

# LEGAL CONSIDERATIONS AS TO THE PETROCHEMICAL INDUSTRY IN MEXICO

Alejandro López-Velarde\*

## I. INTRODUCTION.

Petrochemicals represent one of the pillars of the Mexican industrial structure as an economic supplier of widely diffused raw material. Nevertheless, during the nineties a large controversy has arisen in Mexico about the constitutionality of the basic petrochemical industry (“BPI”) and the secondary petrochemical industry (“SPI”). This controversy was intensified since the month of July of 1995, when the Mexican Government began to realize the possibility of selling off various assets for the production of secondary petrochemicals located at 61 petrochemical plants distributed in 10 complexes owned by Pemex-Petrochemical (*Pemex-Petroquímica*).<sup>1</sup>

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 have 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.<sup>2</sup>

The object of this article is to set forth some legal considerations about the constitutionality or unconstitutionality participation of the private investors either national or foreign in the BPI and the SPI and the need of private investment in this sector.

## II. BACKGROUND OF THE PETROCHEMICAL INDUSTRY.

The transformation of hydrocarbons through chemicals began in the first decades of last century in the United States of America (“United States”). However, it was not until the

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\* Attorney and Counselor-at-law, admitted in Mexico in 1991; J.D., National Autonomous University of Mexico, summa cum laude; LL.M. University of Houston Law Center, 1993. Mr. López-Velarde was in-house counsel for the Pemex Houston Legal Department in 1992. Currently he is a Professor of Law on International Trade and Energy in the postgraduate program of the National Autonomous University of Mexico, and partner in the law firm of LOPEZ VERLARDE WILSON, ABOGADOS, S.C. This article was published in the *International Energy Law and Taxation Review*, Issue 8, August 2002.

<sup>1</sup> It is important to mention that since 1993, the Federal Government started to announce the possibility of selling and privatizing petrochemical plants. The 10 petrochemical complexes are: (i) Cosoleacaque; (ii) Morelos; (iii) La Cangrejera; (iv) Pajaritos; (v) Escolin; (vi) Tula; (vii) Reynosa; (viii) Poza Rica; (ix) San Martin Texmelucan; and (x) Salamanca. 85% of the activities performed by these complexes are in the State of Veracruz, Mexico.

<sup>2</sup> Some of the companies which declared interest in relation to the privatization of assets for the SPI were: (i) Down Chemical; (ii) Alfa; (iii) Polioles; (iv) Celanese; (v) Cydsa; (vi) Idea; (vii) Exxon; (viii) Chevron; (ix) Union Caribe; (x) Shell; (xi) Mitsui; (xii) Mitsubishi; (xiii) Vitro; (xiv) Hoeschst; (xv) Basf; (xvi) Girsas; (xvii) Nirsho Iwai; (xviii) Mobil; (xix) Amoco; (xx) Monsanto; (xxi) Femiquimez; (xxii) Petromex; (xxiii) Parmal; (xxiv) Canamex; (xxv) Poliquimia; (xxvi) Policid, among others.

Second World War when due to the need to find substitutes for natural products and raw materials that the petrochemical industrial developed to an industrial scale.<sup>3</sup>

In Mexico, this industry started in the decade of the fifties and beginning of the sixties. It was created as the industry responsible for fulfilling domestic demand to support the policy of import substitution of petrochemical products. During the fifties, the construction of plants began for the purpose of substituting the importation of products such as **(i)** formaldehyde; **(ii)** plastic resins; and **(iii)** ammonia, which the country was importing in such years to meet domestic demand.

During the administration of President Adolfo Lopez Mateos in 1959, the development of the petrochemical industry was established as priority. During this period, the possibility of agreeing to the use of private capital to develop the industry in question started to become apparent in the Mexican Government. In fact, the then Director of Petroleos Mexicanos (“Pemex”) Mr. Pascual Gutierrez Roldan analyzed the possibility of “associating with interested Mexican and foreign private parties for the production of polyethylene”.<sup>4</sup> Later, during the sixties and beginning of the seventies, the petrochemical industry developed greatly. Production in the volume of petrochemicals increased 53 times, 359 petrochemical permits were awarded between the years of 1961 and 1983, 163 of which were delivered to companies, and investment rose to more than 500 thousand million of Pesos.<sup>5</sup>

The Petrochemical Industry boom was spurred on by the “Six Year Basic Petrochemical Program 1977-1982” during the era of the administration of President Jose Lopez Portillo. Under said program, the whole petrochemical industry was established as a priority, reflecting the government’s intention to develop this industry to levels of international competition.

Further, in 1986 a new program was enacted for further developing economic petrochemical activities known as the “Integral Program for Development of the Petrochemical Industry”, attempting among other things to convert the domestic petrochemical industry into a net generator of foreign currency.<sup>6</sup>

With the purpose of having greater control over productivity and investment in the Petrochemical Industry, in 1990 all companies manufacturing petrochemicals through the direct transformation of basic and secondary petrochemicals were obligated to be registered in the Mexican Petrochemical Commission.<sup>7</sup>

In 1992, through the promulgation of the Organic Act of Petroleos Mexicanos and Subsidiary Entities (“Pemex Charter”), Pemex-Gas and Basic Petrochemical (*Pemex-Gas y*

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<sup>3</sup> See Michele Snoeck, *La Industria Petroquímica Básica en México* (The Basic Petrochemical Industry in Mexico). Colegio de México, 1996, at 15.

<sup>4</sup> *Id.* At 20. The Pili- Rey company incorporated by Pemex, Cellulosa y Derivados, S.A. de C.V. and Simon Carves Ltd. with the technical participation of Imperial Chemical Industries succeeded in obtaining a permit to operate a new polyethylene plant. *Id.*

<sup>5</sup> See Comisión Petroquímica Mexicana (hereinafter cited as “CPM”), *Petroquímica 1984*, Ministry of Energy, Mines and Parastatal Industry, 1984, at 11.

<sup>6</sup> See Integral Program of Development of the Petrochemical Industry, *pub’d in* Official Gazette of the Federation (“D.O.”) Oct. 13, 1986.

<sup>7</sup> See Resolution which Restructures the Registration in the Registry of the Petrochemical Industry of the Companies which Produce Petrochemical Products, *pub’d in* D.O. Jul. 13, 1990.

*Petroquímica Básica*) (“Pemex-G&PB”) and Pemex-Petrochemical were created as decentralized bodies with their own legal status and patrimony.<sup>8</sup>

### **III. BASIC AND SECONDARY PETROCHEMICAL INDUSTRIES.**

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 order that said chains function in an efficient manner, adequate articulation is required between the supply of raw materials and the establishment of prices culminating in various products that we use in our daily life. Before going on to a legal analysis of the industry in question, it is appropriate to briefly set forth the headings which each one of these two industries encompass.

#### **(a) Basic Petrochemicals.**

The Mexican Doctrine has said that the BPI includes:

*“Such products which are susceptible to serving as basic industrial raw materials which result from the petrochemical processes founded on the first important chemical transformation which is done to products or sub-products by refining natural petroleum hydrocarbons.”*<sup>9</sup>

Thus, the BPI is a source of supply of raw materials for the SPI.

As it will be reviewed below, the BPI is an economic activity that the State exercises exclusively. In practice, private companies acquire the national products of the first processes from Pemex-G&PB or from abroad and with them create hundreds of chemicals which are transformed into articles for daily use.

#### **(b) Secondary Petrochemicals.**

The SPI has been defined by the Mexican Doctrine as:

*“The subsequent transformations of basic products with which is obtained a large diversity of intermediate and use petrochemical products”*<sup>10</sup>

In the SPI sector, said secondary products may be obtained from the Mexican State and private parties of Mexican or foreign nationality.

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<sup>8</sup> See Mex. Ley Orgánica de Petróleos Mexicanos y Organismos Subsidiarios (Organic Act of Petróleos Mexicanos and Subsidiary Entity) [hereinafter cited as the “Pemex Charter”], *pub’d in* D.O. July 6, 1992, Art. 3 (iii) – (iv).

<sup>9</sup> See Susan Chow, *Petroquímica y Sociedad* (Petrochemical and Society). Fondo de Cultura Económica, 1982, at 170. Other conceptualizations of the BPI set forth that same includes “*the conversion of components of natural gas petroleum and its derivatives in basic petrochemical and raw materials named first generation, as well as those of other more manufactured products.*” See Report on the Process of Privatization of Assets of the Secondary Petrochemical of Pemex, H. CAMARA DE DIPUTADOS, Comisión de Energéticos, Petrochemical Subcommittee ( hereinafter cited as “Privatization Report”), 1996, at 8. Michele Snoeck establishes that the BPI includes “*those derived from the first physical or chemical transformation of hydrocarbons or products of refining*”. See Michele Snoeck, *supra* note 3, at 29.

<sup>10</sup> See Privatization Report, *supra* note 9, at 9.

#### IV. LEGAL FRAMEWORK APPLICABLE TO THE PETROCHEMICAL INDUSTRY

##### (a) The Mexican Constitution.

Pursuant to the Mexican Constitution, the Mexican government has direct dominion over the subsoil as well as the exclusive right to exploit and develop petroleum and gas. The wording of the Constitution bars the private ownership of hydrocarbons and reserves ownership of petroleum and all solid, liquid, and gaseous hydrocarbons to the State.<sup>11</sup> The ownership of such natural resources is a constitutional right that is inalienable and not subject to any statute of limitations.<sup>12</sup> Consequently, on a constitutional basis, it is not possible for the Mexican government to concede oil exploration and exploitation rights to private parties.

Furthermore, the Mexican Constitution considers the petroleum and BPI industries as *strategic areas* in which all domestic hydrocarbon resources and basic petrochemicals are exclusively reserved to the State.<sup>13</sup>

##### (b) The Pemex Charter.

Pemex was created by the Mexican Congress via decree, immediately following the expropriation of the oil and gas industry.<sup>14</sup> In 1992, the Mexican government submitted a bill to the Congress which restructured Pemex in order to preserve and guarantee its role in the Mexican economy and the international market. Upon approval of the bill, the Pemex Charter effectively restructured the operative sub-agencies of Pemex by creating the following subsidiaries: (a) Pemex-Exploration and Production (*Pemex Exploración y Producción*); (b) Pemex-Refining (*Pemex-Refinación*); (c) Pemex-G&PB;<sup>15</sup> and (d) Pemex-Petrochemical.<sup>16</sup> Pemex-Petrochemical participates in the SPI together with national and foreign investors.

Each of the foregoing subsidiaries enjoys a distinct legal status with the capacity to own property, and each is independently responsible for the functions entrusted to it. The

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<sup>11</sup> See Mex. Constitución Política de los Estados Unidos Mexicanos, (Political Constitution of the United Mexican States) [hereinafter cited as “Const.”], *pub’d in* D.O., Feb. 5, 1917, Art. 27. Article 27 is a complex provision, directed toward defining the limitations of foreign interests in different strategic areas of the Mexican economy. However, Article 27 was not fully employed between 1917 and 1923. Foreign interests were mostly unaffected by the new Constitution, and mining and oil interests continued an unfettered increase in production. When problems arose after World War I, and the subsequent world recession, oil production dropped significantly. At this point, President Alvaro Obregón planned the retroactive application of Article 27 to foreign-owned oil companies. Concern on the part of these investors led to tensions and conflict between the investors and the State. However, due to vast lobbying on the part of the investors, Obregón finally agreed to respect existing concessions. After this initial effort to impose these strict Constitutional regulations, Mexico and its investors continued a relentless period of high volatility and tension that lasted nearly fifteen years.

<sup>12</sup> *Id.* Art. 27.

<sup>13</sup> *Id.* Art. 28.

<sup>14</sup> See Mex. Decreto que Crea la Institución Petróleos Mexicanos ( Decree that Incorporates the Petroleos Mexicanos Institution) *pub’d in* D.O. June 7, 1938, art. 3.

<sup>15</sup> The Pemex-G&PB subsidiary processes natural gas, liquefied natural gas, and synthetic gas; engages in storage, transportation, distribution, and marketing of hydrocarbons and the by-products that may be used as basic industrial raw materials. Consequently, it is the subsidiary that exercises the monopoly over the BPI. See Pemex Charter, *supra* note 8, art. 3 (III).

<sup>16</sup> The Petrochemical subsidiary develops the processing of products that are not part of the BPI, as well as the storage, distribution and marketing of such products. *Id.* Art. 3 (IV).

subsidiaries are structured along integrated lines of business and operate as cost centers which are evaluated based on their own productivity. At the same time Pemex-Corporativo remains the entity primarily responsible for the oil and gas industry.<sup>17</sup> Foreign participation in Pemex or in its subsidiaries is completely prohibited.

Gradually, Pemex has expanded its scope of activities to include a variety of economic activities that are not considered strategic areas constitutionally reserved to the Mexican government, nor the exclusive domain of the oil and gas industry in accordance with the Regulatory Law of Article 27 of the Mexican Constitution in the Petroleum Branch (the “Petroleum Law”), such as the SPI.

In view of the above cited constitutional restrictions relating to the petroleum and the BPI industries, it follows that the BPI is reserved to the Mexican government for its exclusive ownership, development and commercialization. As a result, Pemex and its decentralized subsidiaries, in particular Pemex-G&PB carry out the development of this industrial sector in an exclusive manner. Thus, direct participation of foreign or Mexican private investment is not allowed in the development of the petroleum and BPI industries.<sup>18</sup> Notably, however, by not forming part of a strategic area as set forth in the Mexican Constitution, public, private (either Mexican or foreign), and social sector participation is allowed in the SPI.<sup>19</sup>

### **(c) The Regulatory Law of Article 27 of the Mexican Constitution in the Petroleum Branch**

In 1958, the constitutional provisions noted above were embellished by the Mexican Congress through the enactment of the Regulatory Law of Article 27 of the Mexican Constitution in the Petroleum Branch (the “Petroleum Law”). The original version of the Petroleum Law enlarged the scope of activities reserved for the oil and gas industry.<sup>20</sup>

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<sup>17</sup> Pemex and its subsidiaries are decentralized public entities of the Mexican federal government, entrusted by the Mexican government to manage the oil and gas industry. *See* Const., *supra* note 11, arts. 27-28; Pemex Charter, *supra* note 8, art. 1.

<sup>18</sup> It is the public sector which shall exclusively develop the strategic areas, the federal government maintaining at all times the ownership and control of the bodies established for said purposes. *See* Const. *Supra* note 11, arts. 25, paragraph 4; 28 paragraphs 4 and 5.

<sup>19</sup> In 1983, Article 28 of the Constitution was amended to include strategic areas for the purpose of reserving said areas exclusively to the State. The BPI was included within said areas as a result of its importance. Pemex develops the SPI through its subsidiary Pemex-Petrochemical.

<sup>20</sup> The petroleum monopoly expanded even more during the administration of President Adolfo Lopez Mateos with the publishing of the Regulation of the Regulatory Law of Article 27 of the Mexican Constitution in the Petroleum Branch in 1959 (*See* Mex. Reglamento de la Ley Reglamentaria del Artículo 27 Constitucional en el Ramo del Petróleo (Regulation of the Regulatory Law of Article 27 of the Mexican Constitution in the Petroleum Branch) [hereinafter referred as to the “Regulation of the Petroleum Law”], *pub’d in* D.O. Aug. 25, 1959). In said Regulation the State monopoly was reinforced in Chapter VIII with respect to the BPI in establishing the followings terms: **(i)** the petrochemical industry is embody the realization of the chemical and physical processes for the manufacture of compounds through the transformation from petroleum, gas and its derivatives; **(ii)** Pemex is the entity which exercises the monopoly over products susceptible to serving as basic industrial raw materials, thereby prohibiting the participation of private parties in the manufacture of said products; **(iii)** the participation of private parties is allowed in the manufacture of the products resulting from petrochemical processes subsequent to the first important chemical transformation or the first important physical process made to products or sub-products by refining natural petroleum hydrocarbons (e.g., SPI); **(iv)** the Mexican president has the authority to resolve cases of conflict or doubt with respect to the participation of the public or private sector in the petrochemical industry; and **(v)** it has been conferred upon the Mexican Petrochemical Commission the supervisory authority as technical advisor and auxiliary body on matters of petrochemicals on behalf of the Ministry of Energy. *See* Regulation of the Petroleum Law, *supra* note 20, arts. 3, 26-29. The general provisions set forth above were repealed by the Regulations to the Regulatory Law of

Significantly, however, in subsequent reforms to the Petroleum Law, approved by the Mexican Congress on May 11, 1995 and November 13, 1996, restrictions were eased on the natural gas and petrochemical sectors.<sup>21</sup> As a result of these reforms, the petroleum industry currently encompasses:

- (i) the exploration, exploitation, refining, transportation, storage, distribution and first-hand sale of petroleum, and its by-products obtained through the refining process;
- (ii) the exploration, exploitation, production, and first hand sale of gas; and
- (iii) production, storage, transportation, distribution, and first-hand sale of by-products that can be used as basic industrial materials, as well as the following basic petrochemicals: (a) ethane; (b) propane; (c) butane; (d) pentane; (e) hexane; (f) heptane; (g) naphtha; (h) the raw material for smoke lampblack; and (i) methane when such product comes from Mexican source hydrocarbons and used as a basic industrial material in petrochemical industrial processes.<sup>22</sup>

Notably, should the production of secondary petrochemicals also result in the generation of basic petrochemicals by private investors, such basic petrochemical products may be used by the investors in their own operations or sold to Pemex or its subsidiaries. In any event, private investors are obligated to notify the Ministry of Energy as to the generation of such basic petrochemical products.<sup>23</sup>

With the modifications and reforms made to the Petroleum Law above-mentioned, the classification of BPI and SPI, as it had been known, was ended. At the time when Mexico changed its international economic policy by becoming a member of the Agreement on Tariffs and Trade (“GATT”) in 1986, Mexico commenced with the deregulation of the BPI products. Thus, in October of 1986, the prior Ministry of Energy reclassified petrochemical products, reducing primary products.<sup>24</sup> The products which remained as basic petrochemicals were: (i) cetaldehyde; (ii) acetonitrile; (iii) acrylonitrile; (iv) alfaolefins; (v) ammonia; (vi) benzene; (vii) cyclohexane; (viii) vinyl chloride; (ix) cumen; (x) dictoroetano; (xi) dodecibenceno; (xii) styrene; (xiii) ethane; (xiv) ether metilterbulico; (xv) etilvenzene; (xvi)

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Constitutional Article 27 in the Field of Petroleum on Matters of Petrochemicals in 1971. *See* Mex. Reglamento de la Ley Reglamentaria del Artículo 27 Constitucional en Materia del Petróleo en el Ramo de la Petroquímica (Regulation to the Regulatory Law of Constitutional Article 27 in the Field of Petroleum on Matters of Petrochemicals) [hereinafter cited as the “Petrochemical Regulation”], *pub’d in* D.O. Feb. 9, 1971. In said Petrochemical Regulation, the necessity for defining the petrochemical industry was reaffirmed, setting forth: (a) the activities reserved to the State; (b) the activities in which private parties could participate; (c) the procedures for the obtention of permits and authorizations; and (d) the establishment of the authority and duties of the Mexican Petrochemical Commission. The Petrochemical Regulation also reaffirms the participation of private parties in the manufacture of chemical products which result from the secondary industry. *See* Petrochemical Regulation, *supra* note 20, art. 4.

<sup>21</sup> The old tradition of dividing the BPI and SPI through classifications issued by the Ministry of Energy in accordance with the Petrochemical Regulation and the Regulation of the Petroleum Law in their petrochemical part, were repealed when the Mexican government published the modifications and reforms to the Petroleum Law on November 13, 1996.

<sup>22</sup> *See* Mex. Ley Reglamentaria del Artículo 27 Constitucional en el Ramo del Petróleo (Regulatory Law of Article 27 of the Mexican Constitution in the Petroleum Branch) [hereinafter cited as the “Petroleum Law”], *pub’d in* D.O. Nov. 29, 1958 *amended in* D.O., May 22, 1995 and Nov. 13, 1996, art. 3.

<sup>23</sup> *See* Petroleum Law, *supra* note 22, art. 4.

<sup>24</sup> *See* Mex. Resolución que Clasifica los Productos Petroquímicos que se Indican, dentro de la Petroquímica Básica o Secundaria (Resolution which Classifies Petrochemical Products as Basic or Secondary Petrochemicals), *pub’d in* D.O. Oct. 13, 1986.

ethylene; **(xvii)** heptane; **(xviii)** hexane; **(xix)** isopropanol; **(xx)** raw material for black smoke; **(xxi)** methanol; **(xxii)** N-paraffins; **(xxiii)** interofelins; **(xxiv)** ortoxilene; **(xxv)** ethylene oxide; **(xxvi)** paraxilene; **(xxvii)** pentane; **(xxviii)** polyethylene, A.D.; **(xxix)** polyethylene, B.D.; **(xxx)** propylene; **(xxxi)** propylene tetramer; **(xxxii)** toluene; and **(xxxiii)** xylene.<sup>25</sup> Three years later, the government maintained only 20 products as basic, establishing 66 as secondary.<sup>26</sup> The products which were removed from the basic petrochemical list are: **(a)** acetaldehyde; **(b)** acetonitrile; **(c)** acrylonitrile; **(d)** alfolefinas; **(e)** cicloexano; **(f)** chloride de vinyl; **(g)** cumeno; **(h)** dicloroetano; **(i)** styrene; **(j)** etilbencano; **(k)** isopropanol; **(l)** olefinas internas; **(m)** oxide de ethylene; **(n)** polietifeno A.D., and **(o)** polyethylene B.D.<sup>27</sup> In 1991, ether methyl was also reclassified as a secondary product.<sup>28</sup> Finally, the last resolution classifying basic and secondary petrochemicals was issued in 1992 establishing the following eight products as basic: **(i)** ethane; **(ii)** propane; **(iii)** butane; **(iv)** pentane; **(v)** hexane; and **(vi)** heptane, derived from natural gas, as well as **(vii)** naphtha; and **(viii)** the raw material for smoke lampblack.<sup>29</sup>

In sum, all aspects of the oil and gas industry have been exclusively reserved to the Mexican government which is in charge of the petroleum industry through Pemex and its subsidiaries, excluding the SPI and the storage, transportation and distribution of natural gas. Moreover, the Mexican Congress, in observance of the Constitution, crafted the Petroleum Law to place the exclusive control and management of the BPI in the hands of the Mexican government as part of the petroleum industry. Hence, the exclusion of the SPI from petroleum activities is due to the fact that the SPI does not form part of the strategic areas established in the Constitution.

#### **(d) Foreign Investment Law.**

As indicated above, since the administration of president Adolfo López Mateos in 1959, private parties have been able to, and have obtained the authority to participate in the SPI. This right was curtailed in 1973, with the passage by the Mexican Congress of the Law to Promote Mexican Investment and to Regulate Foreign Investment.<sup>30</sup> Through this legislation, the Mexican Congress limited foreign participation in the SPI to a percentage not to exceed 40%.<sup>31</sup> This protectionist law was repealed and replaced in 1993 by a new Foreign Investment Law (“FIL”), which allowed foreign investors to freely participate in the SPI, without being subject to any percentage limitation. The centerpiece of the FIL was the repeal of the general standard of 49% foreign investment (51% Mexican investment) applicable to all economic activities not otherwise subject to a specific percentage limitation in the FIL. The FIL covers the following restricted activities: **(i)** activities reserved for the Mexican State

<sup>25</sup> Id.

<sup>26</sup> See Mex. Resolución que Clasifica los Productos Petroquímicos que se Indican, Dentro de la Petroquímica Básica o Secundaria (Resolution which Classifies the Petrochemical Products as Basic or Secondary Petrochemicals), *pub'd in* D.O. Aug. 15, 1989.

<sup>27</sup> Id.

<sup>28</sup> See Mex. Resolución que Reclasifica el Eter Metil Terbutílico como Petroquímico Secundario ( Resolution which Reclassifies Ether Methyl Terbutílico as a Secondary Petrochemical), *pub'd in* D.O. Jun. 7, 1991.

<sup>29</sup> See Mex. Resolución que Clasifica los Productos Petroquímicos que se Indican, Dentro de la Petroquímica Básica o Secundaria (Resolution which Classifies the Petrochemical Products which are indicated, within the Basic or Secondary Petrochemical), *pub'd in* D.O. Aug. 17, 1992.

<sup>30</sup> See Mex. Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera (Law to Promote Mexican Investment and to Regulate Foreign Investment), *pub'd in* D.O. Mar. 9, 1973.

<sup>31</sup> Id. Art. 5. See also, Mex. Reglamento de la Ley para Promover la Inversión Mexicana y Regular la Inversión Extranjera (Regulation to the Law to Promote Mexican Investment and to Regulate Foreign Investment), *pub'd in* D.O., May 16, 1989, arts. 23-26.

(e.g., the upstream activities); **(ii)** activities reserved for Mexicans or Mexican corporations with foreign exclusion clauses; **(iii)** activities and acquisitions with specific restrictions; and **(iv)** activities and corporations that may exceed the maximum percentage of foreign investment through favorable resolution by the Foreign Investment Commission.<sup>32</sup>

The impetus behind the FIL was plainly Mexico's effort to open up its markets concomitant with the objectives of international agreements such as the North America Free Trade Agreement ("NAFTA"); moreover, insofar as the FIL relates to the SPI, the latter remained unaffected given that it is not representative of economic activities considered to be strategic by the Mexican Constitution.<sup>33</sup>

Based on the foregoing, the participation of the private sector in the BPI and the SPI can be effected under the following conditions:

**(i)** The national BPI integrated by **(a)** ethane; **(b)** propane; **(c)** butane; **(d)** pentane; **(e)** hexane; **(f)** heptane; **(g)** naphtha; **(h)** the raw material for smoke lampblack; and **(i)** methane when such product comes from hydrocarbons located in Mexico and it is used as a basic industrial material in petrochemical industrial processes, will be the exclusive domain of Pemex and its subsidiaries.

**(ii)** Pemex maintains control over the production, transportation, distribution, storage and first-hand sale of Mexican basic petrochemical products.

**(iii)** Foreign and domestic private investors can participate in the SPI in terms of **(a)** production; **(b)** transportation; **(c)** distribution; **(d)** storage; and **(e)** commercialization.

**(iv)** In the event that the production process of secondary petrochemical products results in basic petrochemical products, the investors will be able to use such primary products in their own facilities or sell them to Pemex and its subsidiaries.<sup>34</sup>

**(v)** As noted in point (iii) above, Mexican and foreign companies can freely engage in the above-mentioned SPI activities. Significantly, investing companies are able to operate and own petrochemical plants, installations and related facilities in Mexico, with no

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<sup>32</sup> See Mex. Ley de Inversión Extranjera (Foreign Investment Law) [hereinafter cited as "FIL"], *pub'd in* D.O. Dec. 27, 1993, arts. 5-8.

<sup>33</sup> In fact, during the Zedillo Administration, the Mexican government worked on one of the most important and ambitious petrochemical developments in the world. In said development the government attempted to converge national and foreign petrochemical industries. In another case, an inter-coastal canal was projected linking the Municipality of Altamira, Tamaulipas, Mexico with Corpus Christi, Texas in the United States. For its dimensions and importance, this corridor was considered to be one of the largest in the world in that it also was to have connections with Brownsville, Texas and the East Coast of the United States.

<sup>34</sup> See Mex. Acuerdo por el que se Regulan las Actividades de las Empresas Vinculadas con la Generación de Petrolíferos y Petroquímicos Básicos, como Subproductos en la Elaboración de Productos Petroquímicos Básicos (Agreement for the Regulation of the Activities of Companies Linked with the Generation of Oil-bearing and Basic Petrochemicals and Sub-products in the Processing of Basic Petrochemical Products), *pub'd in* D.O., May. 18, 2000. See also Mex. Especificaciones Técnicas Oficiales de Subproductos Básicos en Cumplimiento del Acuerdo por el que se Regulan las Actividades de las Empresas Vinculadas con la Generación de Petrolíferos y Petroquímicos Básicos, como Subproductos en la Elaboración de Productos Petroquímicos Básicos Publicado el 18 de Mayo de 2000 (Official Technical Specifications of Basic Sub-products in Accordance with the Agreement for the Regulation of the Activities of Companies Linked with the Generation of Oil-bearing and Basic Petrochemicals and Sub-products in the Processing of Basic Petrochemical Products published on May 18, 2000), *pub'd in* D.O. Mar. 9, 2001.

cap as to their percentage participation (in other words they may participate up to 100%). Consequently, even if the petrochemical plants of Pemex-Petrochemical remain unsold, foreign investors may continue to participate in the SPI.<sup>35</sup>

**(e) NAFTA.**

Without a doubt, with the force and effect of the NAFTA opened up one of the largest energy blocks of the world.<sup>36</sup> Chapter VI of the NAFTA entitled “Energy and Basic Petrochemicals” establishes the rules of the game to be followed by the three signatory countries in relation to the trade of energy products and the BPI. However, in order to be able to carry out a complete analysis of the commitments acquired by Mexico in this sector, it is necessary to analyze Chapter VI together with Chapters **(i)** “X Government Procurement”; **(ii)** “XI Investment, Services and Related Matters”; **(iii)** “XII Cross Border Trade in Services”; and **(iv)** “XV Competition Policy, Monopolies and State Enterprises”.

Mexico in negotiating NAFTA at all times established that the Mexican Constitution in no manner would be on the negotiation table, thus, it expressly ordered not only the full respect of the Constitution, but also the respect of the Constitutions of Canada and the United States.<sup>37</sup> Likewise, it established the necessity of observing domestic law on matters of the BPI by establishing that attention be paid to the standards adopted in Mexico by the parties.<sup>38</sup>

In NAFTA, the Mexican government secured the inclusion of reservations applicable to the activities which are exclusively the domain of the Mexican State (e.g., BPI), the same which may be gradually opened up to direct private investment with respect to: **(i)** the development and commercialization of the same economic activity; and **(ii)** the sale of assets which have been dedicated to the development of the BPI. Hence, the Mexican government’s assets devoted to the BPI are presently subject to foreign investment restrictions. Nevertheless, the Mexican government may sell the secondary petrochemical assets owned by Pemex-Petrochemical since such assets are not considered a strategic activity in accordance with the Constitution and the Petroleum Law.

On the other hand, the Mexican negotiators, in observance of the Constitution, not only expressly established the applicable reservations for **(i)** foreign investment;<sup>39</sup> **(ii)**

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<sup>35</sup> As previously established, Pemex-Petrochemical was created by the Pemex Charter as a decentralized body of a technical, industrial and commercial character. Pemex-Petrochemical cannot have foreign participation in a direct manner. The ownership and control of Pemex-Petrochemical lies with the Mexican federal government. See Const., *supra* note 11 art. 25; Pemex Charter, *supra* note 8, art. 3. It is legally possible for Pemex-Petrochemical to sell its assets subject to a prior privatization decree and when the same is no longer of any use for the rendering of public services. See Mex. Ley General de Bienes Nacionales (General National Goods Law), *pub’d in* D.O. Jan 8. 1992, art. 28. Consequently, as long as the petrochemical plants are no longer of use to the Mexican government and the same are not devoted to the BPI, such facilities may be sold to the private sector. The incorporation of Pemex-Petrochemical as a decentralized body is questionable since the same is not directed to: **(i)** develop a strategic or economic activity priority; **(ii)** provide a public or social service; or **(iii)** engage in the obtention or application of resources for purposes of assistance or social security. See Ley Federal de Entidades Paraestatales (Federal Law of Parastatal Entities), *pub’d in* D.O. May 14, 1986, art.14.

<sup>36</sup> See Mex. Decreto de Promulgación del Tratado de Libre Comercio de América del Norte (Decree of Promulgation of the North American Free Trade Agreement) [hereinafter cited as “NAFTA”], *pub’d in* D.O. Dec. 20, 1993.

<sup>37</sup> *Id.* Art. 601.

<sup>38</sup> *Id.* Art. 602.

<sup>39</sup> *Id.* Art. 1101 (2); Annex III 1 (a) (ii).

production;<sup>40</sup> **(iii)** foreign trade; **(iv)** transportation; **(v)** storage; **(vi)** distribution; and **(vii)** first hand sales of the BPI, but also reserved the other strategic areas which is prescribed for energy matters in the Constitution.<sup>41</sup>

With respect to the supply of primary products and for the purpose of promoting cross border trade of the BPI, NAFTA establishes the possibility that PEMEX-G&PB, end users and suppliers of these products may negotiate supply contracts in accordance with the Mexican domestic legislation. As we have already established, the first hand sale of Mexican BPI is part of Pemex's monopoly and said body carries out this function through Pemex-G&PB.<sup>42</sup>

In view of the above, it is evident that NAFTA only covers the strategic areas cited, including the BPI, but excluding the SPI. As a result, the Mexican domestic laws such as the Constitution, the FIL, and the Petroleum Law are in line with NAFTA allowing foreign participation up to 100% in companies dedicated to the SPI sector, as well as the purchase of assets forming part of the SPI.

## V. CONCLUSION.

Putting aside the sensational declarations on the supposed damage which the sale would cause to our history or the dogma created about the petroleum industry since 1995 when the Mexican government tried to sell off various Pemex-Petrochemical assets for the production of secondary petrochemical products, we have had the opportunity above to briefly set forth what is understood by the petroleum industry and clearly indicated how the BPI and the SPI are regulated. Since the administration of President Lopez Mateos, Mexico has allowed the participation of private parties in the SPI.

Article 28 of the Mexican Constitution reserves exclusively in favor of the Mexican State the dominion, exploitation and enjoyment of the BPI only, not the SPI. Thus, our legislature through various laws, such as the Petroleum Law and the FIL, has permitted the participation of private investment of national or foreign nature in the SPI.

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<sup>40</sup> Id. Annex 602.3 (1) (a).

<sup>41</sup> The Mexican State reserved **(i)** the exploration and exploitation of crude petroleum and natural gas, refining and processing of said products, as well as the production of artificial gas; **(ii)** foreign trade, transportation, storage, distribution and first hand sales of crude petroleum, natural gas and artificial gas, and other goods which are obtained from the refining or processing of crude petroleum or natural gas. Id. Annex 602.3 (1) (b). See also Petroleum Law, *supra* note 22. Art. 3.

<sup>42</sup> See NAFTA, *supra* note 36, Annex 602,3 (3); Petroleum Law, *supra* note 22, Art. 3. Mexico reserved the foreign trade establishing the possibility of restricting the awarding of a permit for importation and exportation of the following products: **(i)** mixes of aromatic hydrocarbons which distill 65% or more of its volume (losses included) to 250 centigrade, according to the norm ASTM D 86, **(ii)** naphtha solvent, oil extender for rubber latex and raw material for black smoke, **(iii)** crude oil of petroleum or bituminous minerals, **(iv)** airplane gasoline, gasoline and components for the manufacture of gasoline for motors, kerosene, gas oil and oil diesel, petroleum ether, fuel-oil, oil which are not those which are used of the manufacture of lubricants, pentane, raw material for black smoke, hexane, heptane, and naphtha, **(v)** petroleum gases and other hydrocarbon gases except ethylene, propylene, butylene and butadiene. With degrees of purity greater than 50%, **(vi)** paraffins with gross content of oil greater than 0.75% in weight only when they are imported for their later refining, **(vii)** petroleum coke without calcine, **(viii)** petroleum bitumen, **(ix)** the other residues of petroleum or oil obtained from bituminous minerals, **(x)** bitumen and natural asphalts, slate and bituminous sand, asphalt and bituminous rocks, and **(xi)** ethane, butane, pentanes, hexane and heptane. See NAFTA, *supra* note 36, Annex 603.6.

On the other hand, it is important to consider the fact that Pemex and its subsidiaries have been created by legal mandate in order to develop the petroleum industry, to carry out the direct dominion of the nation over hydrocarbons and to be in charge exclusively for the BPI, not to develop the SPI.

Today, Mexico requires investment to generate employment and infrastructure, investment in facilities, pipelines, technology, equipment, investors who risk their capital in long term, not financing or swallow investment. Mexico requires a strong Pemex which allots its resources and income to the strategic areas for which it has been created, a Pemex which exploits, not that which closes our oil deposits and imports raw material and products. Consequently, the administration of President Fox is trying to bring fresh private capitals to the SPI in order to comply with the national demand and avoid the imports deficit in this sector.