by means of this legislative coalition. Furthermore, Peña Nieto's efforts of political operation were astonishingly successful in getting approved the majority of the promised structural reforms in less than three years.

Yet the political strategy applied to process of the 2013 hydrocarbon reform was much more *incremental* and *carefully implemented* than the previous amendments emerged from the Pact. Moreover, it was handled to the very end along with the tax reform, given the political passions and sensitivities its discussion arouses in the Mexican public opinion. This complex political process required first for President Peña to secure the control of its party in order to amend –after the Pact had been already announced- the PRI's bylaws, which forbade its members and congressmen to support any sort of constitutional reform on

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[242] *Ib.* at 111-112.
[243] *See* Samuel Huntington, Political Order in Changing Societies, New Haven, Yale University Press, originally published in 1968 and renewed in 1996, Foreword by Francis Fukuyama included in 2006, at 346.
[244] *Id.*

energy since 1997. Once the nationalist wing of the PRI was neutralized as consequence of the culture of discipline and loyalty this party has traditionally showed towards the presidential figure, the Executive branch sent a clear signal that this would be an energy reform leaning towards a market-friendly approach.[245]

In light of the Pact's commitments and its political operation, on August 12, 2013, President Peña Nieto presented before the Senate its bill to reform articles 27, paragraph sixth, and 28, paragraph, paragraph fourth, of the Constitution, which was immediately embraced by the PRI's legislators.[246] The presidential initiative employed a minimalist legal technique and was extremely ambiguous from an economic perspective, because it basically consisted in suppressing from article 27 of the constitution the ban on contracts for the exploitation of hydrocarbons, but leaving intact the same prohibition for concessions. In doing so, the Executive gained leverage in the further negotiations with its counterparts, playing on safe ground regarding the expectations as to how radical the constitutional reform could be, and delegating much of the key policy decisions to secondary legislation.[247]

Almost a month earlier, on July 31, 2013, the PAN had presented an initiative of its own to reform articles 25, 27 and 28 of the constitution on energy. The PAN's proposal of constitutional reform was the most *radical* one in view of its *liberalizing* scope[248], which covered the transformation of the sectorial regulators into constitutionally-autonomous bodies, completely independent from the presidential administration, and the possibility of using a concession regime, and not just contracts, for those private developers of upstream oil operations –a scheme that confers a wider sphere of 'private property rights' than the public law contracting regime that would be finally agreed and imprinted on the constitution by the winning legislative coalition.[249]

Yet, despite their differences of degree in addressing certain regulatory and policy questions of the energy industry, neither the administration nor the PAN's proposals of reform dared to change the constitutional provision ordaining that hydrocarbon reservoirs must be part of the nation's public dominion.

For its part, one week later after the presidential bill was released, PRD congressmen submitted their energy reform initiative. It is worth flagging that the PRD initiative exclusively involved changes to statutory law because, according to them, there was not need to amend the constitutional text at all.[250] Based on its economic policy objectives, the

[245] *See* Del Tronco and Hernández, *supra note* 238, at 115.
[246] *See* Cossío Díaz and Cossío Barragán, *supra note* 195, at 66.
[247] Article 27 of the Mexican constitution.
[248] *See* Del Tronco and Hernández, *supra note* 238, at 117.
[249] The PAN's reform proposal pursued to modify article 28 of the Constitution in order to qualify the "exploration and exploitation of petroleum and other hydrocarbons" as *priority areas* and thus authorize the participation of the business sector through an administrative law regime based on the assignation of concessions. *See* explanation at *supra note* 201.
[250] *See* Cossío Díaz and Cossío Barragán, *supra note* 195, at 67, 88-89. See the explanation described at note 23 of the essay cited.

PRD's energy reform proposal was the most conservative of all three due to its concern to maintain the regulatory status quo that had been in force since 1960.

Considering that the PAN elites knew the administration's need for an *effective winning coalition* in both chambers of Congress, besides asking for an electoral-political reform as bargaining chip, they also conditioned their support on the following policy grounds: First, (a) the creation of a more flexible contracting regime to conduct upstream operations, whether by private oil companies themselves or in partnership with Pemex. Second, (b) the grant of greater institutional autonomy to the sectorial regulators – both the CNH and the Energy Regulatory Commission (CRE) – in relation to the Executive branch. Third, (c) the commitment to establish aggressive policies and mechanisms to incentivize the transition to renewable energy sources and to tackle climate change challenges.[251]

To the end of structuring an ordained discussion and definition of the legal design and policy technicalities of the 2013 energy reform, the administration formed an inter-institutional setting that was coordinated by the ministries of Finance ("Secretaría de Hacienda y Crédito Público") and Energy ("Secretaría de Energía") and the Office of the Executive's Legal Counsel ("Consejería Jurídica del Ejecutivo Federal").[252]

After long-lasting debates, complex negotiations, and mutual concessions within Pact's negotiation forums, both the PRI and the PAN reached an agreement on a final draft that was first approved by the Senate on December 11, 2013, and by the House of Representatives the day after. Taking into account the time it took Congress and local legislatures to sanction this amendment on Mexico's supreme norm, it could be said that this was a fast-track political process.

Behind the scarce discussion that formally took place in the parliamentary tribune, most of the bargaining and resulting agreements had been reached after nine months of heavy work done within Pact for Mexico's informal platform. Yet it is not whether these discussions were insufficient, superficial, or extremely technical what casts doubt on the legitimacy of the 2013 energy reform, but the lack of transparency and democratic deliberation under which those agreements among the political elites were made vis-à-vis civil society.[253]

It is understandable, though, that both the Peña Nieto administration and the PAN were not willing to jeopardize their chances of passing this structural reform, by giving López Obrador enough time and information to build up another boycott as the one he successfully organized in 2008 against the Calderón energy overhaul proposal.

It still raises many questions how the Peña Nieto administration managed to get approved most of the Pact for Mexico's reform agenda. Except for few demonstrations and a frustrated attack on the constitutionality of the energy reform, even López Obrador and

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[251] *See* Del Tronco and Hernández, *supra note* 238, at 119.
[252] *Ib.* at 117.
[253] *See* Jesús Silva-Herzog Márquez, "El vaciamiento democrático" [The democratic emptying], *Nexos,* Mexico City, October 1, 2015, available at: http://www.nexos.com.mx/?p=26468.

his loyalists in Congress were not as anti-systemic against the passage of the 2013-2014 hydrocarbon reform as they were in 2008.

All these concerns might suggest the emergence of a *cartelized* political system when, during the Peña Nieto government, the most expensive budgetary bills in the history of Mexico were approved in the face of low –or even null– opposition in the legislature compared to the fiscal negotiations the alternation governments went through from 2000 to 2012.

Suspicions as to how the Pact for Mexico could have been "*greased*" to glue political elites altogether, have held up following the pattern of the political environment during the rest of Peña Nieto's presidential term: 1) First of all, the series of corruption scandals involving the federal government[254] and several governorships headed by PRI members[255];

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[254] Including President Peña Nieto himself, his wife and his former Minister of Finance (2012-2016), Luis Videgaray Caso, for fact-supported media reports upon the multimillionaire real estate properties and the mortgage loans with an interest rate below the market's to purchase those properties, received by them from a private contractor ("Grupo HIGA"), who in turn has received several juicy contracts during the present administration. As for Emilio Lozoya Austin, the first General Director of Pemex (2012-2016) during the current administration, for allegedly having received a bribe from executives of the Brazilian oil company Petrobras, as a contribution to the financing of Enrique Peña Nieto's electoral campaign in 2012, in exchange for the assignation of some service contracts in the Mexican hydrocarbon industry. *See*, also, Azam Ahmed, "Mexico's Government Is Blocking Its Own Anti-Corruption Drive, Commissioners Say", *The New York Times,* New York City, December 2, 2017, available at https://www.nytimes.com/2017/12/02/world/americas/mexico-corruption-commission.html?rref=collection%2Fbyline%2Fazam-ahmed&action=click&contentCollection=undefined®ion=stream&module=stream_unit&version=latest&contentPlacement=7&pgtype=collection&mtrref=undefined&gwh=80FE77471E3C098E0078FFE22E328141&gwt=pay. *See* Luis Carlos Ugalde, "¿Por qué más democracia significa más corrupción?" [Why more democracy means more corruption?], *Nexos,* Mexico City, February 1, 2015, available at http://www.nexos.com.mx/?p=24049. *See*, also, Elisabeth Malkin, "Investigation Lifts a Cloud Over President of Mexico", from *The New York Times,* New York, August 21, 2015, available at http://www.nytimes.com/2015/08/22/world/americas/investigation-lifts-a-cloud-over-president-of-mexico.html. *See* María Amparo Casar, "México: Anatomía de la Corrupción" [Mexico: Anatomy of Corruption], Centro de Investigación y Docencia Económicas (CIDE) – Instituto Mexicano para la Competitividad (IMCO), Mexico City, May 2015. *See*, also, María Amparo Casar, "Corrupción" [Corruption], *Nexos,* Mexico City, December 2016, available at https://www.nexos.com.mx/?p=30475. *See*, also, María Amparo Casar, "Impostores" [Impostors], *Excélsior,* Mexico City, August 1, 2014, available at http://www.excelsior.com.mx/opinion/maria-amparo-casar/2014/12/17/998172.

[255] Both Javier Duarte de Ochoa, former Governor of the state of Veracruz (2010-2016), and Roberto Borge, former Governor of the state of Quintana Roo (2011-2016), were extradited from Guatemala in 2017 and from Panamá in 2018, respectively, after having fled out of the country while they were being accused and prosecuted, by both federal and local authorities, for alleged corruption crimes (i.e. embezzlement of public funds, money-laundereeing, etcetera). In mid-2017, Tomás Yarrington Ruvalcaba, former Governor of the state of Tamaulipas (1999-2005), was arrested by INTERPOL agents in Italy, after being an outlaw since 2012, when he was judicially accused by Mexico's law enforcement authorities for having allegedly committed multiple crimes, such as money laundereeing, organized crime, drug trafficking, bribery, and being the intellectual mind behind the assassination of the PRI politician, Rodolfo Torre Cantú, in 2010. The Mexican government has also requested to the United States government its assistance to detain and extradite Mr. César Duarte Jáquez, former Governor of Chihuahua (2010-2016), who is believed to be in the U.S. territory in a fugitive status with respect to the criminal law proceedings by which he has been prosecuted and judicially accused by state judicial authorities for corruption-related charges (i.e. embezzlement, money-laundereeing, bribery), following the investigations conducted by Chihuahua's prosecution office, under the sponsorship of the current Governor, Javier Corral Jurado – a PAN militant who won state elections in 2016. In what has been interpreted by independent journalists, social activists, and intellectuals (i.e. Carmen Aristegui, Jorge Castañeda Gutmann, Juan Pardinas, Denisse Dresser, and Jesús Silva Herzog Márquez) as a

2) second, the media scandal involving the participation of legislators of the main political forces in pork-barrel corruption schemes through which they promise the earmarking of federal budget funds for public works on behalf of a certain municipality major or state governor with electoral ambitions, in exchange of a money quota or certain percentage of the project at issue; 3) third, the discovery of an illegal nationwide spy and wiretapping program, which was operated by the Ministry of the Interior's Center of Intelligence and National Security, in detriment of an ample group of social activists, journalists, intellectuals, and opposition leaders[256] who lobbied in Congress for the passage of anticorruption laws in 2015 and 2016[257] and were also against the 9-year appointment of Peña Nieto's former Attorney General ("Procurador General de la República"), Raúl

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retaliatory measure from President Peña's federal government, the Finance Ministry has engaged in a tug-of-war negotiation by conditioning, and even suspending in January 2018, the transfer of an extraordinary expenditures package for the state of Chihuahua, despite they had been formally committed through a federal-state agreement, for as long as Governor Javier Corral and his state attorney general do not reveal the scope and status of their anticorruption investigations, which so far have already caused the capture and prosecution of a PRI national figure, former representative and senator Alejandro Gutiérrez, for presumptively having channeled federal funds earmarked for local education services into the PRI's electoral campaigns in other states. It is worth flagging, in this context, that when Governor Javier Corral took office he found his predecessor had seriously affected the state's public finance, as a result of an aggressive public debt increase and corruption practices. *See* Azam Ahmed, "Mexico Graft Inquiry Deepens with Arrest of a President Ally", *The New York Times,* New York City, December 21, 2017, available at https://www.nytimes.com/2017/12/20/world/americas/mexico-corruption-pri.html?rref=collection%2Fbyline%2Fazam-ahmed&action=click&contentCollection=undefined®ion=stream&module=stream_unit&version=latest&contentPlacement=6&pgtype=collection. *See*, also, Azam Ahmed and Jesús Esquivel, "Mexican Governor Says His State Is Being Punished for Corruption Inquiry", *The New York Times,* New York City, January 8, 2018, available at https://www.nytimes.com/2018/01/08/world/americas/mexico-pena-nieto-corruption-chihuahua.html?rref=collection%2Fbyline%2Fazam-ahmed&action=click&contentCollection=undefined®ion=stream&module=stream_unit&version=latest&contentPlacement=4&pgtype=collection&mtrref=www.nytimes.com&gwh=64D4EBE0FF13D8D544E4DCEF4FCB4081&gwt=pay. *See*, also, Azam Ahmed, "Mexico's Government Is Blocking Its Own Anti-Corruption Drive, Commissioners Say", *The New York Times,* New York City, December 2, 2017, available at https://www.nytimes.com/2017/12/02/world/americas/mexico-corruption-commission.html?rref=collection%2Fbyline%2F-ahmed&action=click&contentCollection=undefined®ion=stream&module=stream_unit&version=latest&contentPlacement=7&pgtype=collection&mtrref=undefined&gwh=80FE77471E3C098E0078FFE22E328141&gwt=pay

[256] *See* Azam Ahmed and Nicole Perlroth, "Using Texts as Lures, Government Spyware Targets Mexican Journalists and Their Families", *The New York Times*, New York City, June 19, 2017, available at https://www.nytimes.com/2017/06/19/world/americas/mexico-spyware-anticrime.html?rref=collection%2Fbyline%2Fazam-ahmed&action=click&contentCollection=undefined®ion=stream&module=stream_unit&version=latest&contentPlacement=14&pgtype=collection. *See*, also, Azam Ahmed, "Mexico to Investigate Spying Campaign Against Journalists and Activists", *The New York Times*, New York City, June 21, 2017, available at https://www.nytimes.com/2017/06/21/world/americas/mexico-pena-nieto-spying-hacking-surveillance.html?rref=collection%2Fbyline%2Fazam-ahmed&action=click&contentCollection=undefined®ion=stream&module=stream_unit&version=latest&contentPlacement=10&pgtype=collection. *See*, also, Azam Ahmed, "A Scion of Mexico Fights Corruption, and Becomes a Target", *The New York Times,* New York City, August 30, 2017, available at https://www.nytimes.com/2017/08/30/world/americas/mexico-claudio-gonzalez-laporte.html?mtrref=www.google.com.

[257] *See* María Amparo Casar, "Iniciativa ciudadana contra la corrupción" [Citizen initiative against corruption], *Excélsior,* Mexico City, February 3, 2016, available at http://www.excelsior.com.mx/opinion/maria-amparo-casar/2016/02/03/1072758. *See*, also, María Amparo Casar, "El SNA y el Comité de Participación Ciudadana" [The National Anticorruption System (SNA) and the Citizen Participation Committee], *Excélsior,* Mexico City, August 23, 2017, available at http://www.excelsior.com.mx/opinion/maria-amparo-casar/2017/08/23/1183453. *See*, also, Juan Pardinas, "Ley 3 de 3" [Law 3 out of 3], *Reforma*, Mexico City, March 6, 2016, available at https://www.reforma.com/aplicaciones/editoriales/editorial.aspx?id=83563.

Cervantes, as head of the newly created Attorney General Office ("Fiscalía General de la República") –an agency whose institutional design provide it with wider autonomy from the Executive than its predecessor's[258]; 4) fourth, the lack of political commitment on the part of PRI to advance in the Senate the designation of the Anticorruption Prosecutor ("Fiscal Especial Anticorrupción") with a lawyer profile who is technically competent, ethically above suspicion, and politically independent. Not surprisingly, these illustrations of the use of public office and government resources for private gain have been publicly ventilated thanks to the thorough research work done by the foreign media[259], few domestic journalists[260], and nongovernmental think-thanks.[261]

A similar process was followed through by the Pact's allies to achieve congressional approval of the energy reform on a legislative level, which implied the creation of 9 brand new secondary laws and the amendment of 12 statutory acts already in force. The whole omnibus legislation bill, by which the coalition in Congress developed the mandates from the constitutional system on energy put in motion since December 2013, was published in the Federal Official Journal on August 11, 2014.[262] After these large-scale institutional changes, the Mexican legal framework would never be the same. Only in this formal sense it could be said that Peña Nieto administration's legacy was "revolutionary" compared to the legal and policy reforms made by its predecessors.

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[258] *See* Denise Dresser, "Fiscal floral" [Ornamental Prosecutor], *Reforma,* Mexico City, March 13, 2017, available at https://www.reforma.com/aplicaciones/editoriales/editorial.aspx?id=108821&po=3. *See* Juan Pardinas, "El enigma brasileño" [The Brazilian enygma], *Reforma,* Mexico City, September 17, 2017, available at https://www.reforma.com/aplicaciones/editoriales/editorial.aspx?id=120222&po=3. *See,* also, Juan Pardinas, "Oposición que sirva" [Effective opposition], *Reforma,* Mexico City, September 3, 2017, available at https://www.reforma.com/aplicaciones/editoriales/editorial.aspx?id=119385&po=3. *See* María Amparo Casar, "¿Simuladores?" [Pretenders?], *Excélsior,* Mexico City, September 13, 2017, at http://www.excelsior.com.mx/opinion/maria-amparo-casar/2017/09/13/1188013. *See*, also, María Amparo Casar, "Hacer política" [Politicking], *Excélsior,* Mexico City, September 6, 2017, available at http://www.excelsior.com.mx/opinion/maria-amparo-casar/2017/09/06/1186482. *See*, also, María Amparo Casar, "La fiscalía y el fiscal", *Excélsior,* Mexico City, November 2, 2016, available at http://www.excelsior.com.mx/opinion/maria-amparo-casar/2016/11/02/1125769.

[259] In particular, the coverage deployed by *The New York Times* through their corresponsals in Mexico during the last six years: Ahmed Azad, Elisabeth Malkin, and Nicole Perlroth.

[260] I mostly refer to Carmen Aristegui, Leonardo Curzio, Ricardo Raphael, Raymundo Rivapalacio, Dolia Estévez, among others.

[261] Two civil society organizations focused on doing public policy analysis standout: "Mexicanos Contra la Corrupción y la Impunidad (MCCI)" [Mexicans Against Corruption and Impunity], headed by the academic María Amparo Casar and chaired by the activist Claudio X. González Guajardo; "Instituto Mexicano para la Competitividad (IMCO)" [Mexican Institute for Competitiveness], whose chief executive is the activist and editorialist Juan Pardinas.

[262] Comisión de Energía del Senado de la República, "Presentación de las iniciativas de las Leyes Secundarias de la Reforma Constitucional en Materia Energética enviadas al Senado de la República por el Poder Ejecutivo Federal" [Presentation of the initiatives of Secondary Laws of the Constitutional Reform on Energy, which were sent to the Senate by the head of the Executive Power], *Encuentros Reforma Energética* [Energy Reform Sessions], Senado de la República, Mexico City, 2014, , at 4, available at http://www.senado.gob.mx/comisiones/energia/docs/reforma_energetica/presentacion.pdf.

2. Constitutional Design of the Energy Reform

The Mexican energy reform set up its foundations from the constitutional text itself – namely, article 25, paragraphs fourth, sixth, and eight; article 27, paragraphs sixth and seventh, and article 28, paragraphs fourth, sixth, and eight, of the federal constitution. Moreover, on this occasion regulatory constitutional lawmaking was used to the extent of drafting a transitory body compounded by a total of 21 articles.

In Mexico, conventional legal technique makes use of transitory provisions as means to indicate as of when, and under what conditions, a certain legal norm should be binding and enforced accordingly. Yet the constitutional amendment on energy is an illustration of the framers' recent approach to using a *transitory* regime for *substantive regulatory purposes* that went beyond the question of governing the temporal validity of the new legal mandates.

This constitutional drafting style deserves criticism due to the problems that poses on *legal certainty* as for what contents should be considered 'substantive normative' or 'transitory', but surprisingly it was never challenged before the Supreme Court. When the amount of transitory provisions, which in fact has normative force of substantive character, exceed those that were actually added into the constitutional text, one could raise the question about whether this *heterodox* legislative technique amounts to regulating a certain subject through *backdoors*. Consequently, if a person wants to interpret Mexico's constitutional system on energy, then it won't suffice to assess the corresponding provisions in articles 25, 27, and 28 of the supreme law, but it shall be necessary to construe them systematically with the mandates established throughout the transitory regime, making more difficult to know what is the applicable law to certain questions of this economic sector.

One counterargument to sustain the stand of using a vast number of regulatory and fiscally-oriented provisions could be that the framers considered necessary to wire up the Mexican constitutional system in order to *shield* the new energy policy consensus from future swings in the political arena –that is, the constitutional reformers seemed imperative to submit the ordinary legislature to a set of positive obligations, whose compliance bound them to the issuance of a legislative package with certain normative contents of law and policy, under a schedule of 'sunset' rules.

Anyway, if the ultimate goal was to *entrench* a new regulatory governance on energy at the fundamental law of the state, then, for the sake of legal certainty, the framers could have explored a clearer drafting technique that had put most of the detailed mandates of fiscal, regulatory, and organic nature on the main constitutuional text, thus leaving the transitory regime exclusively for the establishment of sunset provisions. Hence, the 2013 energy reform implied mostly an overhaul of few norms embodied by Constitution's economic chapter, whereas most of the *small letter* of *key details* of this structural change were left to the transitory articles.

With respect to the hydrocarbon sector, Article Third Transitory indicated that secondary legislation shall establish the form and the deadlines, which in any case cannot exceed the lapse of two years as of the publication of the constitutional reform decree (December 20, 2013), for the conversion process of Pemex – Mexico's NOC – into a productive state enterprise. During this transition, the constitutional legislature disposes, Pemex was entitled "to obtain the assignations and to celebrate the contracts referred by article 27, paragrapgh seventh, of the constitution" – which was amended through the aforementioned decree.[263]

For its part, the aim of Article Fourth Transitory was to establish general deadlines for a multiplicity of actions – whether legislative, administrative, or regulatory. This provision declared a time window of 120 days, as of the publication of the constitutional reform decree, for Congress to carry out the necessary legislative measures to make effective the mandates of the aforementioned amendment. At the same time, different transitory norms commanding the fulfillment of different administrative and regulatory acts resulting from the energy reform, were indirectly linked to the time lapse indicated by article fourth transitory.[264]

By means of Article Seventeenth Transitory, the constitutional legislature allowed for a term of 365 days, as of the publication of the constitutional energy reform, for Congress to legislate on environmental protection and climate change, as a result of the impact that the implementation of this overhaul could have on these matters.[265]

Last, Article Sixteenth Transitory of the amendment decree commanded the creation of the National Center for Natural Gas Control (CENAGAS), as the decentralized public organism in charge of the operation of the transportantion and storage pipeline system, within the next 12 months to the entry into force of the Secondary Law on Article 27 of the Constitution with regard to Petroleum.[266]

3. Petroleum Ownership and its Constitutional Regime

This section aims to analyze the amendments made by Mexico's constitutional legislature over the *ownership rules* of the hydrocarbons industry, as consequence of the energy reform of 2013. In light of the analytical categories suggested by José Ramón Cossío to address the Constitution's economic chapter[267], the following juridical analysis breaks

[263] *See* Cossío Díaz and Cossío Barragán, *supra note* 195, at 67-68.
[264] *Id.* The National Center for Energy Control (CENACE) is the other decentralized public organism whose creation was ordained by the Constitution to execute, in the electricity industry, the following tasks: (1) controlling the National Electric System; (2) the operation of the Wholesale Electricity Market; (3) guaranteeing access on a non-discriminatory basis to the transmission and distribution lines network.
[265] *Id.*
[266] *Ib.* at 68-69.
[267] *See* Cossío Díaz and Cossío Barragán, *supra note* 195, at 57-58.

down the ownership component of the Mexican regulatory governance on petroleum. For that purpose, I first evaluate the *constitutional directives* that structure the property regime of oil understood as a commodity, and then proceed to draw the legal and policy implications such fundamental rules have within the industry's regulatory model and fiscal regime. Although a review of the property rights structure on petroleum comprises an analysis of the ownership and control of Pemex, the Mexican NOC, it should be noted that those questions are unpacked in detail at the chapter where I discuss the administrative design chosen by the framers to manage the hydrocarbon sector.

A. Constitutional Rules on Oil Ownership

With respect to hydrocarbons conceived as natural resources, the energy reform did not entail a radical of the property rights framework that was previously in force. Reading systematically both the unchanged paragraph fourth and the recently added paragraph seventh of article 27 of the Mexican constitution, oil and the rest of hydrocarbons remain under the *direct*, *inalienable*, and *imprescriptible dominion* of the collective subject referred as the "nation". However, unlike the former provisions of article 27 of the constitution, the new wording of this provision is innovative because it applies the mentioned public property attributes only to petroleum and hydrocarbons that are located in Mexican territory "subsoil". As a result, the first logical inference resulting from that drafting is that ownership of oil and gas resources can be transferred to a proprietor other than the state once they are displaced from the subsoil.

The second change made by the addition of a seventh paragraph to article 27 of the constitution, is that *concession* grants for oil and gas exploitation are still *not permitted*, yet the explicit ban that existed on contracts for the same purposes was removed, enabling therefore the possibility of developing a *contract regime* through which private investors could get involved in the extraction of oil resources and share the corresponding proceeds with the state. In so doing, the Mexican constitutional legislature has given a more permissive shape to the regulatory framework on hydrocarbons.[268]

Third, this new constitutional provision not longer talks about "exploitation" of hydrocarbons products as the former paragraph sixth of article 27 of the constitution did before the energy reform of 2013. Instead, the recently added paragraph seventh of constitution's article 27 states that the nation shall carry out "exploration and extraction" of oil and gas resources either through *assignation* titles granted to productive state enterprises, or through *contracts* celebrated with these state-owned companies or with private persons. Accordingly, this normative portion gives meaning to the removal of the contract prohibition mentioned above, by making explicit that the nation, via the state, has the authority to perform upstream operations –namely, exploratory and production activities of the oil and gas business – in terms of the respective enabling law.

Moreover, in order to comply with the target of upstream oil assignations and contracts, the framers specified that *productive state enterprises* posses the legal capacity to establish

[268] *See* Cossío Díaz and Cossío Barragán, *supra note* 195, at 70.

‘*strategic alliances*’[269] with private corporations. In other words, regarding those assignations or contracts granted exclusively to state-owned companies for conducting upstream oil operations, article 27 of the constitution authorized the latter to team up with private agents through business alliances. So the 2013 hydrocarbon reform signified not just the opening for private investors to develop upstream oil activities on their own by means of contracts, but to get associated with Pemex to explore and produce the oil blocks obtained by the NOC, whether via assignation titles or contractual agreements. From a policy perspective, this meant the enabling of private capital to perform both a *competitive* as well as a *collaborative* role vis-à-vis Pemex.

Another relevant aspect of article 27, paragraph seventh, of the constitution is the last portion which states that, either way, hydrocarbons in Mexican “*subsoil*” are property of the nation and so be should asserted in both assignations and contracts. This mandate reiterates the framers’ concern for underlining that *full state ownership* as long as this commodity has not been drilled up, opening the door for a permissive regulatory governance that allows for oil and gas trading after being extracted from the subsoil. Yet the objective of this constitutional order is to avoid any misinterpretation regarding who is the legal owner of the hydrocarbon reserves before and during process of upstream operations – which the nation might contract out to private companies, or assign to the NOC or assigned to a pubic-private partnership.

More importantly, article 27, paragraph seventh, of the constitution stands out because of the policy it underscores as the *fundamental directive* that should guide hydrocarbon exploration and extraction implemented by the nation – either through contracting out mechanisms with private agents or through assignations conferred to Pemex or to hybrid alliances – and which is “the procurement of revenue for the state that contributes to the long-term development of the nation itself”.

If reviewed carefully, it is possible to identify a couple of policy goals in such constitutional norm: On the one hand, the mandate for obtaining *oil revenue* in favor of the *state* coffers. On the other hand, the use of oil rents for the nation’s long-term *development*. This literal interpretation of the constitutional text also allows to read the fiscal objective as subordinate to an ultimate development target, so the state plays a dual role both as 1) mediate principal in relation to Pemex and private contractors and as 2) the prime agent of the nation, who in turns appears is the main principal in the Mexican upstream oil industry.

B. Constitutional Directives on Oil Regulation

Having explored the constitutional norms which govern the property rights on hydrocarbons from their natural state in the subsoil to their exploration and extraction phase, I would like to deepen my legal analysis of the regulatory governance of the oil industry’s upstream segment. To that end, it is essential to identify at the Constitution’s economic chapter those provisions that describe how the upstream oil sector is characterized in light of the ‘*strategic*’ / ‘*priority*’ areas legal typology.

[269] In the oil and gas context, these upstream oil partnerships are also known as ‘*farm-outs’*.

Before the energy reform was enacted, article 28, paragraph fourth of the constitution listed an array of strategic areas, among which the "petroleum and the rest of hydrocarbons" were included, where functions exclusively conferred to the state should not be regarded as monopolies against the law. This meant a privileged treatment of strategic areas as *legal monopolies*. After the 2013 hydrocarbon reform, the rationale of such rule was maintained, but the former reference to hydrocarbons in abstract was replaced by the mention of "*exploration* and *extraction* of petroleum and the rest of hydrocarbons, in terms of paragraphs sixth and seventh of article 27 of this Constitution".[270] Accordingly, the constitutional legislature removed the mention of the oil industry in block and chose instead to keep only the *upstream* sector under a '*strategic area*' status, fully liberalizing the rest of the oil and gas supply chain.

Despite the state ownership prevailing over subsoil hydrocarbons and exclusive government control of the upstream industry as result from its '*strategic area*' status, when linked to article 27 of the constitution, the discretion government now has to *contract out* these oil production operations to private corporations or to public-private alliances through competitive bidding proceedings, rather than having the obligation to assign them directly to Pemex, overthrows the old notion of a monopolistic structure dominating Mexico's upstream oil market. Critics could sustain, though, that upstream oil activities are still framed within a *'virtual legal monopoly'* when the Mexican constitution leaves open the possibility for state officials to support the development of the Mexican oil upstream industry exclusively on *assignations*, if they wanted to do so.

The present conjuncture affecting the Mexican petroleum sector is characterized by Pemex's financial and technology constraints; the government's incentive to maximize oil revenue and use it for patching budget gaps; multiple oil blocks adjudicated to private companies and public-private alliances in the two bidding rounds celebrated this far, and a low prices trend at the international oil markets for the past three years – all of which are empirical evidence of economic pressures that cut against the legalistic assumption on the persistence of a '*virtual monopoly*' in Mexico's upstream oil market. Yet these circumstances are contingent and might change at some point, so future governments could face different incentives and the legal framework in force could be employed to deploy an oil development strategy based exclusively on state-run assignations.

To avoid the administrative discretion of the Executive Branch, Congress could equip sectorial legislation –particularly the Hydrocarbons Act, enacted in September 2014– with more checks and balances over the Energy Ministry, which is the administration's department entrusted with the authority to adjudicate upstream oil assignations. It is worth flagging, though, that article 6 of the Hydrocarbons Act mandates that *assignation* titles will be granted by the Executive on an *exceptional* basis, which can be interpreted in the sense that contractual agreements should be the generally preferred tool by which the state should commission the execution of upstream oil operations. Moreover, the Hydrocarbons Act ordains the Energy Ministry to get a favorable judgment from CNH before granting the respective assignation.

[270] The italics are mine.

For reasons I explained further in chapter VI of this work, CNH is an oil industry regulator lacking of functional independence from the Executive branch, resembling instead to a technical regulatory body with some direct statutory powers but serving mostly at the pleasure of the Energy Ministry. Accordingly, there could two mechanisms to offset this potential source of governmental arbitrariness:

First, Congress could equip the Hydrocarbons Act with a set of normative criteria so that the Energy Ministry is bound to justify the use of direct assignation grants on a certain oil block to a NOC rather than a competitive bidding process to select a potential contractor –which could be either the NOC, a private company, or a public-private partnership.

Second, grant a wider sphere of independence to the sectorial regulator (CNH) vis-à-vis the Executive branch, so the favorable judgment the former has to provide the Energy Ministry to grant an assignation title is an opportunity to review the reasons why the latter has decided this is the best mechanism to engage in upstream operations for a certain petroleum block. From the vantage point of checks and balances, CNH's institutional design might be reformed to serve as an agent of Congress instead of the Executive, but this is a topic I develop further next chapter.

On the other hand, article 28 of the constitution has another applicable provision for the hydrocarbons industry in its paragraph fifth, which determines the state shall have the "*organisms* and *enterprises*"[271] that needs for the effective management of the strategic areas under its charge. This constitutional rule's origin dates back to the construction of the Constitution's economic chapter in 1983 and the framers' intent was to refer to the satellite apparatus of public entities through which the Executive branch intervenes directly in a certain sector or industry of the economy, either providing a public service or managing an economic activity under a state-owned monopolistic structure.

The rationale of the provisions above is linked to article 25, paragraph fifth of the constitution, which in turn determines that the "*public sector* shall be in charge, in an *exclusive manner*, of the strategic areas mentioned in article 28, paragraph fourth of the Constitution, keeping always the federal government the *ownership* and *control* over the organisms and productive state enterprises that are thereof established".[272]

Once article 25, paragraph fifth, and article 28, paragraphs fourth and fifth, of the constitution are read together with article 90 of the supreme law and applied to our subject matter of study, the corresponding conclusion is that both the organisms and enterprises given to the state to conduct domestic upstream oil activity on *exclusionary* grounds, are components of the federal administration working under the Executive's command.

The second relevant aspect of article 25, paragraph fifth, of the constitution is the *state ownership* imposed over the organic instrumentalities of the administration to manage and intervene in the upstream petroleum industry, on behalf of the state and therefore the nation. If strategic areas are to be ruled under exclusive government control pursuant

[271] The italics are mine.
[272] The italics are mine.

constitutional law, the corollary in Mexican jurisprudence is that the NOCs should be fully state-owned accordingly. This feature did not change after the energy reform of 2013 and was reinforced on statutory law – article 2 of the Petróleos Mexicanos Act indicates that Pemex is a "productive state enterprise of exclusive ownership of the federal government".

Yet it is worthwhile to ask whether or not the *strategic / priority* areas distinction is still relevant in legal terms, because thanks to the 2013 energy reform, the upstream oil along with the national electric system planning and the power distribution and transmission public service have been transformed into a *sui generis* type of 'strategic sectors' to allow private investment participation, via a competitive scheme of regulated contracts, undermining the traditional doctrine that constitutional strategic areas should be exclusively managed and operated by the Executive branch of the federal government.

The Mexican energy reform of 2013 has therefore created an exception regime for two capital-intensive sectors of the economy –the upstream oil and electricity– to authorize private equity collaboration for development purposes, despite their strategic legal status and the exclusive intervention prerogative the state has upon these industries as such.

This criticism on the *differential treatment* of 'strategic areas' seems to be accurate, at least from a legal standpoint, when articles 25 and 28 of the constitution explicitly confine the regulation of the upstream oil and electrical power to the specific boundaries of article 27, paragraphs sixth and seventh, of the supreme norm.

If petroleum exploration and production are to be ruled by an administrative law scheme of 'contracts' which resemble to 'concessions', which is a vehicle with the practical effect of permitting private capital in a regulated industry but is forbidden in the context of exclusively state-controlled sectors, would not have been more coherent and transparent that reformers had given the upstream oil industry the status of a '*priority area*'[273] rather than an *exceptional* type of '*strategic area*'?

The answer to this query lies more in politics than in legal reasoning. As indicated in prior sections, the constitutional reform initiative proposed by the Peña Nieto administration was minimalist in the sense of removing the former ban on upstream oil contracts, placing on Congress the key responsibility to make most of the regulatory policy decisions on the oil and gas industry through the issuance of secondary legislation.

More importantly, the motivation statement of the Executive's energy reform proposal based the suppression of the former contractual ban over the oil sector on the fact that during the administration of President Cárdenas, who decreed the expropriation of foreign petroleum companies in 1938, the oil legal framework was even much more flexible than the one in force from 1958 through 2013.[274]

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[273] The PAN's proposal of constitutional reform on energy had the purpose of reclassifying oil exploration and exploitation actitivities as 'priority' areas, so that the use of an administrative concessions regime was permissible for the regulation and management of such extractive industry.
[274] *See* Enrique Peña Nieto, "Exposición de motivos a la Iniciativa de Decreto por el que se Reforman los Artículos 27 y 28 de la Constitución Política de los Estados Unidos Mexicanos" [Statement of Purpose to the

My view is that this justification was *politically calculated* as follows: First, calming the concerns coming from President Peña's left-wing allies with regard to the scope of the administration's energy reform plans in the context of the Pact for Mexico. Second, setting as a normative threshold for the energy amendment the legal rules that were actually in force during the Cárdenas presidency, who was a beacon the nationalist left would not dare to contradict. Once the bargaining on the constitutional text began, the PRI government chose to make a heterodox use of the constitutional law categories for the sake of one of the energy reform's pillars – the participation of private investment.

Finally, the energy reform architects made explicit reference to the National Hydrocarbons Commission (CNH) as the Executive's administrative agency with the authority to conduct the regulation and supervision of the upstream oil sector, in terms of article 28, paragraph seventh of the constitution. In so doing, the constitutional legislature shaped CNH as a "*coordinated regulatory organ on energy*", meaning its institutional placement within the Executive's administration orbit. Based on Article Twelfth Transitory of the 2013 amendment decree, CNH was granted a greater independence for budget, management, and functional purposes than to its predecessor organization, which was just recognized on statutory law and had just technical tasks applicable to Pemex as the only sector player.

Prior the petroleum reform of 2013, the Mexican constitution was silent and vague about the agencies by which the "state" or the "public sector" was supposed to perform its *regulatory* and *police* powers over the oil industry. The general interpretation was that sectorial regulation on hydrocarbons was within the exclusive purview of the Executive branch, not just because of the strategic status imposed over such extractive industry, but by virtue of article 90 of the constitutional text –which commands to the Executive branch the dispatch of federal administrative through a centralized administration and an auxiliary decentralized apparatus pursuant the Organic Act that Congress enacts for that effect. Hence, this used to be the only constitutional law source on which the Federal Administration Organic Act was based to confer the Energy Ministry –in its executive capacity –the power to regulate the whole oil industry in the past. This legal architecture was fortified by providing CNH with direct constitutional authority to regulate the upstream oil sector as of the 2013 reform.

Despite this new constitutional design, it stands out that this regulatory body was modeled to work subordinated to, rather than coordinated with, the Energy Ministry –that is, the Executive's agent in charge of deciding and implementing the specific policies for the upstream oil industry. Hence, it should be asked whether the recent amendment to the upstream oil governance constitute a *legal façade* or a genuine improvement. Yet this topic will be thoroughly explore in Chapter VI.

Reform Decree of Articles 27 and 28 of the Political Constitution of the United Mexican States], Enrique Peña Nieto, Presidente de la República, August 12, 2013, at 6-12.

TABLE II. COMPARATIVE OF MEXICO'S CONSTITUTIONAL SYSTEM ON PETROLEUM		
Structural component	**Before the Energy Reform**	**Energy Reform of 2013**
Ownership	- Petroleum and other hydrocarbons are subject to the nation's direct, inalienable, and imprescriptible dominion. - The state works as agent of the nation who is the principal of oil wealth. - Hydrocarbons as commodities fall under full state ownerhip.	- Hydrocarbons located on the country's subsoil are subject to the nation's direct, inalienable, and imprescriptible dominion. - The state works as agent of the nation, who in turn is the principal of oil wealth. - Only subsoil petroleum falls under full state ownerhip, whereas extracted hydrocarbons may be subject to different property rights structures across the industry's supply chain.
Industry Qualification	- The whole oil and gas industry in block is defined as an strategic area for the development of the national economy.	- Only exploration and extraction of petroleum and other hydrocarbons – namely, the upstream oil – have a strategic area status.
Regulatory Governance	- National development is the ultimate policy objective. - Explotaition of oil and gas resources shall be conducted by the nation, via the state, in an exclusive and exclusionary manner. - The state ownership structure on oil is coincidental with an exclusively state-commanded governance. - Organisms and corporations by which the state intervenes in hydrocarbon exploitation – as an strategic area – are fully owned and controlled by the federal government. - The Executive branch has regulatory authority over the sector through the Energy Ministry, which is part of the centralized administration.	- The upstream oil sector has an explicit fiscal goal as proxy to the long-run development of the nation. - Upstream oil functions, formally under the state's exclusive purview, allow private capital participation, breaking up the traditional concept of strategic areas. - Upstream oil is governed by an administrative law regime which gives the state the discretion either to award contracts to private companies, Pemex, or public-private alliances, following a competitive bidding as rule, or to grant assignations directly to Pemex on exceptional grounds. - CNH is the sectorial regulator, is formally part of the Executive branch, so it has to be coordinated to policy views of the Energy Ministry.

4. Contract Regime on Upstream Oil

Although state ownership still is the reigning structure over the Mexican upstream oil, the participation of private business in such link of the petroleum industry is governed by a *public law contract regime* guaranteeing an array of property rights aimed at protecting a fair return on their capital investment if profitable for the state. As indicated above, in terms of article 27 of the Mexican constitution, the key index of profitability in upstream oil

activities is the oil revenue streams the state gets from an exploration or extraction agreement it has with a private company, or with Pemex, or with a hybrid partnership. By '*private property rights*', I mean here the contractual basis on which investors can support their legal claim to a fair, competitive, and non-discriminatory compensation from the state as public interest administrator of this strategic industry, in exchange for their equity and services contribution in successful upstream oil operations.

Technically speaking, the ownership on petroleum as *commodity* must not be confused with the property rights recognized by the *contract* regime on upstream oil. The former regulates the rights to use, exploit, and to dispose oil and gas resources, whereas the latter is the legal regime that seeks to guarantee upstream contractors a fair treatment of their investments as agreed on contract. Yet both institutions are intertwined in two ways: First, they are complementary components of the oil industry's ownership structure and its regulatory governance. Second, it is reasonable that private stakeholders who make a productive venture in an upstream agreement have the expectation of being rewarded in proportion to oil output or oil profits as well as to the risks taken.

A. PUBLIC LAW FEATURES OF THE PETROLEUM CONTRACT REGIME

In addition to article 27 of the constitution, the transitory regime of the petroleum reform's decree established –in article fourth– substantive guidelines along which Congress should develop legislation on 1) upstream contracting modalities, 2) contractors' compensation and on 3) oil revenue for the state. As indicated earlier, the constitution specifies that upstream oil activities should have as immediate objective the generation of state revenue, which in turn ought to be applied for the long-term development of the nation.

Both the taxation and the expenditure dimensions are covered by that constitutional mandate. Yet, by means of Article Fourth Transitory of the reform and not through the main constitutional text, the framers granted the state the authority to "[…] define the *contractual model* that is more convenient for the purpose of *maximizing* the nation's revenue".[275] The new normative element added by this provision is not the discretion to choose among the best contractual vehicle by itself, but rather to choose the one with the ability to maximize oil revenue for the state on behalf of the nation – that is, a clear *fiscal purpose*.

Beyond the criticism that the prescription above should have been posited in the constitution's main text rather than in transitory precepts, what is clear is the framers' notion of the upstream oil sector as a *rent extractive* activity at the immediate service of state and, ultimately, for the long-run development of the nation. In the end, it is up to the budgetary institutional capacity of government that this oil revenue is actually applied to long-term development purposes.

Meanwhile the short-term policy ought to be the boosting of revenue into state coffers. Hence, the *fiscal rationale* underlying the regulation of the upstream oil seems to be the key

[275] The italics are mine.

determinant that pushed the framers to cloth this economic sector with a strategic legal status under exclusive state command and control, regardless of its resort to private investment, which could be considered merely instrumental.[276]

In connection to the fiscally oriented approach towards the Mexican upstream oil, the '*strategic*' nature this industry has for the state can also be found in the fact that the framework legislation governing the contractual partnership between the public and private sectors is based on an *administrative law regime*, which is heavily regulated and grants the state a great amount of discretion to intervene at any moment –whether as policymaker, sectorial regulator, tax authority, or as an entrepreneur via Pemex. Here, I highlight the 'administrative law' part of this remark because it is precisely the strategic constitutional qualification what triggers the exclusive state prerogative over the upstream oil, justifying then a strong presence of its regulatory and tax agents in light of the *public interest* affecting this extractive industry.

As a result, the use of the term '*contract*' in this public law context can be misleading because in Mexico – a jurisdiction strongly influenced by the French civil law tradition – such legal concept is defined as an agreement between two or more persons who commit themselves to perform an array of reciprocal behaviors under certain terms and conditions.

According to the Continental civil law doctrine, contracts are governed by a principle of formal equality among the signing parties which relates to a fairness minimum from which contractors negotiate and agree on a set of rights and obligations to rule their reciprocal relationship, meaning the absence of disproportionate power asymmetries or coercion that might impair or distort the fundamental premise consisting of a free, voluntary agreement between rational agents.

The resemblance this notion of *contract law* shares with the *marketplace* modeled by neoclassical economic theory is obvious. However, the legal regime through which the reform architects have come to authorize the involvement of private business in upstream oil could not be farther from the traditional conception of contract law. Why? Because the new contract regime on upstream oil activities is governed by a complex network of *public interest* regulation – framed in constitutional, legislative, and administrative law sources – which places burdensome constraints and obligations upon contractors and, ultimately, gives the Executive branch the discretion to choose the best bid for as long as it maximizes the oil revenue for the state.

In a nutshell, it is not the contractors, but the Executive branch of government who has the 'upper hand' in the governance model of this sector. In light of this formal power asymmetry, the traditional premise of contract law on formal equality is not properly met in this context.

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[276] In words of the English thinker and statesman Edmund Burke: "the revenue of the state is the state". *See* Edmund Burke, *Reflections on the Revolution in France* (1790), The Harvard Classics, Vol. 24, Part 3, Bartleby.com, New York, 2001, at http://www.bartleby.com/24/3/16.html

It is very likely that the decision to use the word '*contract*' obeyed to three reasons: Firstly, contracts as a private investment mechanism were still valid under the oil regulatory design in force during the Cárdenas era (1934-1940), which ultimately served as normative benchmark for the administration's proposal of constitutional reform on energy. Secondly, the restoration of administrative concessions was out of the question during the 2013 amendment process, given the stigma this tool has for facilitating the market dominance of few foreign oil corporations in the past, making necessary for the government to intervene by means of an expropriation decree in 1938. Thirdly, by alluding to contracts the purpose was to sow the connotation of a market-friendly environment in which parties come together freely to negotiate and agree on the exchange of goods and services for a certain a price, keeping state intervention minimal – that is, exclusively for guaranteeing impartial dispute resolution proceedings and enforcing the corresponding contract law.

In doing so, the administration's strategy was twofold in the sense of setting up an attractive atmosphere for private investment, on the one hand, and calming down the concerns in the left side of the political spectrum about maintaining state ownership on petroleum resources, on the other. Nevertheless, as I will argue later on in this chapter, Mexico's contract framework on upstream oil resembles in one way to a concession regime.

B. ASSIGNATIONS

The present section is mainly focused on upstream oil contracts, leaving aside the so-called 'assignations'. My plan is to continue with the same approach for the rest of this section. The reason for doing so is that I do not see in assignations a critical question deserving an extensive analysis, except for a few notes.

First off, assignations are an administrative instrument the Executive's Energy Ministry – supported on the technical assistance from CNH– has the *discretionary* power to grant directly to productive state enterprises, such as Pemex, without any competitive bidding process in between, in order to operate those areas and oil fields that are already subject to exploratory and extractive works. To that end, the structural condition a productive state enterprise has to meet is "proof of having the technical, financial, and execution capacities which are necessary for hydrocarbon exploration and extraction in a competitive and efficient manner".[277]

Thereupon, after the energy reform of 2013, the administration kept under Pemex's operational control –through upstream assignations signed in "Round Zero"– those areas in which the state-owned enterprise had done discoveries with commercial potential or investments in exploration, for a three-year period, extendable for another two years at the

[277] Article Sixth Transitory, first and second paragraphs of the decree relative to the constitutional reform on energy, published on December 20th, 2013, in Mexico's Federal Official Journal.

most, for as long as this NOC has the investment capacity and a detailed exploration plan which, if fruitful, may become into an assignation for oil and gas extractive operations.[278]

Also during "Round Zero", the Ministry of Energy, assisted by CNH as sectorial regulator, granted Pemex –via upstream oil *assignation* grants– those fields that were operational producing hydrocarbons at the time the reform decree took effect, provided Pemex delivered a development plan justifying the works and investments to perform in the future, the adequate exploitation of the area, as well as an efficient and competitive production of petroleum resources.[279]

In parallel, the same transitory precept of the reform decree establishes that if Pemex's prior investments are affected as a result of the grant of assignations, the "fair economic value" of such property rights will be recognized in the terms established by the Energy Ministry, so an compensation will be paid by the state either to Pemex or to the respective productive state enterprise.

The second aspect that is worth underlining is that, according to article 6 of the Hydrocarbons Act, the Executive –by means of its Energy Ministry– has the power to adjudicate an assignation to Pemex or to a state-owned enterprise on an *exceptional* basis, which means that the bidding process for upstream oil contracts shall be the rule.

Yet there is always the possibility that administrative assignations may become the preferred instrument of statist-oriented administration for the performance of upstream oil activities. For that purpose, the same legislative precept determines that the Energy Ministry must obtain CNH's favorable judgment. Considering that CNH is part of the Executive branch ad must be coordinated to the sectorial policies of the Energy Ministry, the likelihood that a statist-driven administration makes an abusive and arbitrary use of this statutory power is very high, manipulating then the checking function of the exceptional basis condition.

Someone could counter by saying that the Executive Regulations to the Hydrocarbon Revenue Act –decreed in 2014 by the President– lists an array of hypotheses about what can be understood as permissible exceptions for the state to create additional assignations to those of Round Zero.[280] The Executive Regulations mention several situations, such as oil fields in which the geological and opportunity conditions are suitable to be exploited by Pemex; or where Pemex's technical, financial and executive capacities are outstanding to extract a petroleum reservoir in an efficient and competitive fashion; or when there is a specific area which offers an opportunity to develop a specific technology by Pemex; or when as consequence of an administrative rescission, there is a necessity to operate temporarily the retrieved area via a NOC.[281] It is worth noting that the last of these

[278] Article Sixth Transitory, third paragraph, subsection A of the decree relative to the constitutional reform on energy, published on December 20th, 2013, in Mexico's Federal Official Journal.
[279] Article Sixth Transitory, third paragraph, subsection B of the decree relative to the constitutional reform on energy, published on December 20th, 2013, in Mexico's Federal Official Journal.
[280] *See* article 9 of the Executive Regulations to the Hydrocarbons Act, published on October 31, 2014, in Mexico's Federal Official Journal.
[281] *See* fractions I through IV of article 9 of the Executive Regulations to the Hydrocarbons Act.

exceptional hypotheses refers vaguely to "any other case in which the Energy Ministry determines that an assignation is the most adequate mechanism for the state in terms of hydrocarbon production and supply, taking into account the economic and social returns of such course of action".[282]

Although in all of the hypotheses above the Energy Ministry must justify why an assignation is the best vehicle the state can use in terms of production efficiency, guaranteed supply, and socioeconomic returns, I am skeptical about the possibility to *control* the *delegated discretion* on the Energy Ministry from an executive regulation platform because of the following reasons.

First, the for-cause regime to authorize additional assignations on an exceptional basis is drafted very broadly, maximizing the Energy Ministry's administrative discretion to have an available tag to cloth almost every situation at issue and validate the corresponding use of assignations. Second, considering the Energy Ministry serves at the pleasure of the President, the executive parameters governing the for-cause creation of exceptional assignations are a weak legal source to keep the administration's discretion properly checked. Put differently, is it credible to imagine the Energy Ministry acting arbitrarily and capriciously, stretching to the limits its interpretation of what can be understood as a permissible exceptional assignation, without the President's approval? Third, the President can modify the Executive Regulations to the Hydrocarbons Act without the intervention of other government branch at any time, since this legal instrument results from his *exclusive prerogative* to keep the laws faithfully executed.

In order to keep the creation of additional assignations as genuine exceptional mechanisms to perform upstream oil functions, this research strongly recommends putting the catalogue of permissible exceptions on a *legislative law source*, rather than on an executive regulation which possess a lower legal status and, above all, is extremely weak from a checks and balances standpoint.

The energy reform decree also foresees the possibility for assignations to be *migrated* into a contract legal status, for which it places on CNH the task to trigger the corresponding bidding process pursuant the Hydrocarbons Act. In such case, articles 12 and 13 of the Hydrocarbons Act confer to the Energy Ministry the power to *authorize* this legal status shift, supported on the technical assistance of CNH as sectorial regulator. In the context of an assignation being migrated into a contract vehicle, articles 13 of the Hydrocarbons Act states explicitly the possibility of *strategic alliances* between Pemex and private investors – also known as 'farm-outs'. For that purpose, the Energy Ministry is able to request from Pemex or the corresponding state-owned enterprise an opinion regarding the technical, financial, executive, and expertise capacities the potential contractor of the former assigned are might have, so CNH is capable of designing and implementing accordingly a bidding process aimed at finding the suitable candidate.

Finally, the Hydrocarbons Act grants the federal Executive –by means of the Energy Ministry– the competence to *revoke* any assignation and retrieve for the nation the area at

[282] *See* fraction V of article 9 of the Executive Regulations to the Hydrocarbons Act.

which the grantee incurs in for-cause non-compliance, meaning a breach of its title that is framed within the catalogue of hypotheses foreseen by this legislation. In that case, the recipient shall have a fair hearing to explain the situation and solve the respective fault, paying for the applicable penalties. If not, the Energy Ministry may proceed to *revoke* the title and the grantee will be liable for the following concepts: 1) it shall transfer the nation the assigned area and the necessary infrastructure capacity for its operation without charge nor a right for compensation; 2) the applicable payment for punitive damages resulting from the breach of the assignation title.

As a result of "Round Zero" ordered by the 2013 energy reform, Pemex was granted a total of 108 assignations, from which two titles have suspended because of judicial proceedings, whereas three have been migrated into contracts; thereby, Pemex had to carry out exploration works for the remaining 103 grants. Unfortunately, Pemex fulfilled all its commitments for only 24 assignations, while was only capable of meeting the investment component for 13 of them.[283]

Given this poor performance on Pemex's part, in August 2017 CNH recommended the Energy Ministry to provide an extension for two years accordingly.[284] If this massive non-compliance scenario continues, it is very likely to foresee either the *revocation* of these assignations or the *migration* into contracts in the near future, provided there is an Executive branch that is friendly to private investment.[285] Otherwise, if this situation of non-compliance still goes on in the context of assignations, this administrative vehicle could be used abusively by a statist-driven administration despite the state's evident failures to carry out – through Pemex – upstream oil functions at conventional oil fields.[286]

C. CONTRACT TYPOLOGY, CONSIDERATIONS, AND THE FISCAL APPROACH

Based on Article Fourth Transitory of the 2013 reform decree, Congress has the authority to legislate on the contractual modalities on upstream oil activities, which shall be at least the following: 1) *services*, 2) *profit-sharing*, 3) *production-sharing*, and 4) *licenses*. In this sense, the transitory provision states, upstream activities shall be executed on behalf of the nation in terms of article 27 of the constitution and the state shall select the model that best fits the policy of maximizing the nation's oil revenue.

The second paragraph of the same transitory precept indicates that the legislature shall set up the different consideration types the state must pay either to its productive enterprises or to private business by virtue of the upstream oil operations performed by them. This

[283] *See* Karol García, "Pemex descuida asignaciones de la Ronda Cero y las arriesga" [Pemex neglects and jeopardizes Round Zero's assignations], in *El Economista,* newspaper, August 15, 2017, available at https://www.eleconomista.com.mx/empresas/Pemex-desatiende-asignaciones-de-Ronda-Cero-y-las-arriesga-20170816-0045.html. *See* also Oil and Gas Magazine Staff, "Pemex descuida asignaciones de la Ronda Cero" [Pemex neglects Round Zero's assignations], in *Oil and Gas Magazine,* August 16, 2017, available at https://www.oilandgasmagazine.com.mx/2017/08/Pemex-descuida-asignaciones-la-ronda-cero/.

[284] *Id.*

[285] *Id.*

[286] *Id.*

transitory precept says that secondary legislation shall regulate, at least, the following compensation modalities: 1) in *cash*, which applies to services agreements; 2) with a *profit percentage* for profit-sharing agreements; 3) with a *commodity percentage* of for the case of production-sharing contracts; 4) with the *onerous transfer*[287] of hydrocarbons once they have been extracted from the subsoil, for the case of the license agreements, or 5) any *combination* of the prior consideration types.

With regard t the question of choosing a contract modality, the only *constitutional directive* for selecting the proper consideration type is that the nation shall always maximize oil revenue to achieve the greatest benefit for long-term development. Immediately after, this transitory precept delegates on the legislature the task of setting up '*considerations*' and '*tax contributions*' to be charged on state enterprises or private contractors, and of regulating the cases in which the latter shall pay the nation for the extracted petroleum products that are transferred to them.[288]

Hence, the regulatory framework on upstream oil contracts considers two type of considerations depending the *recipient* at issue: On the one hand, 1) the payments the state should transfer to contractors in compensation for their services and capital ventures for the exploration and production subsoil petroleum resources. On the other hand, 2) the considerations that contractors must pay the state as a result of having the exclusive right of carrying out upstream activities in a determined oil field, which belongs to the nation and whose effective proceeds shall be a measure to determine contractors' premium share in exchange for their investment and services.

In light of the legal distinctions above, the *fiscal* structure of upstream oil contracts consists in a '*double source*' of revenue for the state. First, either the package of considerations – such as fees, bonuses, and royalties – or the set of duties which contractors or assignation grantees, in each case, shall pay to the government for having the state-granted privilege of performing oil and gas exploration and extraction activities.[289] Second, the bundle of taxes imposed by legislation over exploration and extraction contractors.[290]

The *fiscal* character of such petroleum revenue streams stems, on the one hand, from their collection into government coffers. On the other hand, petroleum taxes and considerations have a fiscal nature also because their extraction is supported on the taxing

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[287] According to Mexican civil law, an "onerous transfer" means a sale of goods or services in exchange for an agreed price between the contracting parties.

[288] This last hypothesis refers to *license* agreements which contemplate the contractor's right to get transferred the ownership rights on the extracted oil resources in exchange for a payment in favor of the state as agent of the nation.

[289] While contractors must pay to the state what the law defines as '*considerations*' for conducting upstream oil operations, assignation grantees are obliged to pay the following '*duties*' for the same concept of activity: 1) a shared profit duty, 2) an extraction duty, and 3) an exploration duty.

[290] Income taxes (ISR) are imposed on both assignations' grantees and contractors, irrespective of their legal status whether as a state-owned enterprise or as a private company. Additionally, contractors have to pay a *special contribution* called "hydrocarbon exploration and extraction tax". Value-added tax (IVA) shall be caused at a rate of 0% by upstream oil contractors. *See* Article Fourteenth Transitory of the Decree of the Constitutional Reform on Oil, published on December 20, 2013. *See*, also, articles 33, 39-45 and 54-57 of the Hydrocarbon Revenue Act.

and police powers of the state. Both taxation and regulation yield a compulsory ingredient that makes them fall under the typically *authoritative* behavior of the state, which holds the monopoly to execute –by public force– the legal order.

Yet some voices might sustain that considerations have a *commercial* nature instead, because contract law governs them –that is, a realm where private agents regulate themselves through rational, voluntary agreements whose enforcement is the only intervention required from the state. For reasons indicated above, such notion of contract law is a *fallacy* –especially in the context of the Mexican upstream petroleum industry.

The '*strategic*' legal status coating the Mexican upstream oil grants the state an exclusive command and control over it, meaning wide legal grounds to justify the intrusion of public interest regulation and deference towards the discretion of the administrative state in charge of enforcing it. So these upstream oil agreements do not exist in a regulatory vacuum, but rather are governed by rules of higher legal hierarchy –namely, the constitution itself, legislation, and administrative instruments. In this sense, compensation payments from upstream oil agreements are not agreed by contractors at a free marketplace in equality of circumstances, but are instead determined and managed by an array government agencies –such as the Finance Ministry and the Mexican Petroleum Fund– acting in their *authoritative* capacity.

In fact, those who conceive the establishment and payment of upstream oil considerations as purely 'commercial', rather than 'administrative' or 'authoritative', can actually justify their interpretation on positive law. According to article 35 of the Hydrocarbon Revenue Act, the Mexican Petroleum Fund is the autonomous government vehicle in charge of the management of incoming and outgoing payments coming from upstream oil activity; whereas the legislature confers upon the Finance Ministry the task of verifying and enforcing the *financial aspects* of upstream oil contracts.

In this context, article 36 of this secondary law expressly indicates that neither the determinations made by the Petroleum Fund and the Finance Ministry in their managerial and enforcing roles on the financial aspects of contracts, nor the fiscal terms set up by the latter on each upstream oil contract shall be considered '*authoritative*' in nature.

The legislature is silent about the reasons to remove these regulatory acts from their '*authoritative*' status. Although I explain later on why this formalistic move on the legislature's part has to do with procedural matters on dispute mechanisms, my view is that this provision is conflicting with the substantive treatment that the same legal framework confers upon those determinations made by government bodies with managerial and administrative authority over the *financial aspects* and *fiscal terms* of upstream oil contracts.

By way of illustration, article 20, fraction IV, of the Hydrocarbons Act delegates on the Executive –by means of CNH– the authority to declare the "*anticipated termination*" or the "*administrative rescission*" of any oil contract when contractor breaches, without justified cause, their obligation to make a payment or to deliver petroleum production the state is entitled to pursuant the terms stipulated by the agreement.

So far, every petroleum contract CNH has signed off on behalf of the state, replicates the same rescission clause. The legal consequence for any contract that is "administratively rescinded" consists in the governmental take over of the contractual area, without charge or compensation to be paid by the state, irrespective of the punitive damages the contractor is liable for this breach of contract. Aside the discussion on the judicial and alternative means to dispute this government measure, is it reasonably to deny then that a contract's administrative rescission for lack of committed payments amounts to *unilateral* exercise of *authority*?

Supporters of the reading that oil contact considerations stipulated in favor of the state have a greater commercial component than fiscal can construe the Hydrocarbon Revenue Act in intricate ways, stretching beyond reasonable limits the interpretation of the letter of the law so as to fit in their desired policy goals. On the one side, article 22 of the Hydrocarbons Act states that every matter over which that secondary law and the corresponding executive regulations have been silent, shall thereof be ruled by *commercial law* and *civil law*, for as long as the latter do not contradict the mandates established by the former. On the other, article 97 of the Hydrocarbons Act establishes that "on what is not provided by such secondary law, activities relative to the upstream oil industry shall be considered *mercantile*, thereby being governed by the Commerce Code and, in a supplementary way, by the Federal Civil Code".[291] Drawing upon these legislative precepts, one could say legislative intent was to treat upstream oil considerations received by the state as income resulting from a mere commercial activity.

There is an implicit, market-friendly policy underlying the legal language above, which, despite its purpose to attract private investors, is *contradictory* on the following grounds:

First, the Mexican upstream oil industry is in fact governed by *public interest regulation* carved out in the constitution itself. Second, the constitutional regulation and policy on the Mexican upstream oil industry is dominated by a *fiscally oriented* approach, in view of the concern to maximize the revenue from extractive activities. Third, in close connection to the last point, upstream oil functions are constitutionally classified as a '*strategic area*' of the Mexican economy and, as result of such legal status, its governance shall be exclusively state-commanded. Fourth, even from a positive law perspective, the Executive's Statement of Purpose on his initiative for Hydrocarbons Act states that considerations have the *fiscal* nature of what, under Mexican tax law, is defined as "aprovechamiento" – a type of income the state is entitled to for its public law functions, but which differs from "contributions" in that it does not necessarily have to be protected certain legislative guarantees.[292] Fifth, the Hydrocarbon Revenue Act –which is the main law governing consideration payments resulting from upstream oil agreements –establishes that its precepts should be considered of "*public interest*".[293]

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[291] *See* article 96 of the Hydrocarbons Act. The italics are mine.
[292] *See* articles 2 and 3 of the Federal Fiscal Code, Federal Fiscal Code, originally published on December 31, 1981, in Mexico's Federal Official Journal.
[293] *See* article 1 of the Hydrocarbon Revenue Act. The italics are mine.

A more sophisticated defense of state's upstream oil considerations as mercantile would be to distinguish administrative acts with *commercial* effects from administrative acts with an *authoritative* connotation. The commonality shared by these two types of behavior is a mere formality – their source is an administrative agency or executive branch department. This does not mean, though, that such behavior is authoritative from a material standpoint. There are many actions performed by government bodies or public officials that can be considered purely commercial.[294]

In the context of upstream oil contracts, it could be inferred from article 25 of the Hydrocarbons Act that only resolutions adjudicating or canceling the respective auction as well as every other act related exclusively to biddings are *authoritative*, since this statutory law indicates that they can only be judicially challenged via the "writ of amparo" –a judicial proceeding to attack the constitutionality and legality of *authoritative* acts.

That said, whatever has to do with the management of oil contracts *after* or *outside* the bidding and adjudication stages, should be considered *commercial* in both its essence and impact. Certainly, the content of article 36 of the Hydrocarbon Revenue Act adds up to this interpretation by explicitly removing administrative determinations on the contracts' financial aspects and fiscal terms from their presumptive authoritative character.

According to this legal distinction, the Mexican Petroleum Fund and the Finance Ministry's intervention would be treated as administrative in attention to their source, but lacking of the authoritative nature because of their orientation to coordinate a commercial relationship between the Mexican state and upstream oil contractors.

Despite the possibility of framing a legal interpretation in the sense explained above, neither the Executive in the corresponding statements of purpose, nor Congress in the secondary laws approved, were clear in making the legal distinction between '*commercially oriented administrative acts*' and '*administrative action with an authoritative scope*'. Instead, the legislative treatment of considerations the state is entitled to look at for granting upstream oil contracts is highly confusing and contradictory.

This research identifies the overwhelming presence of a *public law* system on the Mexican upstream oil sector from the constitution itself, considering the fiscal importance this industry has for state coffers and national development accordingly. In this sense, the Executive's statement of purpose on the Hydrocarbon Revenue Act explicitly confirms the *fiscal* content that upstream oil considerations have for the government.

Additionally, if there is a default on the payment that contractors owe to the state, the latter – through the CNH – can always appeal on the *administrative rescission* of the agreement as last resort. So, the legislature's selective mix of commercial law and public law institutions, as well as the removal of the authoritative attribute possessed by determinations on the fiscal and financial terms of oil agreements, seem *out of context*

[294] For instance, buying mobile inventory for their staff, paying the rent of a building they use to perform their jobs, renting out a facility the government is not longer using, or booking flight tickets to transport public officials from one place to other, etcetera.

when contrasted with the public interest and fiscal pillars around which this industry's regulatory system is organized.

This disorder in the legal technique supporting the hydrocarbon laws can only be explained from a *political standpoint* –which is the convenience of using a legal wording that seems friendly to free markets and their preference for private law institutions, with the aim of attracting as much private investment as possible for the development of the sector. Yet these legal remarks are not academic, since the aforementioned *contradictions* cut against both private contractors and market-friendly public administrators.

On the one hand, it is highly questionable that private investors are not able to challenge either the administrative determinations on the terms to calculate the considerations they must pay the state for the performance of a public interest economic activity, or the resolutions resulting from their verifying authority on the financial aspects of petroleum agreements. Based on article 36 of the Hydrocarbon Revenue Act, upstream oil contractors should sue CNH which seems to work as the *one-stop shop* of the administrative state involved in the management and policing of Mexican upstream oil contracts – whether via the writ of "amparo", through an ordinary administrative proceeding, or via an arbitration mechanism if applicable.

But, why should CNH be held liable for the potential wrongdoings of the Finance Ministry of Finance in setting up the fiscal terms or verifying the cost structure of upstream oil contractors? Either for rule of law or expertise reasons, this work strongly recommends that the Finance Ministry could be held directly accountable before the federal courts for their administrative action in this regard.

On the other hand, voices in favor of maintaining this mix of *public law and private law* tools could argue that the contract model annexes takes care of the possibility of emerging administrative disputes or management misunderstandings between the state and contractors, by setting up a communication channel between the latter and the relevant administrative agencies through CNH as one-stop shop.

Paradoxically, this *fragile equilibrium* of *hybrid* legal institutions on Mexico's upstream oil could easily crumble down if the regulatory state in charge of their interpretation and implementation is taken over by a presidential leadership that favors a state-driven development strategy. Although there are plenty of arguments to oppose a policy agenda favoring the state as the orchestrator of economic development, the exorbitant presence of the public sector on the Mexican oil sector seems to pass constitutional muster for the reasons and evidence above.

For the sake of *legal certainty, regulatory stability* and *coherence* of petroleum regulatory institutions, the energy reform architects could have given a different regulatory treatment to upstream oil contracts if they had wanted the mercantile or commercial component to overweigh a state-commanded governance. Unfortunately, they privileged the latter, so this fragmented puzzle of legal institutions of different nature and scope could backfire on them in the case a new political leadership comes to wield the Executive power

and changes the legal interpretation towards a state-oriented development of the upstream oil. At least, such interpretation would be permissible on constitutional law grounds.

The Hydrocarbons Act is the secondary law that develops further the agreement templates laid out by the constitution and specifies that oil contract considerations shall be regulated in terms of the Hydrocarbon Revenue Act. This federal statute on hydrocarbons goes on in establishing the minimum content which shall be unpacked by the contract's clauses. Now, it is my purpose to discuss some of the elements of the agreement models: licenses, production-sharing contracts, profit-sharing contracts, and services agreements.

i. Licenses

As stated by the constitution and the Hydrocarbons Act[295], upstream oil contracts should declare that underground hydrocarbons belong to the nation under full state ownership. In this sense, license agreements are the *only* scheme that consists in the *transfer of property rights* on extracted petroleum resources in favor of the licensee, who in turn pays the state a bundle of considerations consisting in a signing bonus, an exploratory fee, royalties, a profit share if applicable, and a price for the oil production at issue.[296]

In other words, contractors perform upstream operations and purchase the ownership on oil production in return for a price and a set of leasing fees.[297] Unlike profit- and production-sharing agreements, which assure contractor the retrieve of their costs plus a profit in revenue or in kind, licenses guarantee the right to buy the produced oil as the only consideration to be paid to the contractor, making the latter to absorb the risk of recovering its costs – a question which ultimately depends on the prices of the petroleum market.

That said, one might ask whether licenses pose a challenge to the constitutional mandate of maintaining state ownership over subsoil petroleum resources. Legally speaking, these upstream contracts pass constitutional muster because the transfer of property rights from public dominion to the contractor's dominion occurs when hydrocarbons have already been *extracted* from the subsoil, making inapplicable the ownership rule laid out in article 27 of the constitution.

Yet a more complex constitutional challenge for licenses comes from the argument that they are vehicles that work as '*administrative concessions*' for every practical effect. This analogy is legally relevant because, as mentioned in several prior parts of this research, the framers of the 2013 energy reform kept the constitutional ban on upstream oil concessions that has been in force since the Cárdenas era.

Further explanation is required to understand the point above. The concept of concessions in Mexico derives from French public law doctrine, according to which this

[295] *See* article 27, paragraph seventh, of the constitution and article 11 of the Hydrocarbons Act.
[296] *See* article 6 of the Hydrocarbon Revenue Act, originally published on August 11, 2014, in Mexico's Federal Official Journal.
[297] *Id.*

title is discretionally granted by the administration and confers its holder –also known as ‘concessionaire’– *exclusive rights* to *operate, use and commercially exploit* a *public domain asset* or a *public interest service*, which in turn remains property or jurisdiction of the state and can be unilaterally disposed –taken back or sold, for example– by the latter in its owner capacity. In order to enjoy a concession grant, the concessionaire must provide an adequate service, or exploit the regulated good in question, in strict compliance with the terms and conditions established by legislation, which in turn is both supervised and enforced by the administration through its *delegated police powers* on behalf of the public interest. In exchange of that public law privilege, the private concessionaire pays the state a bundle of considerations – such as leasing fees and royalties – and the corresponding taxes.

For its part, licenses are a state-granted privilege regulated by public interest legislation and an administrative regime to take care that upstream oil operations are performed by license-holders in accordance to their strategic status. In this sense, licensees can recover and benefit from the investment costs and risks they incur in the development of crude oil resources by means of the ownership on oil production and then achieving a surplus from the market sale of the commodity. The compensation paid to the licensee – in return for its upstream operations, leasing fees, royalties, the price for ownership, and a profit share[298] – consists precisely in the *acquisition* of the *ownership rights* on oil production.

Another important aspect is that both licenses and concessions grant the licensee *greater decision-making power* and *flexibility* over managerial and operative matters within the oil drilling area, as opposed to profit- and production-sharing agreements, which impose on contractors the obligation to submit a development and work plans for the approval for the state. Hence, this is a reason why concessions pertain to a private foreign ownership structure (P_2), whereas the latter are attached to state ownership without control (S_2).

Is there any clear distinction between how concessions are understood in Mexican jurisprudence and the function actually performed by upstream oil licenses? From a functional standpoint, the answer is *negative* since both administrative law institutions seem to be doing the same work. Yet concessions for hydrocarbon exploration and extraction are constitutionally forbidden, whereas licenses are permitted as of the 2013 constitutional amendment on energy – they are explicitly mentioned Article Fourth Transitory of the reform decree. The architects of the 2013 overhaul figured out a way to bypass the constitutional ban on administrative concessions and still produce their material effects through a legal vehicle with a different name. It is strange that those leftwing political forces opposing the passage of the energy reform –such as MORENA and the PRD– did not raise this constitutional challenge before the Supreme Court in this respect.

Finally, according to article 10 of the Hydrocarbon Revenue Act, the consideration paid by the licensee for the ownership transfer of the oil production can be modified through a sliding scale mechanism aimed at capturing oil revenue windfalls. For this purpose, this flexible mechanism to determine of the oil production price shall be included in the contract clauses. In so doing, the state eludes Raymond Vernon’s *obsolescing bargain* problem – that is, the necessity to amend the upstream oil contracts right away

[298] This last consideration is *optional* in licenses, depending on whether the state has a carried interest.

after signing them in case of a sustained price peak–, making compatible the extractive *revenue policy* with the *regulatory flexibility* required by sectorial development and the *legal certainty* demanded for a healthy business environment. The fact that the upstream oil markets are extremely volatile induces the state –through the Finance Ministry – to come up with tools that take into account the variable factors of the equation. From a rule-of-law perspective, the key task for the state is to be transparent in advance about the sliding-scale formula components and the possibility of using it, so contractors know what to expect in this regard if a petroleum windfall occurs.

ii. Profit-sharing agreements

In terms of the Hydrocarbon Revenue Act[299], this contract type supposes a business partnership between the state as agent of the nation's public interest and the contractor, who in turn commits to delivering upstream production with the purpose of splitting the oil proceeds as agreed. While licenses just cover the sale of the extracted oil in favor of the licensee, profit-sharing agreements establish two *compensation concepts* in interest of the contractor: First, the costs made by the contractor and recognized accordingly by the Finance Ministry pursuant the fiscal terms it issues for this purpose. Second, a profit share as agreed on the contractual instrument signed by the state and the contractor. For its part, the Hydrocarbons Revenue Act mentions three considerations in favor of the Mexican state when it comes to profit-sharing agreements: a leasing fee for the exploratory phase of the contract, royalties, and a profit percentage for the state as established by contract.

Once the contractor has extracted oil resources, it delivers the whole production to a third entity which legislation dubs as a *market retailer* ("comercializador") who then turns in the oil revenue resulting from the sale to a fiscal body known as the Mexican Petroleum Fund. Then, this autonomous instrument shall keep the equivalent amount of the considerations corresponding to the state and shall pay the contractor theirs as committed.

The market retailer is the entity hired by CNH, under prior petition of the Mexican Petroleum Fund, to perform the service of selling out the hydrocarbon resources received by the state as result from an upstream oil agreement.[300] This seller shall turn into the Mexican Petroleum Fund all the revenue obtained from market sale of petroleum production in accordance to the upstream oil agreement at hand, once it has discounted its service compensation pursuant the service contract it has celebrated with CNH.[301]

It is in this business link where *profit-* and *production-sharing* agreements differ from *licenses*. In the case of the former, the Hydrocarbon Revenue Act ordains the intervention of a third-party, who in turn must celebrate a contract with the Mexican state to perform this retailing service on behalf of the nation. It is needless to say that the sole addition of intermediaries for the implementation of profit- and production-sharing contracts increases the *administrative costs* and *burdens* for both the state and the contractor. As indicated

[299] Article 11 of the Hydrocarbon Revenue Act.
[300] *See* article 3, fraction III, of the Hydrocarbon Revenue Act.
[301] *See* article 27 of the Hydrocarbon Revenue Act.

above, oil concessions and licenses grant their holders the privilege to exploit the regulated commodity in question, whereas profit- and production-sharing agreements submit their contractors to a retailer, who also takes part of the oil proceeds because of their service compensation.

iii. Production-sharing agreements

Like profit-sharing agreements, the production-sharing modality also implies a partnership between the state and contractors with the aim to perform upstream oil activities and split the resulting oil proceeds –not the production– according to the proportions stipulated in the corresponding contractual instrument. Consequently, the state is entitled to claim the payment of a leasing fee for the exploration stage, royalties, and a profit share, whereas the contractor has the right to retrieve its costs for as long as they are cleared by the Finance Ministry pursuant its fiscal terms and the Hydrocarbon Revenue Act, as well as right to a share of the oil profits.

The *distinctive feature* of production-sharing contracts lies in that contractors shall be paid off *in kind* for all the considerations stipulated in their interest, whereas the state shall be compensated also in 'commodity units' for their royalties and equity share – namely, with a percentage of the extracted petroleum production that exactly amounts to the monetary worth of these considerations.

The payment mechanism in production-sharing agreements is slightly different from the *profit-sharing* arrangement. In the case of the former, the state shall stipulate in contract the overall amount of considerations the contractor must pay in kind to the state, so that this oil production share is received and sold out by the market retailer, who in turn should hand over to the Petroleum Fund the revenue resulting from the sale of this commodities. Obviously, the contractor shall keep the remainder of the oil production, once it has deducted the proportion claimed by the state pursuant the terms and conditions stipulated in the agreement.

As in *profit-sharing contracts*, the production-sharing template also stipulates the intervention from a third-party retailer. Thus this type of upstream oil contract should deduct a percentage of the state's oil production to cover the commercial services provided by the marketer. Along with *licenses*, in production-sharing agreements the contractor gets commodity units as payment. However, the commodity units received by the contractor represent only a portion of the profit resulting from the whole oil produce, but not the whole production as in licenses.

iv. Services agreements

In this type of vehicles, contractors perform upstream services on behalf of the state, absorbing the capital costs of those projects, and they receive in return a consideration consisting in a *quota* –either fixed or variable– based on their oil production. Considerations set up in favor of the contractor are paid *in cash* and based on the common

standards of the oil industry. If there is hydrocarbon production involved, this is handed over completely to the state. The service contractor's compensation is disbursed from the revenue resulting from the market retailing transactions of petroleum sales.[302]

Irrespective of the oil contract model that is being used, there are a couple of hypotheses for which articles 16 and 17 of the Hydrocarbons Act sets specific parameters for the establishment of a carried equity interest in favor of the Mexican state. First, the Energy Ministry has the authority to include, at the technical guidelines governing CNH's bidding rules, an '*optional*' *carried interest* for the state of maximum 30% of the project overall investments of an upstream oil agreement concerning: 1) a contractual area bordering an assignation's block, 2) the opportunity to foster the transference of the know-how and technology for the development of Pemex, or 3) projects the state desires to encourage through a specific financial vehicle.

On the other hand, the second hypothesis has to do with the Energy Ministry's obligation to constitute – "with the technical assistance" from CNH – a '*mandatory*' *carried interest* in favor of Pemex or any other state-owned enterprise of at least 20% of the project's investments, for any contract entailing the exploration and extraction of "transboundary hydrocarbon reservoirs".[303] In sum, these are two scenarios where the Energy Ministry shall be exercising a policy judgment strictly speaking, because the constitution of either of these *carried interests* in favor Mexican state into a contract, irrespective of its modality, are questions pertaining the nation's energy sovereignty, the protection of prior public investment made by Pemex, or the development of technological and human capital capacities within this NOC or other state-owned companies.

At the moment of writing this dissertation, the upstream oil contract regime is at an implementation stage, which is why this work has not adopted a retrospective approach in analyzing this investment instruments. Yet it is worth exploring some of the figures resulting from this execution process.

According to official records published by the sectorial regulator, 110 agreements on oil exploration and extraction have been granted to diverse contractors by means of a competitive bidding process. These auction proceedings have been grouped in different scheduled phases, also known as "rounds", considering the geological, technical, and financial features of the hydrocarbon reservoirs the state –through the Energy Ministry's policy guidelines and the CNH's technical assistance– has judged convenient to tender. Except for Round Zero, which was devoted to assign Pemex those oil fields where this state-owned enterprise had proven the realization of sound investment and development plans, the following three rounds have implied exclusively the grant of contractual areas.

[302] *See* articles 21 and 22 of the Hydrocarbon Revenue Act.

[303] According to article 1, paragraph third of the Hydrocarbons Act, the transboundary hydrocarbon reservoirs are those oil and gas resources located under national jurisdiction, but have physical continuity beyond it. Also under this legal category are those reservoirs of hydrocarbon resources that are out of national jurisdiction, but are shared with other countries pursuant the international treaties or according to the United Nations Conveniton on the Law of the Sea. For example, the "*Agreement between the United States and Mexico Concerning Transboundary Hydrocarbon Reservoirs in the Gulf of Mexico*".

By January 2018, Rounds 1[304] and 2[305] were completed with four auction proceedings each, whereas Round 3[306] is in process of being executed, starting with its first bidding in March 2018. As a result, the first two rounds have produced a total of 8 auctions, all of which have meant the allocation of 110 upstream oil agreements. Additionally, in 2016 and 2017 five separate tenders were launched in order to choose a partner for Pemex in what the petroleum industry dubs as strategic alliances or farm-outs – from which three were successful[307], whereas the other two biddings was declared deserted by CNH due to the lack of bidders.[308]

Until January 2018, the upstream oil contracts bid and granted by CNH have represented an investment of $ 536,950,192.28 dollars for the Mexican petroleum industry[309], but based on the overall investment commitments made by Rounds 1 and 2 contractors, this amount is expected to reach approximately the $153,000,000,000 dollars.[310]

These numbers are expected to increase over the following years for as long as sectorial authorities –such as the Energy Ministry in its policy enforcement capacity, the CNH in its regulatory role, and the Finance Ministry as the fiscal authority– continue to judge private business collaboration as the best tool for achieving this sector's development and the country's fiscal standing accordingly. Yet, considering the current legal framework, the Executive has exorbitant discretion to *roll back* this oil development strategy through administrative law channels, such as the eventual '*rescission*' of these contracts and the abuse of '*assignations*' instead. This is a topic to which I will come back later on in the next sections of this work.

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[304] Round 1 covered four bidding processes during 2014 and 2015. Two of these auction proceedings were targeted on 'shallow waters', whereas one was for 'terrestrial grounds' and the another one was focused on 'deepwaters'.

[305] Round 2 included a total of four bidding mechanisms through 2016 and 2017. From these tender proceedings, two were centered on 'terrestrial grounds', one was for 'shallow waters', and the last one was aimed at granting oil blocks at 'deepwaters'.

[306] Round 3 is planned to have three biddings from which the first one took place in late March 2018 and consisted in the conferral of contracts for 'shallow waters', while the other two tenders are targeted on 'terrestrial grounds' and 'deepwaters', respectively.

[307] Succesful farm-outs include the following contractual areas: Trion in 2016, as well as Cárdenas Mora and Ogarrio in 2017. *See* National Hydrocarbons Commission (CNH), "Asociaciones Estratégicas con Petróleos Mexicanos (Farmouts)" [Strategic Alliances with Pemex], Mexico, consulted on March 21, 2018, available at https://rondasmexico.gob.mx/#AsociacionesEstrateg.

[308] Ayin-Batsil and Nobilis-Maximino were the two oil blocks whose auction processes to incorporate farm-outs with Pemex were declared unsuccesful by CNH in October and December 2017. *See* National Hydrocarbons Commission (CNH), *supranote* 305, available at https://rondasmexico.gob.mx/a1-ayin-xulum-2017/ and at https://rondasmexico.gob.mx/wp-content/uploads/2017/12/Resolucion-CNH.E.66.002.17.pdf

[309] *See* National Hydrocarbons Commission (CNH), "Cifras relevantes" [Relevant figures], Mexico, consulted on March 21, 2018, available at https://rondasmexico.gob.mx/cnh-cifra-inicio/.

[310] Atzayaelh Torres, "Las 8 rondas petroleras traerían hasta 153 mil mdd a México" [The 8 oil round would bring up to 153 thousand million dollars to Mexico], *El Financiero,* newspaper, February 2, 2018, available at http://www.elfinanciero.com.mx/economia/las-rondas-petroleras-traerian-hasta-153-mil-mdd-a-mexico.

TABLE III. MEXICO'S CONTRACT REGIME ON UPSTREAM OIL		
Instruments	**Regulatory Aspects**	**Typology / Consideration Type**
Contracts	- The Executive, through CNH, pursuant the regulatory guidelines that are issued for that purpose by the ministries of Energy and of Finance, in their respective spheres of authority, signs the contracts for the exploration and extraction of subsoil petroleum resources. - The contract may be adjudicated to a private oil company, a state-owned enterprise (i.e. Pemex), or to a public-private partnership (farm-out). - The state, by means of CNH as sectorial regulator, shall be in charge of adjudicating the corresponding upstream oil contract as a result of the implementation of a bidding process, in terms of the Hydrocarbons Act. - Contracts shall have a clause indicating the nation's ownership on subsoil hydrocarbons.	1. Services – Cash 2. Profit-sharing – Profit % 3. Production-sharing – Profit in commodity units % 4. Licenses – Onerous transfer of production (Q) for a price ($), once the oil and gas resources have been extracted from the subsoil.

D. KEY REGULATORY ASPECTS OF NEW HYDROCARBON LAWS

The Hydrocarbons Act is the federal statute passed by Congress in August 2014 with the purpose of developing and unpacking the constitution's prescriptive content on the upstream oil industry as of the 2013 energy reform. In addition to the questions this work has already addressed earlier in this section, my purpose here is to go through the fundamental regulatory tools of Mexico's contract framework on upstream oil activities.

According to the constitution and the new legislation, it is the federal Executive power –by means of CNH– in compliance with the regulations issued by the ministries of Energy and of Finance, in their respective orbit of legal authority, who has the power to celebrate contracts on upstream petroleum activities. Four institutional actors standout within the Mexican *administrative state* of the petroleum industry: 1) the Energy Ministry, 2) CNH, 3) the Finance Ministry, and 4) the Mexican Petroleum Fund.

First, the Energy Ministry (SENER) is the Executive's department that functions as the petroleum policy enforcer and coordinator within the administration. For its part, CNH is the upstream oil's sectorial regulator with the authority to administer the auction and implementation of upstream oil contracts. But, for reasons I explain later on, this administrative agency is subordinated to the authority of the Energy Ministry, despite the independence margins it possess now as a result of the energy reform. Third, the Ministry of Finance is in charge of regulating the *fiscal terms* of the upstream oil contracts and policing their *financial aspects*, in order to capture the revenue that is earmarked for the

nation's long-term development, in terms of the Hydrocarbon Revenue Act. Fourth, the Mexican Petroleum Fund for Stabilization and Development is the autonomous entity of the Mexican state that is tasked with managing the incoming and outgoing payments on the nation's oil profits produced by upstream activities, except for taxes. The fiduciary role of this stabilization fund corresponds to the Central Bank of Mexico, which is another autonomous entity from the Executive branch. The constitutional mandate of the petroleum fund is mainly 'fiscal' since, aside from collecting the petroleum revenue coming from assignations or contracts, it is in charge of distributing these proceeds for earmarked public investment purposes, in terms of the 2013 constitutional reform and its enabling legislation.

Mexico's new legal regime on upstream oil fosters more *competition* compared to the prior monopolistic structure of the past, meaning that the privilege of exploring and extracting hydrocarbons results now from a *competitive*, *transparent bidding* process, which seeks to choose the best fit of an agent for this purpose in light of the Executive's fiscal and sectorial goals.

As established by article 15 of the Hydrocarbons Act, CNH –as *sectorial regulator*– represents the Mexican state in the grant of exploration and extraction agreements. CNH's regulatory capacity over the upstream oil industry makes it responsible for implementing the bidding process aimed at selecting a grantee for the corresponding agreement. To that end, CNH has the prerogative to issue the administrative rules according to which this tender should be realized. These *bidding rules* shall at least determine the contractual modality at issue, the criteria and mechanism to determine the winning offer, and a timetable with deadlines for the pre-qualifying and clarifying stages, the adjudication variables, as well as the proceeding to modify of the terms and conditions of the tender itself.

At first glance, it seems the auctions of upstream oil contracts are mainly overseen and implemented by CNH; however, a deeper analysis of the relevant legal framework leads to the conclusion that CNH's regulatory function must in turn be *coordinated* and, in some instances, *subordinated* to the intervention of other administrative authorities. By of illustration, Congress grants Federal Economic Competition Commission (COFECE) –as the antitrust authority in Mexico– with the power to formulate a favorable opinion on the bidding's administrative rules; in particular with regard to the pre-qualifying criteria and the adjudication mechanism. Fortunately, this participation in the bidding process from COFECE –which possess constitutional autonomy from the Executive– is set up in terms of 'coordination' and could be extremely positive for sectorial development from an antitrust policy standpoint.

In parallel, the bidding regulations must comply with both the "*technical guidelines*" and the "*fiscal terms*" formulated by the ministries of Energy and of Finance, respectively.[311] On one hand, the Hydrocarbons Act empowers SENER to issue the technical guidelines, which are administrative rules and policy standards with a legally binding character not only over contractors, but also upon the authoritative acts of the

[311] *See* articles 11, 16, 23, 24, and 31, fraction III, of the Hydrocarbons Act.

regulator (CNH) in relation to the design and implementation contract auctions.[312] The secondary law in question consistently ordains in several provisions that the bidding for upstream petroleum contracts shall encompass the acts and stages established by both SENER's *guidelines* and CNH *regulations*, respectively.

Yet Congress sustains that the corresponding applicants should comply with the pre-qualifying criteria concerning the technical, financial, executive, and expertise elements that are required by the *guidelines* issued by SENER to such effect. This hypothesis is confirmed by taking a look at the provisions listing the authoritative purview of the sectorial regulator on the bidding and adjudication of upstream oil contracts – articles 24 and 31 of the Hydrocarbons Act explicitly order that CNH shall submit to the *technical guidelines* formulated by the Executive's Energy Ministry.

It is out of question that the pre-qualifying criteria highlighted above are elements of regulatory policy. Hence, should not be the sectorial regulator who gets to decide these technical matters, from a *checks and balances* perspective? Whether or not SENER's supremacy over CNH is worthy of criticism on institutional design grounds, Congress has made clear what governmental body should be given a higher administrative hierarchy when it comes to a potential disagreement, or inconsistency, on regulatory policy.

The *constraints* on CNH's regulatory power can also be seen when the Hydrocarbons Act vests this administrative agency with the *police power* to authorize *ex ante* the incorporation of 'strategic partnerships' involving the transfer either of the corporate control and management of the contractor, or of the operational control over the contractual area at hand. On the surface, it appears that CNH has plain statutory authority to decide on this matter, for as long as this resolution has considered the expertise as well as the technical and financial capacities as the minimum criteria. However, the same legislative instrument confers SENER the prerogative to manifest its inconformity to a request for a transfer of the contractor legal status as a result of a proposed partnership.[313]

Although the example above cannot be judged as direct obstruction to the regulatory authority of CNH, the institutional placement of the regulator is not suitable to resist the political pressures of keeping a standing opposed to that of SENER, given the former's *subordination* to the Executive and its obligation to coordinate itself with the Energy Ministry, which is the sector's main policy enforcer. This is a scenario where CNH's regulatory power is clearly weakened, so it is worth asking: Who is the '*de facto*' regulator instead?

On the other hand, both the Hydrocarbons Act and the Hydrocarbon Revenue Act vest in the Finance Ministry, commonly known as "Hacienda", the authority to determine –via administrative rules– the "economic conditions relative to the *fiscal terms* on upstream oil

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[312] This statutory authority is explicitly delegated by Congress to the Energy Ministry, in terms of articles 23, 24, fraction I, 29, 31, fraction III, of the Hydrocarbons Act, originally published on August 11, 2014, in Mexico's Federal Official Journal.

[313] *See* article 15 of the Hydrocarbons Act, originally published on August 11, 2014, in Mexico's Federal Official Journal.

contracts"[314], which in turn shall be considered by the bidding regulations aimed at adjudicating these agreements.

According to the governing secondary laws, the "*adjudication variables*"[315] implied by the fiscal terms shall be economic in nature and prone to maximize government revenue to accomplish the greatest benefit for the nation's long-term development. In this context, Congress enables Hacienda with the discretionary authority to determine the minimum shares or amounts relative to the adjudication variables which in any case shall be associated to a twofold formula: 1) the oil revenue promised to the state and 2) the investment committed by contractors. So it is Hacienda who gets to design the fiscal floor on which CNH shall support its decision to choose the best market player to develop upstream oil functions for any given contract.

Since the new hydrocarbon laws do not say how the CNH should exactly weigh each of the two adjudication variables, once the *technical* and *fiscal minimums* are met by bidders, it is up to the regulator's discretion and expertise to decide which 'revenue / investment' combination could suit better the development of the Mexican petroleum industry. There is, however, one *fundamental policy* the energy reform architects installed for solving any question or controversy in this regard – the state should maximize the oil-related revenue for the nation's long-term development.

Considering this directive is transmitted by the constitution and replicated by the hydrocarbon laws accordingly, it is sound to conclude that Hacienda has the 'upper hand' in defining the space boundaries within which CNH, and even SENER, may exercise their technical expertise on the oil industry. By being shielded at a constitutional level, the *fiscal* understanding of Mexico's upstream oil industry trumps any other alternative reading that policymaking and regulatory authorities could have on that economic sector.

Certainly there is room to read the Hacienda's fiscal authority in coordination with the policing and regulatory powers of other Executive branch agencies, when last paragraph of article 26 of the Hydrocarbons Act establishes that determination of the contract adjudication variables by the Finance Ministry shall not be understood in detriment of the functions tasked by law on CNH. The arguments above, though, demonstrate that Mexico's new oil legal design makes CNH's regulatory role *dependent* on the input that is given to it by other government departments. From a checks and balances standpoint, the upshot is that CNH ends up working with the *regulatory* and *fiscal* policy elements the Executive wants, by means of the administrative determinations of the Energy and Finance ministries.

There is a nuancing remark to add up in this regard. It is worth distinguishing the nature of the *functional dependence* the upstream oil regulator has with SENER and that it has with Hacienda. While the Finance Ministry's intervention in configuring the fiscal requirements of the upstream oil contracts at a bidding stage turns out reasonable given its purview and expertise as the administration's fiscal agent, SENER's institutional placement

[314] *See* article 26 of the Hydrocarbon Revenue Act, originally published on August 11, 2014, in Mexico's Federal Official Journal. The italics are mine.
[315] *Id.* The italics are mine.

vis-à-vis CNH is more questionable because it directly intrudes into *regulatory policy* matters of the upstream oil that could, and perhaps should, be entertained directly by the sectorial regulator. This condition, therefore, exemplifies to what extent CNH is not sovereign in regulating Mexico's upstream oil industry, but rather works as SENER's *technical support arm*, being subject to the control of the Executive at any time. To buttress this criticism on jurisdictional distribution between the sectorial regulator and the policymaking executive department of the Mexican upstream oil, it is be useful to take a look at Table IV below:

TABLE IV. JURISDICTION OF ADMINISTRATIVE INSTITUTIONS ON UPSTREAM OIL

Institution	Role	Functions
Energy Ministry (SENER)	Policymaking Coordinator	- Selecting the contractual areas pursuant their technical guidelines and supported on CNH's technical assistance. - Approving and enacting a five-year bidding plan of contractual areas. - Establishing the contract model that best suits to maximize the nation's oil revenue, with Hacienda and CNH's opinions. - Designing the technical terms and conditions of upstream oil contracts. - Issuing the technical guidelines ruling CNH's regulations on the upstream oil contract biddings. - Planning and developing the promotion and diffusion of the bidding rounds.
National Hydrocarbons Commission (CNH)	Sectorial Regulator	- Providing technical assistance to SENER in the selection of contractual areas. - Advancing to SENER's final decision a five-year bidding plan proposal on contractual areas. - Enacting the administrative regulations governing the upstream oil contract biddings, in compliance with SENER and Hacienda's technical guidelines and fiscal terms, respectively. - Implementing the upstream oil biddings. - Signing off the upstream oil contracts. - Administering and overseeing the technical aspects of upstream oil contracts, with the possibility of getting the support from external inspectors. - Approving the amendment, cancelation or termination of upstream oil contracts, according to the agreement clauses, to SENER's technical guidelines, and to Hacienda's fiscal terms. - Approving exploration and extractive development plans that maximize the productivity of contractual areas. - Providing technical support to Hacienda and the Mexican Petroleum Fund in the execution of their authoritative purview, in terms of the Hydrocarbon Revenue Act.

TABLE IV. JURISDICTION OF ADMINISTRATIVE INSTITUTIONS ON UPSTREAM OIL		
		- Approving investment and operational annual plans for upstream oil contracts. - Approving the transfer of corporate or operational control affecting a corporation with a 'contractor' status.
Finance Ministry (Hacienda)	Fiscal Authority	- Formulating the economic conditions relative to the fiscal terms of upstream oil contract biddings with the purpose of getting the oil revenue that allows the nation's long-term development. - Determining the variables of adjudication of upstream oil biddings, according the Hydrocarbon Revenue Act. - Participating in the administration and accounting supervision on the fiscal terms of upstream oil contracts. - Determining the rules for the record of the costs, expenses, and investment of each upstream oil contract, according its own fiscal terms. - Determining the rules for the goods and services procurement for each contract, according its own fiscal terms. - Receiving from the Petroleum Fund the information and documents related to the costs, expenditures, and investments and to the fiscal deduction of those investments. - Keeping a record on the investment and expenses information on upstream oil contracts that gets from the Petroleum Fund. - Verifying the correct payment of royalties, leasing fees and other consideration payments for each upstream oil contract.
Mexican Petroleum Fund for Stabilization and Development	Independent Management Entity	- Managing the incoming and outgoing payments on the nation's oil profits produced by upstream activities, except for taxes. - Distributing these proceeds for earmarked public investment purposes, in terms of the 2013 constitutional reform and its enabling legislation. - Requesting CNH's technical assistance to execute its tasked functions. - Receiving the accounting information and documents from upstream oil contractors. - Receiving all type of consideration payments from upstream oil contractors. - Calculating the amounts and payments related to the considerations that the Mexican state owes to contractors.

Source: Articles 29, 30 and 31 of the Hydrocarbons Act as well as Article 37, subsections A and B of the Hydrocarbon Revenue Act.

In light of the comparative chart above, CNH's jurisdiction on upstream oil is the typical of an administrator lacking of '*functional autonomy*' from the Executive, but whose institutional placement in the Mexican regulatory state seems to be justified on specialization and division of labor efficiency – namely, the administration's necessity of having the technical counseling from a body of experts in the regulation of the sector. However, once these *technical* decisions are intertwined to some degree with *regulatory policy* questions, such as the selection of oil fields to be contracted out for exploration and extraction, the five-year auction plan, the contract model design, or when these determinations entail an impact on the oil revenue expected by the state, the law confers plain *authority* either to SENER or to Hacienda, respectively.

In this context, it is worth asking: Would not have been more reasonable, from *a checks and balances* standpoint, that the framers had given CNH greater '*functional autonomy*' from the Executive to address every regulatory matter of the upstream oil industry, including those touching on the sectorial policy sphere? Such outcome would have feasible and desirable with respect to SENER, but harder to justify with respect to Hacienda, which has both the expertise and the constitutional mandate to maximize the oil profits coming from these public law contract regime.

As this work's next chapter explains in exploring the organic architecture of this regulatory system, my view is that the Finance Ministry has an exorbitant authority as a result of the *fiscally oriented policy* dominating the Mexican upstream oil –something that has an impact on the regulatory governance of the sector as a whole and is not necessarily adequate from a checks and balances perspective. In the end, this specific weight given to *formal* prerogatives on fiscal matters translates into *material* regulatory power as well, fostering a governance imbalance within the upstream oil's administrative structure.

E. DISPUTE RESOLUTION MECHANISMS

There is no effective rule of law in any political community, unless the legal system is equipped with a mechanism by which an impartial third-party –usually, the state through the judiciary– assumes the law enforcement role, meaning the adjudication of legal disputes occurring either between private subjects or between a private party and a governmental authority – whether administrative, judicial, or legislative. This is the case for the array of legal rights and obligations regulating the relationship between the state and investors, in light of the exploration and production contracts established by the Mexican constitution and hydrocarbon laws.

In this sense, article 25 of the Hydrocarbons Act establishes that only the writ of "*amparo indirecto*"[316] should proceed against resolutions by which CNH determines a

[316] According to constitutional law doctrine, the writ of "*amparo*" can be either *direct* or *indirect.* The former type is the one the affected party can trigger before a district judge of the federal judiciary, whereas the latter is the one filed against the rulings held by an ordinary tribunal –whether judicial or administrative– for as

winning offer or declares deserted any bidding process on upstream oil contracts. The writ of *amparo* is the judicial proceeding of '*extraordinary*' nature[317] through which any person with legal standing[318] can raise a constitutional challenge against any authoritative act from the government –whether administrative, judicial, or legislative– that is causing an actual, particular injury on their sphere of rights, so that the reviewing court provides a remedy aimed at redressing the irregularity on the part of the corresponding public official or government agency.

In short, the amparo action is the only *judicial mechanism* that competing companies can resort to dispute CNH's final judgments on upstream oil auctions. Thereupon, by constraining the scope of the amparo suit against final resolutions on upstream oil auctions, it can be inferred that for Congress only those CNH decisions possess '*authoritative*' status. Despite how problematic is to harmonically articulate this legislative interpretation into the constitutional regime on hydrocarbons, congressional intent seems to be that every administrative action other than final resolutions on upstream oil biddings should be considered '*commercial*' and therefore can only be tackled either through 1) ordinary judicial mechanisms, or through 2) arbitration proceedings if applicable.[319]

That said, article 25 of the Hydrocarbons Act stands out because of its second paragraph for which every act related to the bidding and adjudication of upstream oil agreements shall be considered a question of "*public order and social interest*".[320] This legislative provision is extremely relevant when read systematically along with the Amparo Act –the federal statute that governs the procedural aspects and develops further the constitutional precepts on this judicial mechanism of '*extraordinary*' character. According to articles 128 and 129 of this procedural law, except for matters excluded by the constitution or the Amparo Act itself[321], the reviewing judge is entitled to concede the amparo plaintiff an *injunctive relief* consisting in the suspension of every authoritative act that is allegedly causing the legal harm, for as long as two *requisites* concur: first, 1) that this provisional measure is directly requested by the affected party and, second, 2) that neither damages on "social interest" nor violations of "public order provisions" may follow the concession of the injunctive relief at issue.

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long as the challenged resolution represents a final determination and is aimed exclusively to review legality and constitutionality questions.

[317] In terms of the definitivity principle established by its governing statute, the writ of "*amparo*" is *extraordinary* in the sense that the affected party must exhaust first all the *ordinary* defense means to challenge the authoritative act in question before resorting to this constitutional control mechanism.

[318] For the writ of "*amparo*" to proceed before a federal district judge in the Mexican legal system, the plaintiff must have legal standing, which means their sphere of rights has been directly affected by an actual, particular harm presumptively caused by the authoritative act in question.

[319] This legal interpretation gets reinforced when read along article 36, second paragraph of the Hydrocarbon Revenue Act – the legislative precept that removes the *authoritative* nature from administrative determinations on the fiscal terms and financial aspects of upstream oil contracts.

[320] *See* article 28 of the Hydrocarbons Act. The italics are mine.

[321] Those are the legally binding rules as well as the authoritative acts or ommissions deployed both by the Federal Telecommunitations Institute (IFETEL), which is the sectorial regulator for the Mexican telecommunications industry, and by the Federal Economic Competition Commission (COFECE), which is the Mexican antitrust authority. It is worth noting that both are constitutionally created entities with full autonomy from the Executive branch. Therefore, IFETEL and COFECE's legislative rules, acts and ommissions are not be subject to the "*amparo*" suspension.

In denying the grant of the injunction petitioned by the affected party, the legal policy is to prevent the regulatory process and the development of the Mexican upstream oil industry from being stopped by *litigation bottlenecks* in the judicial system. This interpretation finds constitutional law hold on that the upstream petroleum industry is considered a '*strategic*' area of the Mexican economy, whose regulatory system is organized around public interest and fiscal foundations.[322]

Regardless of the discussion about which are the judicial ways to object upstream oil contract auctions, on the one hand, and the management of these agreements, on the other, article 27 of the Coordinated Regulatory Organs on Energy Act establishes that "legally binding rules, acts, and omissions" from CNH shall be only challenged through the writ of "*amparo indirecto*". If the amparo is the domestic vehicle aimed at testing the constitutional regularity of authoritative action affecting a particular interest in Mexico, then article 27 of CNH's enabling law refers exclusively to regulatory action which is essentially *authoritative*.

Given the precedent at which the Second Chamber of the Mexican Supreme Court ruled that the *"amparo"* suspension –as the injunctive relief par excellence– can only be regulated either through the constitution or through the Amparo Act, it is worth challenging whether or not the other provisions by which article 27 of the Coordinated Regulatory Organs on Energy Act *constrains* the reach and scope of the "amparo" suit, pass constitutional muster.[323] As such, these legislative barriers seem *invalid*. Either way, this work's understanding is that the amparo vehicle would still be admissible before a federal court of law, even in the absence of article 27 of CNH's enabling law, because this regulatory activity results from the exercise of an authority delegated by Congress.

What is more questionable, though, is congressional intent to consolidate "amparo" – via an enabling secondary law– as the only *judicial tool* to object any CNH's regulatory action in a domestic forum. Considering the precedent above, since neither the constitution nor the Amparo Act have been reformed to set up the writ of "amparo" as the only judicial proceeding to solve controversies not just on the bidding resolutions, but also on CNH's

[322] In August 2017, as result of an judicial case that went all the way up to the Mexican Supreme Court of Justice, article 27 of the Coordinated Regulatory Organs on Energy Act was ruled unconstitutional because, according to the Court, the regulation of the amparo proceeding can exclusively be made through either the constitution or the Amparo Act, provided the amendment is compatible with the constitutional regulation of this judicial tool. Yet, the Court sustained, the inadmissibility of the suspension affecting upstream oil biddings still holds by a direct application of articles 128 and 129 of the Amparo Act explained above. The realization of upstream oil contract auctions is directly regulated by article 27 of the Mexican constitution, so the concession of an injunctive relief on a bidding would amount to prevent the state from exploiting or using the strategic natural resources, something that article 129, fraction XIII of the Amparo Act equates both as a damage on "*social interest*" and as a violation of a "*public order provision*". *See* Tesis 2a. / CLIX / 2017 [judicial precedent number], Segunda Sala de la Suprema Corte de Justicia de la Nación [Second Chamber of the Mexican Supreme Court of Justice], *Semanario Judicial de la Fedración y su Gaceta*, Décima Época, Libro 47, Tomo II, Octubre de 2017, p. 1232. Rubro: "SUSPENSIÓN EN EL JUCIIO DE AMPARO. EL ARTÍCULO 27 DE LA LEY DE LOS ÓRGANOS REGULADORES COORDINADOS EN MATERIA ENERGÉTICA, ES INCONSTITUCIONAL POR NO RESPETAR EL PRINCIPIO DE RESERVA DE LEY REGLAMENTARIA" [Suspension in the writ of amparo. Article 27 of the Coordinated Regulatory Organs on Energy Act, is unconstitutional for violating the principle of regulatory law reserve].

[323] Since the Mexican Supreme Court did not take a stand in this regard. *Id.*

regulatory behavior, this research concludes that contractors could also have the possibility of filing their lawsuits before the Federal Administrative Justice Court –which is a specialized tribunal with relative independence from the Executive and is not formally part of the Judicial branch.[324]

As highlighted earlier, one outcome from the energy reform is the explicit legislative authorization to stipulate *arbitration* agreement clauses within the Mexican upstream oil contracts. In accordance to article 21 of the Hydrocarbons Act, all the controversies related to the administration or management of petroleum contracts –also known as "*contractual controversies*"– may be addressed through alternative dispute mechanisms –such as arbitration proceedings– in terms of the Commerce Code and the international treaties that have been signed by the Mexican state on these matters.

For that purpose, the aforementioned precept states that neither CNH nor contractors shall be governed in any case by foreign laws and arbitration trials shall always adjust to the following *conditions*: (1) the applicable law shall be Mexican federal laws; (2) the arbitration proceeding shall be realized in Spanish language, and (3) the arbitration award shall be compulsory for both parties involved in the dispute.

Yet Congress *exempted* the so-called "*administrative rescission*" from being challenged via alternative dispute mechanisms.[325] This remark is not trivial considering that the legal consequence of declaring the administrative rescission of a petroleum contract is that the state can take over the contractual area free of charge or compensation, on the one hand; and the contractor's obligation to pay a settlement pursuant the relevant legal provisions, let alone the payment of punitive damages for the nation, on the other.

In connection to arguments above, this is another point where this research finds a *disorderly mixture* of public law and private law institutions at the Mexican hydrocarbon legislation. Although article 97 of the Hydrocarbons Act orders that on what is not provided by such secondary law, activities relative to the upstream oil industry shall be considered "mercantile", thereby being governed by the commerce and civil codes, the case of contract *rescission* illustrates not just *administrative* action, but one of the most *authoritative* type of behavior the state can deploy against a regulated subject.

This work identifies a *dominance* of *public law* tools around the upstream oil industry, in stark contrast with the residual role that commercial law figures have in fact. Given that the core rules governing this extractive sector pertain to the administrative law realm, the legislative calls in favor of the mercantile conception of the hydrocarbon industry on whatever is not explicitly provided by the letter of the law seem ornamental.

In this context, the *legislative impossibility* to *arbitrate* the "administrative rescission" of upstream oil contracts results from the importation of the French law doctrine on

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[324] *See supra note* 320.

[325] *See* article 21 of the Hydrocarbons Act, which explicitly excluded the Mexican state's unilateral authority to terminate upstream oil contracts for causes traceable to the contractors' liability in terms of the secondary law and the relevant contracts.

administrative contracts.[326] According to French public law, the state has exorbitant powers with respect to public procurement, such as the authority to modify, terminate, or rescind in unilateral terms without a prior judicial proceeding.[327]

Nonetheless, the French conception of the administrative rescission differs from that applicable in Mexico because it allows for the payment of compensation for damages and sunk investments borne by contractors.[328] Taking into account the impossibility to challenge a contract's administrative rescission through the arbitration arena, there are several commentators who see in this feature of Mexico's upstream oil regulatory governance as a '*political risk*'[329] which might become into source of investor-state arbitration cases based on international law grounds –for instance, the unfair treatment or lack of due process the Mexican legal system might confer contractors' property rights.[330]

In light of the *non-arbitrability* the Mexican legal system decrees on upstream petroleum contracts that are administratively rescinded by CNH, contractors could trigger either a constitutional control proceeding before the federal judiciary –also known as "*amparo*"– or an ordinary nullity trial before an administrative court, in order to object this action of ius imperii domestically.

From a *rule of law* standpoint, this research identifies a lack of sound legal reasoning on the legislature's part to constrain alternative dispute resolution forums aimed at contesting and controlling the state's regulatory power when this has presumptively been exercised in an arbitrarily at the expense of private contractors.

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[326] *See* Gabriel Cavazos Villanueva, "Arbitraje y protección a la inversión en el contexto de la reforma energética en México: una primera aproximación desde los casos COMMISA vs. Pemex y KBR vs. MÉXICO" [Arbitration and investment protection in the context of the Mexican energy reform: a first approximation from cases COMMISA vs. Pemex and KBR vs. México], in Tony Payan, Stephen P. Zamora, José Ramón Cossío (eds.), *Estado de derecho y Reforma Energética en México* [Rule of Law and the Energy Reform in Mexico], Tirant Lo Blanch, Mexico City, 2016, at 354. *See* also Herfried Wöss *et al,* "El Contrato administrativo, inarbitrabilidad y el reconocimiento de laudos anulados en el país de origen. El caso *Commisa*" [The administrative contract, the non-arbitrability, and the execution of arbitration awards in the country of origin. The Commisa case], *Revista Lima Arbitration,* 6, 2014, at 81, available at http://limaarbitration.net/LAR6/Herfried_Woss_Dante_Figueroa_Jennifer_Cabrera.pdf. *See* also Jennifer Cabrera, Dante Figueroa, and Herfried Wöss, "The administrative contract, the non-arbitrability, and the execution of awards annulled in the country of origin. The case of *Commisa* v *Pemex*", *Arbitration International*, Volume 32, Issue 1, 1 March 2016, at 125–148, https://doi.org/10.1093/arbint/aiv057.

[327] *Id.*

[328] *See* Cavazos Villanueva, *supra note* 326, at 355.

[329] *See* Wöss *et al, supra note* 326, at 80-82. *See* also Cabrera, Figueroa, and Wöss, *supra note* 326, at 127, 130 and 147.

[330] *Id.* The concept of '*systemic political risk*' refers to the legal uncertainty that any potential dispute investors might have with the Mexican government on the administration of upstream petroleum contracts ends up replicating the scenario resulting from the COMMISA v. Pemex and KBR v. MEXICO cases, at which: 1) Mexican federal courts have refused to recognize the validity and execute accordingly an arbitration award, based on public policy arguments to defend the administrative rescission as a prerogative the Mexican state has over the hydrocarbons sector as consequence of its strategic constitutional status; 2) the Mexican state has been condemned through investor-arbitration proceedings because of the unfair treatment of an investor's private property rights, and where 3) the affected investor has sought to execute these arbitration awards by means of a third-party state's court system[330], by exploiting the points of contact the condemned government and its state-owned enterprise have at such jurisdiction.

Aside from sharing the remark about the '*political risk*' affecting the Mexican upstream oil's regulatory framework as result of the non-arbitrability of administrative rescission, this research casts doubt on the *constitutional validity* of the legislative exclusion of such dispute resolution gateways. According to judicial precedents ruled by the Mexican Supreme Court, international agreements subscribed by the Mexican state have a higher legal status than federal legislation, positing this international law source just below the constitution in terms of normative hierarchy.[331]

Mexico has signed an array of bilateral and multilateral *international law treaties*, which provide a bundle of procedural safeguards aimed at protecting investors' property rights against the unlawful treatment that state members might deploy against them. So by limiting to domestic forums the possibility of challenging a petroleum contract's rescission, which allegedly is ill-motivated or violates guarantees of due process, based on public order or public policy arguments, my claim is that Mexican hydrocarbon laws could be in *violation* of the *international law obligations* the Mexican state has by virtue of the investment protection agreements it is part of.

A second argument to support the challenge against the administrative rescission of upstream oil contracts has to do with observing the right to *due process of law* when the state sees fit to proceed with this act of '*ius imperii*' – in particular when the stake is the loss of capital investment without compensation on the part of the government. Considering that private property on investment is the fundamental right affected by an administrative rescission, it is reasonable to build an expansive reading of due process guarantees, so that the affected contractors have a fair opportunity to frame allegations and offer proof that are aimed at defending their sphere of constitutional guarantees before an impartial third-party.

This legal interpretation is compatible with article 1 of the Mexican constitution, which provides the following: First, it states that *all* persons shall enjoy both the human rights and the guarantees for their protection that are recognized by the constitution and the international law treaties signed by the Mexican state. Second, these human rights and their guarantees shall *not admit restrictions* or *suspension*, except for the ones the constitutional text provides for. Third, every government authority –whether executive, legislative, judicial, whether federal or local– the obligation to exercise their functions in a way they guarantee, respect, and protect every fundamental right established by the constitution pursuant the pro-persona principle[332], in a *progressive* and *universal* fashion.

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[331] *See* Tesis P. IX / 2007 [precedent number], Pleno de la Suprema Corte de Justicia de la Nación [Mexican Supreme Court of Justice], *Semanario Judicial de la Fedración y su Gaceta*, Novena Época, Tomo XXV, Abril de 2007, p. 6. Rubro: "TRATADOS INTERNACIONALES. SON PARTE INTEGRANTE DE LA LEY SUPREMA DE LA UNIÓN Y SE UBICAN JERÁRQUICAMENT POR ENCIMA DE LAS LEYES GENERALES, FEDERALES Y LOCALES. INTERPRETACIÓN DEL ARTÍCULO 133 CONSTITUCIONAL" [International Treaties. They are part of the Supreme Law of the Union and are hierarchically above general laws, federal laws and local laws. Interpretation of article 133 of the Constitution].

[332] This legal standard mandates to favor the interpretation of the law that implies an expansive reading of the rights and guarantees conceded to a certain person.

Precedents ruled by the Mexican Supreme Court have confirmed these three features.[333] Moreover, according to the highest tribunal, to be valid legislative restrictions on human rights conceded by the Mexican legal system must satisfy the following *conditions*: 1) Congress can only restrict or suspend the exercise of constitutional guarantees for as long as there are objectives provided by the constitution itself to justify such restriction; 2) the legislative restriction must be strictly necessary to achieve the constitutional objective which supports the restriction at issue, meaning that such constitutional purpose cannot be accomplished through other alternative means; 3) the legislative restriction must be proportional in terms of a reasonable correspondence between the restriction of the rights at hand and the corresponding constitutional purpose at stake, without causing any excessive or unnecessary harm over the affected person. Some voices could reply, however, that the legal capacity of oil contractor always rests upon corporations, which are not persons and therefore lack of human rights.

To counter this claim, one could say that legal *personhood* is not limited to an individual, but extends to entities who are capable of exercising a bundle of rights and obligations. There is a Mexican Supreme Court precedent that explicitly backs up this work's interpretation, in the sense that entities or corporations shall also enjoy the human rights guaranteed by the constitution, which also covers the international agreements subscribed by Mexico, to the extent that these are according to their nature and purpose.[334] Consequently, the pro persona principle is also applicable to corporations in these terms.

In order to make operational the arguments above, upstream oil contractors would have to put themselves in a situation where there is an administrative rescission being challenged and submit these allegations via the "*amparo*" instance, so that Mexico's federal judiciary –including the Supreme Court itself– can construe a constitutional law standard in this regard. Although the '*strategic*' constitutional status clothing the fiscal relevance of the upstream oil industry is the key criterion to justify the exorbitant presence of public interest regulation and an administrative state policing its implementation, this *public policy* reason

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[333] *See* Tesis 2ª. LXXV / 2012 [precedent number], Segunda Sala de la Suprema Corte de Justicia de la Nación [Second Chamber of the Mexican Supreme Court of Justice], *Semanario Judicial de la Fedración y su Gaceta*, Décima Época, Libro XIII, Tomo III, Octubre de 2012, p. 2038. Rubro: "SUPREMACÍA CONSTITUCIONAL. LA REFORMA AL ARTÍCULO 1º. DE LA CONSTITUCIÓN POLÍTICA DE LOS ESTADOS UNIDOS MEXICANOS, DE 10 DE JUNIO DE 2011, RESPETA ESTE PRINCIPIO" [Constitutional Supremacy. The Reform of Article 1 of the Political Constitution of the Mexican United States, of June 10, 2011, observes this principle]. *See* also 2ª. / J. 56 / 2014 (10ª.) [precedent number], Segunda Sala de la Suprema Corte de Justicia de la Nación [Second Chamber of the Mexican Supreme Court of Justice], *Semanario Judicial de la Fedración y su Gaceta*, Décima Época, Libro 6, Tomo II, Mayo de 2014, p. 772. Rubro: "PRINCIPIO DE INTERPRETACIÓN MÁS FAVORABLE A LA PERSONA. SU CUMPLIMIENTO NO IMPLICA QUE LOS ÓRGANOS JURISDICCIONALES NACIONALES, AL EJERCER SU FUNCIÓN, DEJEN DE OBSERVAR LOS DIVERSOS PRINCIPIOS Y RESTRICCIONES QUE PREVÉ LA NORMA FUNDAMENTAL" [Principle of the most favorable interpretation to a person. Its compliance does not imply that domestic judicial organs, in the exercise of their function, ignore the several principles and restrictions provided by the Fundamental Norm].

[334] *See* also P. / J. 1 / 2015 (10ª.) [precedent number], Pleno de la Suprema Corte de Justicia de la Nación [Mexican Supreme Court of Justice], *Semanario Judicial de la Fedración y su Gaceta*, Décima Época, Libro 16, Tomo II, Marzo de 2015, p.117. Rubro: "PRINCIPIO DE INTERPRETACIÓN MÁS FAVORABLE A LA PERSONA. ES APLICABLE RESPECTO DE LA NORMAS RELATIVAS A LOS DERECHOS HUMANOS DE LOS QUE SEAN TITULARES LAS PERSONAS MORALES" [Principle of the most favorable interpretation to a person. It is applicable with respect to the norms relative to human rights that corporations are entitled to].

cannot become into a patent to authorize a lawlessness environment where contractors' investments are at the mercy of the public power wielders.

It is important, though, to highlight what are the possibility conditions for Mexican federal courts –including the Supreme Court– to declare the *unconstitutionality* or the *non-applicability* of the legislative precept exempting the administrative rescission on upstream oil contracts from being controlled through arbitration proceedings. Without taking this discussion too far, my view is that such '*judicial activism*' would require a great amount of independence from the political branches of government –both Congress and the Executive.

Since a proper analysis of judicial politics would exceed the scope of this research, my only purpose here is to raise awareness of the available constitutional law arguments to increase the degree of certainty among private investors in the Mexican legal order, by *opening* the *gateways* to keep *accountable* the most powerful weapon the state has to control and punish a contractor that presumptively defaults on his contractual obligations. In fact, the possibility to arbitrate the administrative rescission would be a coherent measure with the supposedly '*commercial*' character Congress tried to imprint on the upstream oil industry, on the one hand; and it would also be a compatible move towards a more balanced playing field for the signing parties of a contract, on the other.

F. The ICSID Convention and the Political Environment

At the moment of writing this work, it should be noted that the Mexican state signed the World Bank Group's International Centre for Settlement of Investment Disputes Convention (ICSID), on January 11 of 2018.[335] This convention has the legal status of an obligation to which the Mexico's Executive has committed on international law grounds and was ratified on by the Senate on April 18, 2018, so it shall be also considered valid domestic law according to the constitution. The ICSID Convention entered into force in 1965 and Mexico is now part of the 162 the state members who have signed it, from which 153 contracting parties have been able to ratify with the respective deposit of the instrument.[336] In a nutshell, the ICSID Convention sets up an arbitration mechanism to solve the disputes arising between investors and contracting states of this international law instrument, under a transparent protocol of procedural rules and an annulment mechanism for specific arbitration awards.[337]

Save for the *administrative rescission* of upstream oil contracts in terms of the Hydrocarbons Act, Mexico's membership to the ICSID treaty would be applicable to every other *contractual dispute* between petroleum contractors and the state. Legally speaking,

[335] Secretaría de Hacienda y Crédito Público (SHCP) [Ministry of Finance], "Comunicado SHCP-SE. México firma Convenio sobre Arreglo de Diferencia Relativas a Inversiones entre Estados Nacionales y de Otros Estados" [Joint Press Release SHCP-SE. Mexico signs ICSID Conveniton], Gobierno de la República, gob.mx, Washington, D.C., January 11, 2018, at https://www.gob.mx/shcp/prensa/comunicado-shcp-se-mexico-firma-convenio-sobre-arreglo-de-diferencias-relativas-a-inversiones-entre-estados-y-nacionales-de-otros-estados
[336] *Id.*
[337] *Id.*

this move by the Peña Nieto's administration is at odds with the explicit legislative intent to prevent international arbitration proceedings to challenge the administrative rescission on upstream oil contracts, because it increases the risk for the government that the ICSID Convention could be invoked by an affected party seeking to frame an international law claim not directly against the rescission itself, but regarding the *unfairness* and *lawlessness* of the consequences that such unilateral act has on the investors' property rights – that is, the reversion of the contractual area with all the installed infrastructure without an obligation to pay a compensation on the part of the state.

In parallel, an affected contractor could resort to the domestic court system and frame this conflict of laws between the Mexico's international obligations and its petroleum legislation, basing their claim on judicial precedent, which privilege the former over the latter by virtue of their normative hierarchy.

Yet the adoption of the ICSID Convention makes more sense when read from a *political standpoint*. Throughout this dissertation, I have purposefully played with the hypothesis consisting in the take over of presidential power in Mexico by an administration with a policy agenda that pursues state command and control of the economy and is averse to foreign private investment in the petroleum sector.

This hypothetical assumption is not naïve, but is linked to the high likelihood of having a Mexican presidency prone to resource nationalism and statist policy orientations in the near future: Andrés Manuel López Obrador. So far, this radical politician has promised a review the upstream oil contracts that the Peña Nieto administration has already granted after the energy reform, so that the correspondent legal measures can be applied wherever there is evidence of political grand corruption.[338]

Regardless of the *negative impact* this electoral campaign promise might have on private investors' expectations on the Mexican oil industry and on the governmental goal to replace the oil revenue it used to get from Pemex with rents resulting from taxes and fees on upstream oil contractors, López Obrador's commitment to review the oil contracts has been widely welcomed by a population which was ignored in the negotiations of the petroleum reform and has witnessed the array of corruption scandals of the Peña Nieto's presidency.[339] The polarization and therefore the uncertainty of the current *political environment* fostered President Peña Nieto's administration to seek for *additional safeguards* on private oil investors, by going beyond constitutional law through the use international law tools aimed at raising the costs on the Mexican government, in case it decides fails to comply its commitment to give a fair and lawful treatment to contractors' sphere of rights.

The skepticism that a radical presidency provokes among elites has led the incumbent administration to adopt an *investor-state dispute settlement* (ISDS) treaty, which, despite

[338] *See* Clifford Krauss, "'Mexico First' Campaign Could End Welcome for U.S. Oil Giants", The New York Times, New York, April 26, 2018, available at https://www.nytimes.com/2018/04/26/business/energy-environment/mexico-election-oil-companies-usa.html.

[339] *Id.*

contradicting the Hydrocarbons Act, seems to be a minor cost to pay when the greater goal is to counter the *regulatory instability* that might come from the threat to renege on upstream oil contracts previously subscribed pursuant the law. Based upon the joint press release issued by the Finance and the Economy ministries of the federal government, the adoption of the ICSID Convention "shall strengthen Mexico's standing as a safe, predictable, and attractive country for investment, as a country that protects and fosters foreign investment, thereby providing greater legal certainty to both domestic and foreign investors […]".[340]

There are some voices against the use of the World Bank's ISDS proceedings, since for some scholars, government officials, and policymakers ICSID is politically *biased* in favor of corporations, foreign investors and commercial interests. According to these critics, ICSID alleged bias towards investment-friendly policies, results from the "revolving door" phenomenon affecting the constitution of their ad hoc arbitration tribunals and therefore facilitating the regulatory capture of these tribunals' members.[341] By "*revolving door*", I mean that political phenomenon consisting in the reversible movement of personnel between roles as arbitration judges, on one hand, and legal counsels or attorneys representing the corporate interests – whether those of the claimant itself or those of their holdings or subsidiaries – being affected by arbitration awards, on the other.[342]

When this reversible exchange of roles occur in sequence, at the same time, or after the relevant arbitration proceeding is taking place, *conflicts of interest* arise, increasing the likelihood for the ISDS panels to be captured by commercial interests –in particular because of the high compensations these arbitration adjudicators receive from these companies or from indirectly related corporate interests, when providing them legal counsel in different transactions or representing their direct or indirect interest in governing boards.[343]

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[340] *Id.* In Spanish, the quotation states: "*La firma de este instrumento robustecerá la posición de México como un país seguro, confiable y atractivo para las inversiones, que protege y promueve la inversión extranjera, otorgando así mayor certidumbre jurídica a los inversionistas nacionales en el exterior y a los extranjeros en nuestro país*".

[341] *See* Robin Broad, "Corporate Bias in the World Bank Group's International Centre for Settlement of Investment Disputes: A Case Study of a Global Mining Corporation Suing El Salvador", 36 U. Pa. J. Int'l L. 851 (2015), available at: https://scholarship.law.upenn.edu/jil/vol36/iss4/1. *See* also Anton Strezhnev, "Detecting Bias in International Investment Arbitration" (Draft), March 12, 2016, at 22-23, available at https://static1.squarespace.com/static/5931baca440243906ef65ca3/t/5966ed6be58c6243347ac6e1/1499917675752/are_investment_arbitrators_biased.pdf.

[342] *See* Peter Grabosky and John Braithwaite, *Of Manners Gentle: Enforcement Strategies of Australian Business Regulatory Agencies,* Oxford University Press, Melbourne, at 198-1998, available at http://johnbraithwaite.com/wp-content/uploads/2016/06/Of-Manners-Gentle-Enforcement-2.pdf.

[343] *Id. See* also Toni Makkai and John Braithwaite, "In and out of the Revolving Door: Making sense of Regulatory Capture", *Journal of Public Policy*, Vol. 12, No. 1 (Jan. - Mar., 1992), pp. 61-78, at 62-77, available at
https://www.jstor.org/stable/pdf/4007430.pdf?refreqid=excelsior%3A0e533daf9b120a6672c59b2455b1286b. *See also* George Stigler, "The Theory of Economic Regulation", *The Bell Journal of Economics and Management Science*, Vol. 2, No. 1 (Spring, 1971), RAND Corporation - JSTOR pp. 3-21, available at http://www.jstor.org/stable/pdf/3003160.pdf?refreqid=excelsior%3Ad9d7b91750e0d3b944205ddeedb4b7fb.

It is possible to offer several *counterarguments* against the claims above. Fist, empirical research on the topic indicates that, *prima facie*, the question of whether international investment arbitrators are biased in favor of corporate interests is unanswerable by only looking at the outcome data alone. According to Anton Strezhnev:

> "Claimants are strategic in when they choose to file disputes and both sides have incentives to reach a settlement when the outcome is evident. Win rates for both sides theoretically tend towards 50% irrespective of the legal standard".[344]

For this scholar, it turns out more feasible to address this question by looking at individual type of bias, rather than trying to find a systemic pattern. In this way, a more fruitful query would be: How do different type of judges decide cases? To address this question, Strezhnev's work evaluates judicial identity elements in ICSID disputes –such as professional networks and academic backgrounds– and concludes that when arbitration tribunals presidents were nationals of advanced economies and had worked as government officials, claimants' win probabilities –that is, corporate investors– jumped significantly".[345] Yet this scholar underlines that this conclusion should not be extrapolated because this finding just applies to public ICSID disputes, whereas many of investor-state arbitration procedures in the globe occur in different arenas based on confidentiality and secrecy rules.[346]

The second remark to *counter* the account that the World Bank's ISDS is biased to and therefore captured by foreign commercial interests when affected by national policy in a host developing state member, is that the ICSID Convention foresees the possibility to request the *annulment* of an *arbitration award* on the following grounds: 1) that the tribunal was not properly constituted; 2) that the tribunal exceeded its authority; 3) that there was corruption on the part of a member of the tribunal; 4) that there was a serious departure from the rule of procedure or that the award failed to state the reasons on which it was delivered. Moreover, article 52(2) of the ICSID Convention determines that annulment application shall be made within the 120 days after the decision was rendered, except for the case of corruption, in which the annulment petition can be filed within 120 days after the discovery of the presumptive corruption event and in any case 3 years after the arbitration award was rendered. In addition to the possibility to invalidate an award for the causes above, article 52(3) of ICSID treaty states an array of conflicts of interest hypotheses that would made someone ineligible to integrate an arbitration tribunal.

For these legal reasons, it seems that the World Bank's ISDS tool is *equipped* with *checks and balances* to revoke an arbitration ruling that has been the direct outcome from a conflict of interest affecting any of its members or when this adjudication has been issued against rule of law standards. Furthermore, the ICSID treaty provides the contracting state a reasonable time horizon to make effective an annulment claim in view of a presumptive corrupt behavior in the tribunal.

[344] *See* Anton Strezhnev, *supra note* 341, at 22.
[345] *Ib.* at 23.
[346] *Id.*

The criticism against ISDS is relevant from the context of the Mexican regulatory regime on upstream oil. In principle, except for the question of the administrative rescission, the ICSID Convention would apply to every other contractual dispute there is between the Mexican state and upstream oil contractors. Yet, if oil contractors are successful to file ISDS claims against the *taking over* their investment property rights as consequence of an administrative rescission, despite the legislative impediment to object this act of government itself through arbitration, my account is that the Mexican government has *several avenues* to either demonstrate the legality of this behavior or avoid reaching the point of an investor-state arbitration.

Firstly, both administrative and judicial authorities of the Mexican state should be coherent and transparent regarding the legal grounds, proof, and motivation on which they might be backing up the revocation of the contract at issue.

Secondly, the Hydrocarbons Act grants the contractor a lapse of 30 days after being notified of an administrative rescission procedure to offer proof and arguments aimed at explaining the situation motivating the to put in motion this administrative proceeding. Once this time period expires, CNH shall have up to 90 days to dictate the corresponding resolution, a temporal space within the contractor may still solve the situation.

Thirdly, the Mexican model contract for upstream oil exploration and production establishes a '*one stop-shop'* mechanism for the contractor and the government to keep an open channel to coordinate and settle questions of diverse matters regarding to execution of each agreement. Hence, Mexican hydrocarbon legislation provides both contractors and government authorities a reasonable *time window* and *non-adversarial settings* to avoid the administrative rescission of an upstream petroleum contract and therefore the risk of an investor-state arbitration trial.[347]

Finally, the Mexican government could invoke and elaborate a robust defense of its '*public order and policy*' reasons in the case of having to revoke a contract. To that end, lawyers representing the Mexican state have the constitutional text itself to buttress the account that upstream oil industry has a *strategic* legal status, which authorizes an important degree of administrative discretion for the state to deploy its policing regulatory powers and hence to rescind a contract at last resort, if needed.

Yet *administrative discretion* must not be taken as an authorization for the government to rescind an upstream oil contract without satisfying due process of law guarantees for contractors to make the corresponding allegations or offer proof to solve the presumptive breach of contract, or to demonstrate that the non-compliance situation should not be attributed to them.

In this way, if the state is able to prove, on a case-by-case basis, that its use of the administrative rescission tool was legal, necessary, and proportional to address the breach of contract attachable to the contractor's liability sphere, then government lawyers should ask the arbitration tribunal for *deference* to its *regulatory policy* decision, considering that

[347] *See* article 20 of the Hydrocarbons Act.

1) this extractive industry is constitutionally classified as a 'strategic' area of the Mexican economy, in which the state plays the role of public interest guarantor, and that 2) the respective contractor decided to invest in a heavily regulated sector with the *ex ante* knowledge that an administrative rescission of its title could be expected to occur, by putting itself in a non-complying their contractual commitments and legal obligations, according to Mexico's hydrocarbon laws and regulations.

All arguments considered, this work sees more benefits than costs for the state itself that these legal and public policy questions are ventilated before an *impartial third-party* that is not biased, but which is also competent to check the use of administrative discretion on the part of the government. In so doing, the intervention of an ISDS tribunal will be contributing to Mexico's institution-building efforts over its petroleum sector along rule-of-law lines. Put differently, I see more benefits in introducing ISDS tool in order to *balance* the policing powers of the state, on one hand, and private property rights, on the other.

From an *economic* and *geopolitical* standpoint, my view is that Mexico's new membership to the ICSID Convention will fortify the *credibility* of the state commitment both to a genuine liberalization of its petroleum sector and therefore foreign companies will see this jurisdiction with a safe and predictable environment for them to invest their resources and get a fair return for their capital ventures. On the one hand, Pemex as a fully state-owned company is not longer in a financial and technical position to be the country's upstream monopoly for extracting and transforming these petroleum resources into revenue. On the other, the global petroleum markets have not recovered yet from the plummeting streak affecting the commodity prices, so only foreign corporations have the financial capacity to perform risky upstream oil operations and absorb short profit margins resulting from this price downfall for long periods. Therefore, the Mexican state should make its regulatory environment as attractive as possible for the private sector, since there is also a jurisdiction competition for investors over their oil sectors going on.

5. Oil Budgetary Reliance: The Mexican Petroleum Fund

This dissertation previously addressed the question about whether the Mexican state is affected by a chronic problem known as the "*political oil curse*". My skepticism about the oil curse narrative is founded on the following grounds. On the one hand, it does not provide for a specific policy solution for countries to get rid of a presumptive trap, whose conception itself carries on features of fatalism and generalization. On the other hand, based on Jones Luong and Weinthal's research, the traditional oil curse literature lacks of in-depth analysis of the relevant legal institutions at stake, such as those governing petroleum ownership and the fiscal component.

So instead of deviating this assessment of Mexico's oil governance towards an endless quest to answer whether or not the Mexican oil revenue dependency is an illustration of the oil curse, my approach is to evaluate whether the Mexican energy reform did change in fact

the oil ownership regime and which could be the fiscal consequences triggered by this ownership structure. In this context, this subsection is aimed at exploring the constitutional law rules supporting the *budgetary function* Mexico's upstream oil sector has as of the energy reform of 2013.

Despite the breakup of Pemex's monopoly over hydrocarbon exploration and production, the architects of the energy reform took care of substituting the oil rents resulting from contractual considerations for the revenue the state used to get exclusively from its NOC before. To that end, the "*Mexican Petroleum Fund for Stabilization and Development*" was created as a constitutionally autonomous entity to manage incoming and outgoing payments on the nation's oil proceeds produced by upstream activities, except for taxes.

The *fiduciary role* of this stabilization fund corresponds to the Central Bank of Mexico, which is another autonomous entity from the Executive branch. As underlined above, the mandate of the petroleum fund is mainly fiscal because, aside from 1) collecting the petroleum revenue coming from assignations or contracts, it is in charge of 2) distributing these proceeds for earmarked public investment purposes, in terms of the 2013 constitutional reform and its enabling legislation.

Accordingly, the Petroleum Fund has both a *stabilizing* role and a *savings* function in Mexican public finance. Best international practices recommend the use of sovereign funds to prevent oil revenue from being depleted by an unchecked budgetary system that works at the service of the government elites, but instead targets these funds for long-term development goals in benefit of the country.

Article Fourteenth Transitory of the constitutional reform decree on energy, published in December 2013, *earmarks* the rents collected by the Mexican Petroleum Fund pursuant a 'priority order' among different policy goals. The constitution instructs the Petroleum Fund to make the outgoing transfers of revenue directed at two other stabilization mechanisms, whose purpose is to end up at the federal and local government budgets.

Once the so-called the Petroleum Revenue Stabilization Fund reaches the cap that is set by legislation, the constitution enables the Mexican Petroleum Fund to allocate the *surplus* income to an array of *long-term investment* objectives, such as: 1) an universal pensions system up to a 10% of surplus detected in the long-term savings balance sheet in relation to the last year; 2) investment projects in science, technology, and innovation and in renewable energies up to a 10% of the surplus resulting from the long-term savings balance sheet in relation to the last year; 3) an investment vehicle specialized in petroleum projects that responds to the Energy Ministry up to a 30% of the surplus produced in the long-term savings balance compared to last year's balance; 4) human capital and skills training through scholarships to be applied in higher education institutions and postgraduate degrees, improvement connectivity projects, and regional development projects up to 10% of the increase identified in the savings balance sheet compared to that of last year.

Furthermore, the constitutional legislature specifies that the allocation of such *long-term investment projects* should never result in a decrease of that posits the savings balance

sheet below 3% of last year's GDP. Additionally, whenever the long-term savings balance sheet is equivalent to or higher than 10% of last year's GDP, the real[348] financial returns generated –on a yearly basis– by the savings managed by the Mexican Petroleum Fund shall be transferred to the federal treasury, which is part of the Finance Ministry. In other words, once the real savings go beyond a ratio of 10% of last year's GDP, the surplus shall be earmarked for central government's budget.

In light of the paragraph above, the Mexican Petroleum Fund appears to exclusively support long-term public investment objectives. Yet there is one provision that *casts doubt* on the Mexican state's commitment to genuinely use the Petroleum Fund for long-term investment purposes –namely, the constitutional transitory regime orders the Petroleum Fund to transfer to the federal treasury the income that is necessary for the federal government to cover a ratio of 4.7% of Mexico's GDP in 2013, which is the baseline year when the energy reform was passed.[349]

Considering that in the past decade the Mexican government has relied on oil exports to patch one third of its budget[350], the same constitution sought to *hedge the fiscal security* of the *state* in this regard. Furthermore, in case of a sharp drop in government revenue resulting from either plunging oil prices or a hydrocarbon production downfall, and once the stabilization sub-funds have been exhausted, the constitution grants Congress's House of Representatives ("Cámara de Diputados") with the authority to approve –with a qualified majority of two thirds – the integration of the Fund's long-term savings balance into the government budget, even when as consequence of this transaction such balance is diminished below 3% of last year's GDP.

Thereupon, it is after contributing to the *government budget* –also known as the 'stabilization' task– that the Petroleum Fund actually performs its savings function for the purpose of using oil profits exclusively for long-term public investment projects.

Although this public law and regulation analysis is far from being a research on macroeconomics and public finance, two questions remain in this respect. Firstly, was it wise policy to fix on the constitution a GDP ratio in which the Petroleum Fund should contribute to *government budget* on a yearly basis? Secondly, was it prudent to set up a 'scape valve' provision on the constitution to permit the use of the Petroleum Fund's long-term savings for *budgetary purposes* in case of a fiscal emergency scenario?

The first of these queries highlights the mechanism by which the energy reform secured a yearly share of the nation's oil profits for government budget. Neither the constitution nor the Petroleum Fund's enabling law laid out an institutional devise to even assess a *progressive reduction* of the fixed quota the Fund must transfer to the government's treasury every year. The fact that this *budgetary quota* imposed on the Petroleum Fund is posited on the constitution itself –without any checks and controls to incentivize its

[348] "*Real*" refers to the result of deducting inflation to nominal returns.
[349] The transfers of revenue to the stabilization sub-funds indicated above are considered part of this budget-earmarked income.
[350] According to the Extractive Industries Transparency Initiative.

reduction – shields the government's reliance on oil rents at the expense of its taxation capacities development.

On the other hand, an objection against the enabling of oil revenue savings for a fiscal emergency is less powerful than criticism on the yearly contribution to the budget, since the former function is precisely what a sovereign fund is for. The counterargument, though, could be that by defining this *contingency* scenario as a drop of government revenue, which may be linked either to the volatility of oil market prices or to declining commodity production, the legal framework fosters *path-dependency* of the Mexican state on petroleum rents. Therefore government can always appeal on the Petroleum Fund as last resort instance to cover budget gaps for as long as these are correlated with oil revenue.

Fortunately, the counterweight set up by the framers to keep the Petroleum Fund's budgetary role under control was to place this decision making power on a *qualified majority* of two thirds of Congress's House of Representatives. In the end, the efficacy of such accountability mechanism rests on the fact that there is enough political competition in Mexico to the extent of having a strong party opposition in Congress.

From a governance standpoint, the Petroleum Fund shall be under the supervision of a Technical Committee. According to the constitution, the Technical Committee shall be integrated by a total of seven members – three of which will be representing the interest of the state, whereas four of them shall have an independent status. The independent members shall be nominated by the Executive and ratified by a two-third majority of the Senate. The members acting on behalf of the state shall be the heads of the Energy and Finance ministries, as well as by the Central Bank governor. Given its fiscal relevance, it is not surprising that the constitution entrusts the Finance Minister with the Chair of the Petroleum Fund's Technical Committee.

For all the arguments above, my account is that the Mexican Petroleum Fund has a critical *backup role* with regard to government budget, illustrating the *rentier rationale* that still informs Mexico's new regulatory governance on the upstream oil industry. This rentier logic seems to be the reason why the energy reform framers chose to catalogue the upstream petroleum sector with a '*strategic*' status, setting the legal grounds for full state ownership over this industry, an overwhelming presence of public interest regulation and exorbitant police powers for the administration to execute it. In light of this rentier function and an exclusively state-commanded governance on upstream oil, it is that the reformers' appeal on contract law and a free markets look as an institutional façade.

6. Political Economy Implications for Mexico

Having explained Mexico's regulatory framework on the upstream oil industry, this research has enough input to apply Jones Luong and Weinthal's theory and therefore identify the type of *ownership and control structure* that applies to the Mexican case. In so doing, it is necessary to address the following queries: 1) First, whether the Mexican

hydrocarbon laws grant to either the state or private companies the rights to develop the majority of hydrocarbon reservoirs and to hold the majority of financial shares of the oil industry; 2) second, whether the Mexican legal system permits private capital within Pemex's ownership structure; 3) third, what type of contract regime on upstream oil activity is established by the Mexican energy laws in order to identify whether *state ownership* remains *with* or *without control*, depending on the participation degree of private investment authorized.

Considering the regulatory analysis above, we are in good standing to sustain that the Mexican state has the authority to define who gets the rights to develop the majority of hydrocarbon reservoirs in the country. According to official data, although 107 contracts have been placed on private companies to conduct upstream oil activities until 2018, these rights just amount to 5% of the Mexican petroleum reserves.[351] This basically means the state oil firm, Pemex, keeps control over 90% of petroleum deposits.[352]

So, despite it is the legal policy that 'contracts' should be the instrument *par excellence* to deliver upstream oil functions, our analysis warned about the administrative discretion and political risk surrounding the use 'assignations' – namely, the *exception* regime the government could abuse of in case it decides to pursue a state-driven developmental policy for the Mexican upstream oil industry. Based on our earlier legal remarks, the Mexican legal regime lacks of strong *checks and controls* to keep assignations as a genuinely exceptional instrument to grant the state itself rights to perform oil exploration and extraction activities.

As for the question of who holds the majority of financial shares, there is no answer in abstract. Moreover, this question can be responded in reference either to *each contract* granted to private companies or to the whole petroleum *industry*. In the first case, an accurate answer to this part of the first question depends on each of the profit share agreements that contractors subscribe with the state, once the contractor's cost structure is discounted from overall revenue. In the second situation, it is clear that the state holds the majority of financial shares given its 95% control of the overall oil deposits in Mexico.

Secondly, according to the letter of the constitution and the Petróleos Mexicanos Act, the Mexican NOC shall be under *exclusive ownership* and *control* of the federal government, as a result of the '*strategic*' legal status that has been given to upstream oil industry. Although the new organic architecture is explored in the next chapter of this work,

[351] This information was confirmed by Juan Carlos Zepeda who is Presiding Commissioner of the National Hydrocarbons Commission (CNH), which is the regulatory authority of the upstream oil sector in Mexico. *See* Karol García, "Privados ya controlan 5% de las reservas petroleras del país" [Private sector already controls 5% of the country's oil reservoires], *El Economista*, May 30, 2018, available at https://www.eleconomista.com.mx/empresas/Privados-ya-controlan-5-de-las-reservas-petroleras-del-pais-20180530-0012.html.

[352] *See* Petróleos Mexicanos, "Investor Presentation", Petróleos Mexicanos, México, August 2018, at http://www.pemex.com/en/investors/investortools/Presentaciones%20Archivos/Investor%20presentation_20180802.pdf. *See,* also, Grupo Expansión, Interview to Juan Carlos Zepeda, Presiding Commissioner of CNH, "AMLO puede transformar a Pemex en menos de un año: CNH" [Andrés Manuel López Obrador may transform PEMEX in less than one year: National Hydrocarbons Commission], *Expansión,* August 17, 2018, available at https://www.youtube.com/watch?v=Hfl_DZJp_u4.

the upshot is that Pemex did not change the full state ownership that has prevailed within its capital structure since 1938. This is a feature that prevents Mexico from evolving to a modality of state ownership without control (S_2) –such as in Norway and Brazil, whose national oil champions partially privatized a relevant minority of their capital structures.

Thirdly, in terms of the regulatory framework analyzed above, it could be said that the Mexican contract regime on upstream oil activities is a *mixture* of concessions through the figure of licenses, on the one hand, as well as profit- and production sharing agreements and services contracts, on the other. The difference between these two types of contract lies in who and when the ownership rights on crude oil are transferred to contractors.

The Mexican legal system mandates that *state ownership* over "subsoil" petroleum, meaning that the commodity cannot be transferred to other person than the state for as long as the resources are not extracted from the ground. Despite the constitutionality issues that there could be against *licenses* because of their attempt to bypass a constitutional ban on concessions, they authorize the transfer of oil property from the state to the contractor, once the resources have been extracted from the subsoil, in exchange for the payment of a royalties, leasing quotas, and corporate taxes. Moreover, in the case of concessions, the upstream infrastructure belongs to the contractor.

On the contrary, in the case of *profit-* and *production-sharing* agreements oil ownership always remains in state domain. Additionally, the contractor has to submit a development and budget plan for the final approval of the state. Once the crude oil is extracted, *profit-sharing* agreements require the intervention of a 'third-party retailer', who is in charge of selling out the total production in the market and transferring the oil proceeds from those sales to the Petroleum Fund, so that the latter makes corresponding payments to cover contractors' profit share and costs; whereas in the case of *production-sharing* agreements, contractors just deliver to the market retailer the worth in kind of the profit share belonging to the state, which sells these commodity units and transfers the oil proceeds to the Petroleum Fund.

As for *services* agreements, contractors shall provide the capital investment associated to oil exploration and extraction operations. If the investment turns out successful in terms of production, whose ownership rights are kept by the state, contractors get either a fixed or a sliding-scale quota deducted from the proceeds resulting from petroleum sale that is executed through the retailer authorized by the state.

As for the *contract regime* as a whole, the Mexican upstream oil industry has evolved to a structure falling between state ownership without control (S_2) and private ownership (P_2), in terms of Jones Luong and Weinthal's theory. At first glance, this is a hint revealing the energy reform's purpose to incentivize the aggressive participation of private capital. Yet the *state ownership with control* that still remains on "subsoil" petroleum resources and within the Pemex's capital structure, along with the weak system of checks and balances to in the administrative state policing the sector, makes us wonder to what extent Mexican ruling elites are credibly committed with providing legal certainty to private investors.

In light of the present considerations to the three questions above, my overall view is that Mexico has moved itself from having a pure state ownership (S_1) model during the 75-year monopoly era to a position closer to *state ownership without control* (S_2) after the energy reform of 2013. The Mexican regime on upstream oil is not yet at (S_2) because, despite a sympathetic legal wording to private law, the insertion of competition, and the execution of a contract regime seeking to attract private investment, the state still has the 'upper hand' in controlling this extractive industry and this exorbitant police powers have the constitution as their legal base – something which can only be explained because of the *rentier rationale* that still guides this regulatory system.

In the context of Jones Luong and Weinthal's theory of oil ownership, what are the type of incentives and fiscal institutions that would be reasonable to expect from the overlapping presence of some full state ownership (S_1) elements with features of state ownership without control (S_2)? The resulting *hybrid* regime in Mexico after the energy reform – in which state ownership and control seem to prevail slightly over the private investment-friendly parts of it – is likely to shape incentives in the following three ways:

First, *transactions costs* might be low among ruling elites and Pemex's managerial bureaucracy, who play the role of direct claimants to oil proceeds and therefore have aligned interests in maximizing their administrative discretion over their regulatory, taxing, and managerial roles of the crude oil industry. With regard to the *transaction costs* existing between the state and private contractors, the supporting literature above suggests that they would be low, but higher than among direct claimants, as a result of the standardized adoption of model contracts by CNH in each of upstream oil contract biddings.

Second, *social expectations* on the state are likely to be high, but lower than to those existing in the past monopoly era, because ownerships rights over underground oil resources and on Pemex still belong to the nation who, as legal principal, delegates them on the state which in turn becomes an agent of the latter's interest. On the contrary, it would be also reasonable to expect high *social expectations* vis-à-vis private foreign investors, in light of the historical pattern consisting in the expansion of domestic demands of direct financial support upon corporations, in addition to their tax contributions.

Third, *power relations* are those pressures inducing how the subsequent fiscal institutions to ownership rights come forth and whether or not such fiscal arrangements are likely to be resilient over time. In spite of the overlap of state ownership regimes with and without control in Mexico, it does not follow that the new fiscal institutions on the upstream oil industry have emerged from governmental *coercion*. Instead, this work's view is that international financial organizations (IFIs), international non-governmental think tanks, and foreign governments –in particular the United States– exerted strong political pressure on Mexican policymakers for the implementation of an upstream oil contract regime that followed the best international practices.

In parallel, the political process that gave birth to the Mexican energy reform exemplifies the complex bargaining that took place among the Mexican political elites. It is a different question, though, how *implicit* or *explicit* this political process was in fact. The

consensus among political analysts is that the Mexican energy reform of 2013 was negotiated with *neither* the input *nor* the feedback from domestic civil society.

Furthermore, since the year of 2014 oil prices have suffered a pronounced drop, which has been relatively nuanced with slow, gradual hikes through 2017 and 2018. This global volatility in petroleum prices has adversely impacted the revenue expectations that were initially projected by President Peña Nieto's administration for the energy reform. In fact, few upstream oil tenders of Round 1 were amended by CNH because the original fiscal terms relative to the profit share and considerations in favor of the state seemed out of economic context, in view of the petroleum price downfall in global markets and the huge capital costs that some of these projects require from contractors.[353]

Hence, this phenomenon forced Mexican petroleum authorities to reduce their original investment and fiscal requirements for these upstream contracts, so that investors were willing to deploy these risky investments. In this economic and political environment, both domestically and internationally, *private investors* might have more *de facto* leverage than that of government to influence the type of fiscal institutions in the country's upstream petroleum industry.

Having clarified the form of incentives that might be shaped by Mexico's ownership regime on upstream petroleum after the hydrocarbons reform, it very likely that the *fiscal institutions* produced by this regulatory model are stronger than those of the past, but still leaning to the weak side.

On one hand, foreign investors face incentives to demand robust checks and balances over the *fiscal rules* that are applied on them, meaning that accountability and transparency could be *exclusively* constrained to those aspects having points of contact with *foreign oil corporations*, thus leaving aside the institutional building of fiscal capacities outside the petroleum sector.

On the other hand, the *power leverage* that *private conglomerates* could exert at this state-controlled ownership setting could also add up another actor into the cartelized corruption and rent seeking practices that have usually affected the Mexican oil industry. Following up Jones Luong and Weinthal's claim as to risks that come along *hybrid ownership regimes*, greater participation from foreign oil investors in the institutional building and the economic development of Mexico, may also plant the seeds for the "capture" of state institutions by *private de facto powers*. The likelihood of getting this institutional outcome increases, paradoxically, where *ex ante* checks and balances and state capacity have a record of weaknesses and deficiencies.

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[353] *See* Javier Arreola, "Cambios fiscales y burocráticos en la Ronda 1" [Fiscal and bureaucratic changes in Round 1], Forbes México, April 9, 2015, available at https://www.forbes.com.mx/cambios-fiscales-y-burocraticos-en-la-ronda-1/.

VI. MEXICO'S ADMINISTRATIVE STATE ON PETROLEUM

1. **Tripartite Organization of Administrative Intervention**

This chapter is aimed at identifying the weaknesses present at the Mexican upstream oil administrative design resulting from the energy reform of 2013. Unlike the prior chapter, where I analyzed Mexico's regulatory governance on oil from a *functional* perspective, my purpose here is to focus on the checks and balances structure supporting the *administrative organization* of this extractive industry.

The oil governance template the Mexican Congress chose to transplant through the 2013 energy reform is based on the "*Norwegian triangle model*" – that is, a blueprint that assigns policy, regulatory, and commercial functions of upstream oil to three distinct governmental bodies.[354] By means of the 2013 energy reform, Congress chose to transplant a governance system that is based on a blueprint that assigns policy, regulatory, and commercial functions of upstream oil to three distinct governmental bodies.[355]

In this context, the *administrative state structure* of the Mexican upstream oil can be depicted as follows. First, the Ministry of Energy (SENER) as the central government department directly accountable to the Executive branch, which is in charge of setting public policy for the oil sector as well as coordinating and overseeing policy goals are being properly implemented.[356] Second, the National Hydrocarbons Commission (CNH) works as upstream oil's sectorial regulator with a direct constitutional mandate, but which is partially subordinated to the Executive branch by means of a mandatory 'coordination' it must maintain with the Energy Ministry for certain oil regulation and policy purposes.[357] Third, "Petróleos Mexicanos" (Pemex) is the national oil company tasked with conducting upstream operations on behalf of the state[358], either through assignations directly granted by the Energy Ministry, or through contracts resulting from public tenders where it has to compete with other private oil corporations. Under the new legal terminology in force, Pemex has become a "*productive state enterprise*" under exclusive government ownership and control, whose new corporate governance entrenches a business-oriented rationale within its decision-making organs and provides this NOC with budgetary and financial autonomy from the central government.

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[354] *See* Mark C. Thurber, David R. Hults, and Patrick R.P. Heller, "Exporting the 'Norwegian Model': The effect of administrative design on oil sector performance", from *Energy Policy,* Elsevier, Research Program on Energy and Sustainable Development, Stanford University, May 2011, at 1-2.
[355] *Id*.
[356] *See* Article Tenth Transitory of the Constitutional Reform Decree on Energy of 2013, published at Mexico's Federal Official Journal on December 20, 2013. *See,* also, Mark C. Thurber and Benedicte Tangen Istad, "Norway's evolving champion: Statoil and the politics of state enterprise", at David G. Victor, David R. Hults, and Mark C. Thurber (eds.), *Oil and Governance: State-owned Enterprises and the World Energy Supply*, Cambridge University Press, 2012, at 599.
[357] *Id.*
[358] *Id.*

In the next pages, this section aims to add an evaluation of Mexico's new administrative state on upstream oil, based on an *organic* perspective of *checks and balances*. Drawing upon different criteria, such as appointment and removal powers, budgetary autonomy, accountability system, corporate governance, and coordination tools, the following *institutional design* analysis is aimed at complementing the critique that the previous chapter makes of the *functional* relations among the relevant state authorities interacting in the context of Mexico's new regulatory framework on the upstream oil industry.

2. Executive Branch Control of Petroleum Policy and Regulation

At first glance, one would say that *policy enforcement* and *coordinating* functions in Mexico's oil industry are placed within the purview of the Executive, who acts by means of the Energy Ministry; whereas the *regulatory* and *technical advisory* roles rests on CNH's jurisdiction. Yet this assertion is idealistic and simplistic, given the remarks of the previous chapter and the transmission belts structuring these two government bodies' placement within the Mexican administrative state on upstream petroleum.

Mexico is a presidential democracy with a federal system of government. The Energy Ministry – also known as "SENER" – belongs to the federal centralized administration, which is headed by the President of Mexico in its Executive power capacity. The President has full discretion to *appoint*[359] and *remove* the Minister of Energy, in terms of the Mexican constitution and the Federal Public Administration Organic Act.

Additionally, the Minister of Energy is *politically accountable* to Congress, which has the power to summon the former to appear before any of its bodies – whether the House of Representatives, the Senate, or their committees – and respond to legislative inquiries on the administrative dispatch of the affairs falling within the former's authoritative sphere. These citations to show up in Congress and answer questioning on policy enforcement tasks entrusted to administration ministers is different from testifying before legislative committees under subpoena in the United States. Whereas in the U.S. case, testifying before the legislature is a constitutional mandate imposed on executive officials and whose disobedience may trigger administrative sanctions or even criminal charges before a court of law, in Mexico this is an imperfect obligation because non-compliance lacks of sanction.

The Minister of Energy is also *politically liable* before Congress in the sense that its office incumbent may be subject to a type of "impeachment" – which is a constitutional proceeding that must be triggered by a simple majority of the House of Representatives to accuse high-ranking state officials of political misbehavior in detriment of the nation's fundamental interests or their good dispatch. Once the motion has been filed before the Senate, the latter has the power to judge and sanction accordingly these offenses on political grounds for as long as this has been approved by a qualified majority of two thirds.

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[359] According to article 91 of the Mexican constitution, the eligibility requirements to be Minister or Secretary in the Executive branch are: 1) to have Mexican citizenship by birth, and 2) to be at least 30 years old by the date of appointment.

According to the Mexican constitution, the punishment resulting from an impeachment may consist in the immediate removal and permanent debarment to perform any kind of office, commission or role in public service.[360]

On the other hand, if the Energy Ministry has presumptively committed a felony and still is in office, Congress has the authority to strip away this public servant from the otherwise applicable "procedural immunity". Hence, the constitution regulates the trial to proceed on criminal law grounds, as a specific procedure when the legislature's purpose is that the Attorney General has legal capacity to present criminal charges against the corresponding public servant before a court of law.[361]

On *administrative* grounds, the Minister of Energy is *directly subordinated* to the Executive's command power. The head of the Energy Ministry is therefore the presidential agent entrusted with the authority to take care that the governing laws concerning their administrative purview – that is, energy affairs – are faithfully executed along the Executive's policy guidelines, for as long as the latter imply a permissible interpretation of the Mexican constitution. In parallel, the administration exerts *internal controls* over its officials both through the Ministry of Public Management[362] for the purpose of auditing legality, performance and anticorruption questions, as well as through the Finance Ministry for budgetary matters. Yet the efficacy of these internal checks should be nuanced, since they work at the pleasure of the President who has full power removal upon them regardless of the cause.

As any executive department ascribed to the central administration, SENER's *budgetary dependence* means that the management and control of its resources falls ultimately within the purview of the Finance Ministry. Then, SENER's budget shall be subject to the review and amendments that Hacienda determines convenient to do when it comes to submitting a budget proposal to the House of Representatives on a yearly basis. According to the Federal Budget and Fiscal Accountability Act, in case of budget deficits and surpluses, SENER shall either request the Finance Ministry's authorization for additional income to cover the former or return to the treasury – which is controlled by Hacienda – the excess in the latter.

In Chapter V of this work, my account was that SENER commands not only the coordination and implementation of *hydrocarbon policy* but also *regulatory questions* of Mexico's upstream oil sector[363], reducing CNH to a mere technical advisor at the service of the Executive branch –both the Energy Minister and the President. Rather than an administrative agency with *regulatory powers* to exert on its own independent initiative, the Mexican legal framework places on CNH *technical counseling* and *management* tasks

[360] *See* articles 108, 109 and 110 of the Mexican constitution.
[361] *See* article 111 of the Mexican constitution.
[362] In Spanish this executive department is formally known as "Secretaría de la Función Pública".
[363] For instance, 1) conducting the grant of upstream oil 'assignations' to state-owned companies; 2) choosing the areas which may be subject to the allocation of upstream petroleum 'contracts'; 3) crafting the technical design of upstream oil contracts; 4) enacting the technical guidelines governing the public tenders of upstream oil contracts. *See* Article Tenth Transitory of the Constitutional Reform Decree on Energy of 2013, published at Mexico's Federal Official Journal on December 20, 2013.

relative to geological, technical, corporate, compliance information of the upstream oil contract regime. Somehow, the current functions of CNH could have been delegated on a specialized support unit within the Energy Ministry's organic structure and still perform the jurisdiction that today are prescribed directly by the Mexican constitution, the Hydrocarbons Act, and the Coordinated Regulatory Organs on Energy Act (LORCME).[364]

That was exactly the case before the 2013 energy reform, when CNH predecessor was ascribed to SENER with a "de-concentrated" status which, despite having some degree of functional and management autonomy, was insufficient to achieve an independent performance of its jurisdiction given the budgetary and human capital constraints.[365] It was *trivial* to describe CNH as a robust sectorial regulator back then because there was only one player – with a state monopoly status – controlling the delivery of upstream oil operations in Mexico.

Compared to the Energy Regulatory Commission (CRE), which was created in 1995 with the aim at regulating Mexico's downstream[366] oil after the opening of exclusive segment of the hydrocarbon supply and the emergence of different players in a competitive environment ever since, Josefina Cortés Campos sustains that the first CNH was founded until 2008 with the "uncomfortable role of regulating the operations of Pemex Exploration and Production (PEP)"[367] which in turn enjoyed from legally protected monopoly.[368]

After the Mexican energy reform of 2013, both the mandate and the institutional design of CNH were shaped from the constitution itself. Based upon article 28 of the Mexican constitution, the Executive power shall have "*coordinated regulatory organs on energy*" which will be the National Hydrocarbons Commission and the Energy Regulatory Commission in terms of the enabling laws.

According to Article Twelfth Transitory of the Constitutional Reform Decree on Energy of 2013, the constitutional framers ordered the federal legislature to turn CNH into a 'coordinated regulatory organ' on upstream oil, with the following *attributes*: 1) own legal personality; 2) technical and management autonomy; 3) fiscal autonomy to use the revenue collected through taxes, duties, and royalties that are established by the substantive laws by virtue of the permits, authorizations, assignations, and contracts whose issuance and administration correspond to CNH functions.

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[364] This is the acronym of the legislative statute for its name in Spanish: "Ley de Órganos Reguladores Coordinados en Materia de Energía", published on August 11, 2014 in Mexico's Federal Official Journal.

[365] Miriam Grunstein, "La Coordinación de los Reguladores del Sector Hidrocarburos: ¿Es óptima para el Estado de Derecho?" [The Coordination of the Hydrocarbon Sector Regulators: Is it optimal for the Rule of Law?], in Payan, Zamora, and Cossío (eds.), *supra note* 326, at 165.

[366] By "*downstream*", I understand that segment of the oil supply industry encompassing the storage, tranportation and distribution of oil and gas resources through pipelines, as well as the regulation governing the access of third parties to such infrastructure besideds the owners.

[367] *Ib.* at 166.

[368] *See* Josefina Cortés Campos, "La Comisión Nacional de Hidrocarburos y el debate de las autonomías ¿necesarias?" [The National Hydrocarbons Commission and the debate on autonomies: necessary?], Centro de Investigación para el Desarrollo A.C. (CIDAC), Mexico City, October 2013, available at http://reddecompetencia.cidac.org/es/uploads/1/5RegWeb_CNH1708.pdf.

For that purpose, this constitutional provision states that in case of a surplus balance by the end of the fiscal year, CNH may instruct the transfer of this remainder to a trust created by SENER and order its disbursement to cover future expenditures that are necessary to deliver this agency's mandate.[369]

Likewise, Article Tenth Transitory of the constitutional reform on energy of 2013 defines the boundaries of CNH's jurisdiction. This higher law precept clearly states that CNH should provide technical advisory to the Energy Ministry; collect geological and operational information; authorize superficial exploration services; execute public tenders for the grant of upstream oil and gas contracts; conduct the technical administration of the upstream oil contract regime; oversee that extractive plans maximize oil fields' productivity, and issue the regulation of the Mexican upstream oil sector.

The enabling legislation[370] develops further the specifics of the organic architecture, staff integration, and the powers that were conferred to CNH by the constitution itself. First of all, articles 1 and 2 of the Federal Public Administration Organic Act indicates that coordinated regulatory organs on energy –such as CNH– have the legal status of "*departments*" integrated to the central administrative apparatus, whose purpose is to assist the Executive power in the enforcement of its functions pursuant the latter's policy guidelines. So, this organic arrangement is therefore a first feature bearing support to the account that CNH *lacks* of *enough independence* vis-à-vis the President.

Second, CNH is governed by a board of 7 commissioners who adopt decisions by simple majority and without the possibility of abstaining from voting, unless there is a conflict of interest specified by the LORCME. Based upon the *appointment* and *removal* mechanism established by the Mexican constitution and the LORCME, CNH's governing body enjoys from *relative independence* in relation with the Executive. According to the governing legal rules, when the office of CNH commissioner is vacant, the President has the power to nominate a pool of three candidates from which one shall be appointed by a qualified majority of two thirds in the Senate. If there is no agreement in the Senate to choose one of the three nominees, the President shall integrate a new triple and send it to the Senate. If the second pool gets discarded as well, then the Executive has the power to designate the commissioner among the candidates integrating the second triad.

In this light, the checks and balances above foster the *collaboration* between the Executive and one house of Congress to pass the nominations of those who will conduct the decision-making in CNH. But, who has *more leverage* in this appointing process? At first glance, one would say that Senate prevails because of the qualified majority to ratify the nomination. Yet it is possible to counter that claim because the Senate has to choose among the names that have already been shuffled and chosen in a strategic way by the President. Moreover, if the Senate fails to constitute a qualified majority of two thirds on a second

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[369] Article Twelfth Transitory of the Constitutional Reform Decree on Energy determines that this fiscal autonomy shall have ceiling of three times the annual budget of CNH, taking as benchmark the immediate last budget. In case that the CNH trust accrues more revenue than this budget ceiling, the surplus shall be transferred to the central government's treasury – which is part of the Finance Ministry.

[370] The Hydrocarbons Act, the Federal Public Administration Organic Act, and the LORCME, were either created or amended in August 2014, by virtue of Mexico's constitutional reform on energy of 2013.

round, the Executive gets to designate the person to occupy this post. Even so, the fact that the President has more input in leaning the nomination of CNH commissioners towards someone who is sympathetic to the presidential policies is coherent with this agency's organic position in the legal system as a department incorporated to the Executive's centralized administration. In the end, CNH shall be providing a technical advisory service to SENER so as to support the Executive's contracting policies on stronger foundations.

For its part, the *for-cause removal* regime also contributes to a perception of *relative independence* CNH has regarding the presidential administration. Although the enabling legislation does not provide for the official with this *removal authority*, my interpretation is that this power shall be understood within the President's purview on the following grounds: 1) It is the Executive power incumbent who nominates the pool of candidates from which the Senate has to designate one, so it is reasonable the President has a participation in the removal of the same official; 2) CNH is organically ascribed to the administration according to the constitution and statutory laws; 3) article 89, fraction II of the Mexican constitution contains a residual rule under which the President shall have the authority to remove any federal public official whose dismissal is not dictated otherwise by the constitution itself or the applicable laws. To keep this removal power effectively checked, the legislative catalogue of causes to justify a commissioner's destitution refers exclusively to the incurrence of grave illicit behavior, such as felonies, administrative liability, conflicts of interest, and corruption.

Last, the LORCME statute is equipped with an array of institutional guarantees to secure that CNH's governing body is staffed by professionals in possession of *expertise*, well-known *reputation* in the field, *honorable* ethics, and *independent* credentials for terms that exceed the 6-year period of the incumbent administration. So commissioners are designated for staggered terms of 7 years each, which increases the likelihood they have to work with presidential administrations of different political sign.

To satisfy the profile above, article 8 of the LORCME lists the *eligibility requirements* to perform the office of CNH commissioner, among which we may underline the following: A) a minimum experience of 5 years in the upstream oil sector, with outstanding reputation, whether in the private or public sectors or in academia; B) to have graduate education degree whether in engineering, in chemistry or biology, or economic and administrative disciplines, for as long as they are related to the energy industry activities; C) to be in full exercise of their civil and political rights and to have a record clean of convictions for deliberate criminal offenses; D) not having performed the office of congressional representative, senator, governor, attorney general, or minister in the last year prior their nomination as commissioner; E) not having held managerial or directive positions, in the last year previously to their designation, at any of the companies that are subject to the regulation of Mexico's coordinated regulatory organs on energy – that is, CNH and CRE.

Moreover, considering that CNH is directly involved in the execution of upstream oil contract tenders and the adjudication of these public law grants, CNH's organic law establishes a set of rules and a code of conduct aimed at shielding its decision makers from regulatory *capture* and *corruption*. Yet both the eligibility conditions and the anticorruption

regulation emphasizes protection of CNH's independence and impartiality vis-à-vis the *regulated agents* than with respect to *political interference*. For example, the requirement to refrain from any legislative seat, governorship, or executive job in the year preceding a commissioner's designation should be extended longer back to guarantee a candidate's political independence – whether from the administration or from party politics.

For the reasons above, despite the legal efforts towards assuring a relative sphere of *functional* and *fiscal autonomy* to build up a professional bureaucracy within CNH, this administrative agency is vulnerable to the Executive's meddling given its organic placement in Mexico's central administration. This remark is closely correlated to our Chapter V findings, according to which regulatory decisions that are intertwined with sectorial or fiscal policy questions[371] are adopted within the guidelines determined by the Energy and Finance ministries.

In this way, the regulatory and policing powers on the Mexican upstream oil industry seem to be *fragmented* among a plurality of administrative agents such as SENER, CNH, and Hacienda. Paradoxically, these law enforcement roles are assigned to agencies *concentrated* within the Executive branch and thus subject to its command and control. Hence, is it worth having a *complex articulation* of multiple decision-making points on upstream oil policy and regulation when all those authorities are incorporated to the same administrative apparatus?

3. Autonomy versus Coordination

In order to have a better understanding of the administrative design under which CNH was engineered as of the 2013, it is relevant to take a step back and explore the institutional environment from where this agency was coming from in the recent past. CNH was originally established in 2008 under a "de-concentrated" nature, meaning its placement within the Energy Ministry's organizational space, but with more independence than any ordinary administrative office to deploy its regulatory powers over Pemex –which in turn was the exclusive operator of Mexico's upstream petroleum business.

Despite having some degree of technical autonomy that was above the average, this institutional arrangement was *insufficient* because of 1) the budgetary limitations it posed on CNH, 2) the high political interference from SENER, and 3) the fact that its only regulated party was a state monopoly whose governing board was chaired by the same Minister of Energy.[372] Hence, the former legal status of CNH alongside an institutional context characterized by a *public monopoly*, which at the same time happened to be the government's cash cow for 30-40 % of its fiscal demands, and whose corporate control was

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[371] For instance, such as the selection of oil fields to be contracted out for exploration and extraction, the five-year auction plan, the contract model design, or when these determinations entail an impact on the oil revenue expected by the state.

[372] *See* Miriam Grunstein, "La Coordinación de los Reguladores del Sector Hidrocarburos: ¿Es óptima para el Estado de Derecho?", in Payan, Zamora, and Cossío (eds.), *supra note* 326, at 166, 172 and 173.

held by the Energy Minister, fostered the operation of a rentier scheme through a network of interests which assured the "capture" of CNH by the short-term politics of the incumbent administration. This institutional climate incentivized an extremely weak regulator for Mexico's upstream petroleum, let alone the question of supervising a giant NOC whose dominance in the industry dated back to 1938.[373]

As of the 2013 reform, CNH acquired a constitutional mandate consisting in the regulation of the new upstream oil sector, whose regime was liberalized to contract private capital for hydrocarbon exploration and production activities. Accordingly, the 2013 amendment pulled the trigger to transform CNH into a *genuine sectorial regulator* as a result of the increasing number of private participants other than Pemex that should be bound to its jurisdiction. It was clear that CNH's former administrative design was not optimal to provide this agency with effective institutional capacities to order the *competitive market structure* of the Mexican hydrocarbons industry. From 2008 through 2013, CNH had worked as a technical appendix of SENER in trying to regulate the giant Pemex, so it was necessary that CNH had both the manpower and fiscal resources to build up an independent professional bureaucracy.

So, the relevant debate about CNH among Mexican policymakers concerned how much *autonomy* from the administration should be allocated to the agency to perform its *regulatory powers*? Since the mid-1990s, Mexico began an institution-building trend consisting in the creation of administrative bodies with 'constitutional autonomy' from the Executive to take over the supervision and regulation of different fields, such as monetary policy in the case of the Mexican Central Bank (BANXICO); the organization of elections in the case of the National Electoral Institute; the protection of human rights in the case of the National Commission on Human Rights (CNDH); the access to public information and privacy protection in the case of National Institute on Public Information Access (INAI), among others.

The 'constitutional autonomy' template renewed its vigor with the structural reforms crafted via the Pact for Mexico, since this administrative modality was chosen to shape the new sectorial regulator of the telecommunications sector (IFETEL), the federal competition authority (COFECE), and the teaching evaluation agency (INEE).[374] Constitutional autonomy has achieved wide popularity among Mexican policymakers and scholars in the field of economic regulation, because at the heart of this model lies the notion of checks and balances through which the state credibly commits to an institutional environment that fosters predictability and stability for private investors.[375] In this light, the creation of independent regulatory agencies from the Executive has gone hand in hand with the reformist agenda of liberalizing character that Mexico has implemented in economic affairs since three decades ago.

Yet, in 2013 the energy reform's framers came up with an unprecedented legal category for both CNH and CRE –that is, the '*regulatory coordination*' figure. The energy reform

[373] *Ib.* at 166-167 and 170-173.
[374] *Ib.* at 169.
[375] *Ib.* at 181.

gave recognition to this legal institution from the constitutional text itself. Although there is not clear explanation of the motives justifying the redesign of CNH as a coordinated regulatory agency, rather than as constitutional autonomous body, this seems to be an institutional design response to assure a high degree of "*unified state control*"[376] over the oil and gas industry, making imperative for CNH to align its decisions to the Executive's energy policy.

This claim is also backed by the fiscal orientation that Mexico's constitution has imprinted on the hydrocarbon industry when it commands the maximization of revenue extraction for the nation. In this sense, the rationale underlying '*regulatory coordination*' could have been that if oil rents should be boosted by the state, then there is need for *consistency*, *cohesiveness*, and *stability* in the regulatory environment.[377] Otherwise, the creation of an independent regulator for the Mexican upstream oil could have increased the *risks* of policy and regulatory *fragmentation* in a sector whose proceeds are vital to cover for one third of the government budget.

More importantly, a *fragmented* administrative design fostering contradictory policy decisions ends up impairing the *predictability* and *legal certainty* required for attracting private investors. Finally, there is also ground to argue that the upstream oil regulator should align its decisions to the Executive's policy goals since the latter yields the representation of the Mexican state and hence enjoys the democratic legitimacy that CNH lacks of to control oil rents, which are ultimately owned by the nation. Surprisingly, none of these policy reasons were made transparent by President Peña's reform initiative to justify the establishment of 'regulatory coordination' template for energy bureaucratic bodies.

My account is that the 'regulatory coordination' design resulted from a *political compromise* between the necessity of developing a petroleum technocracy with greater resources and institutional capacities, on one hand, as well as energy sovereignty and national security concerns, on the other. It is not that the framers of Mexico's energy reform a formal structure to shape CNH, but rather that this agency's administrative design

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[376] Based upon a case-study compilation on the oil governance schemes of the 15 most important NOCs worldwide, Victor, Hults, and Thurber find out that, rather than the form of regulatory framework, what seems to be relevant for the functionality and consistency of an oil governance arrangement is a "*unified system of control*". The central finding resulting from Victor *et al* study suggests that best-performing NOCs exist in nations with unified government control, whereas the worst performing ones are subject to a governance characterized by inconsistent, highly variable mandates and by short-term incentives acting on their governing elites. Moreover, these academics conclude that *unified governance control* is a necessary condition of high-performance NOCs, regardless of the particular formal design the state has chosen to regulate the interactions among its oil institutions. *See* David G. Victor, David R. Hults, and Mark C. Thurber, "Major conclusions and implications for the future of the oil industry", at 890 and 907-909, in *Oil and Governance: State-owned Enterprises and the World Energy Supply*, Cambridge University Press, 2012.

[377] *Ib.* at 907-910. Also, for Jody Freeman and Jim Rossi, "*coordination*" fosters eventually the improvement of legal certainty in regulated industries, by decreasing the risks in terms of duplicities, fragmentation, and functional overlapping, "maximizing the strenghts of shared regulatory space". *See* also Jody Freeman and Jim Rossi, "Agency Coordination in Shared Regulatory Space", *Harvard Law Review,* Vol. 125, No. 5, Cambridge, Massachusetts, March 2012, cited by Grunstein, *supra note* 372, at 182.

emerged from the bargaining power of the different political actors with a say in the political process.[378]

In this way, the center-right party PAN took a stand in favor of an upstream oil regulator with '*constitutional autonomy*' to break up with the 76-year "pathologic endogamy"[379] that existed among the Energy Ministry, Pemex, and CNH. Besides the technical rationality of pursuing an arm's-length governance to structure the relations among petroleum regulatory institutions, the demand for administrative autonomy was also logical from a *political standpoint*, considering that the PAN headed the political opposition to the government in 2013. Being the most relevant minority in Congress, the PAN had the incentives to support the integration of CNH as a technocratic body that was politically detached from the presidency as much as possible.

For its part, as incumbent of the presidential office, PRI operators in Congress were induced by short-term incentives to favor *power centralization* within the Executive's orbit as if they could not be kicked out of government few years after. In other words, one could argue that the party in government probably saw in their detriment to completely shield energy regulators from presidential control.[380] History, however, proved wrong the projections of the PRI's ruling elite. They would remain in Executive power until 2018.

I underline the shortsightedness on the part of the PRI elite since –as the main architects of the 2013 oil reform– they failed to see some of the benefits of turning CNH into an *autonomous regulator*: 1) the reduction of administrative costs coming from the delegation or disincorporation of responsibilities on specialized bureaucracies; 2) the avoidance of political costs through the deference of sensitive policy questions on hydrocarbons to a body of experts who are beyond daily politicking, and 3) the long-term entrenchment of the liberalizing policy agenda that supports the hydrocarbon reform of 2013 once the PRI loses presidential power.[381]

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[378] This line of reasoning on administrative agencies has a parallel with the political science literature explaining the emergence of constitutional tribunals, their judicial review power, and the degree of independence these institutions may get vis-à-vis the political branches of goverment, by virtue of the incentives affecting power-holders in the context of competitive democratic regimes. According to Professor Ran Hirschl, these scholarly works can be described as the *hegemonic preservation* theories, whose common pattern is the conception of courts as institutional outcomes resulting from the *strategic* behavior of ruling elites in competitive political regimes. Also known as the 'neo-institutionalist' school in the study of judicial politics, this literature groups the theoretical contributions of several academics, such as: William Landes and Robert Posner, Mark Ramseyer, Tom Ginsburg, and Ran Hirschl. *See* Ran Hirschl, *Towards Juristocracy: The origins and consequences of New Constitutionalism,* Harvard University Press, Cambridge (2004), at 38-39. *See* also William Landes and Richard Posner, "The Independent Judiciary in an Interest Group Perspective", *18 J. of Law, Econ. & Org.* 3:875, (1975). *See* Mark Ramseyer, "The Puzzling (In) Dependence of Courts: A Comparative Approach", *The Journal of Legal Studies,* Vol. 23, No. 2. (Jun., 1994), pp. 721-747. *See* also Tom Ginsburg, "Economic Analysis and the Design of Constitutional Courts", *Theoretical Inquiries in Law*, University of Illinois, Law & Economics Working Paper, December (2001).

[379] *See* Grunstein, *supra note* 372, at 173.

[380] *See* Ginsburg, *supra note* 378, at 49-85.

[381] *See* Douglass North and Barry Weingast, "Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England", *The Journal of Economics History,* Vol. 49, No. 4. (Dec. 1989), at 803–832. *See* also Hirschl, *supra note* 378, at 38-39; Ginsburg, *supra note* 378, at 49-85.

According to Professor Miriam Grunstein, the challenge for these political actors was to find an *intermediate solution* between the constitutional autonomy status and the already eroded tool of administrative de-concentration. In the end, Grunstein observes that the benefits of regulatory autonomy were outweighed by the fragmentation concerns in the political debate. Although the PAN's proposal gained the legislative battle to grant CNH with fiscal autonomy and greater regulatory functions than in the past, my claim is that the PRI managed to keep the upstream oil regulator *subordinated* to the Executive's control through 'regulatory coordination'.

Rather than the halfway solution referred by Grunstein, this work finds ground to say that the ruling elite crafted a legal cover to preserve CNH's transmission belts under the *presidential command* and *control*. Alongside Grunstein's critique, our assessment of 'regulatory coordination' sheds light on an administrative structure whose normative meaning is far from being substantive and consistent in the context of Mexico's new oil regime, looking more as a façade to *centralize power* in the Executive.

First off, the regulatory coordination model seems to be a *legal shell* lacking of specific definition in light of the few precepts that the LORCME devotes to explain what should be understood by coordination with regard to the governing institutions of Mexico's energy sector. Instead of developing further the terms of this institutional coordination, legislation only speaks of the Energy Coordination Council ("Consejo Coordinador del Sector Energético") as the key organic entity to accomplish decision making coordination between the Energy Ministry and both energy regulators, its membership rules [382] and responsibilities.[383]

Surprisingly, only three legislative precepts were devoted to unpack the normative understanding of this organizational modality, which apparently is to be central given its explicit mention on the constitution and legislation. It is as if Congress had *abdicated* its authority to engineer the normative fundamentals of lots of questions, such as the need to align policy and regulation among the agencies in charge of overseeing the upstream,

[382] According to articles 19 and 20 of the LORCME, the Energy Coordinating Council (ECC) shall be integrated by the following public officials:
1) The Minister of Energy as Chair;
2) The Presiding Commissioners of the CNH and the CRE;
3) The Deputy Ministers of Energy;
4) The CEO of the National Center for Natural Gas Control (CENAGAS), and
5) The CEO of the National Center for Energy Control (CENACE).
The CENAGAS is the acronym of the decentralized administrative entity in charge of operating the transportation and storage pipeline system of natural gas in Mexico. Also, CENACE is the acronym of the decentralized administrative entity in charge of the operating the national electricity grid in Mexico.

[383] In terms of article 21 of the LORCME, the functions constituting the ECC's jurisdiction are:
1) To convey both to CNH and CRE the energy policy determined by SENER;
2) To issue recommendations relative to the Executive's energy policy and sectorial programs which are important for CNH or CRE to include in their respective annual working goals;
3) To analyze the recommendations that CNH and CRE have to make upon the Executive's energy policy and sectorial programs;
4) To execute shared information and institutional cooperation systems, and
5) To evaluate those specific cases that may affect the implementation of the Executive's energy policies and to propose further coordination mechanisms.

midstream, and downstream compartments of the hydrocarbon supply; the interconnection between hydrocarbon markets and power supply; or minimum criteria to implement conflicting government action with a transversal impact on petroleum, electricity, and renewables industries.

All these complex policy questions require a high degree of coordination, normative benchmarks, and smart regulatory analysis between the Executive and energy regulators as well as among energy regulators themselves, since there are no permanent or absolute answers but only trade-offs among this plurality of objectives. In summary, this *legislative omission* creates a high degree of *ambiguity* and *vagueness* about the purpose and meaning of 'regulatory coordination' – that is, a normative void which can easily be filled by Executive's discretion, considering that the Energy Coordinating Council (ECC) is fully dominated by public officials who either serve at the pleasure of the President or are indirectly controlled through SENER. This illustration is only one way by which 'regulatory coordination' works as a nominal device to *cover up* the exorbitant control the Executive has over the oil sector at the expense of checks and balances.

Second, the regulatory architecture of the ECC contains several *inconsistencies* with the notion of *checks and balances* that has been articulated throughout this work. Rather than unfolding a governance network based on a 'horizontal' transmission belts, the scarce regulation of the ECC's mandate legalizes 'vertical' control over the Mexican energy industry, faking a decisionmaking among a plurality of agencies at the ECC interface – which is no other thing but a front to conceal power centralization in SENER and therefore in the Executive. Instead, article 21 of the enabling legislation refers to ECC's authority to simply communicate both CNH and CRE what is the energy policy dictated by SENER. How seriously was the concept of coordination taken by Mexican legislators if they dare to enunciate a responsibility as plain and nude as the one above in their attempt to establish vertical command from the Executive?

Likewise, the prevalence of '*vertical*' control over *coordination* in ECC jurisdiction can be seen in the system of recommendations concerning the two way feedback there will be between the Executive –represented by the Energy Ministry– and the coordinated regulatory comissions. When it comes to conveying the Executive's energy policy so that the regulatory process is aligned accordingly, the ECC task consists simply in "issuing" these goals both to CNH and CRE, as opposed to when it is the regulatory agencies who raise these recommendations over the Executive's policy and sectorial programs – a case for which the enabling statue empowers the ECC to "analyze" such proposals.[384]

This remark highlights how the legal regime discriminates among these two type of recommendations, granting higher normative status to recommendations concerning the communication of the Executive's energy policy. This *inconsistency* is questionable because it proves this is not really a governance regime on energy whose regulatory coordination is achieved through authoritative operators exercising its functions at the same level, but by means of '*vertical*' command and control. Somehow, it is misleading to say that it is the ECC the instrumentality by which the Mexican energy regime gets is

[384]*See supra note* 383.

coordination from, when its actual function seems to guarantee that the Executive's instructions are properly dictated and implemented by the rest institutional actors of the administrative pyramid.

Another *inconsistency* challenging the notion of regulatory coordination established by the Mexican oil regime, has been framed by Miriam Grunstein regarding the *conflict of interest* shadowing the decisionmaking inside the ECC – the Energy Minister acts both as chair of the ECC and as president of Pemex's governing board.[385]

This double role granted to SENER's head implies a conflict of interest because the ECC is the instrument conveying the specifics on the Executive's energy policy to CNH, which in turn has regulatory authority over Pemex's upstream operations. Consequently, Congress *confuses* in the same government official the policy enforcement capacity with that of a regulated party.[386] Moreover, this conflict of interest affecting SENER when presiding both the ECC and Pemex, casts doubt on whether the Mexican governing elites are credibly committed to guaranteeing competition in the domestic upstream oil market and keeping a transparent institutional environment.

In Professor Grunstein's view, although the ECC resembles the National Council for Energy Policy that is recognized in Brazilian hydrocarbon law, the way it was placed on Mexico's legal framework on petroleum was more the product of *legislative improvisation* than of a carefully implemented institutional design.[387] So, despite the increasing interest in the notion of coordination in regulation and government studies, there is no precedent in any jurisdiction about an attempt to legislate how regulatory coordination should work in practice. For the reasons above, it is as if Mexican policymakers wanted to achieve through legal design, in an *aprioristic* fashion, an attribute that governance regimes can only develop through institutional practice over time.

4. Unmasking the Coordination Façade: Implications

Considering that for nearly 75 years Mexico's petroleum industry flourished under a state monopoly and an institutional environment captured by rent seeking politics, rather than under a competitive market structure, bureaucratic expertise and transparency, it was imperative for the energy reform to design an oil governance in which the functions and organization of the decisionmakers were founded on *arm's-length* criteria. This meant the need for strong *checks and controls* to deter excessive power concentration in the hands of

[385] In terms of article 15 of the Petróleos Mexicanos Act, published on August 11, 2014, in Mexico's Federal Official Journal.
[386] Although article 21 of the LORCME explicitly keeps the ECC from entertaining any regulatory question related to Pemex and CFE, this legislative prohibition is nominal and thus ineffective because it does not fix the real source of the problem – the two conflicting capacities vested in the Energy Minister.
[387] *Id.*

the Executive branch, given that past instutional practices are still capable of exerting some *path-dependent* inertias over the new petroleum regime.

An independent upstream oil regulator (CNH), whose *functional autonomy* is shielded from central administration, could have been a better –and healthier– institutional design choice to restore an arm's-length relationship with the Executive (SENER). Instead, the framers of the hydrocarbon amendment came up with a unique organic model whose emphasis lies in the coordination of institutions governing the policymaking and regulatory functions within the Mexican administrative state on upstream oil.

There is not any *prima facie* reason or evidence that puts 'checks and balances' at odds with 'coordination', since these two principles can be put to work systematically. Though, in the context of Mexico's hydrocarbon regime, this research has shown the defective ways in which this administrative organization was articulated at the expense of *balanced governance*. These findings keep a common pattern with our remarks in Chapter V, according to which the energy reform of 2013 *concentrated* in the Executive branch –via the empowerment of the Energy and Finance ministries – what I see as 'primary' functions of Mexico's oil regulatory governance, leaving CNH with a 'secondary' role relative to the management of the upstream contract regime.[388]

Instead of instrumenting solutions for overlaps, fragmentation, and information asymmetries that could impair the efficiency of the administrative organization on petroleum, the '*coordination*' principle was used to mask the *command* and *control* of this industry under the Executive. Accordingly, the concept of 'regulatory coordination' seems to be a *legal front* behind which there is neither substantive nor consistent collaboration among equally relevant authorities, but a centralized regulatory state. Paradoxically, even that concentration of functions was ill-designed given its nominal purpose to give the appearance of checks and balances. [389]

This 'vertical' understanding of coordination was driven by the fact that whoever controls the petroleum industry, regulates one third of government revenues as well. Anyhow, there could have been other reasons to support unified control in the Executive branch – for instance, sovereignty and energy security arguments. Yet, the architects of the energy reform omitted to make explicit their motivation for their institutional design choice. These legislative silences are *normative voids* which will be filled by *administrative discretion*, putting at risk the aim for balanced governance in Mexico's petroleum industry.

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[388] Hacienda's intervention to design the adjudication variables of upstream oil contracts is much more robust than trying to justify blurry boundaries between SENER and CNH. While the former division of labor is objectively rooted in expertise, the borders separating the functions of the latter seem arbitrary and formalistic – in particular when both bodies are placed within the same Executive branch. Instead of framing an institutional design to secure regulatory independence from excessive presidential interference, the reform of 2013 turned CNH into a mere administrator and technical support arm at the service of SENER.

[389] If the claim about improving the efficiency and coordination of Mexico's administrative state on upstream oil is to be taken seriously, then the hydrocarbons reform could have concentrated all regulatory policy tasks into one single executive body, rather than fragmentizing these functions among the SENER and an ostensible 'regulatory agency' in the attempt to construct a façade of checks and balances. CNH's regulatory powers seem to be crippled, as opposed to the command and control enjoyed by SENER.

5. The Straitjacket Depleting the Mexican Oil Champion

This section analyzes "*Petróleos Mexicanos*" –commonly known as Pemex– as part of the administrative apparatus on Mexico's upstream oil sector, in light of the checks and balances standard and the institutional shortcomings resulting from that assessment. Although Pemex performs a *commercial role,* both as a contractor and operator of upstream oil activity, I consider instrumental to the government because of its *state-owned* status and its *fiscal* importance. For that purpose, I first overview which have been Pemex's most pressing problems in the last decades and then proceed to discuss how they were modified –or preserved– by the energy reform enacted in 2013 and 2014.

"Petróleos Mexicanos" is the state oil firm that came to existence at the time when President Cárdenas decreed the expropriation of the Mexican petroleum industry in 1938. It is the oldest of the leading national oil companies (NOCs)[390], the largest firm in Mexico, and it is among the three biggest enterprises Latin America.[391] Today, Pemex is ranked the 8th crude oil producer worldwide.[392]

For almost eight decades, Pemex functioned as a *vertically integrated* state monopoly controlling the whole supply chain of Mexico's oil and gas markets. Until the mid-1970s, driven by a self-sufficiency strategy and an active industrial policy, Pemex focused on satisfying Mexico's domestic demand for hydrocarbons in all the business segments.[393]

Yet, after discovering the giant oilfield Cantarell in 1976, Pemex's incentives and those of government would change in two ways. On the one hand, the high availability of crude oil redefined the Mexican oil champion's vocation towards an *exportation-oriented extractive* strategy, leaving aside investment on new exploration projects to restitute exploited reserves and on infrastructure needs in downstream and midstream sectors.

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[390] Stojanovski, "Handcuffed: An assessment of Pemex's performance and strategy", *supra note* 1, at 280.

[391] Pemex is not a publicly listed company in any stock exchange market, because legally it shall remain exclusively owned by the federal government. So, this index measures companies based on revenue. *See* Grupo Expansión, "Ranking 2018: Las Empresas Más Importantes de México" [Ranking 2018: The Most Important Companies in Mexico], *Expansión,* Mexico City, August 3, 2018, available at https://expansion.mx/empresas/2018/08/03/ranking-2018-las-empresas-mas-importantes-de-mexico. *See*, also, América Economía, "Ranking Las 500 Mayores Empresas de Latinoamérica" [Ranking of the Largest 500 Companies in Latin America], América Economía, 2014, at https://rankings.americaeconomia.com/las-500-mayores-empresas-de-latinoamerica-2014/ranking-500-latam-1-50/.

[392] Energy Intelligence Group, "PIW Top 50 Ranking of the World's Largest Oil Companies", *Petroleum Intelligence Weekly*, November 2017, cited by Petróleos Mexicanos, "Presentación a Inversionistas" [Presentation to Investors], Petróleos Mexicanos, August 2018, at 3, available at http://www.pemex.com/ri/herramientas/Presentaciones%20Archivos/Presentación%20Inversionistas_20180803.pdf.

[393] *See* Elizondo Mayer-Serra, "Stuck in the Mud: The Politics of Constitutional Reform in the Oil Sector in Mexico", *supra note* 15, at 14; Stojanovski, *supra note* 1, at 285. According to Esperanza Durán: "Between 1938 and 1976, the prime objective [of the oil industry] was to satisfy internal demand and to support [ISI] through very low, subsidized prices. Oil was regarded as a tool for inward-looking development". *See* Durán, *supra note* 1, at 147.

On the other, the upstream strategy prioritizing the *accelerated depletion* of petroleum resources in the Gulf of Mexico over anything else, was also extremely profitable for the state since oil rents have been syphoned from Pemex to fund 30 to 40% of the government budget ever since (Chart 1 and Table V).

The scheme based on the *mutual interdependence* of Pemex's managers with its government principals still holds today despite the energy reform in 2013. As indicated in Chapters II, III and V of this work, the perverse incentives fueling the arrangement above result from, and reinforce as well, the absence of effective *checks and balances* among relevant actors who lack of interest in breaking up the 'rentier' logic that dictates the management of the Mexican oil champion.

The *monopoly* structure alongside *full state ownership* are the legal means which have guaranteed the use of Pemex as a 'rent-seeking' device put at the service of a ruling elite, whose lack of accountability through the political process has led to the development of weak fiscal institutions in Mexico as follows:

1) First, by replacing the state's low tax collection capacity with a *heavy fiscal burden* on Pemex, which in the end has created an oil revenue dependency to hedge one third of the government budget each year;

2) Second, by fostering a *perverse fiscal culture* in which non-compliant taxpayers are systematically pardoned from their due tax obligations, in exchange for what is perceived as unchecked government spending for defective public services, rampant corruption of state officials, and high levels of impunity;

3) Third, by squandering Pemex's revenue for different purposes than those of a business-oriented corporation seeking to maximize profits and reward its stakeholders under competitive conditions, Mexico's petroleum governance subordinates this NOC to a purely *extractive policy* on behalf of the "national interest" represented by the state – which is essentially a political goal.

The way Mexican public finance is intertwined with the extraction of petroleum rents constitutes a "*path-dependent institutional arrangement*"[394] in the sense of a vicious circle of incentives which have entrenched over time, giving the impression about the impossibility to break them up through reforms inside the system. The resilience of this "institutional bottleneck"[395] is rooted in the rentier approach from which both governing elites and organized groups of interest[396] have benefited alike.

It is politically understandable, though, that maximizing oil revenues receives gets top *priority* in detriment of Pemex's efficient performance, considering that preservation of the

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[394] Christopher J. Coyne and Abigail R. Hall, "Institutional Bottlenecks: What Can Be Done?", *The Annual Proceedings of the Wealth and Well-Being of the Nations,* Beloit College, December 11, 2012, at 41, available at https://www.beloit.edu/upton/assets/Coyne.Hall.chapter.final.pdf

[395] *Id.*

[396] For instance, clienteles such as workers' unions which benefit through patronage and exorbitant pensions.

tax and spending capacity amount to the backbone any government needs to enforce its most fundamental duties. As the eighteenth century British political philosopher and statesman, Edmund Burke, wisely put it: "The *revenue* of the state is the *state*. In effect all depends upon it, whether for support or for reformation".[397] Given that Pemex has been the state mechanism to extract oil rents, it is not a big surprise that this NOC is under the *presidential command* via the Energy and Finance ministries. Hence, Pemex has been managed with the verticality and rigidities of a public administration approach, irrespective of its activity's impact on the economy.

It is worth illustrating how the Mexican government has legally operated this *rentier* mechanism against Pemex. Each year the state –acting through Congress and the Executive's Finance Ministry – rips Pemex off its revenues, let alone the profits if there happen to be in the net balance, by means of a *heavy fiscal burden* that is imperative for the administration to collect for patching budget deficits.

Between 2003 and 2009, for example, the Mexican oil champion paid the federal government 60% out of its revenues in taxes and duties; yet, according to financial experts, the real figure is was an average 80% of its total revenues during this period.[398] Notwithstanding the energy reform of 2013, the financial squeezing on Pemex –via a heavy tax load– has worsened due to the recent oil prices collapse.

For analysts from financial ratings companies, such as Fitch and Moody's, the downfall in oil prices starting in 2014 resulted in the *taking* of nearly 100% of Pemex's earnings before interest, taxes, depreciation, and amortization (EBITDA).[399] In this context, Pemex ends up each fiscal year either with a financial loss most time, or with an insignificant surplus as the exception. Even so, if there is a dividend, it goes to government coffers as Pemex's exclusive owner.[400]

The null *capital liquidity* of its own and prior *constitutional constraints* on private business participation in the petroleum industry –whether through contracts or through the NOC's ownership structure – crippled Pemex's long-term investment power, forcing it to get *indebted* to fund its limited upstream projects and fixed costs (see Table V, Charts 2 and 3). Pemex's investment portfolio is small compared to international standards because upstream oil operations are capital intensive and highly risky, so the "cash-cow" of the government budget cannot afford a failed venture. Likewise, before the energy reform of 2013 Pemex was not legally authorized to subscribe *strategic partnerships* with other oil enterprises to allocate on their partners the financial risk of these upstream ventures.

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[397] Edmund Burke, *Reflections on the French Revolution and on the proceedings of certain societies in London relative to that event,* London, J. Dodsley, 1790, at 334. The italics are mine.
[398] Stojanovski, *supra note* 1, at 300.
[399] *See* Moody's Investors Service, "Petróleos Mexicanos – Semiannual Update", Credit Opinion, March 30, 2018, at 1-2, 4, at http://www.pemex.com/ri/Deuda/Calificacin%20crediticia/CO_Pemex_Mar18_vf.pdf. *See* also Business Wire, "Fitch: High Tax Burden Pushes Pemex Towards Insolvency", Chicago, October 21, 2016, available at https://www.businesswire.com/news/home/20161021005536/en/Fitch-High-Tax-Burden-Pushes-Pemex-Insolvency
[400] Pemex's only shareholder is the state acting through government officials who control the governing board and respond directly to the presidential orders.

Even though Pemex has always been part of the administration, it is a *legal entity* with a separate sphere of rights and obligations from that of federal government. In theory, this means Pemex has *legal personhood* to contract debt and honor it with its own assets in its debtor capacity. In practice, however, former statutes governing Pemex always guaranteed the Finance Ministry's strict oversight to control and authorize any debt the state oil firm wanted to commit. Despite Pemex's *diminished capacity* to commit itself to financial obligations, its former regime established that this debt was not to be considered as guaranteed by the Mexican state.[401] This legislative precept was doomed to be "dead letter" because the government would never let Pemex to be on a default situation, taking into account the fiscal service this NOC provides for the state ("*soft-budget*" constraints).

While creditors have discounted that Pemex's financial solvency is *implicitly backed* by the Mexican state, critical implications follow from this *de facto* guarantee: 1) Pemex's financial obligations can be turned in *public debt*, if Congress approves to bail it out from bankruptcy; 2) in case Pemex's financial obligations are absorbed by the state as collateral, the latter would turn on taxpayers to bail it out through a *tax* increase or through external *credit* or both; 3) a failed venture based on debt could put at stake not just the company's survival but the *financial* and *fiscal stability* of the state. For all these reasons, Congress vested on Hacienda the authority to keep checked this company's ability to sign off bonds.

Unfortunately, Pemex's precarious *cash flow* after disbursing the governmental take in taxes has led this NOC to get indebted to pay for its pension and tax liabilities. These days, the Mexican oil champion is highly leveraged and the outlook on the Pemex's *debt profile* is *negative* for the near future, because this lending is targeted for cash spending rather than productive investment in the long-term (see Charts 5, 6 and 7). Surprisingly, Pemex has a large *pretax clash flow*, so it could afford a much higher levels of investment. In fact, Pemex currently has the lowest costs of crude oil production in Latin America. In 2015, each barrel cost $9.5 USD, including duties or royalties, but this increased up to $57 USD per barrel by virtue of the tax burden imposed by the state.[402]

In summary, it looks like full state ownership and control are the instruments which have allowed a *confiscatory taxation* of Pemex, destroying its comparative advantages and curtailing this NOC's autonomy from government to make the competitive investment decisions. By being "captured" by government officials, the Mexican oil champion has been unable to revert its increasingly productivity loss by means of an investment policy on new exploration to counter the depletion of petroleum deposits and production decrease accordingly (see Chart 1 and Table V).

Likewise, given its monopolistic structure since 1938, Pemex was the whole Mexican hydrocarbon industry until 2013. To this extent, the *aggrandizement* of crude oil production also caused the *neglect* of other business segments of the hydrocarbon sector in terms of capital injection (see Table V). Among the drawbacks of this business model, there is an

[401] *See* article 44 of the former Petróleos Mexicanos Act, published on November 28, 2008, in Mexico's Federal Official Journal. This legislative statute was abrogated by the Petróleos Mexicanos Act in force since August 11, 2014.

[402] *See* Moody's Investors Service, *supra note* 399, at 4.

outdated refining system that has turned Mexico in a net importer of natural gas and fossil fuels from the United States and Canada. Still, the Mexican economy has become larger than it was in the 1970s, so Mexico's current demand of refined petroleum products exceeds the supply capacity of the midstream and downstream infrastructure.

Third, during the Peña Nieto administration, Mexico increased the *public sector's debt* as proportion of its GDP from 36.4% in 2012 to 46.8% in 2017, having reached a peak of 50.2% in 2016.[403] This *exponential leverage* of Mexico's public finance overlaps exactly with the years in which the oil prices plunge was at its worst. Analysts have explained that Pemex's financial crisis is the main cause of the public sector's debt increase in Mexico.[404]

This section has emphasized the interconnection between the tax squeezing of Pemex, its resulting financial insolvency, and how the NOC's debt plays against the state. Although Pemex's financial obligations are legally separate from those in charge of the central government, by virtue of state ownership, Pemex is included in Mexico's most comprehensive public debt indicator –also known as "*financial requirements of the public sector*" (RFSP)[405]– which covers all the government branches, autonomous entities, and all type of state instrumentalities.

So, if someone wants to measure the Mexican public debt realistically, Pemex's financial commitments should be accounted for as well. More importantly, the contribution of Pemex to Mexico's public debt growing portrays a *paradox*: By milking the entire revenue of the NOC to guarantee the state's fiscal stability, government ends up leaving its "cash-cow" in intensive care, exposing public finance to absorb the cost of this rehabilitation bill and therefore jeopardizing what the state wanted to protect in the first place –its fiscal backbone. This is evidence of the *perverse communicating vessels*, in terms of weak-budget constraints, between the Mexican government and Pemex.

Finally, it is worth noting that pensions are a significant component of Pemex's debt profile. Labor has a long tradition of influence in Mexican oil politics. Since it was born until the energy reform of 2013 was enacted, the petroleum workers' union was a powerful actor within Pemex's management[406] and Mexican politics. The union emerged as a clientele, whose leaders were co-opted by the post-revolutionary regime in exchange for the service of political stability they provided to successive presidential administrations, including those after the democratic alternation in 2000.

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[403] México Evalúa, "Deuda Pública como % del PIB" [Public debt as percentage of the GDP], *La Caja Negra* [The black box], México, Updated until February 2018, available at https://www.mexicoevalua.org/cajanegra/portfolio/deuda-publica-como-del-pib/

[404] *See* Alejandro Gómez Tamez, "El crecimiento explosivo de la deuda pública externa" [The explosive growing of external public debt], *El Financiero,* México, March 20, 2017, available at http://www.elfinanciero.com.mx/opinion/alejandro-gomez-tamez/el-crecimiento-explosivo-de-la-deuda-publica-externa

[405] "Requerimientos Financieros del Sector Público" in Spanish.

[406] According to article 8 of Pemex's former enabling legislation (2008), the petroleum workers' union had the prerogative to appoint 5 out of the 15 members integrating the governing board.

Sometimes there was the public perception that Pemex was a "*state within the state*" because of the workers union's pervasive influence.[407] For many years, Pemex's workers union opposed resistance to presidential attempts of liberalizing the Mexican oil industry – in particular because this type of reform is often associated with the possibility of privatizing Pemex, which would likely involve massive layoffs and in the end of a juicy labor contract and social security prerogatives. Until the legislative statute of 2014, direct participation of the union in Pemex's management board was removed. To that end, the government absorbed a chunk of the company's pensions liabilities through the central budget. These are signals that taxpayers will be paying for the social benefits committed on behalf of Pemex with patronage purposes, since this debt has to be eventually paid out of taxes levied on the population.

As time goes by, *petroleum markets* and *geology* are the only dykes of reality that have succeeded in making visible the shortsightedness of the rentier model implanted in Pemex and its negative implications for both the NOC's performance and public finance. The *institutional bottleneck* distorting Pemex's relationship with the government showed its harmful effects with particular intensity as of the decline of oil prices in 2014. This *external shock* highlighted the dynamic of perverse incentives and the correlations between the state's voracity for oil revenue, Pemex's insolvency, and oil production decline. In parallel, geological assessments have revealed that the oil reserves with greater productive potential are located in deep waters, thus the "easy oil"[408] era for Pemex seems to be over.

There is not one single response to fix the vicious cycle above, but rather a set of *adjustments* that should be implemented both gradually and systematically. Part of the answer lies in solving the problems in Mexico's political environment; another fragment requires developing a competent bureaucracy; finally, the elephant in the room points to the imperative of enabling stronger fiscal institutions, which means increasing state capacity to collect taxes and legislative controls on public spending. Most of such problems require the collaboration of experts in fiscal policy planning, corporate finance, petroleum engineering, and other highly technical knowledge fields.

My claim, however, is that the main source of the bottlenecks strangling Pemex is one of *institutional* nature. The endeavor to untie these bottlenecks with a magic bullet, once and for all, exceeds the scope of this analysis. Instead, this section and the next shed light on the institutional knots preventing Pemex from making better business decisions and developing a more balanced relationship with the government. To break up this entrenched *inertia* of perverse incentives, I urge for an *arm's-length rationale* by means of institutional *checks and balances* in Pemex's ownership structure and corporate governance. That is how this work plans on contributing to the Mexican oil champion's liberalization from the straitjacket the ruling elite has imposed – and still has – on this NOC.

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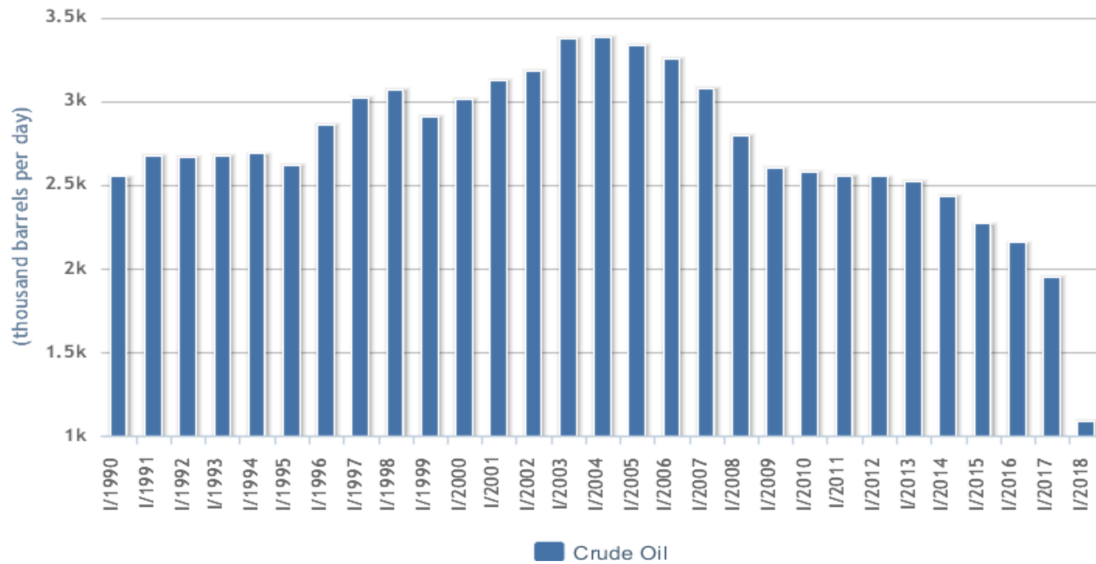
[407] *See* Stojanovski, *supra note* 1, at 281-282.
[408] Samples, "A New Era for Energy Reform in Mexico? The 2013-14 Energy Reform", *supra note* 1, at 613.

CHART 1. PETROLEUM PRODUCTION EVOLUTION IN MEXICO



Source: Petróleos Mexicanos, Base de Datos Institucional [Institutional Data Base], México, available at http://ebdi.pemex.com/bdi/bdiController.do?action=cuadro&cvecua=MESTADOP_I.

TABLE V. PEMEX'S CAPITAL EXPENDITURES ALLOCATION (%) BY BUSINESS SEGMENT

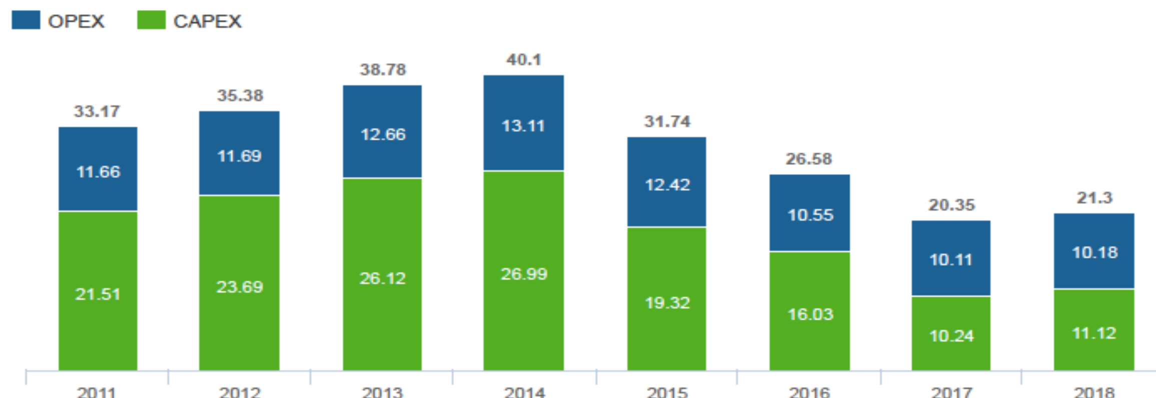
Year / Business Segment	Exploration & Production	Refining	Gas & Basic Petrochemicals	Petrochemicals	Corporate
1998	75%	14%	8%	2%	1%
1999	78%	13%	7%	2%	1%
2000	63%	30%	5%	1%	1%
2001	84%	10%	4%	2%	1%
2002	78%	17%	2%	2%	1%
2003	77.7%	17.5%	2.9%	1.4%	0.5%
2004	92.2%	4.1%	2.0%	1.3%	0.3%
2005	88.9%	7.1%	2.5%	1.2%	0.3%
2006	86.5%	10.1%	2.2%	0.9%	0.2%
2007	87.4%	9.4%	2.4%	0.7%	0.1%
2008	88.3%	8.6%	2.1%	0.8%	0.2%
2009	90.0%	7.4%	1.6%	0.8%	0.2%
2010	89.2%	8.4%	1.4%	0.9%	0.1%

Source: Imported from Ognen Stojanovski, "Handcuffed: An assessment of Pemex's performance and strategy", *supra* note 1, 2012, at 303.

CHART 2. PEMEX'S CAPEX AND OPEX: 2011-2018

Capital and Operating Expenditures

Billion U.S. dollars



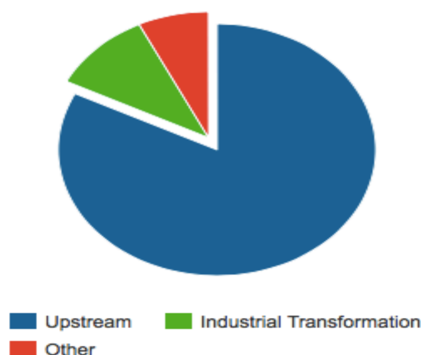
Note: Includes upstream maintenance expenditures. PEMEX´s investment records are in pesos. Figures have been converted at the following average historical exchange rates: MXN 12.4291/USD for 2011, MXN 13.1649/USD for 2012, MXN 12.7677/USD for 2013, MXN 13.2973/USD for 2014, MXN 15.8485/USD for 2015, MXN 15.90/USD for 2016, MXN 18.20/USD for 2017 and an exchange rate of MXN 18.40/USD is used for 2018.

Source: Imported from Petróleos Mexicanos, "Investment Information", Pemex, México, 2018, available at http://www.pemex.com/en/investors/financial-information/Paginas/numbers.aspx

CHART 3. PEMEX'S INVESTMENT PER BUSINESS SEGMENT: 2018

2018 Investment by line of business

100% = 10.81 billion U.S. dollars



Capital expenditures are undertaken by Petróleos Mexicanos and its subsidiary entities.

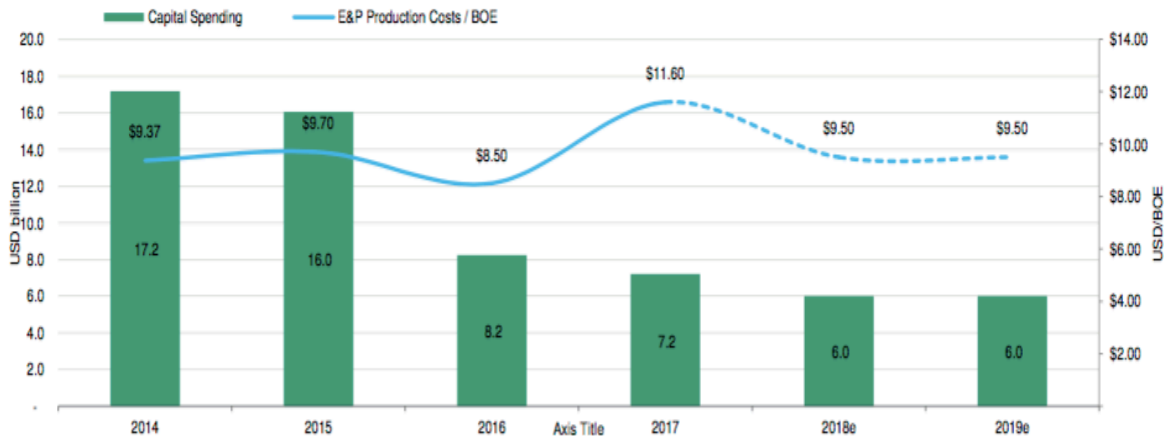
Capital expenditures and operating expense must be authorized in the budget of Petróleos Mexicanos, which is approved by the Mexican Congress.

The exchange rate used (Pesos per USD) is the one approved by the Mexican Congress for 2017 which you may find it in our Guidance section.

Note: Other includes Fertilizers, Ethylene, Cogeneration, Perforation, Logistics and Corporate.

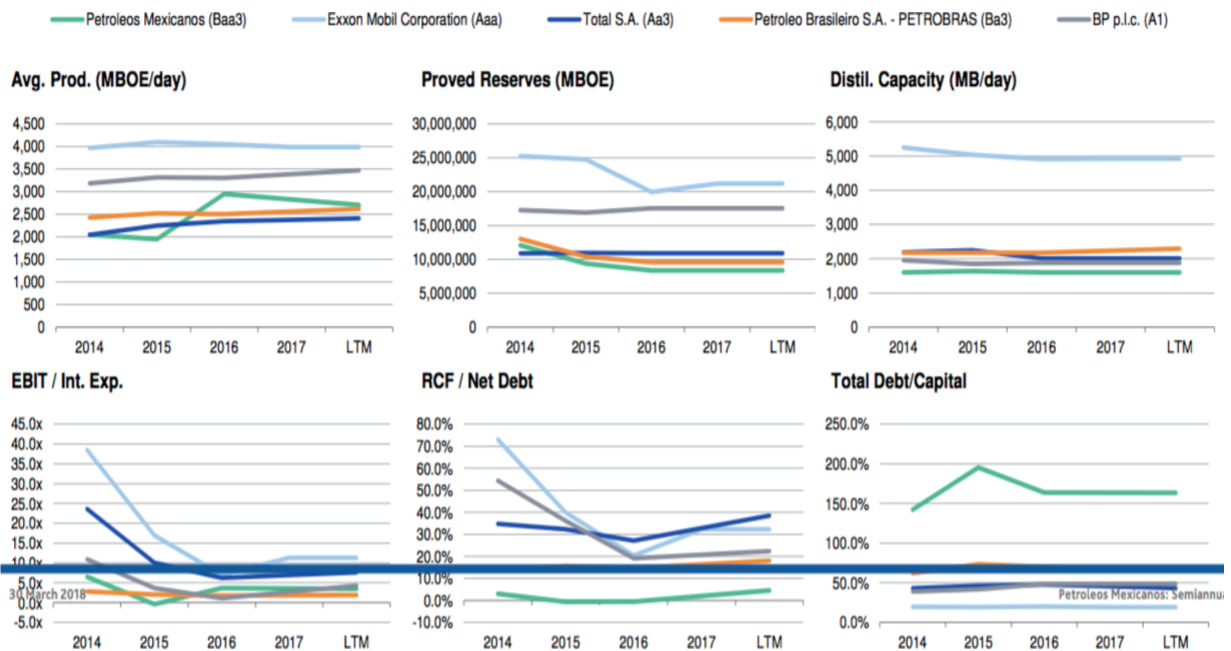
Source: Imported from Petróleos Mexicanos, "Investment Information", Pemex, México, 2018, available at http://www.pemex.com/en/investors/financial-information/Paginas/numbers.aspx

CHART 4. PEMEX'S CAPITAL SPENDING AND DRILLING COST ON UPSTREAM OIL



Source: Imported from Moody's Investors Service, "Petróleos Mexicanos – Semiannual Update", Moody's Financial Metrics, Credit Opinion, March 30, 2018, at 6, available at http://www.pemex.com/ri/Deuda/Calificacin%20crediticia/CO_Pemex_Mar18_vf.pdf

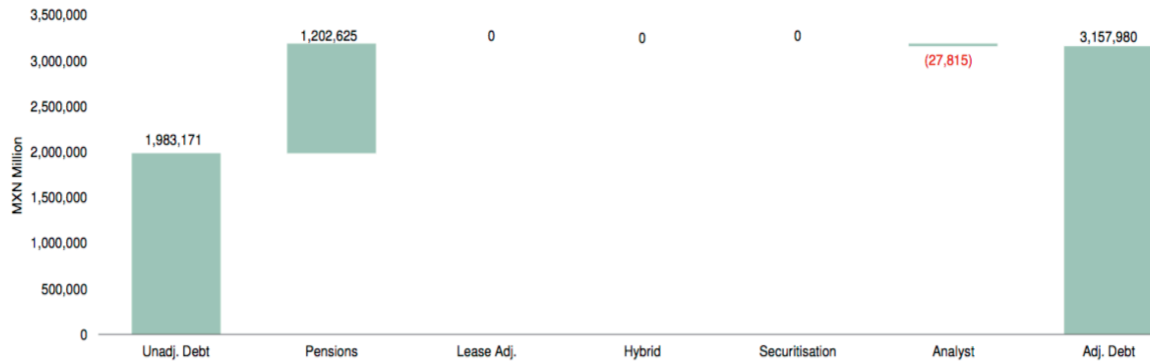
CHART 5. INDEX COMPARATIVE: PEMEX VERSUS OTHER OIL COMPANIES



Source: Imported from Moody's Investors Service, "Petróleos Mexicanos – Semiannual Update", Moody's Financial Metrics, Credit Opinion, March 30, 2018, at 12, available at http://www.pemex.com/ri/Deuda/Calificacin%20crediticia/CO_Pemex_Mar18_vf.pdf

CHART 6. PEMEX'S DEBT COMPOSITION

Components of Debt

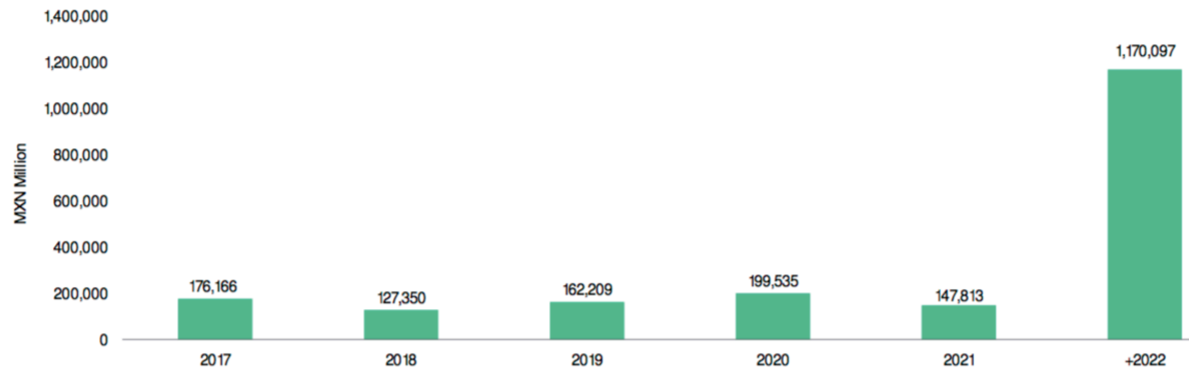


As of 31 Dec 2016
Source: Moody's Financial Metrics

Source: Imported from Moody's Investors Service, "Petróleos Mexicanos – Semiannual Update", Moody's Financial Metrics, Credit Opinion, March 30, 2018, at 13, available at
http://www.pemex.com/ri/Deuda/Calificacin%20crediticia/CO_Pemex_Mar18_vf.pdf

CHART 7. PEMEX'S DEBT MATURITY

Upcoming Long-Term Debt Maturities



As of 31 Dec 2016
Source: Moody's Financial Metrics

Source: Imported from Moody's Investors Service, "Petróleos Mexicanos – Semiannual Update", Moody's Financial Metrics, Credit Opinion, March 30, 2018, at 10, available at
http://www.pemex.com/ri/Deuda/Calificacin%20crediticia/CO_Pemex_Mar18_vf.pdf

6. “Productive State Enterprise” and Pending Liberalization

In 2014, the energy reform transformed Pemex into a “*productive state enterprise*” whose constitutional objective shall be economic value creation and the increase of national revenue, with a strict sense of equity as well as social and environmental responsibility.[409] In terms of the Mexican constitution and the Petróleos Mexicanos Act of 2014, Pemex has the status of a state company *exclusively owned* by the federal government and enjoys legal personhood and a patrimonial sphere of its own.

Before the amendments of 2013 and 2014 were in force, Pemex was governed by the Petróleos Mexicanos Act of 2008, which conceived it as a “decentralized” entity of the ancillary federal administration.[410] Pemex’s prior regime defined it as any other administrative agency of the Executive branch, but with the mandate of intervening in the petroleum business – an economic activity that we hardly classify as governmental *per se.*

Since 1938, Pemex had been the instrumentality by which state –via the *administration* – exerted its *exclusive control* over all the business segments of Mexico’s oil industry. The Mexican oil champion was therefore subject to presidential orders and administrative norms applicable to all the executive departments on matters of budget, management, organization, estate, public procurement, human resources, and debt.

Contrary to ordinary administrative agencies, though, Pemex is a company with capital-intensive functions in the oil industry, so it needs to invest on oil infrastructure. From 1998 through 2008, Pemex performed its investment financing with complex schemes called “*long-term budget deferred infrastructure projects*” – also referred as “PIDIREGAS” – which were directly wired to the government’s budget. Since PIDIREGAS were regulated by fiscal and debt legislation, Pemex was bound to comply with the procedural formalities, administrative burden, and strict oversight enforced by the Finance Ministry. The rigid implementation and tight administrative control on PIDIREGAS made them a highly inflexible tool to capitalize Pemex, to the extent that analysts describe them as “an investment cure that [was] worse than the disease”.[411]

It was until 2008 that Pemex achieved a more flexible regime to contract financial obligations of its own in external *debt* markets, for as long as it satisfied Hacienda’s clearance checks for almost every move in this regard. The legislation of 2008 also modified Pemex’s *corporate governance* by packing the management board with 4 “professional counselors”, who were appointed by the President and ratified by the Senate, as well as governed by a for-cause removal mechanism. The figure of professional counselors was then an attempt to simulate a minimum degree of independence within Pemex’s executive body; yet, this modification was cosmetic, given the Executive’s power to appoint 6 “representatives of the state” and the prerogative of Pemex workers’ union

[409] *See* Article Twentieth Transitory, section I, of the decree relative to the constitutional reform on energy, published on December 20th, 2013, in Mexico’s Federal Official Journal.
[410] “Entidad descentralizada de la administración publica federal paraestatal” in Spanish.
[411] *See* Stojanovski, *supra note* 1, at 304.

contributed with other 5 representatives.[412] On the other side, the Energy Minister held by law the tiebreaking vote privilege. As a result, the reform of 2008 kept intact the Executive's command over Pemex.

Based on the institutional landscape surrounding Pemex, it was imperative for the energy reform of 2013 to craft a legal regime with '*check-and-balance*' mechanisms to shield Mexico's NOC with greater corporate *autonomy* vis-à-vis the government, so that the former has the capacity to make competitive decisions on business strategy, investment planning, debt portfolio, and human resources, from a long-term commercial basis.

Underlying the notion of a "*productive state enterprise*" there is the policy of keeping Pemex as insulated as possible from the excessive political pressures and administrative burden it has been traditionally submitted to as a state-owned entity, with the ultimate purpose of optimizing its *competitiveness* and performance in the oil business. The realization of the productivity objective has a correlate in terms of profitability. One could hardly disagree with that any commercial enterprise seeks for the maximization of financial gain for the owners of the investment. This is the reason why the constitution also understands the mandate of a productive state enterprise as the increase of the nation's revenue, since Pemex is Mexico's national oil company. In this context, the constitutional reform on energy of 2013 ordered the passage of special legislation in 2014 to transform fundamental aspects of Pemex's regime as follows:

A. Corporate governance

According to the legislative statute passed in 2014, the governance of the Mexican oil champion is entrusted to a *council board* and a *chief executive officer* (CEO).[413] The law mandates defines the council board as the supreme governing body in charge of defining the policies, guidelines, and strategic vision of Pemex, whereas the CEO is responsible for the management, operation, and execution of Pemex's objectives and the strategy, policies, and decisions instructed by the council board.[414] So, the CEO is functionally subordinated to the management board.

With regard to the integration of Pemex's governance bodies, the CEO may be *freely appointed* and *removed* at discretion of the President.[415] The law also vests Pemex's governing board with the authority to dismiss the CEO, for as long as 7 counselors agree on

[412] Regarding the workers' union, Mexican presidents have managed to keep it under relative control – whether by the selective use of the prosecution system or by patronage. Past union leaders have been jailed for defying presidential authority, whereas those government-friendly have been compensated with congressional office and their clienteles appeased with labor privileges. Certainly, after the Mexican democratic transition and the corresponding fragmentation of the authoritarian regime, the government-union relations went through cycles of full capture by the former to a collusion stage based on equal footing at which Pemex seemed to be a 'state within a state'.

[413] *See* article 12 of the Petróleos Mexicanos Act, published on August 11, 2014, in Mexico's Federal Official Journal. This is the legislative statute currently in force.

[414] *See* articles13 and 46 of the Petróleos Mexicanos Act in force.

[415] *See* articles 47 and 48 of the Petróleos Mexicanos Act in force.

this decision.[416] The eligibility requirements to be CEO of Pemex are: 1) to have graduated from a set of background disciplines for at least 5 years before the designation occurs; 2) to have academic or professional expertise of at least 10 years in the hydrocarbon industry before the nomination takes place; 3) not to have been condemned for intentional felonies or subject to administrative sanctions; and, 4) not to be in certain conflict of interest situations.[417]

On the other hand, Pemex's governing board must be integrated by the Minister of Energy, who holds the *chairmanship* with the tiebreaking vote; 3 government counselors representing the Executive, and 5 "*independent counselors*", who shall perform their tasks part-time and are not public servants.[418] Save for the Energy Minister, Pemex governing legislation orders that government counselors and the so-called "independent counselors" shall be nominated by virtue of their expertise, capacity, and professional reputation, having to comply with the same eligibility conditions applicable to the CEO.[419]

As a result, 4 out of the 9 board counselors are directly accountable to the Executive's command since they may be freely appointed and removed at presidential discretion, as opposed to "*independent counselors*", who are governed by a *for-cause removal* catalogue and where the dismissal must be determined by the President and validated by the Senate.[420] This outcome virtually places the majority on the "independent" block (5 out 9), which is certainly an institutional improvement in terms of decisional autonomy compared to the past laws governing Pemex.

Yet, how autonomous are "*independent counselors*" from the Executive branch? Based on the institutional guarantees established by current legislation, there are three indicators to presume some degree of *autonomy* from the Executive power in the delivery of their role. First, the eligibility standards above are evidence that this positions are reserved, in principle, to persons with a high-level expertise, professional background, and a reputation that is beyond any conflict of interest, corruption scandal, or criminal background. Certainly, this is only technocratic and ethical test, but not necessarily proof of political independence. Second, one could say that some degree of political impartiality comes from an appointing and removal mechanism that requires the collaboration of two branches of government – the President nominates or fires them, whereas the Senate ratifies these determinations. Third, the independents shall perform this commission for staggered periods of five years with the possibility of reelection for one more period, so their incorporation and withdrawal from Pemex's board will normally take place through different presidential administration, fueling incentives for long-term horizons for decision-making purposes.

It is accurate to say the President has more leverage than the Senate in designating "*independent counselors*", since there could be some degree of political sympathy or

[416] *See* article 48 of the Petróleos Mexicanos Act in force.
[417] *See* articles 20 and 47 of the Petróleos Mexicanos Act in force.
[418] *See* article 15 of the Petróleos Mexicanos Act in force.
[419] *See* articles 20 and 21 of the Petróleos Mexicanos Act in force.
[420] *See* articles 15, 37, and 38 of the Petróleos Mexicanos Act in force.

alignment between the Executive calling the nomination and the nominee. But, once in their commission, independent counselors can perform their tasks autonomously. There is legal room to justify the Executive's greater intervention than the Senate in the nomination, since articles 25 and 28 of the constitution explicitly subordinate productive state enterprises to the Executive's command.

On the contrary, there is also legal ground to challenge the view supporting the *autonomy* of independent counselors from the Executive branch. There is a legislative precept weakening the autonomy enjoyed by the "independents" vis-à-vis the government. The salary or compensation paid to independent counselors is set up by a "special committee", which happens to be integrated by two officials from the Finance Ministry and one from the Energy Ministry – that is, public servants accountable to the Executive branch.[421] This situation provokes the next question: What are the incentives of opposing and departing from the views and determinations of those who decide by themselves the monetary compensation someone gets as "independent counselor" of Pemex?

Last, there is one institutional design choice on Pemex's corporate governance that the energy reform solved in a *contradictory* way from a check-and-balance standpoint. While *arm's-length* governance from presidential politics is relatively guaranteed through the appointment and removal system chosen for Pemex's management board, which is the supreme management body of the company, Congress gave a *different treatment* to the CEO, who is the executive arm of the same governing board. Legislation confers the President the right to freely designate and remove Pemex's CEO. Then, what is the reason supporting the relative insulation of Pemex's council board from presidential pressures, but conceding the Executive direct intervention on the NOC's management through the control of its CEO?

Drawing upon balanced governance and coherence reasons, the legislature could have established for the appointment of Pemex's CEO the same designation mechanism chosen for members of the council board, as well as a for-cause device for the President to validly dismiss this officer. An alternative mechanism with stronger *checks and balances* than the chosen would have been that the management board may vote on a list of nominees elaborated by the President, if the latter is to receive some deference in the nomination of Pemex's CEO. Thus, it would have been reasonable to propose the participation of the board for choosing the holding's CEO.

In summary, this work identifies relevant improvements achieved by the Mexican energy reform concerning the corporate governance of what should be a "*productive state enterprise*". It is evident that substantive steps were taken by Mexican policymakers to confer Pemex greater decision-making independence from government. At the same time, there still are minor, but important, questions that should be taken care of by reformers in order to complete this liberalization of Pemex's governance regime.

[421] *See* article 15 of the Petróleos Mexicanos Act in force.

B. Corporate Structure: Subsidiary and Affiliate Enterprises

The energy reform of 2013-2014 modified the rules governing the corporate organization in which the Pemex has ownership interests. The Petróleos Mexicanos Act distinguishes two types of enterprises related to the holding: *subsidiary* and *affiliates*. According to such legislation, Pemex's subsidiaries shall have the status of "productive state enterprises", with legal personhood and a patrimonial sphere of its own.

Before the recent energy overhaul, Pemex was a "decentralized" entity of the administration, compounded by four subsidiaries –each of them focused on a different business segment of the hydrocarbon industry– with the same legal status of their matrix. Until 2014, "*Pemex Exploración y Producción*" (PEP) was the subsidiary organism in charge of conducting exploration and production operations under a monopoly structure.

The Mexican NOC's subsidiaries are now regulated by the precepts of the Petróleos Mexicanos Act of 2014 and must be *subordinated* to the command, leadership, and coordination directives issued by the council board of their matrix. In the same way as Pemex, *subsidiary* enterprises shall be governed by the special regime established by Pemex's enabling statute on budget, debt, procurement, administrative responsibilities, and human and material resources. In case there is a question on subsidiaries that is not regulated by the Petróleos Mexicanos Act, *civil* and *mercantile law* shall be applicable by extension, for as long as supplementary law is compatible with Pemex's *special regime*.

For these reasons, it seems that Congress also followed a *liberalizing* rationale for detaching Pemex's subsidiaries from their former public administration governance, so that they enjoy of an *arm's-length* relationship with the Mexican government and are able to make competitive management decisions on a commercial basis.

Current legislation has a general precept whose purpose is to distribute Pemex's business depending on whether or not the operation at hand is *upstream* petroleum activity. If so, crude oil exploration and production shall only be carried out by *subsidiary* entities, whereas the rest of business may be executed through a variety of corporate structures such as: 1) Pemex itself, 2) *affiliate* enterprises, 3) corporations in which Pemex has a minority equity participation, or through 4) strategic alliances or joint ventures.

Yet, in the context of *upstream* oil operations, article 63 of the Petróleos Mexicanos Act specifies the range of corporate vehicles by which Pemex can deliver exploration and production activities. On the one hand, if the enabling grant at issue is an *assignation*, then Pemex shall operate via their *subsidiaries* (PEP). On the other, when the enabling instrument to conduct upstream oil activity is a *contract*, then there are two possibilities. If Pemex is the *only contractor*, then it can make use of one or more *subsidiaries* (PEP). On the contrary, if Pemex participates along with other oil companies, via a *farm-out* or a *joint venture*, Pemex must formalize such partnership through an *affiliate* enterprise, a corporation where it has a minority equity interest, or through other type of alliances permitted by the Hydrocarbons Act.

The second kind of company in Pemex's corporate structure are *affiliates*, which the enabling legislation defines as those enterprises in which the Mexican oil champion owns – directly or indirectly – more than 50% of their capital. As opposed to Pemex and its subsidiary entities, the enabling legislation states that Pemex's affiliates are *not part* of the *public administration*, thus they have a private law nature and shall be governed according to the law of the jurisdiction where they are incorporated. In light of these legislative premises, Pemex's affiliates have a much more flexible regime than Pemex and its subsidiaries, since they are not heavily regulated by the public law governing the latter.

The remark above is extremely relevant because, as private law agents, Pemex's *affiliates* could be used to build up a parallel structure aimed at bypassing the constitutional and legislative restrictions that were preserved after the energy reform of 2013 and still constrain Pemex's prospects to become into a worldwide competitive NOC. Given the scarcity of fresh capital to conduct productive investment and remain competitive, the constitutional mandate to keep Pemex under full state ownership represents a legal obstacle to capitalize the Mexican oil champion itself. [422]

Despite that it would not be the most orthodox course of action, in case of an emergency scenario, this work conceives the possibility of recurring to a *parallel corporate structure* where most of the fresh capital required by Pemex's managers is passed through a network of affiliate enterprises. The business purpose of this affiliate enterprise should be merely financial, forbidding any direct intervention or operation in the Mexican hydrocarbons industry. Hence, the affiliate's incorporation should be carefully crafted by assuring Pemex's majority control and by specifying that other than Pemex or its subsidiaries, minority investors' equity on the affiliate shall not translate or exert any corporate right on Pemex's matrix. Otherwise, the incorporation of such affiliate is very likely to be judged in flagrant violation of the Mexican constitution and the enabling legislation. The ideological aversion that privatizing measures arouse in Mexico increases the likelihood that this corporate decision might be disputed in judiciary is high, so Pemex's governing bodies must shield its legal vulnerability as much as possible.

C. BUDGET, DEBT, AND HUMAN RESOURCES

The conversion of Pemex into a "productive state enterprise" required the establishment of a *special regime* on different managerial aspects to provide this NOC with greater flexibility and independence than that of public administration entities, so that it may mimic the best international practices of competitive oil companies – most of which do not have to comply with the administrative burden Pemex had to face as a company belonging to Mexico's Executive branch.

Budgetary autonomy is one the most important dimensions to address, if there is a genuine desire to increase an organization's independence in functional terms. As of the its

[422] *See* Grupo Expansión, Interview to Juan Carlos Zepeda, Presiding Commissioner of CNH, Presiding Commissioner of CNH, *supra note* 352, available at https://www.youtube.com/watch?v=Hfl_DZJp_u4.

legal transformation into a "*productive state enterprise*", Pemex and its subsidiaries got a *special budgetary regime* which has much less of the Finance Ministry's overwhelming intervention of the past. According to the Petróleos Mexicanos Act, the NOC must only abide to the cap set by the Finance Ministry on 'financial balance' and 'human resources expenditures'. This means that Hacienda shall have power to exclusively regulate and adjust Pemex's proposal for its financial balance and human resources contracting.[423]

Except for those two concepts, this NOC's governing bodies may elaborate the company's budget, which should be submitted to the House of Representatives for approval. Later on, Pemex's managers are relatively *independent* to *execute* the approved budget with respect to the time and form instructed by its governance bodies.[424] Hence, the budgetary control authority over Pemex, which used to be purview of the Executive branch, has now been transferred to the jurisdiction of Pemex's council board and CEO.

Therefore, it seems that the energy reform of 2013 *simplified* the budget regime of Pemex, by cutting off much of the clearance authorizations that allowed the discretional intrusion of the Finance Ministry in the design of the company's annual budget. On the other hand, it is understandable that the administration preserved the authority to check and control the global financial balance and the programmed spending for human resources of the company, even against Pemex's determinations, since this NOC still is intertwined to the state's fiscal and financial stability and excessive labor has been a traditional problem for the company's productivity. In short, *budgetary autonomy* was not understood by Congress as a blank check to Pemex's managers to incur in huge deficits that, in the end, could force the government to fund either via taxes or public debt.

The other dimension that is worth of mention refers to Pemex's *debt regime*. In terms of the Petróleos Mexicanos Act, there is a set of specific rules governing the Mexican oil champion and their subsidiaries' management of their obligations constitutive of public debt. As opposed to the legal framework ruling Pemex's budget, the special regime on Pemex's debt is apparently more *flexible* and grants this NOC with greater i*ndependence* to negotiate and manage its debt compared to the prior precepts in this regard.

For instance, Pemex may send its proposal of global financing to be directly incorporated by Hacienda in the Revenue Act bill the President must submit to Congress's approval each fiscal year.[425] Second, Pemex has the prerogative to enter into official negotiations and informal arrangements aimed at exploring financing alternatives – both in the external and domestic debt markets – without prior authorization from the Finance Ministry.[426] Third, instead of subordinating the NOC to the Executive, the enabling legislation indicates that the NOC shall coordinate with Hacienda to agree on the schedule of the financial transactions the former decides to subscribe, provided that these commitments do not result either in an increase of the rest of the public sector's financing

[423] *See* articles 100 and 101, section III, of the Petróleos Mexicanos Act in force.
[424] *See* article 102 of the Petróleos Mexicanos Act in force.
[425] *See* article 106, section I, of the Petróleos Mexicanos Act in force.
[426] *See* article 106, section II, of the Petróleos Mexicanos Act in force.

cost or in a reduction of this financing sources.[427] Fourth, Pemex's enabling legislation even concedes the NOC the prerogative to commit on additional financial obligations to the debt approved by Congress, or to modify the debt previously authorized, for as long as Pemex notifies Hacienda about this new situation at least 15 business days earlier to the date in which the transaction has been scheduled to take place.[428]

At first glance, it looks like the *coordination* between Pemex and Hacienda to agree on the contracting and scheduling of the former's debt is based on equal footing. There is, however, a hidden rule in Pemex's debt regime which empowers the Finance Ministry to *order* the *put on hold* any financial transaction by which the Mexican NOC plans on contracting debt, if Hacienda considers that the operation could cause either an increase of the public sector's financing cost or a diminishing of the financing supply alternatives. According Pemex's governing statue, the transaction shall get Hacienda's clearance until the situation motivating the block is overcome.[429]

This remark leads support to sustain that the coordination ruling the relation of Pemex with the Finance Ministry to agree on the former's debt transactions, is not really based on equal footing, because Hacienda preserves the *authoritative discretion* to *suspend* these financing operations in case these are judged in detriment of the Mexican public sector. The incentives resulting from this rule induce Pemex's managers to get in advance the approval of the Finance Ministry, in light of Hacienda's 'last resource' to *freeze* Pemex's financing plans. So, it is clear that the Executive power keeps the last word in this regard. But, who could object this discretion when Pemex's financial capacity has direct consequences on the financial and fiscal stability of the Mexican state?

Concerning the management of human resources, compensations, and procurement, the Petróleos Mexicanos Act establishes that the executive board shall constitute "committees" in charge of designing the policies and directives governing these matters, so the laws governing the same affairs in relation to the central administration *are not longer applicable* to Pemex. The purpose is to *simplify* and *reduce administrative costs* for Pemex. With respect to human resources and compensations, it is worth noting that Pemex's enabling legislation mandates the need to set up salaries and bonus for employees and officials in accordance to the best international practices in petroleum industry.

D. THE PENDING CHANGE TOWARDS HYBRID OWNERSHIP

The "productive state enterprise" template is then an institution-building effort that can be described as *incomplete* or even *superficia*l. Behind the amendments to Pemex's corporate governance, many of which undeniably signify a step to guarantee an *arm's-length* relation with the state, the energy reform of 2013 kept the ruling elite's "crown jewel" in Pemex away from this liberalization. It is not coincidence that the framers of hydrocarbon reform

[427] *See* article 106, section VI, subsection a) of the Petróleos Mexicanos Act in force.
[428] *See* article 106, section VI, subsection b) of the Petróleos Mexicanos Act in force.
[429] *Id.*

are the same group of political leaders who have benefited from full *state ownership* and *control* of Pemex. Behaving otherwise would have meant acting against their short-term interests to extract rents and remain in power – namely, a third party holding property rights on corporate equity seeks to maximize the return on their investment, rather than optimizing oil revenue for the state, so their participation eventually results in *competitive pressures* the ruling elites not want to deal with inside the NOC's management.

Unlike its peers in Brazil, Colombia, and Norway[430], whose competitive performance was a reason for mimicking their oil governance model, Pemex remains as a 100% state-owned company since 1938. Then the missing piece in the energy reform of 2013 is the liberalization of the NOC's *equity ownership*, meaning the entrance of private capital with corporate rights to check and balance the government hegemony over the management of the company.

As illustrated in Chapter II of this research, *ownership* is the mother key to subsequent institutional building in oil-rich nations because property rights mean who, how and when has access and control to petroleum rents. Although *checks and balances* can also be achieved through other legal and regulatory tools, ownership governs the access to and distribution of certain goods, thus developing a social meaning with a sense of 'materiality' other institutions lack of. This *materiality* gives ownership rights a concrete weight that – as spheres with certain boundaries and dimensions – makes highly visible when they move in opposing directions, checking one another. When it comes to Pemex, the interest of government officials leans to maximizing revenue extraction, whereas private stakes are driven by the desire to increase dividends.

It is often said that *state ownership* and *control* of Pemex has always been an ideological taboo, which no one has dared to challenge in the Mexican political arena. But, what is behind this myth? Using political economy concepts, low transaction costs stemming from the mutual dependence among ruling elites and Pemex's managers provoke a lack of incentives to move from state ownership to a hybrid equity regime, since these actors are interested in maximizing their discretion over their regulatory, taxing, and managerial roles over the crude oil. A transition towards a *mixed ownership* regime would insert a minority of shareholders who will most likely work as a *check and balance* of the government interests in Pemex.

In parallel, since social expectations on the state are high with full state ownership of Pemex, government elites are induced to employ the NOC for patronage and social policy goals. In exchange for these public works at the expense of the NOC, ruling elites are motivated in maximizing their electoral clienteles to help them to remain in office.

The political economy insights above only reinforce what seems to be unlikely at the *political arena* in the near future. In 2018, Andrés López Obrador won the Mexican presidential elections by a 53% of the popular vote. The President elect's party coalition

[430] I mean national oil companies, such as *Petrobras* in Brazil, *Ecopetrol* in Colombia, and Norway's *Statoil*.

achieved a representation of 61% in the House of Representatives and 54% in the Senate.[431] During the electoral campaign, López Obrador promised to review the upstream oil contracts that the Peña Nieto administration has already granted after the energy reform, so that the correspondent legal measures can be applied wherever there is proof of political grand corruption. Moreover, he also campaigned supported on the proposal to update the Mexican petroleum refining system, so that Mexico guarantees self-sufficiency of fossil fuels and is not dependent on the United States for their importation.

Considering the strong democratic mandate López Obrador received in the past election as well as his well-known *resource nationalism* and statist policy orientation, the liberalization of Pemex's ownership regime –whether by a constitutional reform or by the use of affiliate corporations– is *highly unlikely* during his presidential term. On the contrary, he could either employ the sources of executive discretion this work has highlighted above –the abuse of assignations, for instance– with the purpose of rolling back the 'liberalizing' elements of the 2013 reform, or even attempt a constitutional repeal of it given his majoritarian legislative support – which is close to the qualified majority to that effect. This degree of presidential control over Congress foreshadows a *hostile political environment* for effective checks and balances in Mexican oil governance.

All factors considered, the difficult *international context*, which I characterize by a slow recover from petroleum markets collapse in 2014 and the passing of the "easy oil" era, has become the only external reality with the power to weaken –by means of *natural*, *contingent necessity*– the consensus on full state ownership for Pemex. As result of the rentier model applied to Pemex and its contribution to Mexico's depletion of oil reserves, poor investment capacity and a negative debt portfolio, the Mexican oil champion is urged of an aggressive capitalization strategy. It turns to be another *paradox* but, if the Mexican government desires to increase its profits from upstream oil operations in the long-term, it is in its best interest to trigger a *liberalizing* policy that is aimed at attracting investment in the domestic oil industry, not just through upstream oil contracts granted to private companies and strategic alliances involving Pemex and foreign oil corporations, but also via the *partial privatization* of the Mexican oil champion itself.

Once the injections of fresh capital on Pemex become profitable and productive in time, the Mexican state would benefit from revenue streams coming from three sources:

1) Corporate tax and duties paid in exchange for assignations;

2) Corporate tax and considerations paid for an upstream oil contracts granted either to Pemex alone or to an alliance this NOC is part of, and

3) Dividends paid to the state as majority shareholder of the company.

[431] El Universal, "INE presenta asignación de diputados y senadores; Morena será mayoría" [The Electoral National Institute presents the allocation of representatives and senators; the National Regeneration Movement (MORENA) will be majority], *El Universal,* México, August 22, 2018, available at http://www.eluniversal.com.mx/nacion/politica/ine-presenta-asignacion-de-diputados-y-senadores-morena-sera-mayoria

Furthermore, the concession of ownership rights to equity investors in Pemex would give fresh air to the Mexican government by not having to borrow this capital liquidity from debt markets. In doing so, the government could decrease Pemex's leverage and therefore ease the financial requirements in charge of the whole Mexican public sector, since Pemex's debt is implicitly guaranteed by the Mexican state as de facto collateral.

The symptoms highlighting Pemex's performance decline in the upstream oil sector – that is, the business segment from which it gets most revenue– have worsened even after the energy reform of 2013. Out of 108 assignations granted to carry out upstream operations, this NOC fulfilled all of its commitments for only 24 assignations, while was capable of meeting the investment component for just 13.

Privatization, as means for achieving a genuine liberalization of an industry, should not amount to the migration from a *public monopoly* to a *private* one. Before addressing the upstream sector, the Mexican government should first explore the possibility of privatizing some parts of the downstream and midstream segments of the oil industry that have been completely neglected by Pemex in terms of investment. Once satisfied that step, then policymakers should plan the 1) strategy, 2) degree, and 3) pace under which private capital is to be inserted in the Pemex's upstream subsidiary, so that this *privatization* process benefits the national interest and is attractive for private investors.

Pemex's ownership regime is the institutional pillar whose reform is still pending in Mexico after 2013. The ownership regime in Pemex this work has advocated for is not one characterized by power concentration, but rather by a *competitive* nature that leads to *balanced* governance. Until this liberalization procedure is not done, it seems unlikely that all the rest of legal and institutional changes are capable of fixing the fiscal squeezing of Pemex and its repercussion for development of strong fiscal institutions in Mexico.

VII. NORWAY AS MODEL FOR MEXICO'S PETROLEUM REFORM

1. Transplantation of the Norwegian Model

My claim on the critical role of *checks and balances* in assuring an effective liberalization of the Mexican oil industry's regime is not just supported on theory, but also on a comparative analysis with the oil governing institutions of Norway –a 'benchmark' case whose commonality with Mexico is the dominance of a national oil champion over their domestic upstream markets as well as an extensive presence from a regulatory state.[432]

Policymakers have praised the advantages of the Norwegian template due to the *arm's-length* principle ruling the relations among oil governmental bodies and the positive impact this separation of functions has had for the high performance of the Norway's petroleum industry – which has the most competitive state-owned oil company worldwide.

This work first describes the fundamentals underlying the Norwegian oil model and then *compares* them with the evaluation made of Mexico's petroleum regime in Chapters V and VI, for the sake of finding out the differences that might impair the aim for *balanced governance* in the transplant.

Instead of providing an exhaustive historical description of the Norwegian oil governance model, this research takes as premise that Norway constitutes the *best international experience* to which 'third-way' regimes on petroleum should aspire, in terms of having a balance between an effective administrative state policing the industry's performance and market. Hence, my analytical strategy is focused on highlighting relevant *divergences* –in terms of checks and balances– between petroleum institutions in Mexico and those of Norway.

Considering this excellent worldwide reputation, Mexican reformers[433] mimicked Norway's regulatory design as means for achieving a highly developed petroleum sector and keeping the state's prominent role not just in terms of its regulatory power, but also in the sense of having a commercial intervention of its own. It is worth flagging that Mexico is not the first Latin American country to follow the Norwegian model of petroleum institutions. Brazil and Colombia launched liberalizing reforms over their oil sectors since 1995 and 2003, respectively.[434] As for their state oil enterprises, Norway's Equinor[435],

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[432] *See* Thurber and Tangen Istad, *supra note* 356, at 599.

[433] By *reformers,* I mean both President Peña Nieto's energy overhaul bill proposal at the constitutional and legislative levels as well as the administration's supporters in Congress.

[434] *See* Adilson de Oliveira, "Brazil's Petrobras: strategy and performance", at David G. Victor, David R. Hults, and Mark C. Thurber (eds.), *Oil and Governance: State-owned Enterprises and the World Energy Supply*, Cambridge University Press, 2012, at 535-537. *See*, also, Thurber and Tangen Istad, "Norway's evolving champion: Statoil and the politics of state enterprise", at David G. Victor, David R. Hults, and Mark C. Thurber (eds.), *Oil and Governance: State-owned Enterprises and the World Energy Supply*, Cambridge University Press, 2012, at 599.

which was founded under the name of "*Den Norske Stats Oljeselskap AS*" (Statoil)[436], has been partially owned by private investors since 2001, whereas the Brazilian "*Petróleo Brasileiro SA*" (Petrobras)[437] was partly privatized in 1995 and Colombia's "*Ecopetrol SA*" (Ecopetrol) has launched initial public offering for a minority of its capital share since 2007.

As proof that the 2013 Mexican hydrocarbons reform was modeled on the Norwegian experience and its Latin American replicas, the Executive's initiative of constitutional reform on energy mentions explicitly that:

> "[…] Different countries have amended their legislation in face of the challenges brought by the new environment of more complex petroleum reservoirs, which require huge investments, risk-sharing schemes as well as the development of new technologies. Reforms in *Brazil*, *Colombia*, and *Norway* are clear illustration of this, by designing schemes which fostered the production of non-conventional petroleum deposits".[438]

> "[….] Nowadays, Pemex's fiscal regime is supported on a rigid scheme of tax duties, which are determined without fully acknowledging the company's investment needs. In other countries, such as *Brazil*, *Colombia*, and *Norway*, national oil companies pay more moderate tax contributions than those currently paid by Pemex and then, depending on the investment profitability, it is decided more flexibly whether profits are reinvested into the company's projects or transferred to the treasury".[439]

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[435] On May 16th, 2018, Norway's national oil company had a name change from Statoil to Equinor. This decision was approved in the Annual General Meeting last March 2018, so as to reflect the company's new corporate values, such as equality, the combat of climate change, and the Norwegian national pride rather than a link to the state apparatus. So, from this point on, every bibliographical reference to Statoil should be applied to Equinor interchangeably. *See* Equinor, "About our name change", consulted on May 16, 2018, at https://www.equinor.com.

[436] The Norwegian state currently holds 67% of Equinor's capital stock. The rest of stockholders appeared as consequence of Equinor's partial privatization in 2001. *See* Equinor, "Equinor - Investors", consulted on May 16, 2018, at https://www.equinor.com/en/investors.html#the-statoil-share.

[437] Brazil's federal government has a share of 50.26% of the comon shares (those that confer their holders the right to vote at the governance bodies) in Petrobras' capital composition scheme, plus an additional share of 9.87% of the same type of stock held by the Brazilian Development Bank, which is also federal public company associated to the Ministry of Development, Industry, and Trade of Brazil. *See* Petrobras, "Petrobras – Investor Relations – Capital Ownership", consulted on February 17, 2017, at http://www.investidorpetrobras.com.br/en/corporate-governance/capital-ownership

[438] In Spanish the citation is the following: "*Distintos países han ajustado su legislación ante los retos que representa el nuevo entorno de yacimientos cada vez más complejos, que requieren de grandes inversiones, compartir riesgos, así como desarrollar y aplicar nuevas tecnologías. Las reformas de Brasil, Colombia y Noruega dan muestra clara de ello, al diseñar esquemas que promovieron la producción en yacimientos de petróleo no convencional*". *See* Enrique Peña Nieto, "Exposición de motivos a la Iniciativa de Decreto por el que se Reforman los Artículos 27 y 28 de la Constitución Política de los Estados Unidos Mexicanos" [Statement of Purpose to the Reform Decree of Articles 27 and 28 of the Political Constitution of the United Mexican States], Enrique Peña Nieto, Presidente de la República, August 12, 2013, at 3. The italics are mine.

[439] In Spanish the citation is the following: "*Hoy en día, el régimen fiscal de Pemex está sustentado en un esquema de derechos rígidos, los cuales se determinan sin reconocer plenamente las necesidades de inversión de la empresa. En otros países, como Brasil, Colombia y Noruega, las empresas petroleras*

According to the opinion through which Congress's committees processed all initiatives of energy reform in 2013, the cases of Norway, Colombia and Brazil highlight the need to modernize the organization of the hydrocarbons sector, so the latter is tailored to guarantee the national interest. In Congress's view, each of these nations adopted a *flexible* and *pragmatic* approach with the aim at *maximizing* the nation's oil profits.

Moreover, this legislative document indicates that, in these benchmark countries, ownership rights on subsoil petroleum belong to the nation, but multiple actors –both public and private, domestic and foreign– are authorized to intervene in their extraction. In the end, the legislators sustain, the national oil champions in each of these countries have been reformed to *optimize* the state's own capacity to increase oil production and guarantee new oil deposits for the future.

The Mexican policymakers concluded: the success of Norway, Brazil, and Colombia in reorganizing their state oil enterprises has resulted from the policy of submitting them to *business-oriented* corporate strategy, rather than to the logic of *politics* and *public administration*.[440] This strategy goes through giving these national oil champions the *autonomy* to keep a higher percentage of their profits to be reinvested in productive projects and technology development and to get into strategic alliances with private oil corporations for conducting upstream oil operations.

The congressional opinion which led to the passage of the Mexican petroleum reform of 2013, recognized that Norway developed the original regulatory model on which the Brazilian and Colombian regimes were based afterwards. For the framers of the Mexican energy reform, there are three features responsible for making Norway's oil governance the *best international practice* for 'third-way' oil regulatory systems.

1) First, the Norwegian oil governance is presumptively supported on the *maximization* of oil proceeds for the benefit of the nation.[441]

2) Second, Norway's national development approach towards its hydrocarbon sector has been mainly accomplished through the role played by "*Government Pension Fund Global of Norway*" (Oil Fund) – a sovereign wealth fund that is owned by the state with the task of investing the surplus oil revenue produced by the Norwegian petroleum industry, whether in the form of taxes, licensing royalties, licensing fees, and the corresponding shared of dividends coming from Equinor.[442]

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nacionales pagan contribuciones más moderadas que las que hoy en día paga Pemex y luego, dependiendo de la rentabilidad de la inversión, se decide de forma más flexible si el remanente se reinvierte en la propia empresa o se transfiere a la hacienda pública". *Ib.* at 14. The italics are mine.

[440] *See* Opinion from the Senate's United Committees on Constitutional Affairs, Energy, and Legislative Studies – First, on the Decree Bill that adds and amends several dispositions on energy of the Political Constitution of the Mexican United States, Mexican Federal Congress, *Gaceta del Senado,* Senado de la República 8 de diciembre de 2013, at 188, available at http://www.senado.gob.mx/comisiones/estudios_legislativos1/docs/relevantes/RCME_3-1.pdf.

[441] *Ib.* at 189.

[442] *Id.*

The Norwegian Oil Fund is the largest sovereign fund in the globe, holding a portfolio equivalent to 1.3% of the world's capital stock and shares and owning $1 trillion USD in assets.[443] The size of the Oil Fund is as relevant that, if divided by the total of Norwegian citizens, each one would be entitled to an average of $140,000 USD for retirement purposes –an achievement that developed economies without strong *social safety nets*, such as the United States, have never dreamed of giving its citizens.

Basically, the Oil Fund has prevented Norway's petroleum rent from being depleted by the government for budgetary purposes and has developed instead a sustainable development strategy by placing these oil revenue into long-term investment projects – both domestically and abroad – that have increased the savings for future generations.

3) Third, part of the Norwegian experience success lies in Equinor, the national oil company –formerly known as Statoil– from which the government owns 67% of its capital stock, whereas a minority of private investors hold the rest 33%.[444] A *hybrid ownership* structure has been critical to build *checks and balances* inside Statoil, which in turn have supported a *business-oriented* corporate governance and therefore shielded its decision-making from the encroachment of political interference. This *autonomy* has allowed Equinor to make its own investment decisions without being subordinated to the short-term needs of the Norwegian government and to impede the government from bleeding out this NOC through an excessive tax burden.

2. Institutional and Policy Foundations of Norwegian Success

The Norwegian regime on upstream oil has been praised worldwide because of the *formal separation* of *functions* among its policy, regulatory, and commercial actors. Yet, according to specialists[445], the success of the Norwegian experience obeys to more *circumstantial* factors and *pragmatic policy adjustments* than the right choice of bureaucratic design. To illustrate this point, there are also countries which are not following the approach of separating policy, regulatory, and commercial roles in their petroleum sectors, but rather have centralized regimes with outstanding performance results from economic viewpoint.

In this sense, the idea of a Norwegian blueprint of distinct compartments with specific tasks should not be overrate the fact that Norway's administrative organization of its petroleum industry was the outcome of an *accommodation* process "with conflict and uncertainty".[446] More importantly, this Nordic country jumped in the petroleum business when it already had both a consolidated a 1) democratic system and effective state capacity in the sense of a 2) competent bureaucracy. It is worth flagging in this regard that when

[443] The Economist, "Norway's sovereign-wealth fund passes the $1trn mark", *The Economist,* Finance and economics, September 23, 2017, at https://www.economist.com/news/finance-and-economics/21729458-5m-odd-norwegians-own-more-1-all-shares-world-norways
[444] *See supra note* 353.
[445] *Ib.* at 600. *See* also Farouk Al-Kasim, *Managing Petroleum Resources: The 'Norwegian Model' in a Broad Perspective,* Oxford Institute for Energy Studies, 2006.
[446] *See* Thurber and Tangen Istad, *supra note* 356, at 600.

Equinor was created, Norway already had experience in the regulation of other sectors based on the extraction of natural resources – for example, fishing, mining, and hydropower generation.

Contrary to what the framers of the Mexican energy reform thought by mimicking the Norwegian model on upstream oil, Thurber and Tangen Istad highlight that Norway's main policy was aimed at guaranteeing *state control* on hydrocarbons rather than focusing on revenue maximization.[447] According to these energy policy analysts, the beginning of the Norwegian petroleum experience involved a *gradual policymaking* process concerning the capacity of this Scandinavian nation to absorb the negative impact of excessive oil rents in the domestic economy.[448]

Hence, the government planned to counter the disruptive effects resulting from excessive oil revenue into the economy, by graduating the pace of its petroleum production strategy and regulating foreign and domestic oil contractors. The regulatory component of this objective meant first the development of expertise and professional competence among the government agencies in charge of overseeing the oil industry and, second, the creation of a NOC.

The account above is critical for the purpose of the present work, since it means that main *policy motivations* to shield the *state command* over oil and gas resources were not in fact the same both in Norway and Mexico. While the 'rentier' function was *modulated* by other equally important policy concerns in the benchmark case, such as the domestic economy capacity to gradually process the oil revenue impact, this work has evidenced how Mexico's new regime on upstream oil is entrenched around a fiscally oriented objective explicitly put at the constitution itself.

Instead of assuring control on petroleum exclusively via formal institutions, a deeper examination of the Norwegian case highlights that regulatory command over this extractive industry stemmed from a "skillful bureaucracy operating within a mature and open political system".[449] In short, both *political* and *bureaucratic institutions* have played out a critical role in turning the Norwegian oil governance model into an effective regulatory structure.[450] It stands out, in this context, that the concern of the Norwegian state was to build up *independent regulatory expertise* among its professional bureaucracy as a mechanism to counterweight not only the economic and political power of foreign oil investors, but also from its NOC. Furthermore, the *institutional autonomy* of the Norwegian petroleum bureaucracy has been shielded by the checks and balances coming from a competitive, but stable, political environment in the nation's parliamentary system –that is, alternation in government between conservative and socialist political parties.

A third feature on which policy analysts place a great deal of Norway's petroleum success is the *innovation* and the *engineering-driven culture* present at the organizational

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[447] *Id.*
[448] *Id.*
[449] *Ib.* at 600-601.
[450] *See* Mark C. Thurber, David R. Hults, and Patrick R.P. Heller, *supra note* 354, at 3.

practices of Equinor. Since the beginning of Norway's petroleum era, Equinor has enjoyed enough *independence* to make long-term decisions that prioritize the company's research and development of technology and infrastructure against the short-termism of an exclusive business mindset focused on the extraction of profits. Equinor has applied this technically driven approach in its upstream petroleum projects both in the North Sea and abroad.

For Thurber and Tangen Istad, Equinor is the largest employer in Norway and, as such, has become the engine of the domestic oil industry. Although the 'protectionist' approach in using Equinor's dominant market power to foster the development of other economic sectors in Norway has implied higher costs and a short-term impact on government revenue, these public investment ventures have been an overall success.[451] This is another illustration of how the Norwegian institutions have successfully built a *third-way model*, which has reached an *optimal balance* between a regulatory state with developmental policy connotations and markets as creators of economic growth.

It is the *arm's-length* character what has characterized the institutional relation between Equinor and the government. Experts in the Norwegian petroleum industry have observed, though, that during its first years Equinor took advantage of both its state monopoly status and the political ties this situation facilitated between its managerial bureaucracy with government officials, in order to obtain *special privileges* from the licensing decision-making.

According to their case study, Thurber and Tangen Istad identify a turning point when petroleum resources began to mature and scarce in the North Sea, so Equinor was forced to focus its investment and new business strategy to compete abroad.[452] The necessity to *compete* in *equal terms* with private oil corporations at jurisdictions where Equinor lacked of the political connections it enjoyed at home, was the main factor to modernize the corporate governance of the Norwegian oil champion.

In this sense, Norway's political leadership sought to confer its NOC greater *autonomy* from the state as of the 1980s, so that it could build up an "independent corporate identity".[453] At the same time, the *dominance* of Equinor in Norwegian oil markets became a concern for government officials who then decided to take away many of the special advantages and privileges that have been granted to this NOC in the past. These policy measures were very important steps for Equinor to become *competitive* and increase its offshore operations worldwide. Finally, these decisions were complemented by the injection of private capital resulting from Equinor's *partial privatization* in 2001.

Despite the reforms to guarantee Equinor formal corporate autonomy, observers have underscored the *impossibility* to suppress every conflict of interest resulting from residual political ties existing between this state-owned enterprise and the Norwegian government elites. For Thurber and Tangen Istad, the *resilience* of "capture" and "revolving door" problems between state officials and Equinor's executives have manifested in different

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[451] *See* Thurber and Tangen Istad, *supra note* 356, at 602.
[452] *Id.*
[453] *Id.*

manners, such as: 1) corporate decisions with a direct impact on the domestic oil industry, and 2) demands raised by Norwegian politicians as a way to persuade Norway's public opinion that Equinor is still under complete state control.

By way of illustration, the *collusion* between government leaders and Equinor's managers was clear when the then-called Statoil was merged with its main petroleum competitor at home in 2007, Norsk Hydro[454], despite the negative impact this policy decision could have in competition terms for domestic oil markets – as consequence of this merger, the resulting company took control of nearly 80% of upstream oil operations in the Norwegian continental shelf.[455]

Although the *merger* was authorized based on the efficiencies it would create as a joint entity and on the commercial gains abroad resulting from the consolidation of a Norwegian oil champion, some experts conclude that this transaction had the aim at controlling Norway's continental shelf, but added smaller value for strengthening its assets position in global markets.[456] Hence, what can be learnt from the Norwegian case is that even a country with reputation for having strong *checks and balances* among its petroleum institutions, seems constantly challenged by "capture" and *rent-seeking risks* in general, because of the influence political elites naturally have over a primarily state firm.

The Norwegian experience is then a laboratory where Jones Luong and Weinthal's thesis on oil ownership can be positively tested, since when the most important source of government revenue comes from an activity at which the state owns the bigger share on behalf of the national interest, ruling elites face incentives to make highly visible before civil society the perception of control.

3. Checks and Balances in Norway's Petroleum Institutions

In contrast to views of Mexican policymakers, the Norwegian oil governance was not the outcome of an administrative template designed aprioristically by a group of experts. Instead, the *formal separation* of policy, regulatory, and commercial functions in Norway's oil industry resulted from a gradual process that involved a lot of policy and institutional *experimentalism*. The 'triadic' administrative state supervising the Norwegian oil industry

[454] Norsk Hydro was originally a majoritively private oil company that owned a share of the Ekofisk field, which was discovered in 1969 and started its production stage in the first half of the 1970s decade. In late 1970, the Norwegian government decided to increase up to 51% its capital share in the Norsk Hydro conglomerate. Therefore, as of 1972, Norway had both a fully state-owned oil company (Statoil) as well as a majoritively state-owned enterprise (Norks Hydro) in the petroleum sector. This competitive scenario within the Norwegian state instrumentalities lasted until 2007, when the merger between the two of them took place in order to consolidate efficiencies into only one national oil champion for expanding operations abroad.

[455] *Ib.* at 602-603.

[456] *Id.* According to Thurber and Tangen Istad, the merger between Statoil and Norsk Hydro was planned in advance through the lobbying that managers from both oil companies deployed around Norway's Prime Minister Jens Stoltenberg, well before its consequences could be discussed among state officials, the Parliament, the sectorial regulator, and civil society.

is entangled to the historical interaction around these institutional actors. Yet, as this section highlights, the development of Norway's oil governance is more complex than a simple triangle structure.

The history of the Norwegian oil industry goes back to 1962 when the Phillips Petroleum conglomerate sent an application to the government for the purpose of getting an exclusive concession to carry out exploration activities over the Norwegian territory of the North Sea. At this point, Norway already had developed the possibility conditions of its contemporary regulatory model: 1) a *vibrant democracy* fueling its parliamentary system, on one hand, and 2) a *competent bureaucracy*, on the other.[457] Norway's political regime has contributed to the emergence of an independent, professional, stable *technocracy* staffing the governmental, this work seeks to focus on how the latter was set forth in the context of the oil industry.

Initially, policy and regulatory roles on petroleum were initially performed by Ministry of Industry, whose bureaucratic cadres were first recruited with the help of the then Minister of Foreign Affairs, Jens Evensen, for whom the main concern was to protect as much as possible of Norway's oil resource *sovereignty*.[458] Considering the inexperience of Norwegian state officials concerning petroleum matters, significant budget funds were channeled for this already competent bureaucracy to acquire the *technical* knowledge and *institutional capacity* in oil regulation and policy – in particular, the licensing arrangement governing the upstream operations in the Norwegian continental shelf.

Yet it would not be until 1969, though, when Norway's petroleum industry really took off with the discovery of the Ekofisk field. According to Farouk Al-Kasim, Norway's administrative apparatus on petroleum went through a "learning by doing"[459] phase, meaning that cumulative bidding rounds produced the expertise needed by the government officials because they could learn, on a case-by-case basis, from the gaps and flaws experienced in previous auctions and fix them in the subsequent rounds. In this way, it should be highlighted that all of the Norwegian regulatory policy on hydrocarbons took the form of executive decrees and administrative directives from 1965 through 1985, the year when the first law on petroleum was sanctioned by the Parliament.

Given the significance that the hydrocarbon sector would achieve in Norway, on January 11, 1978, the government saw necessary to create the Ministry of Petroleum and Energy (MPE) to take over the jurisdiction of setting and implementing oil policy.[460] In 1972, the government established in Stavanger the "*Norwegian Petroleum Directorate*" (NPD) as an administrative body tasked with regulatory and technical counseling[461]

[457] *See* Thurber, Hults, and Heller, *supra note* 354, at 3, 6, and 10.
[458] *See* Thurber and Tangen Istad, *supra note* 356, at 605.
[459] This is what Thurber and Tangen Istad dub "learning by doing". *Id. See* also Al-Kasim, *supra note* 445.
[460] *See* Government of Norway, "Norwegian Government Ministries since 1945", consulted on April 1, 2018, available at https://www.regjeringen.no/en/the-government/previous-governments/governments/modern-times/the-council-of-state-since-1945/id438700/
[461] The NPD is the administrative agency in charge of reporting the MPE the technical advisory with regard to hydrocarbon resources estimations, geological surveys, and petroleum engineering matters. *See* Ola Borten Moe, "Gestión y desafíos de una empresa de clase mundial: Statoil (Noruega)" [Management and challenges

functions at the service of the MPE, but with a board of directors who were formally independent from central government.[462] Considering that this board of directors did not added value in favor of the sectorial regulator's autonomy vis-à-vis the government, it was suppressed in 1991.

Today the NPD's staff organization is accountable to a director general. Approximately 230 employees staff this agency, being the rotation of management roles in its work community one of its key features.[463] For Al-Kasim, the NPD had to fought for its *institutional independence* over time[464] and it has managed to do so because of its "complementary, more technical skill set".[465] In words of Al-Kasim, who was the regulator's director of resource management, the first 12 years were difficult for the NPD because oil institutions in Norway were *unbalanced*: "Statoil was much heavier. NPD had to fight to gain respect, and for that it needed enthusiasts with enough competence that they could not be dismissed".[466] For other voices, the NPD's institutional autonomy is often exaggerated since this agency actually works as *technical instrumentality* of the MPE.[467] Therefore, it is not their independent jurisdiction, but rather a specialized mandate based on *division of labor* criteria what has made possible the 'functional coordination' between the NPD and the MPE.

Regarding the commercial component of the Norwegian oil governance, it is worth noting that before Statoil was created, "*Norsk Hydro*" was the first domestic equity investor and operator of upstream oil activities at the Norwegian continental shelf – especially as partner owning a capital share in the Ekofisk field. Originally, the Norwegian government had a minority shareholder in Norsk Hydro. In 1971, a Conservative-led coalition government decided to increase the state's equity participation within Norsk Hydro to 51%, turning it into a mixed capital company at which the government was the majority shareholder. Though, the Labor Party took over the government in 1972 and determined the creation of a fully state-owned oil champion – Statoil. Likewise, the government saw convenient to order the merge of the remainder of private domestic petroleum interests into a third Norwegian hydrocarbon entity named "*Saga Petroleum*".[468]

Following the Ekofisk discovery, in 1971, the Parliament's Industry Committee issued a document – commonly known as the "*The Ten Oil Commandments*" – with a set of policy principles to rule the Norwegian oil industry. According to the Ten Commandments for the Norwegian oil sector, back then the first concern was to secure national supervision and

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of a world-class company: Statoil (Norway)], Adrían Gallardo y Luz María de la Mora (coordinators), *Reforma Energética: Motor de Crecimiento y Bienestar* [Energy Reform: Growth and Development Engine], Fundación Colosio – Partido Revolucionario Institucional (PRI), México, D.F., 2014, at 152.

[462] *See* Al-Kasim, *supra note* 445, cited by Thurber and Tangen Istad, *supra note* 356, at 613. *See,* also, Norwegian Petroleum Directorate, "Norwegian Petroleum Directorate" consulted on April 1, 2018, available at http://www.npd.no/en/About-us/.

[463] *See* Norwegian Petroleum Directorate, "Organisation", consulted on April 1, 2018, available at http://www.npd.no/en/About-us/Organisation/.

[464] *See* Martin Sandbu, "The Iraqi who saved Norway from oil", *Financial Times*, August 29, 2009.

[465] *See* Thurber and Tangen Istad, *supra note* 363, at 613, 648.

[466] *See* Martin Sandbu, *supra note* 464.

[467] *See* Thurber and Tangen Istad, *supra note* 356, at 613.

[468] *See* Thurber and Tangen Istad, *supra note* 356, at 607.

control of the petroleum operations delivered domestically with the purpose of making Norway as independent as possible in terms of oil supply[469] – namely, a clearly mandate to guarantee Norway's hydrocarbon sovereignty.

Having Denmark and the Netherlands as cautionary tales, Norway's Labor government concern was to avoid the adverse impacts that hydrocarbon wealth could have on the economic, political, and social development of this Nordic nation, which it is worth repeating that were working extremely well before these oil resources discoveries. Rather than *oil revenue maximization*, it stands out that the Norwegian state adopted a *moderate extractive* policy for the newborn petroleum sector. This 'incremental' approach was supported on risk management assessment aimed at neutralizing disruptive effects that short-term oil revenue could signify for the traditional interests in Norway's economy.

In this context, the Ministry of Finance sent the Parliament an impact evaluation entitled "*Parliamentary Report No. 25*" through which the government anticipated the potential risks that the opening of the hydrocarbon sector could have for Norway's macroeconomic variables, employment and industries. Hence, the question of keeping *state control* and *oversight* upon the development of the oil wealth was not only ideological, but also pragmatic for two reasons: First, as means to grant the state the necessary *police powers* to regulate the disruptive impact of a new extractive industry, in order to protect the nation and its ability to adjust gradually. Second, control was seen necessary for Norwegian oil institutions could develop the *regulatory* and *technological capacities* to address the future challenges coming up with this extractive industry's boom.[470]

For the reasons above, there was a shared consensus among Norwegian policymakers to create Statoil as a state enterprise that could represent directly the national interest concerning the policy goals of both control and commercial management on domestic petroleum resources. Yet it is relevant to distinguish how this aim for *state control* on petroleum resources, and therefore the role of Statoil could have accordingly, was differently conceived by politicians and government officials. Basically, '*politicians*' thought a NOC would serve the state as an instrument of direct control over hydrocarbons, whereas '*administrative officials*' saw Statoil's incorporation as an opportunity to draw the boundaries between the commercial and regulatory policy orbits.

Put differently, political preference for a dominant *state-owned firm* obeyed the convenience of having a means to control petroleum production and regulate private participants pursuant government instructions. On the contrary, given that creating a NOC increases the risk of having a "state within the state", Ministry of Industry officials were more confident in exerting state control through smart *regulation* and licensing *policy*. Nevertheless, the incorporation of Statoil would be useful to separate 'commercial' and 'regulatory' jurisdictions within the administrate state, fostering a specific type of expertise for each these institutional capacities, as well as disentangling potential conflicts of interest within the state itself. In the bureaucrats' view, when this *functional separation* has a

[469] *See* Norwegian Petroleum Directorate, "10 commanding achievements", December 12, 2010, available at http://www.npd.no/en/Publications/Norwegian-Continental-Shelf/No2-2010/10-commanding-achievements/
[470] *See* Thurber and Tangen Istad, *supra note* 356, at 611.

translation in the organizational architecture, the government's reputation is relatively shielded from the bad business outcomes that the NOC could get in the future.[471]

In some oil-rich states, such as Mexico, the administration directly participates and chairs –through the Energy Ministry– their NOC's board of directors. Although this organic architecture allows for political control over the state-owned company, the downturn of this corporate governance can also backfire on the government, by exposing the administration to unnecessary criticism whenever there is an unsuccessful business venture made by the company's managers.

By the mid-1970s, Norway had established the checks and balances structuring its current regulatory governance on petroleum. First off, the *triangle model* was defined when the Ministry of Industry was joined by the NPD, as the government's technical arm conducting sectorial regulation, and Statoil, as the institutional actor in charge of managing the nation's petroleum wealth.

Since the beginning, Norwegian state officials wanted to imprint an *arm's-length* pattern to set up the functional boundaries of the new administrative design. As indicated earlier, these checks and balances were not just formal blueprint because they were given substance through the institutional practice. Based on Al-Kasim's book, the NPD bureaucracy had to struggle during its first years to consolidate its jurisdictional turf in light of the tensions with Statoil, the Ministry of Industry, and with talented private players. Drawing upon interviews done to former official personnel, Thurber and Tangen Istad conclude that the NPD's *struggle* for *autonomy* meant the need to address challenges, such as limited resources, information asymmetries, low salaries, and scarce expertise on the technicalities of the sector at hand.[472]

As for Statoil, the Ministry of Industry – and later the MPE – had complete control over this NOC, as representative of the state and hence exclusive shareholder of the NOC. Yet to be able to formally exert this legal capacity, the Minister was obliged to invoke the "General Assembly" formality, which meant a fully transparent decision-making process that could be subject to political oversight by Parliament, as opposed to informal back channels. Paradoxically, these *checks* and *balances* permitted the Norwegian oil champion to *aggrandize* its *autonomy* vis-à-vis the central government.

Another relevant factor that helped Statoil to become a 'veto point' in the Norway's oil governance was that, in 1974, the government entitled it with a 'carried interest' of 50% on exploration blocks, with a sliding-scale mechanism that authorized to increase its equity share up to 80%, if the exploration was successful and ready for extraction.[473] The Norwegian carried interest rule of the mid-1970s turn Statoil into a 'veto player' because the state did not have to advance capital for the exploratory venture, since this was delivered by a private oil company. But, if the exploratory enterprise implied the discovery of an oil field, the NOC had the right to opt for 80% of the capital share and to take over

[471] *Ib.* at 611-613.
[472] *Ib.* at 619.
[473] *Ib.* at 607.

operatorship during the extraction phase. This policy measure was originally justified on the imperative to develop domestic expertise.[474]

By the early 1980s, the concerns about Statoil's *aggrandizement* became a critical concern for the other two components of the triadic arrangement – that is, Norway's political class and state bureaucracy. Furthermore, Statoil's *dominance* in the domestic oil market was causing complaints on the part of private oil companies, who saw the government was clothing this NOC with many unjustified prerogatives as result of the company's state-owned status, thereby distorting the competition in the sector.[475]

Taking advantage of a political majority shift in the Norwegian Parliament and the emergence of a Conservative-led new government, the early 1980s decade facilitated the conditions to perform several reforms on Norway's original administrative structure on hydrocarbons –particularly in relation to Statoil.

The policy objective behind the so-called "*wing clipping*" maneuver[476] reform was to insert stronger *checks and controls* over the Norwegian oil champion, which was becoming excessively powerful. On one hand, the government then decided to break up Statoil's balance sheet in two portions, transferring the direct ownership and control of more than half of the Norwegian NOC's interests and assets –such as oil and gas fields, pipelines, and other infrastructure goods– to the Ministry of Finance into an equity stake known as the "*State's Direct Financial Interest*" (SDFI). The SDFI is not a legal entity itself, but rather constitutes the cash flow generated by this equity participation on petroleum owned by Norway's Finance Ministry[477]; nevertheless, Statoil would be in charge of managing the SDFI until 2001.[478] As a result of this legal partition, oil proceeds resulting from the SDFI could then be channeled directly to the state budget, bypassing Statoil's veto power.

On the other hand, the government decided to complement this corporate governance change with an amendment on the licensing regulatory framework, by suppressing Statoil's carried interest prerogative, so that the NOC was not longer able to abuse its dominant power in controlling all the decisions in oil fields.[479] Finally, the Norwegian government – as exclusive owner – retained its corporate right to act as Statoil's General Assembly, through the MPE, yielding the legal capacity to instruct Statoil to vote all state shares – including the SDFI's portfolio– in a certain way.

The 1980s reforms were thus imperative for the state to effectively *constrain* Statoil's power *encroachment* against other institutional players of the Norwegian oil governance network– namely, the central government, the NPD and private competitors. With its balance sheet reduced to a half by the government, Statoil's managers saw this political

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[474] *Ib.* at 607-608.
[475] *Ib.* at 619.
[476] *Ib.* at 620.
[477] *See* Ola Borten Moe, *supra note* 461, at 159.
[478] *See* Petoro, "Foundation of the SDFI and Petoro", consulted on May 1, 2018, available at https://www.petoro.no/about-petoro/foundation
[479] *See* Thurber and Tangen Istad, *supra note* 356, at 620.

conjuncture as an opportunity to pursue an expansion of its petroleum operations internationally and deepen the *arm's-length* relationship with the Norwegian state.

The worldwide diversification of operations by the Norwegian oil champion was accomplished through the 'strategic alliance' it had with British Petroleum from 1990 through 1999.[480] In 2001, as part of this new strategy to keep Statoil's commercial expansion on track while fortifying its autonomy vis-à-vis the Norwegian state in parallel, its managers proposed a *partial privatization* of Statoil through a share offering on a major stock exchange market (NYSE).[481] As consequence of this initial public offering (IPO), a relevant minority of Statoil's capital structure would be then owned by shareholders other than the Norwegian state, modifying the company's corporate governance and therefore adding more *checks and controls* opposable to the government's interests. Other IPOs were realized afterwards. Today the Norwegian state currently holds 67% of Statoil's capital stock.

On the same year Statoil's partial privatization occurred, Norway added up more *checks and balances* to its regulatory governance on petroleum, by creating a non-operational fully state-owned company – "*Petoro*" – to replace Statoil in the management of the SDFI in petroleum. The mandate vested in Petoro is to maximize the worth of the state's equity portfolio in oil and gas fields via the financial management expertise of their personnel – which is legally limited to 70 employees.[482] As a state company, Petoro is accountable to the instructions of the MPE, which represents the government as sole owner and has the legal capacity to act as Petoro's General Assembly.[483]

The *fragmentation* process of Statoil's equity interest in gas fields was deepened in the 2000s decade to comply with EU antitrust rules. In this context, the Norwegian government had to create "*Gassco*" with purpose of conceding control of transmission lines to a separate entity from Statoil, which already was dominant market player in the upstream and downstream segments of the Norwegian oil supply chain. Likewise, in 2003, "*Gassled*" was created as a joint venture conglomerate in order to concentrate all the owners of the oil and gas pipelines and pay them accordingly to the proportion of their ownership stake.[484]

Another dimension to address is how *checks and balances* have been understood in Norway from a *fiscal* standpoint. The government' sources of oil revenue are 1) the SDFI, 2) taxes, and 3) Statoil's dividend as major shareholder. Considering that Statoil is a different legal entity from the Norwegian government, the yearly dividend is not often transferred to the government coffers, but reinvested in the Norwegian champion's business whether domestically or abroad. Drawing upon Norway's official statistics, these oil revenue sources contribute 17% of the state budget.[485]

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[480] *Ib.* at 621-622.
[481] *Id.*
[482] *See* Ola Borten Moe, *supra note* 461, at 160.
[483] *See* Petoro, "Corporate governance", consulted on May 1, 2018, available at https://www.petoro.no/about-petoro/corporate-governance.
[484] *See* Thurber and Tangen Istad, *supra note* 363, at 624, 650.
[485] *See* Norwegian Petroleum, "The Government's Revenues", Economy, consulted on May 1, 2018, available at https://www.norskpetroleum.no/en/economy/governments-revenues/.

As part of the liberalizing reforms of Norway's administrative organization on petroleum, in 1990 the government created the Government Petroleum Fund, whose official nomenclature was changed to "*Government Pension Fund Global*" in 2006. The administration of the Fund is in charge of an investment management unit of Norway's Central Bank, which in turn performs this task on behalf of the Finance Ministry. The Norwegian Pension Fund works both as a 1) *stabilization* mechanism and as a 2) *savings* fund. The former function is aimed at covering state budget deficits and deploying countercyclical fiscal policies to shield the state coffers from oil markets volatility, whereas the latter role has long-term development purposes in favor of the Norwegian population. Accordingly, the Norwegian Pensions Fund was designed, on one hand, to absorb disruptions such as the over-heating effects that the abuse of oil revenues could have on the national economy and, on the other, with a long-term perspective built around the idea of lifting the social development of a whole nation.[486]

The *balance* between the stabilization and the savings roles is pursued by the "*fiscal action rule*" –which is the legal instruction that allows using the Norway's sovereign oil wealth fund to cover deficits in the state budget on a yearly basis, for as long as this injection of funds does not exceed the annual real rate of return on the Fund's capital. Based on a long-term fiscal guidelines, the real rate of return is estimated to be 4% annual usually, but this average does not precludes the action rule from authorizing larger or smaller injections of capital from the Fund to the government budget, in case of economic emergency scenarios.

In an institutional environment characterized by a strong rule of law and independent media, the Government Pensions Fund alongside the fiscal action rule have been effective mechanisms to keep *enabling* and *accountable* fiscal institutions –in the sense of transparency and public finance conservatism– which protect this Norwegian oil profits from the rentier voracity of government elites.[487] Yet, Thurber and Tangen Istad's case study on Norway reveals there is a dominating perception in this country's society about a lack of public visibility regarding oil revenue management affairs.[488]

For the arguments above, checks and balances in Norway's petroleum regulatory governance triggered a *fragmentation* process that forced the government to create different entities with separate commercial roles – a policy pattern that translated into the partition of Statoil in smaller state-owned companies, so as to put effective controls over the NOC's aggrandizement, which was in many ways either challenging the regulatory power of the Norwegian government or jeopardizing *economic competition*. This break up pattern was stopped in 2007, when again Statoil's managers used their close links with Norway's political class to authorize the merge*r* of Statoil with Norsk Hydro, based on the need to create efficiencies and strengthen the NOC for an internationalization strategy.

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[486] *See* Thurber and Tangen Istad, *supra note* 363, at 615-616. The phenomenon known as the "Dutch Disease" is one of these disruptive consequence the excessive use of petroleum revenue could bring up for oil-rich countries and it causes high inflation, distorts exchange rates, and turns other domestic economic sectors than petroleum very uncompetitive. According to Thurber and Tangen Istad, this is a reason why the Norwegian Pensions Fund targets investments abroad, rather than domestically.

[487] *Id.*

[488] *Id.*

Above all, the case study of the Norwegian oil industry illustrates how a structure of *checks* and *balances* underlying a certain regulatory framework is not a once and for all task, but rather a 'back and forth' process from which all relevant institutional actors –such as the political elites, government officials, sectorial regulators, state-owned company managers, private investors, civil society, and the international context –play with their corresponding sphere of authority, contributing then to reach an overall equilibrium, which in turn is susceptible to change itself. Furthermore, the Norwegian petroleum experience exemplifies how important is having both a 1) *vibrant political system* and 2) *competent state capacity* for rooting oil institutions in a social consensus committed to balanced governance.

4. Oil Governance Contrasts: the Model versus Mexico

After exploring the components of the Norwegian oil regime on which the Mexican hydrocarbon reform of 2013 was modeled, this work is now in position to present a *comparative analysis* of petroleum governing institutions in both nations. In making such contrast, my goal here is to underline the institutional and legal design features distinguishing one governance system from the other. Then this work focuses on differences, rather than commonalities, that might provoke that transplanted oil institutions fail to produce the expected outcomes as in Norway.

Today, comparative studies on government institutions, regulation and policy are a field largely dominated by political scientists, economists, and sociologists. Political economy literature and its methods have been an innovative perspective to find macro-arguments and empirical data explaining the correlations of certain institutional phenomena; yet, despite their rationality, academic rigor, and explanatory power, the generality surrounding political economy claims often disregards the fine print and nuances of *legal design analysis*.

This is not only a methodological criticism, but also a remark with *policy reform implications*. The lack of dialogue among political scientists, policy analysts, and legal design architects reverberates in defective implementation of policy proposals prescribed on legal institutions. For these reasons, this research has tried to bridge the gap above by bringing closer political economy insights and their application to specific regulatory institutions and policy questions concerning the Mexican petroleum industry.

This work has made a case for *checks and balances* on the following three layers of the Mexican oil regime: 1) the rules governing property rights, 2) the public law contract regime for upstream oil activities, and 3) the formal administrative design regulating this business link. This was the most fruitful strategy to highlight –by comparison with Norway – the pending governance challenges that were already identified in Chapters VI and VII of this research. Therefore, this section addresses five *divergences* from which the first four points to regulatory design and policy mechanisms, whereas the last one relates to institutions in a broad sense.

A. Legal Policy Governing Resource Management

The core point of contact existing between Norway and Mexico's regulatory framework on crude oil is the institution of public ownership over this natural resource. In terms of Section 1-1 of the Act 29 November No. 72 relating to petroleum activities, the Norwegian state is the owner of the subsea oil deposits and has the 'exclusive' right to conduct the resource management. For its part, article 27 of the Mexican constitution grants the nation the property of underground hydrocarbons. Likewise, articles 25 and 28 of Mexican confer the state the 'exclusive' authority to manage and take care of the upstream petroleum business, which is classified as an a strategic economic activity.

However, the first difference worthy of consideration is the *policy governing oil resource management* in each of these countries. Unlike the Mexican constitution, whose article 27 and a transitory provision instructs that upstream oil activities shall be operated through contract and assignations with the purpose of maximizing revenue for the state to contribute the nation's long-term development, Section 1-2 of Norway's legislation on petroleum activities is more specific because –in addition to the goal of providing revenue to the nation– it understands long-term resource management for the benefit of the society in further ways such as ensuring welfare, employment, and an improved environment; fortifying trade and industrial development, and as taking caring or regional policy considerations. In light of the normative criteria ruling each of these regulatory schemes, my account is that Mexico's legal system orders a *fiscally driven* legal policy on the upstream oil industry; whereas in Norway, national development is understood as a *plurality* of *public policies* where no one is above the others.

The fact that Mexican policymakers decided to carve out a *rentier* petroleum policy on a constitutional level puts a straightjacket to both Congress and the Executive, since this directive orders prioritizing oil revenue maximization above every other policy that might lead oil resource management in a different direction. It is understandable that framers of the energy reform of 2013 tried to entrench Mexico's national interest in light of a new contract regime allowing private participation in petroleum exploration and production activities; yet, by doing so, they also shield the extractive approach many analyses – including this work – have criticized for its negative impact on Mexican public finance and Pemex's productive performance.

If Mexican policymakers would like to get rid of this legal restriction, they are forced to pass another constitutional reform in more flexible terms. To that end, however, they would need to count on a qualified-majority consensus in federal Congress as well as with the approval of 16 state legislatures. In sharp contrast, the legal provisions ruling oil resource management in Norway enjoy not only flexibility of having different policies on equal footing, but also the benefit of being defined at a legislative statute, providing the state with greater degree of adaptability in case of having to redefine this industry.

This illustrates the disadvantages this work has observed earlier about '*regulatory constitutionalism*' because it compels the state to pursue a *rentier* development strategy it might not be policy-wise to maintain for the long-term development of the sector itself,

constraining the flexibility of regulatory authorities to *balance* it with other equally important social goals – namely, competition, environmental sustainability, domestic industrial development, etcetera. This is not to say that the latter policy objectives are absent in Mexico's legal framework, but rather that in case of conflict, maximization of petroleum rents for the state trumps everything else on constitutional grounds.

Someone could counter that comparing public policies established by the Mexican constitution and Norwegian legislative provisions is unfair since these are typically abstract and vague precepts. Moreover, it could be argued that if we are to contrast two regulatory frameworks, the comparison should address the same type of law source. In an effort to double check the critique above on a leveled field, this research surfed through rest of Norway's Act on petroleum activities and the Regulations to that legislation, and then proceed to contrast them with its equivalent enabling statute in Mexico – the Hydrocarbon Act of 2014.

In the Norwegian context, when a company –which has previously conducted exploratory activity– determines an oil field is commercially viable to be exploited, the company must carry out *prudent* development and *preliminary* extraction of the proven oil deposits before competent authorities grant final permission for this activities. For that purpose, the contractor must formulate a development and operation plan, including a the obligation to submit an "*impact assessment*", which is submitted to consultation and review of different administrative agencies whose purview might be affected by the specific development at hand. Norway's impact assessment evaluates the consequence of petroleum production projects on the environment, fisheries, and the Norwegian society. By means of this *comprehensive* administrative process, the Norwegian state seeks that any project's resource management is carried out on prudent terms and that social benefits are greater than its costs.[489]

On the other hand, Mexico's Hydrocarbon Act has a part regulating a *social impact assessment*. This legislation impose on contractors and assignees the duty to conduct their upstream oil operations in accordance to principles of sustainability and respect for the human rights of the population and communities living at places where these petroleum projects are going to take place. As opposed to Norway, where the impact assessment initiates as part of the development plan proposed by the oil production contractor and then goes through different administrative entities, in Mexico this evaluation proceeding is triggered and controlled by the Executive branch – the Energy Ministry in coordination with the Ministry of the Interior ("Secretaría de Gobernación"), as well as with all other executive departments whose jurisdiction is applicable, shall conduct a social impact study of the consequences that might be generated by the upstream oil contract or assignation the state plans on grating afterwards.

According to the Mexican Hydrocarbon Act, by means of the social impact study, administrative authorities must convey contractors and assignees of upstream oil projects whether there are "*social groups in a situation of vulnerability*" – indigenous communities

[489] Yngvild Tormodsgard (ed.), *Facts 2014. The Norwegian Petroleum Sector,* Ministry of Petroleum and Energy, Norway, 2014, at 28.

in particular – with the purpose of adopting the necessary actions to protect their rights. To the end of considering the interests and rights of the native peoples, Mexico's petroleum legislation orders SENER alongside the Ministry of the Interior to organize and launch a "free and informed" consultation process with vulnerable communities in order to reach the "agreements or consent". As a result of such consultation process, the Hydrocarbons Act confers to the Energy Ministry, with the prior opinion of Hacienda, the discretion to include – whether in assignation titles or in contract bidding rounds – the funds or the rules to determine the amounts that contractors or assignees must channel to the vulnerable communities of the places where the former are conducting their petroleum projects.[490]

The mere existence of a consultation accessible to vulnerable indigenous groups, which could be affected by oil and gas activities, is something worthy of recognition because it shows openness to dialogue on the part of the Mexican state, given that the Executive can always employ to his taking power as last resort if an agreement is not reach via negotiation. Even though an expropriation is a legal exercise of administrative authority, its unilateral character could come up with a flavor social illegitimacy.[491]

Yet the legal landscape portrayed above is *confusing* to say the least. Besides proving right Jones Luong and Weinthal's thesis about that contemporary petroleum contracts impose not just a fiscal burden and a profit share on contractors but also direct transfers of money to society, the aforementioned legislative provisions formalize a *redistributive* mechanism to favor vulnerable communities in exchange for allowing oil companies perform their activity without civil conflict. The fact that Mexico's Ministry of the Interior intervenes in the coordination and planning of this consultation suggests this a mechanism aimed at "appeasing" affected parties and securing *governability*.

Unfortunately, this section of the Hydrocarbons Act is drafted as if the Executive branch had already decided, *ex ante*, that petroleum contracts or assignations are to be tendered or adjudicated, regardless of the deliberative outcome resulting from the consultation proceedings with vulnerable communities. It is therefore *questionable* that Mexican oil legislation refers to agreements or consent and then gives to SENER, supported on Hacienda's opinion, the administrative prerogative to set up a price for these social obligations that oil investors must pay to get the contract. Irrespective of the discussion on whether or not it is fair and efficient that oil corporations compensate for the negative externalities they cause on indigenous communities, these legislative provisions are drafted in a way by which the *monetary factor* trumps deliberation, excluding any other type of consideration or argument – whether environmental, social, economic – that might advice on technical grounds an alternative path or even the possibility of taking a step back in the execution of these petroleum extractive operations.

In this light, the Mexican consultation for vulnerable groups lacks of the *prudential* and *comprehensive* approach of the Norwegian impact assessment for oil and gas projects, in

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[490] *See* articles 118-120 of the Hydrocarbons Act.

[491] In this sense, it is worth remembering that Mexico has gone through several agrarian and land use conflicts involving indigenous communities in the past. For instance, the Mexican Revolution of 1910 and the Chiapas rebellion had a partial component related to this type of civil conflict.

which policy gradualism seems to be the touchstone to take into account the plurality of variables at stake and thus accomplish a balanced trade-off among these interests instead of yielding to oil revenue production.

All things considered, rather than a genuine deliberation exercise, Mexico's consultation process seeks to *legitimize* petroleum projects through the *transfer* of *direct funds* from oil contractors to affected population. Still, there is not information about the functioning of the spending mechanism nor transparency about the role played by the Executive in order to guarantee that such social benefits are directly applied to the community of the place at issue. Considering the high levels of grand corruption and weak fiscal institutions in Mexico, it is very likely that these social funds get diverted from its earmark and work instead as a *rent seeking* mechanism in favor of government elites and social clienteles.

B. Ownership Rights And Flexibility of the Contract Regime

The second layer of legal institutions compared by this analysis has to do with the upstream oil contract regime in Norway and Mexico. The main point of contact is that both jurisdictions have a public law regime governing key issues of the contract devices to conduct petroleum exploration and production activities. In principle, there is a competitive public tender to assign these contracts in both countries.

However, the most relevant difference relates to the *exception* regime that the Mexican government has to "assign" directly upstream oil rights to state-owned companies without a preceding competitive bidding, making inapplicable the ordinary contract rules at the Executive's administrative discretion. This research did not find out an equivalent mechanism in the Norwegian petroleum institutions.

Also, there is room to distinguish the type and scope of ownership rights conferred by both contract schemes. On one hand, the Norwegian regulatory framework establishes two differentiated types of petroleum *licenses* – exploration and production grants. Each of them confers a specific package of rights and obligations, so one does not imply an authorization to exercise the prerogatives resulting from the other type of license, since they are assigned on different grounds and according separate administrative processes. As opposed to Mexico's production and profit-sharing agreements or licenses, the Norwegian production license *transfers directly* to the licensee the ownership on produced petroleum in exchange for a profit share and royalties to be paid in favor of the state. Because of this property feature, there is room to conclude that Norway's oil extraction license is what is known as 'concession' under Mexican public law doctrine.

On the other hand, the only type of contract in Mexico that transfers the dominion of extracted petroleum from the nation to the contractor, in exchange for a price paid to the government, is the *license contract*. Whereas the Norwegian licensee becomes owner of extracted petroleum by virtue of being successful in producing the resource, holders of a license contract in Mexico are required to pay a price for the petroleum production if they

want to acquire the property rights on the extracted resource, in addition to the royalties, leasing fees, signature bonus, and profit share[492] for the state.

Moreover, while the enabling legislation allows the licensee to commercialize the oil production at the same time it transfers the property rights over the extracted commodity, such commercial exploitation is regulated by the authorization granted by the Energy Regulatory Commission (CRE) – in short, *more administrative barriers* and *less contractual flexibility*. Another aspect this work has underlined is that Mexican oil licenses function in the same way as concessions do, but whose different legal name obeys the purpose of bypassing a constitutional ban on petroleum concessions.[493]

C. The Privatization Question and Brazil's Cautionary Tale

The third legal divergence between Mexico and Norway's petroleum regime is the total *absence* of *private capital* in the national oil company of the former. Today, Pemex is still an exclusively state-owned petroleum company. As discussed in the last chapter, this research concludes that by keeping Pemex away from this source of capitalization, Mexican policymakers won't be able to fix, from root, the institutional bottleneck that is impairing Pemex's performance and fueling government dependence on oil rents.

On the other hand, the Norwegian oil champion, Statoil, was *partially privatized* since 2001. Today, the Norwegian state holds 67% of the NOC's equity. As illustrated throughout this research, the insertion of a relevant minority of private investors within Statoil's ownership structure has created strong *checks and balances* opposable to the government's interests, generating the synergies and incentives responsible for turning Statoil the most efficient NOC worldwide today.

Although it is not strictly part of this dissertation's scope, I would like to add a remark on the Brazilian experience in replicating the Norwegian oil model and the lessons it could provide to Mexico's oil governance in this regard. In 1995, the Brazilian state performed a *partial privatization* of its NOC. Nowadays, Petrobras is *owned* and *controlled* by the Brazilian government, which holds a share 50.26%, plus a 9.87% held by the Brazilian

[492] This consideration is *optional* in Mexican licenses, depending on whether the state has a carried interest.

[493] A more formalist divergence has to do with the legal design of the petroleum contract typology. My view is that the Norwegian contract regime has higher degree of flexibility and adaptability because it is defined at a legislative law source and only distinguishes between two general categories – exploratory and production licenses. Besides defining its boundaries and their rentier policy on the constitutional text itself, the Hydrocarbons Revenue Act establishes the features for each of the four contracts, generating highly detailed regulation in the enabling legislation. This is not to say that Mexico's oil contract schemes lack of all flexibility whatsoever. On the contrary, the Mexican legal framework allows competent authorities to use the contractual mechanism – including any combination of them – that seems fit for petroleum reservoirs at stake and the market circumstances in force. Either way, Norway's upstream oil contract regime seems simpler and more flexible than that of Mexico, because it just enunciates the definition and main elements for the two types of contract, delegating on administrative authorities with broad discretion to craft the best contract device as the market and geological conditions dictate.

development bank. The remainder of equity share (40%) is diluted among private stockholders.[494]

According to some analysts, however, there is evidence suggesting the correlation between the Brazilian state firm's privatization and its resulting *competitiveness* increase.[495] Much of what has turned Petrobras in a cutting-edge oil company with technology, human capital, and the know-how to conduct offshore deep water upstream operations resulted from the virtuous circle of incentives that was generated through the privatization of 1995, during the government of President Fernando Henrique Cardoso.[496] In order to prove their claim, these analysts contrast the good results with the time period in which the administration of President Luiz Inácio Lula Da Silva regained some state control over the NOC and the performance decline that Petrobras followed almost immediately afterwards.[497]

The Brazilian case is very interesting because it illustrates first the benefits of having implemented an investment-friendly *contract regime* for the upstream oil sector based on 'concessions', as well as a *partial privatization* of the state-owned petroleum company, and then suffers the setbacks following the Pre-Salt discovery in 2006 and the counterattack led by Lula's *statist-oriented* policies to recover government control over Petrobras.[498] First off, the government headed by President Lula replaced the concession regime with production-sharing agreements in oil deposits that were given a "strategic" legal status.[499] The purpose was to attach a mandatory carried interest by which the state has a profit share of at least 30% out of the petroleum produced by contractors. In this way, the Brazilian government conditioned that any winning oil company of the Pre-Salt bidding auctions would have to produce the petroleum reservoirs in consortium with Petrobras.[500]

At the same time, the Lula administration created a fully state-owned company called "*Petrossal*", which was neither an operator nor an investor. According to Adilson de Oliveira, the main task of Petrossal was to control resource management in each of the oil fields in the Pre-Salt region, neutralizing the role of Petrobras in the administration of the production and reducing it to a mere operator.[501] For that purpose, new *ad hoc* legal rules ordered Petrobras the integration of a "management committee" for each of the assigned oil blocks where chairmanship had the power to veto this committee's determinations and is appointed by Petrossal – that is, the Executive instead of the NOC's managers. The third

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[494] *See* Petrobras, "Petrobras – Investor Relations – Capital Ownership", consulted on February 17, 2017, at http://www.investidorpetrobras.com.br/en/corporate-governance/capital-ownership

[495] *See* Adilson de Oliveira, "Brazil's Petrobras: strategy and performance", *supra note* 1, at 515-553. *See* also Juan Pardinas, "La reforma energética en México: Las experiencias de Arabia Saudita, Brasil, Canadá, Cuba y Colombia" [The energy reform in Mexico: The experiences of Saudi Arabia, Brazil, Canada, Cuba and Colombia], from *supra note* 461, at 122-126.

[496] *See* De Oliveira, *supra note* 495, at 535. *See*, also, Pardinas, *supra note* 495, at 123-124.

[497] *See* De Oliveira, *supra note* 495, at 547-548. *See*, also, Pardinas, *supra note* 495, at 125-126.

[498] *Id.*

[499] *Id.*

[500] *See* De Oliveira, *supra note* 495, at 547.

[501] *Id.*

change executed by the Lula administration was to recover state control over Petrobras by increasing government participation from 40 to 48% in the capital structure.[502]

As a result of this *political interference* on Petrobras during the Lula administration, the Mexican policy analyst Juan Pardinas sustains that the Brazilian oil champion has witnessed a drop in its capital stock price since 2006.[503] Moreover, the upstream oil policy launched by Lula's government took advantage of Petrobras' monopolist position in the Brazilian oil industry to maximize oil revenue for the state.

By doing so, unfortunately, the *statist policies* executed after 2006 have only *weakened* the competitiveness and performance of the NOC, its foreign oil partners, and providers. Moreover, in an effort to employ the petroleum industry as a growth engine for the rest of the Brazilian economy, the Lula administration imposed an obligation on contractors to carry out their commercial activity by using a minimum domestic content to activate local business and industries to provide labor, services, and input for the oil industry.[504] The outcome has been that private oil companies have stopped placing investment in Brazil's upstream oil industry, since the government interference of the last decade contributed to raise their costs, curtailing the profit margins that flourished after the mid-1990s liberalization.[505]

For the reasons above, the Brazilian petroleum experience could serve as a *cautionary tale* for Mexico regarding a comeback from government encroaching interventions on a national oil company. This Latin American lesson is particularly relevant for Mexico now that Andrés López Obrador was recently elected for presidential office (December 2018 – November 2022), considering that he campaigned on the need for a new oil development strategy that is focused on boosting Pemex's inner capacities and industrializing the sector via the state and public investment.

The Mexican hydrocarbon law also sets up minimum shares for a *state* '*carried interest*' –which may be either mandatory or optional– in developing of certain oil fields.[506] Such state financial interests attached to oil production shall be guaranteed through the intervention of Pemex or other state-owned entities. Fortunately, unlike Brazil, Mexico's regulatory framework on petroleum is much more flexible and does not constrain or subordinate contractors in any way like the management committees of Brazil's Pre-Salt.

[502] *See* Pardinas, *supra note* 495, at 125-126.
[503] *Ib.* at 126.
[504] *Id.*
[505] In the same way as in Norway and Brazil, the Mexican legal regime on hydrocarbons has a *protectionist* component. Mexico also has minimums requirements (35%) of domestic input that contractors need to carry out their upstream oil operations.[505] The idea is to use the upstream oil industry to boost other sectors of the Mexican economy. Although many countries have this type of protectionist legislation, Mexican policymakers should take care that this minimum requirements or quotas do not translate into cost overruns and excessive administrative burden that make Mexico's oil governance unattractive compared to other jurisdictions. If these minimum content provisions stop to be "neutral" on contractors' costs at some, reducing the competitiveness of Mexico in comparison to other oil-producer jurisdictions, then legislative and administrative measures on the government side should be taken in order to compensate their impact. *See* article 46 of the Hydrocarbons Act.
[506] *See* articles 16 and 17 of the Hydrocarbons Act.

D. REGULATORY EMPOWERMENT AND THE COLOMBIAN LESSON

In the same way as in the Norwegian model, the National Hydrocarbons Commission (CNH) is the technical advisory body and enforcer of the regulatory policy *dictated* by the Energy Ministry. As opposed to Norway, where the Norwegian Petroleum Directorate (NPD) is an administrative unit ascribed to the Ministry of Petroleum and Energy, CNH is not formal part of SENER's administrative structure. Yet, both regulatory bodies are within the Executive branch of government.

The NPD seems to be a more *empowered regulator* than Mexico's CNH in terms of their functional independence from their corresponding governments. According to the Norwegian Act 29 November No. 72 relating to petroleum activities and its Regulations, the NPD works as the state's one-stop shop with delegated authority to collect exploration fees, administrative handling fees, production fees, an royalties from the regulated licensees. Furthermore, the regulatory provisions of the Act 29 November No. 72 grant the NPD with oversight and inspection powers to audit the payment of the considerations that license contractors must pay to the Norwegian state.

On the contrary, in Mexico the authority to regulate and oversee the 'fiscal terms' and 'financial aspects' of upstream oil contracts is distributed among the Finance Ministry and the Mexican Petroleum Fund. As explained in Chapter V of this work, by *fiscal terms*[507] Congress understands the adjudication variables of economic nature that CNH shall consider to choose a contractor to develop oil exploration and extraction on a certain oil field. The Hydrocarbon Revenue Act grants Hacienda with the discretionary authority to determine the minimum shares or amounts relative to the "*adjudication variables*": the oil revenue promised to the state and the investment committed by applicants.

As for the *financial aspects* of upstream petroleum contracts, Congress means the payments relative to considerations (leasing fees, royalties, bonuses, oil profit funds, among others), investment and cash expenditures, goods and services procurement for each contract. In this context, the Mexican Petroleum Fund is the autonomous state vehicle with the legal task of managing the incoming and outgoing of the payments above, whereas the Finance Ministry has the mandate of inspecting and enforcing these financial components.

There are two legal design divergences revealed by the comparative remarks above. First of all, although both Norway and Mexico have an administrative state on hydrocarbons that circumscribes itself to the Executive branch of government, in the case of the latter, policy enforcement and regulatory powers on fiscal, financial, and technical components of the upstream oil sector are *distributed* among a *plurality* of authorities –the Energy and Finance ministries, CNH, and the Mexican Petroleum Fund. Considering our prior critique of the shortcomings underlying 'regulatory coordination' in Mexico's oil regime, the likelihood of *fragmentation* inside the Executive branch is high.

[507] As noted in Chapter V of this dissertation, the *fiscal terms* of upstream oil contracts are not the same as tax obligations imposed over contractors. On tax obligations, the sovereign authority to establish them lies in Congress, whereas the Finance Ministry has the power to enforce and manage tax laws.

For its part, in the Norwegian case, the concentration of policy enforcement and regulatory powers on the upstream oil within the Executive translates itself into a *cohesive* regulatory process where there are only two key actors – the MPE and the NPD.

Put differently, this research did not find evidence that Norway's Ministry of Finance or the Government Pension Fund have a significant role in the management of upstream oil licenses that mirrors in any away the intervention enjoyed by the equivalent authorities in the Mexican petroleum regime.

Second, this analysis has criticized the *exorbitant discretion* that Mexico's regulatory regime on oil confers to the Finance Ministry. In Chapter V of this work, I sustained that both SENER and Hacienda are the two key regulatory authorities of the Mexican contract regime for oil upstream, thereby reducing CNH's role to that of an administrator of the formers' policies and regulations.

Instead, the Norwegian petroleum governance –whose administrative design Mexico's energy reform supposedly mimicked– is itself evidence of the feasibility of a *stronger sectorial regulator* with authority to administer and control the collection of oil revenue coming from upstream contractors.

By virtue of the constitutional policy to maximize oil profits in benefit of the state, as well as the technical and political power accumulated by the Finance Ministry officials, giving away these prerogatives to a recently created CNH would have never been probable –at least at the start of this liberalization of the Mexican petroleum industry. However, it is exactly the need to check and control the *aggrandizement* of Hacienda's *discretionary power* on the upstream oil what this work has tried to call the attention upon.

In an effort to double-check the findings above, this research briefly explored the Colombian regulatory design on hydrocarbons and it confirmed the findings above. In 2003, Colombia became the second institutional transplantation of the Norwegian oil model in Latin America. Just like Norway and Mexico, Colombia preserves the common pattern of a sectorial regulator with an Executive branch membership; yet the National Hydrocarbons Agency (ANH) is not formally ascribed to the Colombian Ministry of Mines and Energy.

Compared to Norway and Mexico, the Colombian innovation consists in having built the *strongest independent regulator* for the upstream oil in terms of its functional relationship with the central administration – in particularly with regard to Colombia's ministries of Energy and Finance. In other words, Colombia deepened the principle of checks and balances in structuring the relations between the Executive and the sectorial regulator of the upstream oil.

By way of illustration, the ANH outstands for the following policy enforcement and regulatory powers: 1) designing, evaluating, and fostering investment plan in the upstream oil sector; 2) managing and overseeing the upstream oil contract regime; 3) supporting the Ministry of Mines and Energy to formulate the national policy on oil and gas as well as government's sectorial plans; 4) fixing hydrocarbon prices to obtain the payment of the

corresponding royalties; 5) collecting, liquidate, and transferring all type of considerations and monetary compensations that should accrue to the state by virtue of petroleum concessions; 6) fixing exportation prices of crude oil for fiscal and currency effects, among others.[508] So, the institutional constraints on the regulatory power of CNH are not mirrored at all in the Colombian oil governance but the opposite.

For the reasons and evidence articulated above, if Mexico's CNH is to become in an *effective sectorial regulator*, instead of focusing on organizational autonomy, its bureaucracy will have to struggle over time for an *arm's-length* relationship with the Finance and Energy Ministries, so that CNH absorbs gradually regulatory powers over the *economic aspects* of the upstream oil contracts, and gets specific weight and *genuine coordination* in determining sectorial policy.

So far, this work has shown that the scales are excessively leaned to the side of Hacienda and SENER. Likewise, Hacienda should *roll back* its duties to its original jurisdiction – which is the administration, coordination and enforcement of fiscal and debt policy in Mexico. Unfortunately, the likelihood of this transition seems very low, provided that the legal policy on upstream oil operations is *maximizing revenue extraction*.

E. STATE-BUILDING DIVERGENCES

In addition to the legal and policy divergences above, there are some contrasts between Norway and Mexico involving certain institutional patterns whose intervention –or absence– has a direct impact on the efficacy and quality of outcomes produced by the Norwegian petroleum model. Yet, the singularity of this institutional environment lies in that it cannot be modeled *ipso facto* by law or government decree, but requires the gradual development of social practices, shared values, and informal governance channels – namely, what is '*institution-building*'. When this process relates specifically to the foundation and development of governmental instruments and authorities in the sense of functions, processes and organizations, we are in the province of '*state building*'.

This work is not foreign to the evidence that much of the shape and path of a nation's institutional development depends on a complex mixture of *structural* and *circumstantial* factors over time. In this context, the critical difference between the Norwegian and the Mexican oil regimes lies in the latter's *weak state capacity*, meaning ineffective governance and rent-seeking bureaucrats acting under short-term incentives rather than professional bureaucracies operating under a technical rationale, formal rules, and long-term horizons for decision making purposes.

The outstanding opinion policymakers have about the Norwegian template of petroleum state institutions obeys not to their *formal separation* of *functions*, but rather the high *performance* it has achieved for the petroleum industry of Norway and its Latin American

[508] *See* Agencia Nacional de Hidrocarburos, "Informe de Gestión 2012" [Management Report 2012], Agencia Nacional de Hidrocarburos, Colombia, January 2013, at 8-9.

transplantations. Both the Nordic nation and its Brazilian replica have two of the most *competitive* NOCs worldwide. Thus, Mexican reformers imported Norway's regulatory design on upstream oil as means for having a highly developed petroleum sector, including a competitive national oil champion, as well as administrative bodies with effective regulatory policy powers.

According to Dani Rodrik, the claim that "best practices applicable under certain institutional conditions can be ineffective or harmful when certain institutional pre-requisites are absent"[509] has a broad consensus among policymakers.[510] Experts have warned about the critical role played by the 'political' and 'bureaucratic' institutions in turning the Norwegian oil model into an effective regulatory structure.[511] This work shares the idea that one of the preconditions for a successful extrapolation of the Norwegian governance on petroleum is a "vibrant political competition".[512] The probability of developing strong check and balances supporting a country's regulatory state is very low when the heads of those administrative agencies are chosen –or captured– by the same political masters recursively.

Despite having a relatively competitive democracy today, Mexico is still *consolidating* the *democratic transition* started back in 1997. For the first time since 2000, when Mexico had political alternation in the Executive power, a left-wing candidate won the presidential election of 2018 by 53% of the popular vote, lashing out against the traditional ruling elites of the PRI and the PAN through an anti-establishment campaign. Thus, the young Mexican democracy is turning to the political left for its first time in history after the PRI hegemonic era. One observer could even sustain that the fact an electoral triumph was recognized to a leftist candidate is evidence itself of the maturity achieved by Mexico's presidential democracy.

However, what made historic –and matter of concern as well– the win of Andrés Manuel López Obrador is that he thrived through a catch-all party coalition whose majoritarian support in Congress will guarantee the passage of all the President's legislative agenda. Yet, a worrying by-product of the Mexican presidential election in 2018 was the collapse of the traditional political parties: the PAN got 23% of the vote, whereas the PRI got 16%. As a result, the young Mexican democracy will be working again with a unified government after 21 years of divided governments. This political landscape means that there won't be effective political checks and balances in the legislative relationship between the Executive and Congress for the next 6 years. At first glance, the judiciary will be the only counterweight to López Obrador's presidency. Even so, expectations on the Supreme Court should not be as high if we take seriously the political science literature on the shrinking of judicial activism in the face of a strong presidential control over Congress.[513]

[509] Dani Rodrik, "Second-best institutions", *American Economic Review: Papers & Proceedings* 2008 98 (2), at 100–104, cited by Mark C. Thurber, David R. Hults, and Patrick R.P. Heller, *supra note* 65, at 3.
[510] *Id.*
[511] *Ib.* at 3.
[512] *Ib.* at 3, 6, 10
[513] In order to prevent any reputational damage on their institutional autonomy coming from the Executive's legislative power to strip them off of jurisdiction, courts of law avoid to strike down the legislation, regulation or administrative action supporting the President's policy agenda. *See* Mark Ramseyer, "The Puzzling (In)

Taking into account that the political system will face a '*unified government*', the diminishing of traditional political forces to symbolic positions, the statist orientation of the President elect towards the oil industry, and the past authoritarian era, the fragile Mexican presidential democracy as well as its newborn petroleum institutions will be definitely tested during the López Obrador administration.

For its part, the second precondition for successful institutional transplants has to do with a '*competent bureaucracy*'. This feature seems more essential because state capacity means having the necessary infrastructure to make work not just Norwegian oil model but any regulatory regime one pretends to enforce in practice, irrespective of whether such system of rules foster democracy, separation of powers, and so forth. In order to shape optimal outcomes in the oil sector, a capable bureaucracy is necessary to increase the institutional quality surrounding a given regulatory governance structure.[514] Where there is a strong and competent bureaucracy, the intended policies for the oil industry can be achieved "even in the face of changes in political leadership".[515] To achieve such outcome, an administrative state requires officials whose selection obeys to high standards of technical knowledge, political impartiality, and meritocratic standards.

Even though state officials are subordinated to political masters, who have the political legitimacy to exert public power, the need for a technocratic body of government officials calls upon a specific notion of '*functional autonomy*' – that is, the capacity for optimizing the administrative means to achieve a given public policy within the legal boundaries set in place, requires this implementation process to work as efficient and flexible as possible, so that political principals intervene with the sole purpose of evaluating bureaucrats based on their effectiveness to achieve the objectives under the constitutional and legal parameters given to them.

In order to avoid any confusion in the readership, the notion of '*functional autonomy*' – which is necessary to develop a competent administrative state– should not be understood in opposition to the main claim this dissertation has sustained about *checks and balances*, since independence here means allowing administrative enforcement authorities to perform their functions on efficiency –and legally valid– grounds. Put differently, a government body should be able to exert its prerogatives as independently as possible, provided its authoritative behavior remains within its jurisdiction sphere. Once this bureaucratic behavior trespasses the rule-based boundaries of its purview, something that is not always very clear and therefore requires judicial interpretation, such *encroachment* is *illicit* and should be *controlled* by *checks and balances*.

Dependence of Courts: A Comparative Approach", *The Journal of Legal Studies,* Vol. 23, No. 2. (Jun., 1994), at 721-747; Rebeca Bill, John A. Ferejohn and Barry R. Weingast, "Una teoría del Poder Judicial independiente políticamente: un estudio comparativo de los Estados Unidos y Argentina", [A Theory of the Politically Independent Judiciary: A Comparative Study of the United States and Argentina] pp. 371-411, in Helmke, Gretchen and Julio Ríos-Figueroa (eds.), *Tribunales Constitucionales en América Latina [Courts in Latin America],* Poder Judicial de la Federación, México (2010).

[514] *Id.*

[515] *Id.*

Pursuant the parameters above, Mexico is still weak in terms of *state building capacities* at the level of policy enforcement and regulatory authorities in the hydrocarbon sector, as well as in terms of having a competitive NOC. It is well-known that poor institutional capacities within the Mexican oil and gas sector are the outcome of a rusted *state monopoly* that has been systematically captured by rent seeking dynamics –such as grand corruption, patronage, and tax evasion– coming from both the political elites and their clienteles. Paradoxically, although the initial motive for establishing a legal oil monopoly with exclusive state ownership was to gain control and to develop indigenous capacities over the hydrocarbons industry, in the long-run these legal institutions of nationalistic flavor were used as an ideological mask to cover up the rent seeking corroding this public interest industry in Mexico.

Otherwise, the adoption of *hybrid ownership* in this heavily regulated sector would have demanded government elites to set up a legal system with *checks* and *balances* aimed at protecting the fair treatment of those stakes belonging to other agents than the state. Regardless of the ideological rhetoric, a market-friendly investment regime in Mexico's energy industry would have meant a system of institutional *constraints* vis-à-vis a *ruling elite* that is accustomed neither to be held politically accountable nor to be legally limited in using its political power. It is not coincidence that Mexico's former oil governance has endured 75 years, since its economic and political goals were closely attached to the survival of an authoritarian regime whose legacy is partly responsible for Mexico's lack of institutional development these days.

The Mexican administrative state on upstream oil has not developed a strong 'functional autonomy' in relation to the Executive and, more importantly, regarding other peer departments in the administration such as the Ministry of Finance. There is a *rentier policy* and an *extractive business model* that have governed petroleum resource management in Mexico since the mid-1970s. This oil revenue maximization goal has meant an overwhelming presence of Finance Ministry officials in the staffing of Mexico's petroleum institutions – that is, a type of "*revolving door*" among Hacienda, as the main source of high-ranking officials, and the rest of government bodies in charge of the policy enforcement, regulation, commercial functions in the upstream oil sector.[516]

Alongside public servants from the Central Bank and the Foreign Ministry, Hacienda officials compound the most renowned isles of bureaucratic excellence in the Mexican state. Consequently, the Finance Ministry has *encroached* with its *fiscal approach* TO the regulation and policy of whatever industrial sector their cadres work on afterwards. This is partly the reason why Pemex has been treated as the state's "cash cow", or why CNH has not gotten the administrative power to regulate the compensation payments the Mexican state must receive from upstream oil contractors.

If the above is to be fixed, then SENER, CNH and Pemex will need to *struggle* and *compete* against the Finance Ministry's monarchy within the Mexican administrative state. If not, the Mexican upstream oil will be *captured* by a *rentier rationale* at the expense of other policy objectives that are equally important to guarantee the competitive performance

[516] Stojanovski, *supra note* 1, at 282.

of this extractive industry –for instance, long-term investment, competition, each oil business segment's challenges, geological and engineering know-how, environmental protection, etcetera.

Save for the management and inspection of the petroleum tax regime, this research did not find any administrative agency of the Norwegian government that parallels the exorbitant regulatory presence that Hacienda has in Mexico's administrative apparatus on upstream oil contracts.

On the contrary, the Norwegian case illustrates that *technocratic expertise* was developed over time by means of an already consolidated Ministry of Industry, whose energy unit was later on transformed in the Petroleum and Energy Ministry (MPE). Then, Statoil was founded and a '*race to the top*' to gain expertise took place among the MPE officials and the NOC's managerial bureaucracy. Once the sectorial regulator was created, according to Al-Kasim, more *competition* pressures were added since the newborn NPD had to struggle to gain a place of its own on the Norwegian oil governance map.

Rather than advocating for organic autonomy from the MPE or the Executive, the way by which the NPD has become more independent is through *functional empowerment*. For example, the NPD and the Colombian ANH regulate and oversee the compensation payments resulting from upstream oil contracts instead of giving away this role to their Finance ministries.

Last, let me shed light on an insight about the *institution-building pattern* in the NOCs here examined. After having explored the Norwegian petroleum institutions and their Latin American replica in Brazil, this dissertation concludes that insertion of checks and controls in these jurisdictions has obeyed the purpose of *balancing* the political, economic, and technical power accumulated by their national oil companies, which have taken advantage to fullest of their former monopoly market position, government-granted prerogatives, and their political connections with the ruling elite.

Because of this *power concentration* over time, both Statoil and Petrobras have become a "state within the state" in the sense of powerful organizations, having forced their governments in different occasions either to *reclaim control* over them –the Brazilian experience– or to *fragment* them into smaller entities with separated functions –the Norwegian experience. This research has illustrated the different economic outcomes these two institutional interventions are likely to produce on the NOC's performance.

In contrast to its Norwegian and Brazilian peers, the development path followed by of the Mexican oil champion is different in the following ways. First off, Pemex was borne a state monopoly after a presidential *expropriation* of foreign oil companies in 1938. On the other hand, Norway's Statoil acquired its human capital, technology, and expertise thanks to the regulatory policy *gradualism* on hydrocarbons that was put in motion by an already *competent* administrative state.

Since the beginning of the Norwegian oil industry in the 1970s, there was a strong sense of *separation-of-functions* and *check-and-balance* institutions that was relatively shared by

government officials and political representatives. This institutional climate induced Statoil to optimize its position as a dominant player to create efficiencies and institutional capacity, so every time it was fragmented or intervened by the state, this NOC was mature for independence from the government.

Likewise, the government use to resort to such regulatory interventions every time it believed that Statoil was *abusing* its economic and financial power. Therefore, the historical evolution of Statoil has been one of tensions with the Norwegian government. By virtue of Norway's balanced governance policy as well as its check-and-balance institutions, these tensions have been fruitful for this Nordic nation.

Compared to Mexico, whose state monopoly was borne from an expropriation in 1938 and where an extractive exportation model goes back to the 1970s, both Norway and Brazil faced *different* type of *incentives* that made them follow a different development path of their petroleum institutions. The Nordic country found petroleum when it already had a stable parliamentary system at work and, above all, a competent state; whereas Brazil was an oil net importer for many decades, so it did not have an export-based extractive model until the late 1990s when it was already consolidated Petrobras' monopoly position to achieve technical expertise, technology, and capital investment in different oil business links other than just the upstream. On the other hand, the history of Pemex is one of a state monopoly resulting from the taking of others' know-how and technology in order to deplete existing oil reserves demanded by the voracity of government elites.

In summary, checks and balances were needed both in Norway and Brazil to held accountable their NOCs, which got strong enough to become *states within the state*. The Mexican case is an illustration of the opposite trend because Pemex has been most time a *weak state firm* performing a public finance role rather than an organization that has taken advantage of its legal monopoly to develop local expertise, human capital, and technology.

This is why I have rest this work's case on the need for an *arm's-length* relationship between Pemex and the Executive branch, something that necessarily goes through a partial *privatization* of the former. If strong checks and balances are not in place to define the boundaries of the government-NOC relations, the government's short-term voracity is about to kill the "goose with the golden eggs".

This work is aware about the huge gaps existing between Norway and Mexico in terms of *state-building* efforts. Despite being against deterministic narratives, I am realistic about path-dependence patterns and circumstantial factors conditioning the probability that Mexico becomes Norway with regard to institutional development, which is a process that transcends any legal design reform. Yet, the *lesson* worthy of being *exported* from the Norwegian oil model to other jurisdictions is the powerful impact of strong checks and controls in the administrative state for having a competitive petroleum industry.

CONCLUSIONS

1. Narrative: Checks and Balances in the Administrative State

This work's enterprise has consisted in presenting a case for checks and balances as *governing principle* to analyze the pending challenges in the Mexican upstream oil regime. Checks and controls and separation of powers are normative standards usually reserved to the province of political theory and constitutional law doctrine. Yet, this dissertation is the product of its time and circumstance. In response to a highly-technified, market-driven and globalized context where decisionmaking fragmentation is the rule, the '*regulatory state*' alongside its characteric *aggrandizement* of the administration has emerged as one of the institutional paradigms of our time with the aim for preserving as much domestic control as possible over strategic sectors from an economic and political standpoint – the oil and gas industry in our case.[517]

For these reasons, the key test for this research has been the buildup of a *narrative* which is capable of bringing down the checks and balances standard to the complex technicalities of the Mexican regulatory governance on the upstream oil business. This challenge meant to dive in the realm of administrative law, regulation, and institutional design since oil governance occurs with greater intensity in the orbit of the administrative state.

Given the *technocratic* nature of the upstream petroleum sector, it was necessary for this work to support its claims on a multidisciplinary spectrum of scholarly disciplines, literatures and methods.[518] By appealing on a plurality of fields and methods, both normative and empirical, my purpose here was to understand the institutional design, regulatory, and government questions surrounding the topic at issue beyond the ortodoxies of microeconomic and political science approaches, which often prioritize the method over storytelling and interpretation of substantive claims.[519] Instead of subordinating one to the other, my contribution has been to balance political economy insights with other perspectives, complementing one another.

[517] When it comes to the political sphere, we are contemporary to an era in which traditional division of public powers in constitutional regimes has given way to a trend of power concentration in the Executive branch as the most effective and expedite means for the state to manage the complex problems of a highly technified, economic-oriented global reality where decision making is largely fragmented among a plurality of formal and informal agents, whose actions create disruption and systemic risks which very often surpass the state's maneuver capacity.

[518] Such as political economy, political theory, history, political development works, administrative law, regulation theory, and comparative studies of oil regulatory regimes.

[519] *See* Giovanni Sartori, "Where is Political Science Going?", *Political Science and Politics*, American Political Science Association, Vol. 37, No. 4, October 2004, pp. 785-787, available at http://www.jstor.org/stable/4488908. *See* also Francis Fukuyama, "What's Wrong with Public Policy Education", *The American Interest*, August 1, 2018, available at https://www.the-american-interest.com/2018/08/01/whats-wrong-with-public-policy-education/; Francis Fukuyama, "The Decline of American Public Administration", *The American Interest*, August 1, 2018, available at https://www.the-american-interest.com/2018/08/13/the-decline-of-american-public-administration/.

This piece found in the notion of checks and balances a transversal scope argument capturing the legal and institutional shortcomings of the Mexican petroleum regime into a *systematic narrative*. Yet the choosing of checks and balances as the touchstone of this critique obeyed not only its analytical reach, but also my commitment to a principled idea of statecraft along the lines of *political liberalism*.

The idea of checks and controls has endured through centuries because it targets one of the crucial tensions in Western political thought – that the state is a necessary means to provide different social goods, so it must have enabling power to control the governed and, likewise, be able to regulate itself. At the heart of this *paradox* underlies a calling for *balanced governance*, which consists in the wisdom to moderate functional state capacity, on the one hand, and constraints on pervasive concentration of political power, on the other. This research analyzed this puzzle in light of Mexico's administrative state on petroleum.

2. Findings and Diagnosis

The purpose of this *public law* and *policy analysis* was to frame a critical account of the Mexican regulatory regime on upstream oil that emerged as a result of the energy reform passed by Congress in 2013 and 2014. This was a turning point for the history of this extractive industry in Mexico because such energy reform meant the liberalization of domestic oil and gas industry, which had been dominated by a vertically integrated state monopoly for 75 years.

The hydrocarbons reform of 2013-2014 was aimed at attracting private capital investment into this extractive industry and propelling economic growth and social development in Mexico. Yet, the only business link of the oil supply chain where the Mexican state preserved its large scope *command* and *control* is the upstream oil sector – namely, petroleum exploration and production operations. The Mexican constitution still bestows the upstream oil segment with a '*strategic*' legal protection, meaning full state ownership structure over subsoil petroleum deposits and a resource management regime that is exclusively controlled by the federal government acting via the Executive branch.

Despite the positive impact that could result from the opening of the Mexican oil sector towards a market-friendly investment regime, my main argument underlines an array of *pending institutional design deficiencies* challenging the government's disposition to credibly commit to a genuine liberalization of petroleum regulation in Mexico. Irrespective of the adverse political environment prevailing both in Mexico and the world, this research calls upon more *aggressive liberalizing* measures –including partial privatization– as means to build up a Mexican upstream oil regime that is supported on robust *checks and balances*. Instead of pursuing an economic ideology that praises crude deregulation as an end in itself, my understanding of a liberalizing reform agenda has been instrumental, placing the *institution-building* component at the center for effective hydrocarbon policy enforcement.

Following the political economy insights and comparative remarks raised in this research, I can conclude that development of effective state capacity –rooted in sound checks and balances– is a *necessary condition* for achieving a competitive petroleum industry in jurisdictions like Mexico. Underlying the *balanced governance* ideal, there is a check-and-control rationale governing the distribution of policy and regulatory roles inside the administrative state, so that the petroleum industry functions as smoothly as possible according to standards proper of a healthy economic sphere –that is, efficiency, productivity, and competitiveness.

Considering a surrounding political environment that has been characterized by a fragile rule of law and weak state capacity as direct correlate of the authoritarian control and rent seeking on the part of the ruling elites, my case for strong *checks and balances* seeks to shield the development of the Mexican hydrocarbon industry against excessive political interference and arbitrariness coming from the Executive branch. The *balanced governance* principle has been therefore used as contrast medium to highlight sources of excessive administrative discretion and power concentration in the legal institutions governing the upstream petroleum business of Mexico.

When it comes to think of checks and balances, we immediately tend to emphasize the legal design of government institutions and their policing and regulatory powers. Yet, before addressing the formal separation of functions and the organization of the administrative state on upstream oil operations, this work began unpacking a borrowed theory about the critical function that *ownership regimes* have –in terms incentives– over the subsequent building of institutions which regulate access and control to petroleum rents.

By virtue of Jones Luong and Weinthal's theory, this research was able to apply the *correlation* between state ownership with full government control on hydrocarbons and weak fiscal institutions as mirror –an association applicable to Mexico, given the state's reliance on oil revenue to patch one third of its budget for the last 30 years. By placing *oil ownership* as the touchstone that shapes and conditions the quality of institutions governing petroleum resource management in a state, the political economy arguments above offer a scape valve to the deterministic commonplaces of the traditional 'oil curse' literature.

Unlike other legal institutions whose existence is limited to the design of formal rules and law enforcement, this work observed that ownership is also entrenched in social relations conveying a *sense of materiality* that shores up its normative force. Accordingly, the assignation of private ownership rights on oil profits creates *checks and balances* of the strongest quality, because the material interests at stake make highly visible the tension existing between the profit maximization sought by its private holders and the tax revenue objective pursued by the state. Such *competitive pressures* among the government and private property rights holders foster the right kind of incentives to build an enabling, but also accountable, fiscal regime for the oil sector. By contrast, when natural resources are legally submitted to public dominion they either belong to no one or, in most cases, end up "captured" by the elites controlling the state apparatus.

Having laid out the analytical premises above, this research proceeded to evaluate the Mexican regulatory framework for oil exploration and production activity on the following

three layers: 1) ownership rights and policy on petroleum; 2) the petroleum resource management regime, and 3) the distribution of functions and formal organization of the Mexican administrative institutions governing this extractive industry.

As a result, this dissertation confirmed that the energy reform of 2013 kept intact the full *state ownership* structure with *government control* of underground oil resources. Although such legal disposition is common even in jurisdictions with competitive petroleum institutions, such as Norway and Brazil, the first problem was found in those constitutional directives ordering that by authorizing upstream oil operations, the Mexican state shall enforce a resource management scheme aimed at *maximizing oil revenue* for national development in the long-term. Although this legal provision could seem inoffensive at first glance, taking into account the state monopoly structure that has dominated this business in Mexico and its public finance repercussions, this *constitutional directive* perpetuates –on positive law grounds– an exclusively extractive policy shadowing this nation's upstream oil regulation.

One could counter that the conclusion above is exaggerated; however, when this analysis looked at the Norwegian legal framework for petroleum, which is the institutional design on which the Mexican energy reform of 2013 was modeled, the hypothesis above gets reinforced. Unlike Mexico, the Norwegian legislation establishes the duty of its administrative authorities to observe a *comprehensive policy impact assessment* of the costs and benefits that might result from a given upstream oil project for different layers of the Norwegian society, before authorizing the auctioning of licenses for that purpose. As opposed to Mexico, where maximization of oil revenue legally trumps any other equally important policy consideration, Norway's oil governance is characterized by *policy gradualism* and by a more *leveled field* for consideration of other *social interests* than oil rents –for instance, sectorial competition, disruptive effects on domestic industries, environmental protection, social conflict, among others.

Additionally, there is a legal technique difficulty in the sense that the *rentier-state model* on upstream oil has been wired around the Mexican constitution. This dissertation addressed the question of '*regulatory constitutionalism*' as the lawmaking approach used by Mexican decision makers to legislate on petroleum regulatory matters from the constitution itself, so that the policy agenda directing their enforcement is shielded from the volatility of the ordinary political process.

In this way, regulatory constitutionalism poses two shortcomings for Mexican oil governance. On one hand, this legal design technique constrains the *regulatory flexibility* of petroleum authorities to change or adjust a sectorial development strategy that might not be policy-wise to preserve in the long-term. On the other, the evidence that the Mexican constitution has been amended 693 times[520] since it was enacted in 1917 and that 164 of those reforms[521] occurred in the past two presidential administrations (2006-2018) under

[520] Nación 321, "101 Años de la Constitución Política Mexicana en 17 Datos" [101 Years of the Mexican Politcal Constitution in 17 Data], Nación 321, México, February 5, 2017, at http://www.nacion321.com/gobierno/100-anos-de-la-constitucion-politica-mexicana-en-17-datos
[521] *Id.*

'divided governments', challenges the common believe that the constitution is the supreme norm in Mexico and cannot be changed as easily as ordinary legislation. Moreover, this could be illustrating that in Mexico political elites rule *by* law[522] instead of being submitted to a rule *of* law, but this question exceeds the scope of this work.

The second layer explored by this work has to do with Mexico's *petroleum resource management* through a new contract regime on hydrocarbon exploration and production. Although the energy reform of 2013 and 2014 took a large step towards a market-friendly investment environment, by creating a competitive and innovative *contract regime* to attract private capital into the Mexican upstream oil industry, the present critique has identified a variety of institutional design weaknesses.

Given the concern of the Peña Nieto administration for justifying the energy reform in a nationalist narrative and hence securing a legislative coalition to approve it, this research underlined how the resulting oil contracts are heavily regulated by an *administrative law regime*. In this regard, this analysis highlighted a legal *inconsistency* relative to exploration and production licenses, which seem to be a nominal front to bypass the constitutional ban on petroleum concessions that still exists in Mexico, since both contract vehicles produce the same effects in the sense of greater property rights on oil production. It is strange that those leftwing forces opposing the passage of the hydrocarbons reform did not raise this constitutional challenge before the Supreme Court.

In this way, the risk for upstream oil licenses to be judicially controverted in federal courts is a permanent danger with each petroleum auction for as long as this legal contradiction remains in the Mexican oil regime. One could certainly minimize this normative inconsistency as mere formality question, yet it is an indicator that weakens the credibility of the Mexican state to commit itself to a genuine liberalization of the petroleum industry.

As a result of this this *heterodox blend* of public interest regulation and private law elements, the Mexican contract regime for upstream oil operations is affected by serious institutional weaknesses in terms of checks and balances.

First off, despite the liberalization efforts, the regulatory framework still grants the state –via the Executive– the discretion to conduct upstream oil activity by means of an administrative vehicle called '*assignations*', which are directly adjudicated to the Mexican NOC and exempted from a competitive process. Although Mexican hydrocarbon legislation explicitly states that contract auctions shall be the rule, whereas assignations the exception,

[522] *See* Francis Fukuyama, Political Order and Political Decay, Farrar, Straus and Giroux, New York, 2014, at 18, 66-667, 71-75, 83, 211, 344, 468. German jurisprudence coins this institutional paradigm as the traditional *Rechtsstaat.* These terms are relevant since they have been used by political scientists to describe a type of "liberal autocracy" that works through a highly institutionalized bureaucracy (e.g. in many cases via the military forces and a technocratic body public servants) within an effective legal framework that both proves efficient for economic development and guarantees the private property rights, but where the fundamental political decisions made by supreme power-wielders, irrespective of the arbitrariness involved in these actions, are not checked or constrained by means of the law and the courts.

the requirements controlling the *exceptional* character of this administrative tool are put at the level of an executive decree and therefore subject to *unchecked* presidential discretion.

In this context of weak checks and controls, there is a high risk that the liberalizing spirit of the Mexican energy reform can be thwarted through the *abuse* of *assignations* if the Executive power gets controlled by a presidency that is more partisan of a statist energy policy –this could be a potential strategy to be followed by President elect of Mexico, Andrés Manuel López Obrador, if he purports to roll back the hydrocarbon amendments of 2013 and 2014 without a formal repeal on a constitutional level.

There is another type of institutional flaws jeopardizing a balanced oil management in Mexico as consequence of the constitutional directive to prioritize *oil revenue maximization* in favor of the state over any other policy consideration. The regime governing oil resource management in Mexico is strongly characterized by a *fiscal* imprint. Although there are some legislative provisions suggesting that the new contracts are ruled by commercial law principles, the new hydrocarbon laws in Mexico have a clear *authoritative* accent when it comes to the regulation of the compensation payments the state is entitled to receive in exchange for the grant of upstream oil contracts.

In order to unmask the supposedly mercantile or commercial character of Mexico's upstream oil contract framework, this thesis showed that the Executive branch enjoys exorbitant policing and regulatory powers over contractors. For instance, the Finance Ministry has the authority to set up *fiscal terms* of the upstream oil auctions and audit the *financial aspects* of the resulting oil contracts during their execution.

But, the crown jewel on which I rest my case is the state prerogative to declare either the "*administrative rescission*" of an oil contract when, lacking of a justified cause, the contractor breaches their payment, investment and production obligations, providing the administration with the power to retrieve the contractual area without any charge of compensation in favor of the contractor. Furthermore, Mexican hydrocarbon law explicitly forbids the possibility of triggering alternative dispute mechanisms –such as international arbitration proceedings– to dispute administrative rescission of an upstream oil contract. Aside the discussion on the judicial and alternative means to dispute this government measure, is it reasonable to deny that such unilateral exercise of administrative power is *intrinsically authoritative*? So, the mercantile law features added to Mexican petroleum legislation were overrated, creating a *façade* concealing the 'upper hand' preserved by the administrative state.

In evaluating the petroleum management functions inside the Mexican administrative state, this critique disclosed that their distribution is circumscribed to the Executive branch. In other words, there are not policy and regulatory powers granted to autonomous agencies located outside the organic orbit of the presidential administration. Yet, drawing upon a supposed *arm's-length* rationale, command and control authority over upstream oil contracts was *fragmented* among a plurality of administrative bodies that are part of the Executive branch: the Energy (SENER) and Finance (Hacienda) ministries, the sectorial regulator (CNH), and the Mexican Petroleum Fund.

This work's findings, however, rebuff the checks-and-balances policy that was apparently pursued by the architects of the new hydrocarbon laws. According to the statutory law reviewed, our appreciation was that both SENER and Hacienda *control* the *key policy and regulatory functions* on the upstream oil sector. On the one hand, as a result of the constitutional policy ordering the maximization of oil revenue for the state, the Finance Ministry is in charge of designing the fiscal and investment terms, which shall dictate who wins a petroleum contract bidding. Likewise, Hacienda is entitled to manage and enforce that the contractor executes the financial aspects of petroleum contracts in terms of the agreement clauses and the hydrocarbon legislation. Additionally, the Finance Ministry is tasked with auditing and overseeing the faithful execution of the tax regime applicable to upstream oil activities.

Neither the Norwegian oil model nor their Latin American replicas have a finance department *concentrating* a degree of power tantamount to the administrative discretion possessed by Hacienda to shape regulatory policy of the Mexican upstream oil industry. In fact, except for the implementation of the tax rules on upstream oil activity, the finance ministries of Norway and Colombia lack of jurisdiction to manage the *fiscal* and *financial* aspects of their upstream oil contracts. Consequently, unlike Norway and Colombia, the Mexican Ministry of Finance is unique in the sense that it concentrates policing and regulatory powers both on tax law in general as well as on the financial aspects of the upstream oil sector.

For its part, the Energy Ministry *concentrates* the power to determine the *technical* guidelines ruling the upstream oil rounds, the five-year bidding plan, the contractual areas to be auctioned, and the suitable contract modality for each bidding process. SENER's control of key regulatory policy decisions over the upstream oil industry ends up *subordinating* CNH to *secondary* decision-making roles –for instance, being the technical advisory arm at the service of SENER, the administrator of upstream petroleum auctions, and the one-stop shop between contractors and the Mexican state.

Instead of bolstering the '*functional autonomy*' of the upstream oil regulator, the jurisdiction CNH is severely crippled by design. As opposed to Mexican case, this research has advanced evidence about the greater empowerment of upstream oil regulators both in Norway and Colombia –that is, two jurisdictions whose oil regime supposedly served as benchmark for Mexico's hydrocarbon reform of 2013.

In addition to the technical advisory and one-stop shop roles to assist their energy ministries in the Executive branch, sectorial regulators in Norway and Colombia are in charge of *managing* and *verifying* public revenue the state is entitled to receive as consequence of upstream oil licensing. In this light, the resulting lesson from this comparison of petroleum institutions is that the autonomy of an upstream petroleum regulator is achieved not necessarily through its organic placement outside the central administration, but rather via the assignation of *key regulatory policy functions* to shape the development strategy of the sector.

As far as the Mexican Petroleum Fund is concerned, this financial vehicle is aimed to work for both *stabilization* and long-term *investment* purposes. Yet the present critique

revealed that the latter function is subordinated to the former, because the energy reform secured a constitutional provision binding this sovereign wealth fund to transfer a fixed amount of revenue as proportion of the GDP into the government budget on a yearly basis. Once this budgetary obligation consisting in the annual injection of funds is met, the Fund is able to earmark the remainder of oil profits for public investment and savings goals.

For the reasons above, this work sustains that for as long as the Finance Ministry remains as the *unchecked monarch* of the Mexican administrative state on hydrocarbons, imposing its fiscally extractive development strategy over other equally important social goals, the Mexican petroleum industry won't be able to build *competent regulatory institutions* nor a *sectorial policy* of its own.

Likewise, considering the exorbitant intervention of Hacienda, this research cannot conclusively say that the Mexican oil management regime is a faithful transplant of the Norwegian blueprint. Sadly, the current constitutional policy on upstream petroleum only reinforces this institutional pathology.

The third layer of institutional deficiencies addressed by this analysis focuses on the tripartite organization of administrative intervention in the upstream oil industry – excluding that of the Finance Ministry, whose overwhelming authority was made clear in the context of the petroleum contract regime management.

The 'tripartite' nature of the administrative state on upstream oil comes from the Norwegian triangle model –that is, *formal separation* of the policy enforcement, regulatory, and commercial *functions* through which the Executive branch of government exerts command and control of oil exploration and production operations. However, this dissertation identified two aspects by which the Mexican oil legal design departs from its Norwegian benchmark and its Colombian replica.

On the one hand, Mexican reformers structured the relations between the Executive's Energy Ministry and the sectorial regulator through a '*regulatory coordination*' mechanism. As pointed out by Grunstein, except for Brazil, this institutional design is unprecedented in the oil industry. After a deep examination, it stood out that this administrative modality is empty of concrete directives regulating the relationship between the Energy Ministry and CNH, or even among the upstream and downstream regulators of the whole supply chain.

In light of this legislative silence on the normative content clarifying what regulatory coordination actually means for the oil sector, as well as a potential conflict of interest affecting the Energy Minister as head of the Energy Coordinating Council, this work concluded that this legal status could be a *nominal front* to justify a complete *subordination* of the sectorial regulator to the Executive – as indicated before, although Mexico's administrative state on petroleum is circumscribed to the Executive branch, its policing and regulatory roles are fragmented among several actors inside this orbit.

On the other, there is Pemex as the state-owned oil champion in Mexico. This research concluded that despite the important improvements made to the corporate governance and

to the budget and debt regime of this NOC to provide it with greater *independence* from the Executive branch, the *state ownership* structure with full *government control* was kept intact by the energy reform of 2013. This is another crucial difference with the Norwegian oil model and its replicas in Brazil and Colombia, because the NOCs in all these benchmark cases have been *partially privatized* in a relevant way and this emergence of private capital into their ownership structure has implied strong checks and balances which have had a positive impact for these companies to reach competitive performance.

Although Pemex worked as vertically integrated state monopoly since 1938, the rentier model applied to the upstream oil has translated into confiscating tax burden by which Pemex has been systematically milked by the state to patch one third of the state budget for the last 40 years. In this way, full state ownership and control over this NOC has legalized the short-term government voracity that these days is about to kill the "goose with the golden eggs".

As a result of a 75-year-old state monopoly with a depletion strategy of oil reserves dating back to the mid-1970s, Pemex is being squeezed by a institutional bottleneck presenting a cycle of perverse incentives, each of them fueling the others: 1) an accelerated collapse of petroleum production as consequence of minimum reinvestment on exploration; 2) lack of technology, financial capacity and human capital to carry out upstream operations in an era were "easy oil" is almost finished; 3) neglect of the downstream and midstream business links of the hydrocarbon supply; 4) a negative debt profile, which is mostly employed for unproductive expenditures, such as pensions, and for funding day-by-day operations; 4) Pemex's debt is starting to have some drag effect on Mexican public debt, since the latter is an implicit collateral of the former. All this has happened while Pemex has the highest pre-tax margins of petroleum production in Latin America.

The key point of contact between Norway, Brazil and Mexico is that they all have state-owned oil companies with *monopolistic* or *dominant* positions in their domestic upstream oil markets. Furthermore, these jurisdictions have an oil resource management regime where state ownership and the government's regulatory presence is pervasive. Yet this work has shown an important *divergence* – checks and balances were implemented both in Norway and Brazil to held accountable their NOCs when they got strong enough to defy the state. The Mexican case, on the contrary, illustrates a weak state firm performing a public finance role rather than an organization that has taken advantage of its legal monopoly to develop local expertise, human capital, and technology. This is why I have rest this work's case on the need for an *arm's-length* principle governing government-NOC relationship, something that necessarily goes through a partial privatization of the latter.

This work is aware about the huge gaps existing between Norway and Mexico in terms of *state-building* efforts. Despite my dislike for deterministic narratives, I am realistic about path-dependence patterns and circumstantial factors conditioning the probability that Mexico becomes Norway with regard to institutional development, which is a process that transcends any legal design reform. Yet, the *lesson* worthy of being *exported* from the Norwegian oil model to other jurisdictions is the powerful impact of strong *checks and controls* in the administrative state for having a competitive petroleum industry.

3. Reform Proposals

Instead of insisting on institutional façades, this work advocates for a more aggressive *liberalization* of the Mexican hydrocarbons industry along the following reform agenda:

1) First, an amendment of the rentier policy prevailing on hydrocarbons towards a petroleum resource management that considers other sectorial development strategies from an arm's-length perspective.

2) Second, the reinforcement of checks and balances –in the sense of stronger judicial or international law guarantees– to protect the property rights of private investors in the upstream oil industry as a result of the exorbitant command and control powers possessed by the Mexican state in this realm.

3) Third, the empowerment of the sectorial regulator in terms of functional autonomy vis-à-vis the Executive branch – particularly from the ministries of Energy and Finance.

4) Fourth, the reform of the full state ownership structure that currently prevails on Pemex to a hybrid equity regime that guarantees government corporate control over this national oil champion – as in Norway, Brazil and Colombia.

5) Fifth, greater legislative directives and higher scrutiny by CNH rather than by the Energy Ministry exclusively on grant, compliance, and performance of upstream oil assignations to Pemex, so that this administrative law instrument is genuinely 'exceptional' compared to upstream oil contracts.

6) Sixth, to privilege the signing of strategic alliances by which Pemex can actually learn from their partners the best international practices in terms of technology, expertise, and human capital and thus become an upstream oil operator in the strict sense of the word, instead of being a simple witness without access to its partner's industrial model.

7) Seventh, although this reform would technically require to operate outside the sphere of the administrative state to hold it accountable to another political power, it is imperative to empower the technical advisory bureaucracy assisting Congress in its oversight and scrutiny role over the Executive branch –in particular, Ministry of Finance officials– in their management of oil revenue flowing from the Mexican Petroleum Fund to government budget. Likewise, Congress in collaboration with the Executive branch must implement a careful macroeconomic plan to gradually reduce the government's budget dependency on oil rents, guaranteeing that the stabilization function of the Petroleum Fund is in fact applied on 'exceptional grounds' for regulated emergency scenarios.

From the package of reforms above, the fourth one is the most sensitive for Mexico's public opinion and therefore it would be facing more political opposition than the others. The negative perception on *privatization* in Mexico cannot only be seen as a reminiscence

of the natural resource nationalism from the authoritarian era, but rather obeys to an *ill-implementation* of *privatizations* whose failure to deliver competitive public interest services, or even the need to rescue them with taxpayers' money, is often blamed onto the grand corruption of the government elites –for example, that of the telecommunications sector, railway transportation, and banking services in the 1990s.

Today, Pemex's *ownership regime* is the most salient challenge for Mexican oil governance. The ownership regime this work has advocated for is not one characterized by power concentration, but rather by a *competitive* nature that leads to *balanced governance*. Until this liberalization is not complete, it is unlikely that all the rest of legal and institutional changes are capable of fixing the fiscal squeezing of Pemex and its repercussion for developing strong fiscal institutions in Mexico. A greater concession of *private property rights* on oil wealth to agents other than the state is conceived here as an effective institutional means, rather than an economic end in itself, to *check* the *rentier* voracity of the government, forcing the latter to focus on building its regulatory role.

Precisely because of our balanced governance claim, privatization should not amount to the conversion of one public monopoly into a private one. Before addressing the upstream sector, the Mexican government should first explore the possibility of privatizing some parts of the downstream and midstream segments of the oil industry that have been completely neglected by Pemex in terms of investment. Once satisfied that step, then policymakers should plan the strategy, degree, and pace under which private capital is to be inserted in the Pemex's upstream subsidiary, so that this *privatization* process benefits the national interest and is attractive for private investors at the same time.

Mexico is rich in evidence illustrating that a privatization strategy upon public interest industries is not immune to poor implementation or corruption risks. Based upon the scholarly contributions of Rodrik, Fukuyama and Huntington, this research has emphasized the necessity for Mexico to increase its *institution-building* efforts along *check-and-balance* guidelines and thus develop *effective state capacity*. The difficulty underlying such institutional transformation is that it cannot be decreed by legal design. Instead, this gradual evolution requires stability and consistency in the institutional environment. However, privatizations implemented in a normative vacuum or without a competent bureaucracy are prone to fail in meeting their goals.

Yet this research is aware that the *current political environment* in Mexico will not be fit in the short term for stronger checks and balances in its petroleum institutions. Andrés López Obrador recently won the presidential election in Mexico and shall be sworn in for a six-year term on December 1st, 2018. As consequence of the strong democratic mandate received by the President elect, his administration will be enjoying from majoritarian control over Congress. In light of López Obrador's well-known resource nationalism and statist policy orientation, a further liberalization of oil ownership in Mexico is highly unlikely during his presidential term.

On the contrary, President López Obrador could either employ the sources of executive discretion this work has highlighted above –the abuse of assignations, for instance– with the purpose of rolling back the liberalizing elements of the 2013 reform, or even attempt a

constitutional repeal of it given his majoritarian legislative support. This degree of presidential control over Congress foreshadows a hostile political environment for effective checks and balances in Mexican oil governance.

It is not coincidence that the incumbent President Peña Nieto has taken advantage of his last months in executive power to sign, on behalf of the Mexican state, an international law treaty –such as the ICSID convention– with the purpose of shielding investors' property rights in upstream oil operations by submitting host state members to *arbitration proceedings* if needed. In this sense, I acknowledge that the 'lame-duck' presidency has taken due action to address the second reform underscored above.

Likewise, the *uncertainty* and high stakes regarding the petroleum policy approach of the future presidential administration in Mexico, led the sectorial regulator (CNH) to announce a deferral of Round 3's oil biddings until February 2019, once there is concrete knowledge on what to expect in this regard.

Despite the political hostility towards the pending liberalization advocated by this research, the difficult *international context* –which I characterized by a slow recover from petroleum markets collapse in 2014 and the passing of the "easy oil" era– has become the only *dyke* of external reality, in the sense of *contingent necessity*, with the power to weaken the consensus on full state ownership. Paradoxically, if the Mexican government desires to increase its profits from upstream oil operations in the long-term, it is in its best interest to trigger a *liberalizing* policy that is aimed at attracting more investment, not just through upstream oil contracts granted to private companies and strategic alliances involving Pemex and foreign oil corporations, but also via the partial privatization of the Mexican oil champion itself.

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f. The Coordinated Regulatory Organs on Energy Act, published on August 11, 2014 in Mexico's Federal Official Journal;

g. The Federal Public Administration Organic Act, published on August 11, 2014, in Mexico's Federal Official Journal;

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i. The Petróleos Mexicanos Act published on August 11, 2014, in Mexico's Federal Official Journal;

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Sentencia dictada por el Tribunal Pleno de la SCJN en la Controversia Constitucional 97/2009, el 6 de diciembre de 2010. Publicada en el Diario Oficial de la Federación el 10 de marzo de 2011 [Mexican Supreme Court of Justice Ruling on the Constitutional Controversy 97/2009, December 6, 2010, published in Mexico's Federal Official Journal on March 10, 2011].

Tesis 2a. / CLIX / 2017 [judicial precedent number], Segunda Sala de la Suprema Corte de Justicia de la Nación [Second Chamber of the Mexican Supreme Court of Justice], *Semanario Judicial de la Fedración y su Gaceta*, Décima Época, Libro 47, Tomo II, Octubre de 2017, p. 1232. Rubro: "SUSPENSIÓN EN EL JUCIIO DE AMPARO. EL ARTÍCULO 27 DE LA LEY DE LOS ÓRGANOS REGULADORES COORDINADOS EN MATERIA ENERGÉTICA, ES INCONSTITUCIONAL POR NO RESPETAR EL PRINCIPIO DE RESERVA DE LEY REGLAMENTARIA" [Suspension in the writ of amparo. Article 27 of the Coordinated Regulatory Organs on Energy Act, is unconstitutional for violating the principle of regulatory law reserve].

Tesis P. IX / 2007 [precedent number], Pleno de la Suprema Corte de Justicia de la Nación [Mexican Supreme Court of Justice], *Semanario Judicial de la Fedración y su Gaceta*, Novena Época, Tomo XXV, Abril de 2007, p. 6. Rubro: "TRATADOS INTERNACIONALES. SON PARTE INTEGRANTE DE LA LEY SUPREMA DE LA UNIÓN Y SE UBICAN JERÁRQUICAMENT POR ENCIMA DE LAS LEYES GENERALES, FEDERALES Y LOCALES. INTERPRETACIÓN DEL ARTÍCULO 133 CONSTITUCIONAL" [International Treaties. They are part of the Supreme Law of the Union and are hierarchically above general laws, federal laws and local laws. Interpretation of article 133 of the Constitution].

Tesis 2ª. LXXV / 2012 [precedent number], Segunda Sala de la Suprema Corte de Justicia de la Nación [Second Chamber of the Mexican Supreme Court of Justice], *Semanario Judicial de la Fedración y su Gaceta*, Décima Época, Libro XIII, Tomo III, Octubre de 2012, p. 2038. Rubro: "SUPREMACÍA CONSTITUCIONAL. LA REFORMA AL ARTÍCULO 1º. DE LA CONSTITUCIÓN POLÍTICA DE LOS ESTADOS UNIDOS MEXICANOS, DE 10 DE JUNIO DE 2011, RESPETA ESTE PRINCIPIO" [Constitutional Supremacy. The Reform of Article 1 of the Political Constitution of the Mexican United States, of June 10, 2011, observes this principle].

2ª. / J. 56 / 2014 (10ª.) [precedent number], Segunda Sala de la Suprema Corte de Justicia de la Nación [Second Chamber of the Mexican Supreme Court of Justice], *Semanario Judicial de la Fedración y su Gaceta*, Décima Época, Libro 6, Tomo II, Mayo de 2014, p. 772. Rubro: "PRINCIPIO DE INTERPRETACIÓN MÁS FAVORABLE A LA PERSONA. SU CUMPLIMIENTO NO IMPLICA QUE LOS ÓRGANOS JURISDICCIONALES NACIONALES, AL EJERCER SU FUNCIÓN, DEJEN DE OBSERVAR LOS DIVERSOS PRINCIPIOS Y RESTRICCIONES QUE PREVÉ LA NORMA FUNDAMENTAL" [Principle of the most favorable interpretation to a person. Its compliance does not imply that domestic judicial organs, in the exercise of their function, ignore the several principles and restrictions provided by the Fundamental Norm].

P. / J. 1 / 2015 (10ª.) [precedent number], Pleno de la Suprema Corte de Justicia de la Nación [Mexican Supreme Court of Justice], *Semanario Judicial de la Fedración y su Gaceta*, Décima Época, Libro 16, Tomo II, Marzo de 2015, p.117. Rubro: "PRINCIPIO DE INTERPRETACIÓN MÁS FAVORABLE A LA PERSONA. ES APLICABLE RESPECTO DE LA NORMAS RELATIVAS A LOS DERECHOS HUMANOS DE LOS QUE SEAN TITULARES LAS PERSONAS MORALES" [Principle of the most favorable interpretation to a person. It is applicable with respect to the norms relative to human rights that corporations are entitled to].