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Keynote Address:

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Panelists:

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P R O C E E D I N G S

MR. TRINKUNAS: Well, welcome, everybody. I see we have some extra space up here in front. Don't be shy. I think you can take advantage of our reserved seating at this point. No, please, please. Come up further and join us at this point. We can be democratic about seat assignments as we go forward.

My name is Harold Trinkunas. I'm the director of the Latin America Initiative here at Brookings. I'd like to welcome you to our event on the future of Mexico's energy reform. There's an event I'm co-hosting with my colleague, Charlie Ebinger, from the Energy Security Initiative, also at Brookings. So, on behalf of both the Energy Security Initiative and the Latin American Initiative, I would like to welcome you to this afternoon's program.

I think we can look forward to a very interesting discussion and some very interesting presentations from our panelists. There's obviously some key challenges lying ahead for Mexico's energy reforms, now that the constitutional reforms themselves have passed.

We still have ahead of us some very important political and social debates, some technical debates that will take place during the discussions of the secondary legislation. They're basically had about how the industry should be regulated; the balance between the public and private sector when it comes to energy in Mexico.

We also know this will have major implications for Mexico in terms of its energy future. Will Mexico remain a net energy exporter, or as it was currently predicted, become a net energy importer in the not too distant future? Obviously, the energy reforms are designed to avoid that possible outcome.

And finally, I'd also say that there's some key implications towards the future of North American energy security, because obviously, what happens in Mexico is

of great interest and importance for U.S. and Canadian energy markets, and in fact, for global markets.

So, without too much further ado, I'm going to introduce our main speaker, Dr. Fluvio Ruiz Alarcón, who is one of four independent directors serving on the board of Petróleos Mexicanos. He will be speaking about the future of energy reform in Mexico, now that the key constitutional reforms have been adopted.

You already have his biography, so I won't go into too much detail. But I think you'll find that Fluvio Ruiz Alarcón is somebody who has been part of the key debates on energy and energy reform in Mexico for well over a decade. And he has a superb breadth and depth of knowledge on this issue; on the historical, technical, regulatory and political dimensions of this reform.

So, I will turn to Fluvio Ruiz Alarcón, who will speak in Spanish for about 20 minutes. We have simultaneous translation available. If you didn't pick up a device on the way in, please feel free to help yourself. His slides are in Spanish, and we have them posted on the web site for the Latin American Initiative, so please feel free to download them.

We have some extra seating here in front, even though it says reserved in a couple of place. At this point, please help yourself to sit down anywhere you like. So, after Dr. Ruiz Alarcón speaks, I will introduce our two discussants, Dr. Diane Negroponte, a Brookings nonresident senior fellow who has done a great deal of research on Mexico and on energy issues, and Ambassador Arturo Sarukhan, currently chair of global solutions; someone who is deeply knowledgeable on North American economic security and political issues. And then, the last half of the session, we hope to spend in Q&A.

So, without much further ado, Dr. Ruiz Alarcón, and please feel free to --

if you're standing in the back, to come forward and take a seat, even if it says reserved.

DR. RUIZ ALARCÓN: Good afternoon. Firstly, I would like to thank Diana Negrofonte and all my friends from the Brookings Institute for this invitation. Even though, whether my English is good enough and with the legal terminology and everything, so I prefer to speak in Spanish and I'll take questions, of course.

With this brief introduction about the energy reform, of course, constitutionally speaking, in Mexico -- I'm just going to give a quick description of this. I'm not going to get into much detail about that. But what I'm going to emphasize is the implication of what has happened with the approval of this reform and the main factors that are at stake, in light of the debate of the secondary legislation which is starting in February, and what factors I'm going to discuss that could constrain the scope of what has been approved already, and the current status of PEMEX at this time in this context, and also, the challenges before us.

Now, once again, the key dates of this process after quite a heated, more implicit than explicit debate about what this reform was supposed to be, we started the -- very quickly, we started the legislative process on the 7th of December of 2013.

On the 12th of December, it's almost a religious day, because it's the Virgin of Guadalupe's Day. That's the day that it was actually approved, and then, it was published or enacted the 20th of December in the official gazette and the local -- the day of the local legislation. And this was quite fast tracked, I would say.

So, the article -- what was amended to Articles 25, 27 and 28 of the political constitutional of the United Mexican States of our country; those articles were amended. And with these amendments, the most important elements that were introduced were the notion of a productive state enterprise.

That's a notion, as you know, that PEMEX and the CFE, the electricity

commission, aren't really enterprises, but they were decentralized agencies that were part of the Mexican state itself, and in number 25, also, the sustainability and development component. And then, that's with 27 and 28, just to say it quickly, what it did was free up or deregulate the oil and electric sector with regard to private investment.

Now, together with the reforms to these constitutional articles, amendments, we all -- 21 transitional articles were also approved to spell out in broad terms, what the new institutional architecture will be. And also, it defines new actors in the Mexican energy sector.

I would say that in addition to this, there are deadlines that have been set by the Congress itself to legislate and create the secondary laws. And in addition to what was -- with regard to what was approved, that there has been a possibility to create different terms and conditions of contractors with private companies with the Mexican state, to take part in all the links of the chain of both the oil sector as well as the electric sector. And these terms and conditions have to be licensing or shared -- profit sharing or service contracts, which already exist but are not as restrictive anymore.

Also, there was approval of the creation of three new entities. The national -- Industrial Security Agency and Environmental Protection, which will be (Inaudible) off of the Hydrocarbon Commission and Natural Gas Center, and the Energy Control Center, which is created, which is the office where electricity is dispensed -- control, is.

And also, the Mexican Fund for Stabilization and Development was created, as well. This is a fund that will, no question, will be reviewed in greater detail in the secondary legislation. The idea is that this fund be similar to what exists already in Norway -- similar to the Norwegian fund. And also, just very quickly, I understand that you have this available.

In my presentation, you can look at the details and the interaction with the powers that have been granted to the Secretariat of Energy, the Secretariat of the Treasury, the National Hydrocarbon Commission, and then, an energy regulating commission who play an absolutely fundamental role in determining the different terms and conditions of contracts in regulating this new situation in the oil and electric sectors of the country.

So, what are the direct implications of this reform? Firstly, the reform that has been approved is, it's much more liberal and lax than the initial bill introduced by Enrique Pena Nieto in the summer -- the bill he introduced. And so, since it was a constitutional amendment or reform, it required the support, or rather -- of PAN or the PRD parties -- either one or the other, the main opposition parties needed to support it to be able to have enough votes, both in the federal Congress as well as in the state Congress.

And in the end, the alliance established by the government was with the PAN, which had a much more -- a position more akin to the PRI in this sector, and that's why it made sense. And this is a reform that basically is going to -- there's going to be profit sharing from oil, and this is the first time.

This is novel in Mexico, and for the first time, there is -- entails a lot of measures that will speed up the process of exploration and exploitation, et cetera, of all of the hydrocarbons that are in the substrata of Mexican soil and Mexican territory. And this is the idea of this reform behind it, and in such a way that the chain -- all of the links of the chain of production will be totally open, and the general administration of these resources is no longer in the hands of one -- a public entity like PEMEX, as it was in (Inaudible).

But the private entities will take part, as well, on their end. And there

was a clear separation made between energy policy, on the one hand, regulation and operations. As a matter of fact, contracts, which in the past because of their very nature, were granted by PEMEX. Now, they will be contracts with the Mexican government itself, and there will be technical support provided by the National Hydrocarbon Commission.

And there are a few elements that are absolutely fundamental, which are expanding and strengthening of the regulatory agencies. This is a process that has also been kicked off, and there will be discussion on the fiscal regime that will be used both to PEMEX, as well as the other private participants, whether they are in national or foreign.

Another issue that's very important is linked to the gas pipeline network in Mexico. These will be centralized and be turned into a single public agency which will be in charge of the administration thereof, and at the same time, this is going to happen as well in the electric sector.

But something, no question, that could change the face and the downstream part in the processing or refining part, is the fact that subsidies will be phased out. Basically, gasoline is very linked to electric. And gasoline as well as electric rates -- electricity rates.

This had been written into an RIA transitional article in the original decision or bill that had been submitted to Congress. But however, in my view, for communication reasons, it did not get approved. It's not explicit. But a very foreseeable consequence of this reform is that the subsidies, particularly on gasoline, will be phased out.

Now, what is at stake as a result of this constitutional amendment? No question. Energy security of Mexico, the role to ensure this security and the role played by the Mexican state in ensuring security. It will cease to have a single operator Mexico. It will have to develop its capacity, its powers, but particularly, its competencies when it

comes to regulating.

And in my view, this is one of the major challenges facing the Mexican state, and in this context, it will have to ensure that fair conditions to PEMEX, both with regard to fiscal area and regulation -- one thing, it must be carefully not to over regulate the public entity, PEMEX, which as a result, of course, of this reform will go from being a public entity to a new legal category called a productive state enterprise.

And lastly, a consequence of this will be a new role of the state as such as an actor, an economic actor, so to speak. What are, in my view, the factors that could be constraining or limiting the scope of this reform? Firstly, I would say, the lack of a broad politic consensus, even though it was designed as a significant, important constitutional reform, the details are very, very -- the fine print is very relevant here.

Each and every one of the points of the content in this reform can have important scope based on what the regulations are, the secondary legislation says. So, with regard to the participation of private enterprise, they may or may not -- there could be a consequence of this, if they can be trading the crude that they produce themselves, that has to be defined. And this may happen in a few years, or maybe it will have to go through, as it has been proposed, at least as we know it to have the revenue -- hydrocarbon through a trading entity of the state first.

And this is a big part of the discussion, the debate, and this will be put into the secondary laws. And it only needs a simple majority to pass in the Congress, so it will be lasting -- the effect will be lasting in time, because energy is the crux of the mid-term elections in 2015, by the way. And so, if there is no secondary legislation that has a broad political consensus behind it, this of course, could create great instability in the long-term.

So, another limiting factor could be -- the scope would be that regulatory

asymmetry. There's a possibility that because this is a public entity that's subject to a higher degree of regulation than private entities are, this is what has happened in other sectors that have opened up to private investment. And in energy itself, for example, when it comes to the petrochemical sector, because there's no budget autonomy. That's what I'm talking about here.

So there's great limitations as a result of this, because the Secretariat of Treasury limits the budget autonomy of these entities. And so, there has to be -- budget entity will be a fundamental factor for PEMEX to be able to properly conduct or play its proper role in this new institutional architect.

PEMEX, no question, will be facing serious complications to be able to hold on to its highly specialized human resources and to train and bring in new human resources, because they're scarce. They're in short supply throughout the world. If there's no clear ability to manage itself because of the budget restrictions that may continue in place to be able to hold onto the talent they have or to bring in and attract new talent.

So of course, the risk is always that institutions, when they become consolidated and solidified, there's the Hydrocarbon Commission or the energy regulating commission, they have a little more time, but there's always a risk of control of -- private interests can take control of these people -- the members of these commissions.

But PEMEX, no question, has -- these are new instruments or tools of participation for it. I believe that the secondary legislation will ensure this fiscal autonomy and will provide flexibility to be able to hire, and the flexibility also to enter into partnerships with whoever it deems most appropriate or most in its best interest for -- in the sector and in the different tasks in the sector that it has to tackle.

And this will allow PEMEX to increase its competencies and its ability to

engage in research, et cetera. And so, PEMEX also has possibilities to refocus its activities through the most profitable areas of the business, and for the mandate of PEMEX is that it has to take part in each one of the areas of the petroleum industry, not necessarily just the best in the best condition.

And so, PEMEX has the ability to decide where it's going to focus its efforts and open up the possibility for new actors to come in, as well. And also, PEMEX will have the possibility to work much more internationally in the framework of a more coherent strategy, consistent -- which is very much in sync with a business plan, which of course, has to be adapted to the new circumstances that it's facing.

Up to this point in time, PEMEX has had a participation outside. It makes it very specific and very short-term, much more guided by or as a result of immediate needs or decisions -- political decisions made by the Mexican state. But we haven't implemented a true international strategy, which doubtlessly will come about now with this new reform.

And this is an incentive for the new circumstances to move towards reintegration of PEMEX as a single company and a model that has been -- that was put into place 20 years ago. PEMEX as a corporation with four subsidiaries, I think, has served its purpose. But what's happened is that it's very inefficient now, and now, we can take advantage and take advantage of the different subsidiaries because of their very nature.

And I think this can be cured -- these problems can be cured, and particularly to acquire competencies in this area -- PEMEX, over the course of 75 years, has been the exclusive operator with which government and Mexico has used for the exploiting of its (Inaudible). But this new reform, of course, will create the need for greater capacity to be acquired to confront the competition.

PEMEX has to streamline its decision making process in that it will be subject to competition. To the extent that it has competition, it will no longer have the deadlines imposed by legislation, but it has very complex legislation in place that will -- and it can't be slow at decision making, and it's a disadvantage to be so slow. And so, it will have to improve in this area.

And so, the technological competencies have to be improved. This is absolutely fundamental to be able to be viable for PEMEX to be in the medium and long-term. The new circumstances in place now is bring -- leading us to discuss the role of the Mexican Institute of Petroleum and the Mexican petroleum industry, and then to decide to figure out how to -- coordinating an innovative sector strategy, and then to take advantage of the strength of PEMEX in the medium term.

And of course, PEMEX has the obligation to develop a strategy -- a partnership forming strategy with other world -- other companies from other parts of -- either outside or inside of Mexico. These, I believe, are the challenges that we're facing at this time. And the discussion will be starting on February 1st, which is when the legislature -- legislative session begins that kicks off that day in the Congress -- February 1st of this year.

And so, within two years, we should have the institutional architect in place, and the actors will be consolidated enough by then, particularly PEMEX, who should finish its transition within a period of two years from a government agency to a public enterprise, to be able to come into line with a new paradigm that is set up, and to have profit sharing and to step up the pace of exploitation and -- exploration and exploitation of petroleum in Mexico. (Applause)

MR. TRINKUNAS: Well, thank you very much to Fluvio Ruiz Alarcón for that very interesting and thorough presentation. I'd now like to introduce our next two

speakers who will be commenting on his discussion of Mexico's energy reforms. We will be joined by my dear colleague, Dr. Diana Negroponte and by one of Brookings' distinguished associates, Ambassador Arturo Sarukhan.

As I said before, you have their biographies in front of them, so I don't want to go into too extensive a detail, but let me just point out a couple highlights that I think are relevant to our discussion today.

Diana Negroponte has been working on and off on Mexico energy reforms and Mexico's politics for quite some time. And in fact, I would recommend to you a very good book that she edited on Mexico's future called "The End of Nostalgia," and she also has two very good analytical essays posted on the Latin America Initiative web site that focus explicitly on the current energy reforms.

She will be speaking next for about 10 minutes, and she will be followed by Ambassador Arturo Sarukhan, who is the chair of Global Solutions, A Podesta Company, and as I said, affiliated with Brookings for quite some time.

Arturo Sarukhan has been involved with Mexico's foreign policy and its relationship with the United States for decades, serving in the foreign ministry, in the foreign -- Mexico's foreign service and concluding his career in that capacity as Mexico's ambassador to the United States from 2007 to 2013. But he's a scholar, and he's taught on the issues of North America's security, North America's economy and politics, and he's deeply knowledgeable on these issues, as I think you'll find when he speaks to the implications of Mexico's energy reforms for North American Energy Security.

So, I'll ask Diana to first speak for about 10 minutes, and she will be followed by Ambassador Sarukhan for about 10 minutes, and then, we will open this to Q&A.

DR. NEGROPONTE: Good afternoon. It is extraordinary that a

representative from the party which has objected so strongly to these reforms would come this afternoon to Washington to what he calls the heart of capitalism. (Laughter) And he therefore, wears no tie to establish his credentials, and presents to us an objective assessment of what these reforms mean.

I want to give a very brief sense of history. In 1938, President Cardenas nationalized the oil companies, which is nationalizing both the British and the American oil companies. But he created a balance. He established and was ratified in the Constitution that the subsoil, that is the oil and gas, belonged to the nation, but that the production and the upstream activities needed the capital, the technological capacity, the risk-taking of the private sector.

And so until 1960, there was this bifurcated approach to Mexican energy in which the subsoil remained the ownership of the Mexican people. But the rest was open. In the '60s and the '70s, increased national pressure closed down those opportunities for the private sector, so that the creation of PEMEX and the power of Petróleos Mexicanos, otherwise known as PEMEX, and I shall use that term, increased significantly.

PEMEX builds roads, runs a fleet of tankers, has sailors, doctors, nurses, teachers, providers of boots and uniforms -- 160,000 people work for PEMEX. And this behemoth has become increasingly corrupt, lacking in transparency and becoming a burden on the Mexican state.

So, the last five presidents have all -- Mexican presidents have all made efforts to reform PEMEX, to reform energy. But in each case, the left and the center-left, both within the governing party, the PRI and the left, the PRD, have been strong enough to prevent any serious reform.

Now, a young president, a president who campaigned on his willingness

to reform the energy sector among other sectors, has come in with a truly grand strategy which Dr. Ruiz Alarcón has just shared with us. The essence of that reform is to return to the balance that (Inaudible) Cardenas introduced in 1938.

The subsoil, the oil and gas will remain in the hands of the Mexican people. But from the moment that that oil or gas reaches the well head, then licenses are permitted, and the capacity for production sharing from the well head onwards will exist.

Now, this is a reform that those of us who have followed the debate did not expect would be as liberal. And Dr. Ruiz has shared with us the debate that's going on at the moment in the implementing legislation. But the key driver in the implementing legislation is that -- the offer of licenses, production sharing contracts, profit sharing contracts and services must be competitive.

Shell, Exxon, Chevron as well as the independent sector have got many alternative wells and fields in which to invest. And if the Mexican regime is not attractive enough, they will be in Kazakhstan or Georgia, but they will not be in Mexico. So, a balance has to be created in which the traditional interests are protected to a degree, but the outside capital, risk-taking ability and technology can be drawn into Mexico.

I see three great advantages. One is that PEMEX, in the next five years, will have an opportunity to enter into joint ventures. PEMEX, as it becomes a national oil company, a profit making oil company rather than a government agency, will engage in joint ventures with international companies as well as with the Mexican private sector. And the opportunity for consortiums of both Mexican private sector together with international oil companies holding the technology and the capital, really is an opportunity to be grabbed at.

Second: Studies must be made of the gulf; seismic studies to determine where and how deep and to what extent that oil belonging to the Mexican people exists.

At the moment, as you can see so clearly, Mexican exploitation is minimal compared to that on the U.S. Gulf Coast.

We know its depth. We know its risks. But the potential is there. Those seismic studies will be open for contract within international consultants and experts beginning with the date that that implementing legislation is passed.

Here's another opportunity. Look at the roots, the pipelines in which U.S. oil and gas is moved, and think of the potential for moving Mexican oil and gas. There's nothing east-west. There are only four major north of, and all of Mexico's oil is transported in tankers. So, the potential for laying those pipelines, managing those pipelines is considerable.

Let me now move to the challenges. And I think that Dr. Ruiz was very honest in it, in that they are considerable, they're complex, but Mexico is not the first country to take a nationalized oil industry and turn it into a national oil company. Commercial, profitable.

First of all, PEMEX need no longer pay the high level of taxes that it pays. PEMEX essentially provides 34 percent of the Mexican government revenue. PEMEX needs to retain the income from its exploitation and production in order to re-invest in its own wells. That will allow it to become competitive with oil companies which the law requires it to do.

But here's the rub. In the first 90 days after the passage of the implementing legislation, it's going to take us till mid April, April 20th, to be precise. PEMEX will present a list of those fields and wells which it wishes to keep. And an independent regulator will determine whether PEMEX has the capacity, the finance and the personnel to operate the wells that it has selected.

That commission, situated within the Ministry of Energy is meant to be

independent. And yet, PEMEX has wells onshore which employ most of the inhabitants of the community in which they're situated. PEMEX pays for the doctors, the nurses, the engineers, the technicians, those who clean, those who make the uniforms in hundreds of communities throughout Mexico.

How an independent authority can truly be independent when the political implications of withdrawing PEMEX are so great, leaves me with great doubt as to whether in the short-term, any regulator authority can truly be independent. The consequences are overridingly political.

Let me raise the other political issue. The left, led in particular by one man who lost the presidential election in 2006, seeks to defeat these reforms and has gathered the necessary number of signatures to hold a referendum. The Constitution says that this referendum must take place at the time of the next election, which will be July, 2015, Mexico's midterm.

There is a sense in Mexico today that that referendum will fail. But if democracy is to be real in Mexico, then that referendum may be very close. And if I'm an investor, I would like to know the outcome of that referendum before I place large sums of money in new energy ventures, pipelines, refineries, petrochemicals in Mexico.

So, I would hope that the auctions take place after that referendum occurs, and I look at that referendum as an opportunity for the government to educate Mexican people; that allowing the private interests into their energy is not a return to the wild west days of the 1930s, but is attracting the private, Mexican private, international private investments, capabilities into a great enterprise for Mexico.

Let me just wrap up. The Mexican PEMEX estimates that they have 11.4 billion barrels of oil in reserve. BP's study group, as well as the U.S. Department of Energy's intelligence assessments calculate that the reserves are more like 35 to 70

billion barrels. There's a lot there for the Mexican people, for North America. And on that note, I turn to Arturo Sarukhan to share with us the impact of these reforms on North America. Thank you. (Applause)

AMBASSADOR ARTUR SARUKHAN: Good afternoon, and I apologize for a bit of the nasal quality to my voice, because as I think you can gather, I've just come out from a bad cold. And so I'm still battling it. But it's a great pleasure to be here.

I would be remiss if I didn't also recognize that a person whose institution and himself as an engineer have played an important role in these debates and could play an important role in these debates, the former president of the Tecnológico de Monterrey system, Dr. Rankel -- Ravel Rankel Saltzman is here with us, and I just wanted to mention that he's here with us. And I would be very surprised if there aren't Mexican graduates here from the Tecnológico de Monterrey, but you always bump into them wherever you go.

I'll be very brief, because I've been given strict instructions by my boss, Harold Trinkunas to try and obviously allow time for questions and answers in the debate. But I thought it made sense to sort of look at this from maybe 35,000 feet and try to ascertain how some of this may impact Mexico's position globally.

And let me start by referring to -- if you're a French speaker, you will say that it was Paul Vallery. If you're an English speaker, you will say it was Robert Graves. But the quote of, "the future is not what it used to be."

And certainly, with what has happened in Mexico this past year with a slate of reforms, but in particular, I think, with energy reforms, the future is no longer what it used to be in Mexico. As you know, all successive Mexican governments attempted to pass larger, smaller, more ambitious, less ambitious reforms that would start opening up the energy sector to private, domestic and foreign investment in Mexico, and for different

reasons that I'm not going to go into, failed.

It is now with this government, with this coalition that is being built, with this willingness and ability to deliver legislation a la carte, or sometimes the PAN will accompany, or sometimes the PRD will accompany, or sometimes a mixture of both have been accompanying the reforms that we now find ourselves on the edge of what could be one of the most significant changes in Mexico's economic and social well-being, probably since NAFTA, and certainly since the days of the very big push for industrialization in Mexico that followed the Mexican revolution in the '30s and '40s.

I think that one of the reasons why we are here today in Mexico is that there was a growing realization across the political spectrum, even though we still have some pockets that will fight against energy reform and will seek to derail it -- Diana mentioned one of them -- but I think there was a growing realization across the political spectrum in Mexico that the (Spanish) on energy was untenable; that not only was Mexico not going to be able to obtain the resources that it needs to invest in human capital, to invest in education, to bridge the economic asymmetries that exist between Mexico and the United States if those resources didn't come from the energy sector.

But also, I think that it was being left behind internationally. That not only because of what was happening in the shale revolution in the United States, what was happening with unconventional sources of energy around the world, I think a creeping realization that despite NAFTA and despite some of the wholesale reforms that Mexico started implementing throughout the '90s, sometimes in a haphazard manner, but certainly with some forward momentum, that despite this and despite being the second largest economy in Latin American, and despite being the 14th largest economy in the world, Mexico was not meeting and has not been meeting its potential to attract investment and leverage its economic power and trading network to build global political

influence around the world; and as the Brits fondly said throughout the whole Cold War and even after the end of the Cold War, to punch above its weight.

At the end of the day, yes, this will have profound domestic, economic and social implications for Mexico. But as a recovering diplomat and as an internationalist, this is also about power projection. This is the ability that Mexico can obtain in playing a very different game on the international arena because of the reforms taking place in the energy sector.

And I think all of this sort of started playing a role. And you know, I used to -- when I was ambassador, I was fond of saying that at the end of the day, I think a lot of people in Mexico started realizing that Cuba had a more liberal energy sector than Mexico, and that something was out of kilter here. And I think there's been a generational change in Mexico as to how to understand this.

I think all of this happened simultaneously with three fundamental shifts; the impact and the result of geography, global economic shifts on the world stage and political domestic momentum.

Geography. Well I don't have to tell you there was a map up here a few minutes ago that I closed, sorry. You just have to look at that map to understand that as many things in this bilateral relationship between Mexico and the United States -- mineral deposits, underground deposits don't respect borders, either, and that Eagle Ford, which is one of the largest shale deposits in the United States, if I'm mistaken. I think it's the second largest shale deposit in the U.S.

It happens to cross deep into the border on the other side of the Mexican border. And in many ways, I think that this understanding is what allowed us to put a critical piece of the jigsaw puzzle for the geopolitics of energy reform in Mexico on the table back in 2009. Many of you will remember that for decades, Mexico and the United

States talked about the famous (Spanish), the western gap and the eastern gap in the Caribbean.

These are -- in fact, they were on -- it was your map, right, Diana? They were on Diana's map. You could see sort of two small triangles in the Gulf of Mexico. One of those is shared by Mexico and the United States, the western gap, and the other one is shared by Cuba, Mexico and the United States.

And there was a moratorium to exploitation of the western gap Mexico and the United States. And in 20 -- when we were in 2011, we suddenly -- everyone realized that the expiration of the moratorium was upon us. And so, there was a very important discussion in the Mexican Foreign Ministry. And you know, the first instructions that I got where, you know, you should really go (Inaudible) on your moratorium.

And we sort of looked at this and said, really? I think we have a chance to do something qualitatively different. And why not? Instead of negotiating a new moratorium, we finally put in place the regulations that will allow Mexico and the United States to jointly exploit common reservoirs in the western gap.

We were looked at and said, you know, you're crazy. A: You're never going to get the U.S. industry to sit down as co-stakeholder because of what your legislation looks like in Mexico. B: You're never going to get the U.S. government to accept. And three, you're never going to get the Mexican senate to support the negotiations.

Well, not only did we conclude negotiations in a record 11 months with the co-stakeholdership of the U.S. private sector, but we also got the Mexican senate to ratify the agreement in a record two months and a half.

We have now waited more than year for the U.S. Congress to get its act together, but finally, as part of the deal on the Omnibus Bill, we have now moved forward.

And I think this is a very important piece of how the United States and Mexico start thinking of how we do joint exploitation. And the trans-boundary reservoir agreement, I think is an incredibly important piece of something which will play -- will have a profound impact on energy security, energy independence and energy efficiency in North America.

Global-economic shifts. The global economy has changed profoundly. I was very fond of always saying -- I still am -- that when you know, you bump into the BRIC acronym that -- I'm a huge Pink Floyd fan, so I would always say that Mexico was more than just another brick in the wall.

But without being frivolous, what I've tried to suggest was that Mexico had been able to put in place a series of structural reforms which put it in a different category from some of the BRIC countries; and that by building a very aggressive, very forward leaning free trade network along with Chile, we have -- I think Chile beats us by one country. And I think we have the same number -- one free trade agreement less, and Chile has one more country. But Chile and Mexico are the two countries that have developed the most wide and aggressive free trade agreement networks on the face of the earth.

I think that as we look at the 3.0 of free trade negotiations, like the TPP and/or the TTIP, you start to think of how the integration and the coming online of energy from Mexico can not only change the dynamics of energy security in the United States, but can also establish Mexico as an important provider of resources and assets to Asian demand centers.

And so, the TPP piece is not only about trade, and it's not about upgrading NAFTA through the back door by having Canada, Mexico and the United States as three of the negotiating partners adhere to these new standards that are being negotiated in TPP. It also changes the nature of how energy and export of energy

renewable/non-renewable, conventional-unconventional can play in the Asia-Pacific sphere.

All of this also plays a very important role in what I think is the most important success story of NAFTA -- integrate supply and production chains, where we are no longer producing Mexican products, U.S. products or Canadian products. We're exporting North American.

Out of every dollar that Mexico exports today, about 42 cents are U.S. content. So, imagine if you inject a decrease in prices of electricity or fuel -- the impact that has on a now one trillion North American trade relationship, and a \$1.2 billions a day trade relationship between Mexico and the United States.

At the end of the day, what this really does is it makes the possibility of a North American paradigm for energy independence and energy security and energy efficiency a reality. It also helps deepen the security structures that we've been developing for common North American security domain awareness after 9/11 by helping wean the U.S. from less reliable sources of oil, both hemispherically and extra hemispherically. And this has a very important impact.

And then, if you also think south, how two countries like Colombia and Mexico, by book-ending Central America can also develop sub-regional energy grids, whether it's electricity or shale or oil. So, and I'm being given -- the hand has gone up that I have to wrap up.

And so, I think that at the end of the day what this can do is not only enhance Mexico's geopolitical clout. It can really propel the next phase of rethinking of the North American architecture by putting energy at the center of this new discussion of how we deepen NAFTA, now that we're at the 20th anniversary mark of NAFTA. This has to be one of the key components.

And the great beauty of it is that we can defang those in Mexico who suggest that this is all about the gringos wanting to take Mexico's oil. Why? Because the U.S. will be wholly self-sufficient in 10, 15 years, and they don't need Mexico's oil. That's the beauty of the timing when all of this has happened, that we can help push back against those who for decades, had suggested that this was all about U.S. corporations or the U.S. government taking over Mexico's ability to produce energy.

Let me end with paraphrasing AGP Taylor, famous British who once famously said, we're at a turning point in history when history didn't turn. I think one of the challenges of this hugely significant and hugely important reform that has occurred in Mexico is that we all work together to ensure that this is a turning point for Mexico and for the security of the hemisphere. Thank you.

(Applause)

MR. TRINKUNAS: Well, thank you to all of my colleagues for all of those wonderful presentations that I think really have given us a broad, but also a very interesting overview of the future of Mexico's energy reforms; so what it means for the United States and for the world.

I would like to open the Q&A period. There will be people -- persons with microphones coming around. And while that gets started, I think we already have one here in front. I'll just ask my -- I'll keep a list and let's just wait for people to come up to bring the microphones.

Let me ask one question to start us off, which is that obviously, Mexico's energy reforms are taking place in the context of a great deal of change in North American energy. But they're also, in a sense, competing with other new energy prospects and energy developments in places like Brazil and Argentina and around the world.

And who do you -- maybe Dr. Ruiz Alarcón can answer this -- how does that international dimension play into the discussions in Mexico going forward, placing Mexico in the context of, in a sense, competing with other new energy developments in the hemisphere for capital, for financing, for partners going forward?

DR. RUIZ ALARCÓN: Well, really, the debate is not being framed in those terms. It's actually been focused on an endogenous, excessively so, development of that industry in our country. And this is an opportunity for PEMEX to think in a more global way. And of course, people think about a significant increase in production in the United States, but because of the quality of the crude and the type of structure here in the United States, which is much more focused on heavy crude and all the refineries in the Atlantic area, the Atlantic coast, this development hasn't quite been as influential.

Mexico has focused on light crude. But in any case, this new circumstance is looked at much more in terms related to the need to build more infrastructure, so that we can accommodate our future new production. That's basically what the debate has centered on in Mexico.

SPEAKER: My name is (Inaudible) Gomez from the Council of the Americas. It's been a very successful professional thus far, and I think the Mexicans have about four months to pass the implementing legislation. I was wondering, are there any pitfalls to look out for in that process? What can we see going forward?

MR. TRINKUNAS: Thank you. I think that's addressed to any?

DR. NEGROPONTE: Christian, the principle one is the independence and autonomy of those regulatory agencies. This is too short a period to develop the laws and administrative requirements for establishing four new regulatory entities which will manage both the auction of the bids, industrial safety, environmental issues as well as the transportation of gas.

This is a huge task, and I would expect that during this very short period, as you say, the four months, that we can only have the outline or the objectives for these regulatory agencies, but the details will have to be developed subsequently.

MR. TRINKUNAS: I think we have -- over here and one over -- I see two or three more back in this middle section. Please, on the aisle here. We'll start here.

SPEAKER: Mike (Inaudible), PBS Online News Hour. To use another British expression, all the hope and promise of Brazilian energy, oil, has turned into rather a damp squib. Do you see the potential pitfalls for Mexico? Are they more political, geological or technical?

AMBASSADOR ARTUR SARUKHAN: All of the above (Laughter).
Look, I certainly think that there will be political challenges. I think -- I'm on now.

I think one of the challenges will be, how do you make sure that the victory that has been achieved conceptualizing what the reform looks like is transferred to public opinion, because in many ways, just like the immigration reform debate here in this country, which is as polarizing and divisive as the energy reform has been historically in Mexico, whereas here, you have the A word which is used to torpedo immigration reform, which is amnesty.

In Mexico, you have the P word, privatization. And that has is what has been used by some on the left to try and scuttle the bill. So, I think in the run up to both the secondary legislation and beyond, a key facet will be how you win the Street; how you convince public opinion that the model that is being put together will not only deliver the goods, but will not transfer a monopoly and the power in the hands of the state to a new monopoly in the hands of the private sector. And that's going to be a very important debate.

You're going to see technical issues, too, because PEMEX has seen an

important flat line in investment over several years, and so the ability to really understand what you've got down there, how much is there, what are the challenges, is going to be a significant issue.

And there may be some international shifts and impacts that may either augment or dampen the willingness, the appetite of international investment to walk in and move into Mexico and invest aggressively. But all in all, I think that we are in a much better place today with this legislation than I think many of us thought six months ago, when we were a bit more concerned as to the scope of the bill.

I think the bill is a very important step forward. And we'll see. The devil will be in the details. The devil will be in these implementing -- in this secondary implementing legislation, and we will have to watch and wait and see what happens.

DR. RUIZ ALARCÓN: To add something to what the ambassador just said, you like Pink Floyd. I want to cite, quote Sex Pistols. I know what I want, but I don't know how to get it, he says (Laughter) -- from Sex Pistols.

One of the big political challenges is the expectations that are going to be raised as a result of this. I think that the idea of winning over public opinion to create an opinion that supports this reform, it's that there's expectations that are just going to be very difficult to win over -- the prices and rates and everything. There's a lot of expectations, and this is going to be in the -- in the short and medium term, it's going to be very difficult to win this over.

That this, perhaps, could be achieved in the long-term -- the expectations that are generated in the initial discussion could rebound against the permanency of this reform. So, that's why I'm saying there is an importance to achieve a political consensus in the legislation with regard to the secondary legislation, which in my view, this political consensus will make it possible among other things, to prevent a possible referendum or

to solidify a model which is underlined in the reform, which would be to create a model in which PEMEX stops being the exclusive operator in the nation, but becomes the dominating actor of the oil industry in Mexico, however.

And if you don't give PEMEX the tools to be able to do so in five or six years, it will be just another operator instead of the exclusive operator, and this will place at risk any reform. And it would be irreversible. The secondary legislation has to limit things, but it's got to be very effective and do the job. Yes?

SPEAKER: Thank you for your very interesting presentation. My question goes with -- you talked about the implications of the energy reform in Mexico for North America. But my question is, what would be the implications of this reform for Central America, considering that there is a lot of appetite for bringing gas all the way down to the sovereign countries, and electricity, as well? Thank you.

DR. RUIZ ALARCÓN: Okay. If, indeed, PEMEX and the Federal Commission become -- if they cease to be government agencies and become enterprise, they could be huge providers of energy in central -- and gas in Central America. I believe in a way, that we're both a federal electrical commission as well as PEMEX.

I think this is a real possibility, but however, it's got to be part of the portfolio of -- both you know, CFE and PEMEX has got to be part of the portfolio. But this has been an expectation and a hope -- it's been limited, of course, because of the nature of PEMEX and the commission. But this possibility is definitely -- it is definitely a possibility. Do you have --

DR. NEGROPONTE: My concern for Central America is the highly protectionist culture that exists within the electrical industry in Central America, so that when an integrated regional grid is created, which exists, each says, oh, better not share. We might have a draught.

And this lack of a willingness to see big, see regionally is really hampering the Central American exchange. Will they look at the Mexican debate? Will they say, this is the trend of the future we have to open up? I hope so.

MR. TRINKUNAS: I think we have a gentleman here and then we had somebody here in front. No, that's a -- center row. There he is.

AMBASSADOR ARTUR SARUKHAN: And simply -- and by the way, Colombia would seem to be closer to being able to have surplus capability in electricity for Central America than obviously Mexico, at this point. But that's why we're sort of thinking of this idea of Mexico and Colombia sort of bookending a Central American grid, because those are the two countries that could actually pull it off.

But in terms of electricity, for example, I think Colombia is much closer to being able to have surplus capability than Mexico does, at this point, obviously.

MR. SADAR: Hi. I'm Frank Sadar. I'm from the other part of the World Bank Group, the International Finance Corporation. Of course, we look forward to these reforms and we're excited about the reforms. We truly think it is absolutely transformational, the potential it has for Mexico.

I wanted to come back to the first question and I have some possible pitfalls. You refer to some of them. You placed a lot of emphasis on the question of the commercialization of PEMEX. And Dr. Negroponte pointed out the socio economic responsibilities of PEMEX throughout Mexico, and pointed out the importance of the PEMEX revenue stream for the general budget of Mexico.

What's the thinking in Mexico right now, in Hacienda, in the government, in general about potential gaping holes in the budget, and maybe in the implementing regulation or legislation, maybe stepping back and not giving this arm's length independence and therefore, commercialization or commercial opportunities for PEMEX

itself, translating possibly in not as many deals or bids coming forward, or them not being as attractive as we would hope them to be?

DR. RUIZ ALARCÓN: As a matter of fact, in the debate that's coming up, this is going to be part of the crux of it all. Point by point, the secondary legislation -- the partnerships can be a variable -- there could be a variable asymmetry. You're talking about budget autonomy of PEMEX. The PRD or Moreno or PT or the Secretariat of the Treasury is going to be the opposition, not those parties.

And it has done so in the past. In 2005, for example, the first major reform of the fiscal regime of PEMEX in the first version of that reform was blocked by the governors and the Secretariat of Treasury. The Mexican Treasury. I took a part as a PRD advisor in the Chamber of Deputies, and we joked that there were two -- there was two parties, the PRD and Hacienda.

And so, they were -- Francisco Selasares, the head of the regulating -- he was a member of the parliament -- there were governors from all of the different parties that were together when there was -- and I think it's going to be the same type of thing -- similar, is what's going to happen.

Because treasury -- it's tough for them to think about the -- how the budget is going to work without the contribution of 40 percent of PEMEX, not only to the budget, but also with the use of the investment. And for now, we import almost 50 percent -- 45 percent of gas is imported. And it's because there's an argument that may be true, that it's absolutely -- but just because you reiterate a fact doesn't make it right -- is that it's more that refining isn't as profitable.

And so for 37 years, it's brought us to 45 percent of importing. And petrochemical, the same thing. So the point -- key points of this secondary debate, the key points of this to make it possible for PEMEX, like Petro Juarez in Brazil, become not

a monopoly, but would be the budget autonomy.

And there's a lot of reticence about this, reluctance about this. And we've already seen this, where they go to the hydrocarbon revenue law. This is the first part of the enforcement of these laws and these circumstances. But in the reasoning behind the law -- and we started to get excited, but when we got to the actual articles after the introduction of the law, there's no basis when that was to move, what the regulations that were established in the -- for treasury to PEMEX.

And now, to say that PEMEX can invest wherever it wants -- but treasury is going to have to decide if the assessments are adequate. And so, this is part of the -- the crux of the debate. And this is one of the most important things over the next weeks that's going to be decided.

MR. TRINKUNAS: I think Charlie wanted to ask a question, then there's a gentleman in a green jacket. And then I'll look -- I think there was somebody in the back, as well. Then I'll switch back to the other side. So, at least four more questions.

MR. EBINGER: Charles Ebinger from Brookings. I'd be interested in your assessment of what is the appetite by the Mexican private sector to invest heavily in the oil and gas industry?

And I'd also pose the query, would there be any potential politic backlash if once -- that's assuming is found, as Diana said, and it comes to the well head for a competitive bid -- would there be any concern if the Mexican private sector and the international private sector started winning all the bids, and PEMEX saw its share increasingly drop?

MR. TRINKUNAS: Let's take two or three questions in a group, as we're starting to get close to the end of our time. Okay? So, the gentleman in the green jacket, and then, I believe there was one in the back on the other side.

MR. HUGHES: Phillip Hughes from the White House Writer's Group.

The discussion has captured the enthusiasm and excitement that is evident about these historic and important Mexican reforms.

But not to introduce a fly in the ointment, I'm wondering what lessons Mexico has learned from the experience of pre-Chavez PDVSA, which made the journey that you, I think have described PEMEX endeavoring to make in implementing these reforms.

And I'm wondering, also, looking sort of around the political corner, what lessons you may learn, what prophylaxis you may be thinking about for the political backlash that's been generated by energy sector reform in practically every country of Latin American, except maybe Colombia, where it -- or Brazil, where it's been endeavored? Sometimes in Bolivia and Ecuador, particularly, not to mention Venezuela, with really corrosive and retrograde ultimate results.

MR. TRINKUNAS: And let's take one more, I think here in the back, and then we'll turn it over to our panel to take a -- answer as they'd like to intervene on any of these?

MR. JUAREZ: Thank you very much. My name is Jesus Juarez. I'm from Spain. I'm from Europe. Jesus Juarez.

I'm surprised. I'm following this reform because I work together with an important lobby group and Mexican lobbying groups, and Mexico is making a significant effort to step up after these 20 years of NAFTA, but with its negotiation with the TTP and Europe.

But however, Mexico is pretty much absent there. This reform, the stage that's beginning to get into this detail, the regulator framework, and with the United States and the European Union are coming to an agreement that could be very

important in this area. And it's very difficult to us in Europe to see how Mexico is not playing an important role in this negotiation, just like Canada, because of the importance that it will have for the entire North American project. Thank you very much.

MR. TRINKUNAS: (Inaudible) in the middle, and people intervene as they -- or start with Arturo and then come back.

AMBASSADOR ARTUR SARUKHAN: I'll take a dig at a couple of them. After Spain, under Lucia and where -- I can't really put my finger on it where -- and sometimes I have to remind myself that I no longer speak to the Mexican government. But this has been very frustrating, because A: of the three North American countries, Mexico is the only country today that has an agreement -- a trade agreement with the European Union.

Canada is in the process of finalizing their deal, and the U.S. is obviously involved in the negotiations for TTIP. So, my position, not that anyone is going to listen to me and care, in my afterlife as a diplomat, is that I understand the politics of why Mexico, both Europeans and my U.S. former colleagues would rather not have Mexico and Canada in the negotiations at this point.

I understand the political underpinnings. I understand the need to move as quickly as possible, and it's much easier to move forward if you're one instead of three North American countries. But sooner rather than later, the United States and Europe will need to harmonize three similar but different free trade agreements between the three North American partners and Europe.

And if you think of sectors like aerospace or automotive, and you start thinking of a BMW plant in South Carolina, or Michelin tires in South Carolina, or Bombardier in Kerataro, or GE designing a new turbine for the new airbus in Toulouse, you start figuring out very quickly that at some point, three parallel but separate free

trade agreements are going to create a nightmare for everything from rules of origin to quotas to import-export provisos.

So, at some point, I hope that negotiators in Europe -- because I don't think it's only our American friends who have said no, no, no, no. Don't bring the Canadians and the Mexicans in right now. Both on the other side of the Atlantic and here, it is fully understood that at the end of the day, what we should really seek to achieve is a North Atlantic free trade agreement between NAFTA and the European Union. Very, very quickly on the issue of --

DR. NEGROPONTE: I'll take that. I'll take the Phillip's.

AMBASSADOR ARTUR SARUKHAN: I'm going to take a very, very small chunk of Phillip's question. No, (Inaudible) tongue in cheek, why would I not be concerned? Because Mexico isn't Venezuela. (Laughter) And because an oil company that has been completely dismantled and destroyed by political consideration, malfeasance, mismanagement, even in the worst scenario in Mexico, of okay, it wasn't as accountable as it should have (Inaudible), is not foreseeable.

So, I think the differences between Mexico trying to look at other models that have been implemented in other parts of the country, trying to replicate those, whether it's the Norwegian type fund, whether it's some of the strategic alliances that other oil companies in other parts of the world have developed, I'm not concerned at all about that.

MR. TRINKUNAS: Diana?

DR. NEGROPONTE: Can I also take up Phillip Hughes' question? Phillips, what are you raising is the phenomena known as the Dutch Disease. You have a single natural resource on which the rest of the country can depend. Nobody bothers to work. Nobody really diversifies, because the black gold or the soy or the copper

continues to ride.

I think there were elements of the Dutch Disease -- forgive me, Dr. Fluvio, in the extent to which PEMEX grew with the corruption which was pervasive, and no one bothered to control it, because it was politically unacceptable. So, I think this very reform tackles in Mexico the phenomena of the Dutch Disease, and seeks to prevent it in Mexico becoming the disease that it is in Venezuela.

DR. RUIZ ALARCÓN: Well, I would start with the appetite of the private sector; not only an appetite, but a physiological capacity to do so.

To the extent that Mexico, that there was a single operator existing among Mexican enterprises in and of themselves, on their own, could -- it's going to be tough to jump to become oil companies. There's a huge evolution to build, and there's no national oil bourgeois. It's going to take time to create this middle part.

And this is only in certain sectors that have done like Alpha -- Alpha has been, which has an interest in shale gas on the Texas side. It could very well pursue a petrochemical side and natural gas, et cetera. It has this advantage.

There's other companies that -- it has that advantage. Other companies have been successful with high technological content businesses like Diavasc has done a great job. I think it was the first -- (Spanish) was the first oil well and it increased production quite a bit.

In fact, there's a company that has started to have make forays in the building of rigs. And Carlos Eslimas started to use his capital and stuff. But beyond Leon's soccer team and telephone, I don't think there's a lot of experience in this. There's a lot to build. This capacity building has to take place.

But the lessons of PDVSA? I think there's three, basically. One is that there has to be, and hence my insistence throughout this event on the social legitimacy

of all the measures that are going to be taken in the legal framework that is connected to such an important sector, that is oil, if you remember, the opening up of Caldera's -- the fact that there was an unsocial conscious in, and Hugo Chavez won because -- that's why Chavez won, because it wasn't social consciousness there. So, this is basic -- this side of it.

And the institutional rules is the second lesson. And if PDVSA was able to go one from one side of the pendulum to the other extreme for an efficient company as such, but not well integrated or structured or built, or suited to the national economy - - I had an opportunity in Venezuela to go in that -- and it's incredible to listen to the people who have PDVSA, when they're done with their day of work.

They say, let's leave Venezuela. It was since I'm -- to separate PDVSA from the country, to think of it. This autonomy isn't desirable. It was a few months ago when they proposed constitutional autonomy for PEMEX, when it was -- I think we can't go to that extreme. I think that's another lesson in the institutional arrangement that's fundamental. It's important for us to give ourselves enough time to mature in the agencies, in the enterprises, and everybody is going to take part.

And then lastly, the preliminary debate is what to do with the product -- the proceeds -- oil proceeds. If I'm going to give you -- put the cart before the horse right away. Everybody is talking a lot about Article 24, as to whether we should change Article 24. There was a huge discussion about this, and (Inaudible) has said something that I should bring up here.

We also produce three and a half billion barrels of (Inaudible) and we're not a more fair or developed country as a result of this. So, we need a serious discussion or debate about what to do now -- particularly now, I stress, that it's going to be profit-sharing between the Mexican state and others.

So, what are going to do with the proceeds? What is the role of the oil sector now in the new economic development model? And what is PEMEX's role? And that's because it's going to cease to be a monopoly. And what's the best way for it to efficiently play its role?

If we don't have this overall debate, it's going to be very easy to end up with a very inefficient PEMEX, which is not in sync with the needs of the country, and we can end up -- and many have arguments that they want a sort of messianic model, is what they want to follow. We're going to be giving them fodder for this. And so, I think we've got to be very wise about how we pursue that.

MR. TRINKUNAS: Thank you very much, Dr. Ruiz Alarcón. You had the last word. We've come to the end of the session. I'd like it if you would please join me in thanking our panelists for a wonderful session. (Applause) And thanks to all of you for joining us. And please, do check out the Latin America Initiative and Energy Security Initiative web sites for more materials on this topic. Thank you.

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I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

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