



A New Regulator in the Hydrocarbons Sector?

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In December of 2013, the Mexican Congress approved a major reform of the energy sector, with the hydrocarbons industry of as one of its focus points. We now await the secondary legislation and implementation that will make or break the reform. As in the case of other major reforms last year in the areas of telecommunications and competition (as well as in the case of the 2008 energy reform) one of the fundamental points of discussion in Congress will undoubtedly relate to the institutional framework and autonomy of regulatory agencies, specifically the National Commission of Hydrocarbons (CNH) and the Energy Regulatory Commission (CRE).

We should start by saying that it would be very difficult to disagree with those who argue that it is necessary to guarantee the institutional strength and autonomy of the regulators. This is because a strong institutional environment capable of effectively regulating monopoly and vertically-integrated industries is always indispensable when it comes to structural reforms and whenever the main goal is to ensure the proper development of processes for opening up to private investment in a free competition environment. This has been shown by the specialized literature of the last thirty years.

However, beyond the mere attributes of "autonomy", "strength", and "independence", which should (and are) undoubtedly present in the legislation applicable to the relevant regulatory bodies, a detailed analysis is also needed of the powers granted to each regulatory body under the Mexican legal system. Only based on such an analysis will it be possible to propose the addition

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of powers and the specification or even the elimination of others, over and above those mentioned above.

This analysis is particularly relevant in the Mexican case since we can say that, until now, political actors, sector specialists, and even the regulatory bodies, have operated under the "spell of constitutional autonomy". In other words, it is only through such an institutional design that the bodies are protected from politics and regulatory capture, yet this is not reflected in the institutional risk that has for several years gained strength through indiscriminate granting of constitutional autonomy, especially in the case of administrative bodies for such a proceeding does not necessarily result in an institutional architecture appropriate to guarantee efficient operation of the Mexican State but which can, on the other hand, compromise governance.

It is based on these considerations that we shall pass this analysis onto the National Commission of Hydrocarbons (CNH).

The CNH was created within the framework of the energy reform of April 2008, when it was considered necessary to create a decentralized body that was part of the of Secretaria de Energia (Sener or Energy Ministry), endowed with technical and operational autonomy to guarantee the nation's energy security in the medium and long term and to provide indispensable support to consolidate the State as the governor of the oil industry.

Under articles 1 and 2 of the National Commission of Hydrocarbons Law (LCNH), the powers of such a decentralized body are specifically responsible for regulating and monitoring exploration and extraction of hydrocarbons found in fields and deposits regardless of their physical condition, including intermediate states, and that comprise, accompany, or are derived from a crude state, as well as for regulating and supervising the processing, transportation, and storage activities that relate directly to hydrocarbons exploration and extraction projects.

To achieve this objective, the CNH is required to exercise its functions, ensuring that exploration and extraction projects by Petroleos Mexicanos (Pemex) and those of its subsidiary bodies are carried out in accordance with the following guidelines (article 3):

- Long-term raising of economically viable conditions, rate of recovery, and obtaining maximum volume of crude oil and natural gas from the wells, fields, and abandoned deposits, or deposits under exploitation.
- Gradually replenishing the hydrocarbons reserves as guarantors of the nation's energy security, starting from prospective resources and based on the available technology and in accordance with the economic viability of the projects.
- Using the most suitable technology for the exploration and extraction of hydrocarbons, according to productive and economic results.
- Protecting the environment and achieving sustainability of natural resources exploration and oil drilling.
- Ensuring the required industrial safety conditions in the exploration and extraction of hydrocarbons.
- Minimizing the burning and venting of gas and hydrocarbons during extraction.

In a first review of these objectives and competencies, it is clear that we are not talking about a conventional regulator. First, the CNH does not regulate a sector from the perspective of the market and of economic competition but, instead, of a regulator for a regulated entity operating in monopoly. It should also be mentioned that the CNH exercises multiple regulatory functions in areas such as the environment, industrial safety, technology, hydrocarbons exploration and extraction projects, and reserves. Such multiplicity of functions is not common globally since regulators tend to focus their duties on administration of contracts, industrial safety, or the environment.

It is evident that the CNH exercises its powers with much greater autonomy than other organs of the federal public administration. This is because these powers were not delegated but rather created with the CNH in mind, even empowering it, for example, to resolve administrative resources resulting from decisions directly without the intervention of Sener (article 4. ° of the LCNH section XXII).

Under the current legal framework, the powers of the CNH are as follows:

1. Oil allocations	Issuance of technical opinions. It should be noted that the granting, modification, or revocation of the allocations is ultimately up to Sener (article 4, section XV LCNH)
2. Approval of E&P projects	Sener is responsible for "approving major hydrocarbons exploration and exploitation projects undertaken by Petroleos Mexicanos based on energy policy guidelines and technical reports issued by the National Hydrocarbons Commission. (article 4, section VI LCNH)
3. Authorizations of surveying and exploration:	Authorizations for surface recognition and exploration to investigate oil possibilities are a factor in Sener's final decision on the approval of projects (articles 4, section XVI, of the LCNH)
4. Reserves and operational efficiency	<p>In this matter the LCNH, assigns the following powers to the CNH:</p> <p>a) For the establishment of reserves zones, Sener will request the proposal of the CNH. (Art. 7 of the Regulations to the Article 27 Regulatory Law)</p> <p>b) The function of preparing technical proposals, which must not be binding, in order to optimize the recovery factors in hydrocarbons extraction projects (article 4, section VII) and,</p> <p>c) The power to evaluate operational efficiency in exploration and exploitation (Section VIII, article 4 of the LCNH)</p>
5. Issuance of General Administrative	The CNH may issue all types of general administrative norms also found in Official Mexican Standards (obligatory technical

Norms	provisions). Article 4°, section III and XVIII, of the LCNH)
6. Verification Visits and Security Measures	The CNH is empowered to monitor compliance with its provisions and to apply industrial security and environmental protection measures (Article 4, section XIII, XIV, of the LCNH, article 15 of the Regulatory Law of Article 27 (LRA27)– precautionary measures -)
7. Supervision and oversight	The CNH is empowered to summon the attendance of the employees of the decentralized agencies, as well as the holder of the permit or of his legal representative (Article 4, XIII).
8. Oil Register	Section XXI, article 4 of the LCNH establishes that it is the responsibility of CNH to "establish and maintain a public Oil Register "
9. Information requirements:	Article 4, section XI of the LCNH indicates that it is the responsibility of the Commission to "request and obtain all technical information required for the performance of its duties laid down in this law from Petroleos Mexicanos and its subsidiary bodies, in accordance with the related instructions issued (section XII)
10. Powers of interpretation	Article 3, of the rules of the Regulations to the LRA27, states that the CNH is empowered to issue application and interpretation criteria for its regulatory framework.
11. Sanctions	Article 4, section XXIII, indicates that the CNH is responsible for "Determining violations to the provisions and technical norms issued it issues," and taking measures conducive to correcting them

So far we have seen a list of the core competencies of the CNH under the current legal framework. We can agree on one point: the catalogue of competences of such decentralized body is quite extensive. Evidently the above statement is not intended to reduce the problem to a

quantitative issue, i.e. more or less powers. Rather, it is based on recognizing that the CNH already has technical autonomy and, considering that this body has jurisdiction over a very broad set of materials, we should consider whether it is indeed necessary to give more authority to the CNH and promote its constitutional autonomy or not.

Following on from this point, in order to allow the CNH to perform its functions adequately, greater autonomy is not needed, but rather that the following actions and results are indispensable:

- a. The regulatory framework should generate regulatory mechanisms that achieve a balance between the functions and competencies of the different administrative bodies operating in the hydrocarbons sector (particularly Sener, CNH and CRE). The aim of this is to prevent incorrect application of standards due to their indeterminacy and the generation of discretionary decisions that in no way contribute to the creation of legal certainty for the regulated entity from becoming the silent "detractors" of any attempt to reform the sector.
- b. The regulatory body must be conducive to its legitimation not through an excessively strict regulatory framework but through resolutions which, with full regard for due process, reflect the standard of knowledge of the industry and the vision of a collegiate organ and not of the different agendas of its members.
- c. The quality of the regulation issued by the CNH, should not only be seen as an issue of legal certainty for the regulated but also as a condition of greater effectiveness and efficiency of the industry.

As we can see, this does not imply reducing the autonomy granted to the CNH but does require a review of the legislation with the following objectives in mind:

- limiting the currently extensive scope of powers established in the LCNH (issuance of technical standards, powers of verification, control, sanction, information, establishment of technical standards requirements;
- specifying the respective mandates of the CNH and Sener, clearly distinguishing between the powers of policy and those inherent to the technical regulator;

- relocating power in other bodies, as in the case of matters such as industrial safety and the environment, establishing inter-agency coordination mechanisms that harmonize the concurrence of various administrative authorities; and,
- as the absence of a regulation of the Executive has led to the accelerated issuance of general administrative rules by the CNH, it is necessary to channel the CNH's general legislation powers along two specific avenues applying, on the one hand, the regulatory improvement process to these types of standards (cost-benefit control) and establishing the obligation for the regulator to issue a Regulatory Plan on which it will base its powers, as well as the information required. All this should be done with attention to transparency, publicity, clarity, and access to information.

In the newly opened hydrocarbons sector in Mexico, we must contemplate not only additional powers to the CNH in terms of design, implementation, management of E&P contracts, along with adjudication mechanisms but it is equally crucial to “re-train” the regulatory body as, at the time of writing, the CNH has the vision of "a regulator for a monopoly entity ".

Finally, if there is a space for undoubted improvement, this must relate to the necessary budget support required by this body in order to ensure that not only are its powers exercised in a timely manner but also to ensure that its efficiency is achieved through the technical quality of the provisions and that a solid road to legitimacy can be built for the CNH.