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ESG ARTICLES

Promoting energy autonomy while advancing environmental protection: a balancing act

By: Adrián Magallanes, *Partner*
Rodrigo Barradas, *Associate*
Jorge Vázquez, *Associate*

One of the main objectives of Mexico's current Federal Administration is to strengthen the energy sector, with particular emphasis on the State's power and oil companies: *Comisión Federal de Electricidad* (CFE) and *Petróleos Mexicanos* (Pemex). In line with this objective, on March 10, 2021, a substantial reform to the Electricity Industry Law went into effect, which purports to provide security and reliability to the electricity system, as well as to foster the country's energy autonomy.

However, several experts have questioned the motivation behind such reform. One alternative reason behind this reform is to find a use for the fuel oil (*combustóleo*) produced by Pemex, which is disdained internationally due to its harmful effects on the environment.

Fuel oil is, broadly speaking, a high-sulfur residue which is left over after refining crude oil. It can be used as an industrial fuel and was typically used to generate

electricity on ships.¹ However, due to its inefficiency, high cost and high volume of pollutant emissions, its use is increasingly limited.

In fact, some international instruments have restricted fuel oil's use. For example, in March 2020, an amendment to Annex VI "Regulations for the Prevention of Air Pollution from Ships" (IMO 2020) of the International Convention for the Prevention of Pollution from Ships (MARPOL), issued by the International Maritime Organization (IMO), came into force. The IMO is the United Nations agency in charge of - among other things - preventing pollution of the sea by ships. Currently, 160 member states are party to this treaty.² IMO 2020 prohibits the use of fuels

1 El Colegio de México, *Glosario de PEMEX*, Fuentes para la Historia del Petróleo en México, 1900-2008 (*PEMEX Glossary, Sources for the History of Petroleum in Mexico, 1900-2008*), accessed on July 21, 2021, available at: <https://petroleo.colmex.mx/index.php/glosarios/78>

2 Mexico has not yet ratified Annex VI to MARPOL, although it is party to MARPOL.

with a sulfur content greater than 0.5% (mass/mass) for ships flying the flag of any of the countries that are signatories to this treaty.³ According to this agency, IMO 2020 “will have important health and environmental benefits for the world, particularly for populations near ports and coasts”.⁴

Although the objective of the change introduced by IMO 2020 is positive to the environment, Pemex suffered certain collateral economic effects, since the international demand for its fuel oil was considerably reduced. In February 2021, using 43.5% of its total installed capacity, Pemex produced 284,100 barrels of fuel oil per day, being its most produced oil.⁵ With IMO 2020, the fuel oil produced by Pemex cannot be used in the international maritime market because it contains between 3.5% and 5% sulfur.⁶

Faced with this problem, Pemex envisioned a potential way out: sell its fuel oil to CFE to be used for electricity generation. In its *2021-2025 Business Plan*, Pemex stated that it would seek to increase the acquisition of fuel oil by CFE for use in electricity generation.⁷

3 Amendments to MARPOL Annex VI, Regulation 14, General requirements: 1. Paragraph 1 is replaced by the following: “The sulphur content of fuel oil used or carried for use on board a ship shall not exceed 0.50% m/m”, accessed on July 21, 2021, available at: [https://wwwcdn.imo.org/localresources/en/OurWork/Environment/Documents/Air%20pollution/MEPC.305\(73\).pdf](https://wwwcdn.imo.org/localresources/en/OurWork/Environment/Documents/Air%20pollution/MEPC.305(73).pdf).

4 International Maritime Organization, *Preguntas frecuentes. El límite de contenido de azufre de 2020, (Frequently Asked Questions. The 2020 sulfur content limit)*, accessed on July 21, 2021, available at: <https://wwwcdn.imo.org/localresources/es/MediaCentre/HotTopics/Documents/Preguntas%20frecuentes%20-%20El%20l%C3%ADmite%20de%20contenido%20de%20azufre%20de%202020.pdf>

5 Pemex Institutional Database, *Volumen de las ventas internas de productos petrolíferos y gas natural (Volume of domestic sales of petroleum products and natural gas)* (own translation), accessed on July 21, 2021, available at: <https://ebdi.pemex.com/bdi/bdiController.do?action=cuadro&cveca=INDI05>.

6 See: Murrieta, Carlos, *Combustóleo: un reto energético, (Fuel Oil: An Energy Challenge)*, accessed on July 21, 2021, available at: <https://www.nexos.com.mx/?p=54538>. See also: *Puerto Dos Bocas, Tipos de petróleo crudo en México, (Puerto Dos Bocas, Types of crude oil in Mexico)*, Secretaría de Comunicaciones y Transportes, accessed on July 21, 2021, available at: <https://www.puertodosbocas.com.mx/ultimas-noticias/288-tipos-de-petroleo-crudo-en-mexico-2019>.

7 *Pemex 2021-2025 Business Plan*, p. 27: “In Mexico, Pemex is promoting agreements to supply power plants, which

There are at least two obstacles to Pemex’s business plan for fuel oil. First, a legal one: the regime established after the 2013 constitutional reform on energy matters prioritizes clean energy sources for electricity generation. Secondly, an environmental one: the impact of using fuel oil instead of promoting the use of clean energy is extremely high.

Regarding the first issue, the Federal Administration has sought to implement various regulatory, administrative and legal measures to allow CFE to obtain priority within the Wholesale Electricity Market and generate electricity using old plants that operate with fuel oil. The reform to the Electricity Industry Law is one of these measures, and it seeks to alter the order of energy dispatch, among other mechanisms, to favor CFE over the rest of the participants in the Wholesale Electricity Market that use more modern and less polluting technologies.

Participants in the electricity industry, members of civil society and various public agencies have filed domestic lawsuits challenging the reform to the Electricity Industry Law, specifically *amparo* lawsuits in which they argue that the reform is unconstitutional. Although some substantive rulings issued by District Courts have already granted protection against the reform, these only benefit the specific claimants under the proceedings.

The District Courts have also granted relief to the plaintiffs suspended the effects of the reform as part of stays of execution that remain in place. However, Collegiate Circuit Courts have begun to overturn some of these reliefs (suspensions) under the argument that the reform has not yet caused any damage to the legal sphere of the plaintiffs, thus implying that the right procedural moment for the *amparos* to be analyzed on their merits will be after the regulations implementing the reform are issued, which is expected to happen in the following months.

In parallel, many members of the industry have considered promoting international arbitration

could imply greater adjustments to fuel prices to compensate its use instead of other alternatives. Additionally, a greater shipment to the Federal Electricity Commission (CFE) is considered feasible due to a possible change to fuel oil consumption in some coal-fired power plants.” (own translation).

under investment promotion and protection treaties. In such proceedings, the affected parties would argue violations of the principles of fair and equitable treatment, minimum standard of treatment, national treatment, and measures tantamount to expropriation or indirect expropriation. To date, these arbitration proceedings have not been filed mainly due to the suspensions issued by the judiciary that are still in force with general effects.

Regarding the second issue, the burning of fuel oil produces the emission of greenhouse gases, such as sulfur dioxide particles (SO₂), which are considered harmful to health due to their effects on the circulatory and respiratory systems.⁸ To date, the Federal Administration has not adopted or

implemented any measures to counter this particular issue, which requires careful consideration.

For the reasons explained above, the new outlet for Pemex's fuel oil created under the reform to the Electricity Industry Law is expected to continue under close scrutiny from legal, environmental, and public health grounds. While the Mexican State is responsible for leading the national development (including energy reliability and security), in accordance with Article 25 of the Mexican Constitution, such development must be integral and sustainable. Therefore, the strengthening of the State's power and oil enterprises should be consistent with the conservation of the environment. These arguments, among many others, are part of the *amparo* lawsuits under analysis by the federal courts.

8 Soto, Jocelyn. *¿Qué es el combustóleo y por qué afecta el medio ambiente?* (What is fuel oil and why does it affect the environment), Greenpeace, accessed on July 21, 2021, available at: <https://www.greenpeace.org/mexico/blog/8613/que-es-el-combustoleo-y-por-que-afecta-al-medio-ambiente/>

At Von Wobeser y Sierra, S.C., we would be delighted to share our experience in the legal matters covered in this article or any related issues, as well as our insight with a multidisciplinary ESG (Environmental, Social and Governance) perspective.

For additional information, please contact our experts:



Adrián Magallanes, Partner:
+52 (55) 5258-1077
amagallanes@vwys.com.mx



Rodrigo Barradas, Associate:
+52 (55) 5258-1077
rbarradas@vwys.com.mx



Jorge Vázquez, Associate:
+52 (55) 5258-1059
jvazquez@vwys.com.mx

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