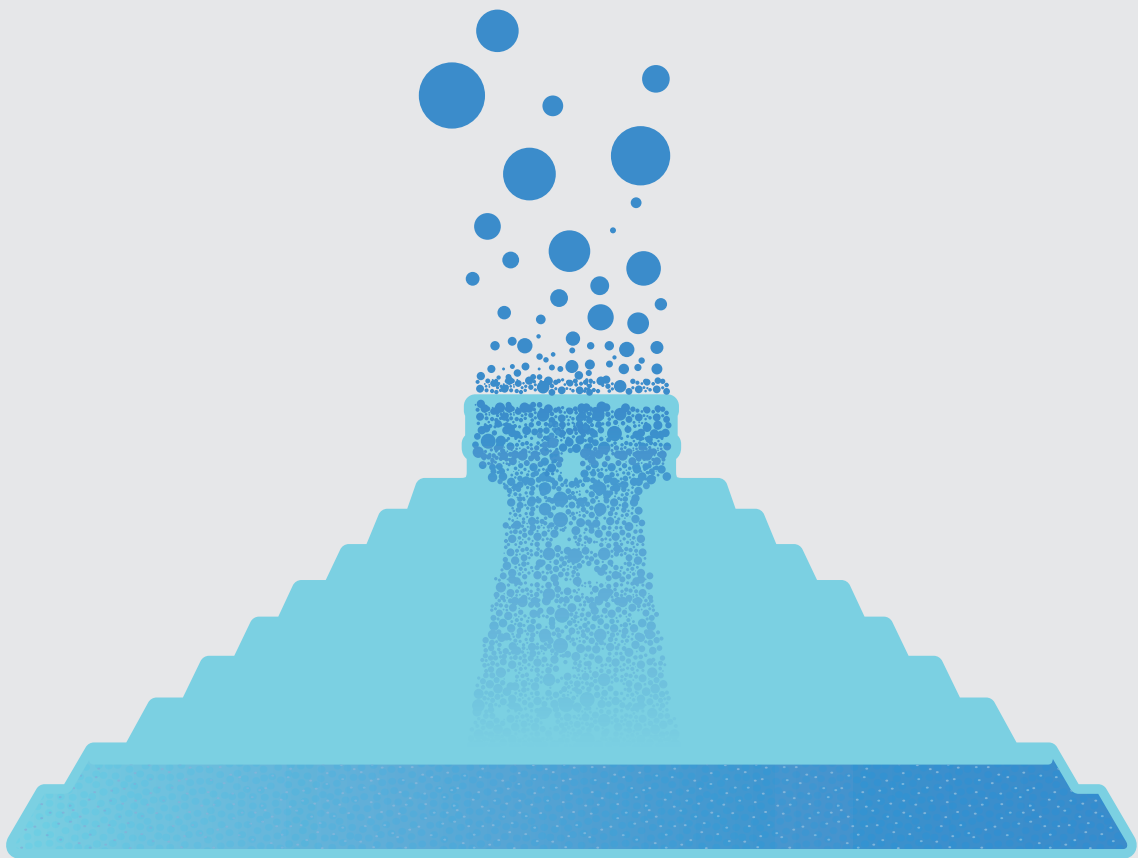


GLOBAL BUSINESS REPORTS

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*Economy - Chemicals - Energy Reforms - Petrochemicals - Agrochemicals
Paints and Coatings - Specialty Chemicals - Distribution*

THE NEW RULES APPLICABLE TO THE PETROCHEMICAL INDUSTRY IN MEXICO

Alejandro López-Velarde¹

●● One of the fundamental characteristics of the petrochemical industry is its integration into long productive chains, which then supply other fields of economic activity, the first link of which are the primary and the secondary petrochemical products. In fact, primary and secondary products are sometimes produced at the same time. However, the Mexican government used to divide this industry in (1) Basic Petrochemical Industry (BPI) integrated by the following products (i) ethane, (ii) propane, (iii) butane, (iv) pentane, (v) hexane, (vi) heptane, (vii) naphtha, (viii) the raw material for smoke lampblack, and (iv) methane; and (2) Secondary Petrochemical Industry (SPI) integrated by the rest of the petrochemical products. The only purpose of this division was to keep in the hands of the State the exclusive production and development of the BPI; while the private sector was able to participate in the SPI. However, when the private sector produce primary products, these products have to be sold to the Mexican government at low prices. Without any questions, this regulation was unattractive for foreign concerns that wishes to invest in the petrochemical sector in Mexico. In fact, Mexico was the only petrochemical jurisdiction in the world that established this unpractical and unattractive division.

In addition to the above-mentioned poor regulation, due to the lack of investment by Pemex in this sector, the commercial international balance in petrochemical products has been for more than a decade in the red.

Before the modifications to the Constitution back on December 20, 2013, article 28 of this paramount law reserved exclusively in favor of the Mexican State the dominion, exploitation and commercialization of the BPI. Consequently, the Mexican government modified the Constitution; the Foreign Investment Law; and promulgate the Hydrocarbons Law on March 11, 2014, with the purpose to end with the undo regulation to the petrochemical industry. Today, the private sector either national or international will be able to do the following:

i. Participate in the production of both BPI and SPI. In fact, in the Mexican legal system there is no longer the division between BPI and SPI; however, private investors will have to obtain a permit from the Energy Regulatory Commission (*Comisión Reguladora de Energía*--known by its Spanish acronym as "CRE").

ii. Participate in the commercialization of petrochemical products as long as companies obtain a permit from CRE and provide statistical information requested by such Commission. It is important to note that petrochemicals that do not need to be transported by pipeline do not need a permit from CRE.

iii. Joint venture with Pemex or any Productive State Entity or Pemex's affiliate for the production and commercialization of petrochemicals is now available even in the so called primary petrochemical products. Further, the Law on Public-Private Partnerships was amended to allow public-private partnerships in this sector. It is expected that Pemex may call interested parties to participate with it joining force or selling assets for the production of petrochemicals. Back in July 1995 the Mexican government tried to sell off various assets for the production of secondary petrochemicals located at 61 petrochemical plants distributed in 10 complexes owned by Pemex-Petrochemical (*Pemex-Petroquímica*); specially, the one located in Cosaloacaque, State of Veracruz with no success since various sectors of the Mexican community opposed the sale and the possibility to liberalize the petrochemical industry to the private sector, among them, senators and representatives, unions, industrial leaders, associations, industrial chambers, Mexican doctrine and of course certain political parties which made this controversy their own under the supposed protection of the Mexican sovereignty. The foregoing caused a climate of uncertainty and lack of confidence with the domestic and foreign investors who wish to invest in this sector in Mexico. With the new provisions of the Hydrocarbons Law these uncertainties ended. The private sector will be able to (i) join venture with Pemex or any of its subsidiaries or affiliates; and (ii) buy petrochemical assets owned by Pemex and its subsidiaries if such public entities decide to sell them. •

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●●● **Can you provide us with a brief introduction to LVWHB and the firm's expertise?**

We are a medium-sized boutique law firm devoted to all phases of the energy sector from upstream to downstream, including exploration, production, petrochemicals, refining, transportation, distribution, storage and commercialization. We have about 25 lawyers, 7 out of which come from the oil industry including myself. I worked at Pemex for eight and a half years, including three years at the Pemex office in Houston. As LVWHB, we have participated not only in the private sector, but also the public sector. We represent Pemex in very special cases such as antitrust and litigation where they need experts outside of their in-house legal team. We have also provided legal advice to the Mexican Congress.

What level of interaction does the firm have with the petrochemical sector?

The petrochemical industry accounts for roughly 30% of our business, while the oil and gas industry accounts for the other 70%. We have several clients doing business in this sector with Pemex, as well as clients that are trying to seize new opportunities from the new laws coming into force. Previously we also participated in the sale of the petrochemical assets of Pemex in Veracruz in the petrochemical complex called "Cosoleacaque," although this sale ultimately was not completed due to political reasons.

Mexico's petrochemical industry has been in decline for the last two decades, leading to a negative trade balance for petrochemical products. Will the reforms improve the sector?

The petrochemical industry saw its boom at the end of the 1970s and beginning of the 1980s. During that time, about 61 plants were built. After that, Pemex did not invest enough money to increase production, maintain its plants, or further develop the industry. Roughly 65% to 85% of Pemex's profits are paid as tax, and the remaining goes to exploration and production. As a result, the petrochemical industry has not been properly developed for a long time. Today we have to import a lot of the products in the industry to comply with the national demand. With the reforms, it is assumed that Pemex will be working with in partnership with private companies.

What differentiates LVWHB's approach to the petrochemical and oil and gas sectors, compared to other law firms in the market?

We have been on the other side of the table working with Pemex on many transactions, so we know how it does business in Mexico. We also provide a quick and personal service to our clients. Additionally, LVWHB holds seminars and writes comprehensive articles about sector issues, such as the history of petrochemical regulation in the country, and the sector's current legal framework. We are currently in the process of publishing an article about the new possibilities for foreign investors in Mexico which will be coming out in January 2015.

As a result of the energy reform, what key changes will impact the petrochemical sector in Mexico?

The energy reform is a huge change and will allow private companies to participate in all sectors of the industry. Mexico's economy has been based on natural resources, but it has not been regulated well in the past. Previously the basic processing in the petrochemical industry was only in the hands of Pemex. This division created inefficiencies in production, because at the same time that companies produce secondary petrochemical products, they also produce primary products reserved only for the Mexican state. According to previous Mexican law, Pemex had to buy the basic petrochemical products at the cheapest price, which is why no companies wanted to invest here. Now that this division is ended, as of August 12, 2014 companies will only have to obtain a permit from the Energy Regulatory Commission before beginning operations. Pemex will also be able to establish joint ventures with the private sector.

Could the sudden enthusiasm for petrochemical investments in Mexico be tempered by the new projects coming online in the United States?

There is a lot of enthusiasm in the border areas with the United States especially concerning shale gas, however it will not have a negative effect on petrochemical investment in Mexico. There are other more salient issues impacting investment, such as the real estate property law. In Mexico a property owner is not the owner of the natural resources found there. The other big issues that need to be confronted are infrastructure and the environment. Overall our clients are enthusiastic about their future prospects.

Can you leave us with a final message about LVWHB?

There are tremendous opportunities in Mexico. The reforms have taken place not only at the level of secondary laws, but at the constitutional level as well. Now Mexico needs foreign investment; the rules are in place to provide legal certainty and to provide commercial terms and conditions to negotiate with Pemex. Going forward Pemex will be a commercial company open to joint ventures. We welcome any questions from companies who are interested in Mexico and can guide clients on how to invest here. •

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