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## **Mexico's Energy Update: Still Open For Business.**

by Carlos A. Chavez.

In the crossroads of the sixth anniversary of the Constitutional Reform that in a predominantly positive way overhauled and reshaped Mexico's energy sector, and getting close to starting the second year of the new federal administration led by President Andres Manuel Lopez Obrador, we find that the Mexican energy sector has not lost the spotlight that was provided by the Mexican federal and local governments since the inception of the reform (explored in depth in our [Energy Handbook](#)). However, myths and confusion regarding its new *status quo* severely affect new investments in this sector while some potential investors may wonder if Mexico's energy sector is still open for business.

Due mostly to the nationalist agenda publicly championed by the federal administration's top officials, put together with the cancellation of the highly popular oil bidding rounds (*rondas petroleras*) and clean energy auctions (*subastas eléctricas*) held by the former federal administration, and adding the settling of public disputes of the government with infrastructure companies around natural gas pipelines' agreements, some national and international investors have grown uneasy with respect to the nature and scope of the permitted activities in the sector and the willingness of the government to honor previous and new commitments.

As the common saying goes, "the devil is in the details", and Mr. Lopez Obrador's administration has in multiple occasions and in several public policy documents such as the Pemex Business Plan and the 2020 Federal Budget, acknowledged the increase of the productivity of the sector (and as a consequence, of the state-owned enterprises: Pemex and CFE) as a top priority, but also enticing more local and foreign investment in certain energy areas. Nonetheless, a staple of this administration is the reconfiguration and redefinition of the "old ways" or at least, of the "energy reform" perceived ways, in some cases returning or actively considering the return to schemes that were employed decades ago in the country's oil & gas and power industries. Understanding the different structures that will be employed in coming years by Mexico's federal administration is crucial for anyone looking to do business in the country's energy sector.

### **a) Oil & Gas**

As previously stated, the oil & gas bidding rounds have been halted for at least a couple of years and while it is widely expected that they will be reactivated at some time, their suspension does put a dent on the development of Mexico's conventional and unconventional resources. Nonetheless, in less than five years, the Mexican upstream sector went from having Pemex as its only true E&P player, to having a vibrant sector with a number of companies that continue to explore and produce their awarded blocks, with increased access to capital by financial companies and institutional investors alike. At the same time, a secondary acreage market is being developed in Mexico and the industry becomes more consolidated with

mergers and acquisitions, partnerships and joint ventures between upstream companies looking to maximize their assets.

The oil services industry will continue growing by the hand of the owners and operators of these oil & gas blocks and predominantly by the hand of Pemex, as the new government focuses on revamping the state-owned enterprise's operations in the upstream and downstream sectors.

For the upstream sector, private operators will continue to look for more oilfield services companies as they keep developing their plays, while Pemex will make use of the Exploration and Production Integral Services Agreement model (*Contratos de Servicio Integral de Exploración y Extracción* or "CSIEE", for their initials in Spanish). The CSIEE will be awarded through public tenders and are E&P services agreements in which Pemex maintains the ownership of the oil blocks and the service provider receives a variable cash consideration subject to the delivery of the hydrocarbons and availability of cash flow. The downstream and midstream sectors will also see more services demand from Pemex, as the company seeks to modernize its existing infrastructure and build state-of-the-art facilities, including refineries, pipelines and storage terminals.

While publicly suggesting a ban on hydraulic fracturing (fracking), public policy and official economic documents allocate resources to Pemex for unconventional pilot projects to be developed with fracking, as sanctioned by the Hydrocarbons National Commission, which opens the door for experienced services companies to join Pemex in this unconventional drilling activities.

## **b) Power**

Three clean energy auctions were held by CENACE between 2016 and 2017 with mostly positive results, which led Mexico to emerge as one of the foremost examples of energy transition. What appeared to be an indefinite suspension of these type of auctions in the country, now faces three probable outcomes: (i) the reactivation of the CENACE-organized auctions, with certain caveats still pending to be defined by the Ministry of Energy, but which may include the reduction of size and geographical redefinition of these auctions; or (ii) the replication through privately organized clean energy auctions; or (iii) both of the foregoing.

Besides the secondary services market that developed as a natural consequence of the number and magnitude of the projects that were awarded in the clean energy auctions, much of the uncertainty caused by the suspension of new auctions could be offset with the plans that the government has announced for the expansion of CFE's power plant portfolio and transmission grid. CFE plans to finance most of its new infrastructure projects through the scheme of Productive Infrastructure Investment Projects with Deferred Impact in the Expenditure Registry (*Proyectos de Inversión de Infraestructura Productiva con Registro Diferido en el Gasto Público* or "PIDIREGAS", for their initials in Spanish), which were formerly used by the government mainly to generate profitability and help CFE to recover and improve its power generation capacity. Through the PIDIREGAS scheme, power plants or transmission lines would be built by private companies under the instructions provided by the CFE, who will in turn pay the projects in full and assume any additional risk as owner of the assets.

As with the oil & gas sector, a sharp increase in services demand is expected from CFE as it looks to modernize its rather old infrastructure, and as the private companies that were awarded renewable energy projects in the long-term auctions kick start and take their projects to the finish line. Likewise, as the

energy market matures in Mexico, it is expected that more merchant projects and bilateral PPAs will become more frequent as the financial institutions grow more accustomed to the risks and benefits associated with these type or projects, and more EPC and BOT projects get commissioned by public and private companies alike.

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For more information on the Mexican Energy Sector, please read our [Practical Handbook and Introduction to Mexico's Energy Sector](#).

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