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México Projects: Get Ready, Get Set . . .

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Development opportunities in Mexico are expected to abound in the coming years with the support and sponsorship of the Mexican government. By all accounts, it appears to be full steam ahead for Mexico in the infrastructure and energy sectors!

On the heels of the National Development Plan (May 20, 2013), the Executive Branch of the Mexican Government has issued the National Infrastructure Program (July 15, 2013), Mexico's Ministry of Transportation and Communications (SCT) has announced a variety of projects in the port, toll road, rail and satellite sectors, Comisión Federal de Electricidad (CFE) has announced independent power producer (IPP) projects for up to 8,000 MW in total in the next five years, and Constitutional reforms in the energy sector (power, oil and gas) have been proposed by President Enrique Peña Nieto and Partido Acción Nacional (PAN), the main opposition party.

To advance the goal of developing infrastructure throughout Mexico, Partido Acción Nacional and President Peña Nieto (of the Partido Revolucionario Institucional) are proposing deep and widespread reforms at the federal level with respect to the power and oil and gas sectors. PAN presented its version of the energy reform on July 31, 2013. On August 12, 2013, President Peña Nieto issued his proposal for reform (available at www.reformaenergetica.gob.mx) under the motto "No to Privatization; Yes to Energy Reform."

The PAN proposal's primary goal is to allow broader and more direct private sector investment in both the power and oil and gas sectors, which are currently restricted to Mexico and its state agents (CFE and Petróleos Mexicanos (PEMEX)), albeit with some limited exceptions. The presidential proposal is more limited in scope with respect to the oil and gas sector but with very similar comprehensive reforms to the power sector as proposed by the PAN.

Both proposals seek to amend Constitutional provisions reserving certain activities in the oil and gas and power sectors to the State.

Proposal of President Enrique Peña Nieto

The proposal addresses the oil and gas sector and the power sector by amending Articles 27 and 28 of the Constitution. The proposal does not indicate the timeline for the issuance of implementing legislation and regulations for the proposed reforms.

Oil and Gas

The presidential proposal, in its essence, embraces the original principles that led to the nationalization of the petroleum industry in Mexico in 1938–the Nation retains title to and control of all petroleum resources. However, it should be noted that the proposal seeks to liberalize these sectors within the context of governmental oversight.

With respect to exploration and production, the proposal keenly adopts and reinforces what has long been close to the heart of Mexico–sovereignty and ownership over hydrocarbon resources while maximizing production, both for conventional and non-conventional fields (including shale gas resources) and through direct contractual arrangements. Concessions will not be granted in connection with exploration and production activities. Instead, profit-sharing contracts, rather than production-sharing contracts, are at the heart of the President's reforms in the exploration and production of oil and gas. Other areas of the sector, namely refining, storage, transportation and distribution, are intended to be open to private investment under a permit regime. Under the President's proposal, the booking of reserves would remain with the Nation.

Specifically with respect to PEMEX, the presidential reforms will be supplemented by tax reforms to lessen PEMEX's tax burden and allow it to reinvest part of its profits where and when needed. The reforms also restructure the organization of PEMEX into two divisions: exploration and production, on the one hand, and industrial processing on the other.

Power

On the power front, the President's proposal describes a national electrical system governed by technical and economic principles, under the domain and regulation of the Mexican government, taking a more open approach, disaggregating the vertically integrated market and affording greater access to private investment in generation (which currently allows private investment, though in limited fashion), while retaining control of transmission and distribution (grid operations). The primary goals of these reforms are reduction in the overall cost of electricity, universal coverage and sustainability.

Under the proposal, CFE will retain its current generating assets and act as any other market participant in the generation segment. The end result of creating a competitive power market will reduce the high-power costs in Mexico and reduce investment and financing costs in the generation segment. Additionally, market and regulatory forces will promote lower production costs and sustainable development. An impartial and independent governmental grid operator, functioning under transparency requirements, will promote an effective power market in Mexico.

Matters Reserved to the State

Under the proposal, radioactive materials and nuclear energy remain within the exclusive purview of the State.

Proposal of Partido Acción Nacional (PAN)

The proposed PAN reforms are more wide-ranging for the energy sector, opening it up significantly to private investment. The proposal amends Articles 25, 27 and 28 of the Constitution, creates the Mexican Petroleum Fund and elevates the Energy Regulatory Commission (CRE) to the rank of a government agency explicitly authorized by the Constitution. Finally, transitory articles in the proposal indicate that implementing legislation and regulations in respect of the Constitutional reforms must be issued within 365 days of the effectiveness of the Constitutional reforms.

Oil and Gas

The PAN proposal is much more significant as it expands private investment in the oil and gas sector through contractual arrangements and, contrary to the presidential proposal, concessions from the State. Though the State retains title to petroleum resources, the underlying treatment of registration of reserves is relegated to secondary legislation and, possibly, international accounting principles, to provide greater access by private investment to petroleum reserves. The proposal is not clear as to the manner in which such registration would occur or be shared.

The National Hydrocarbon Commission is charged with granting concessions and permits for exploration and production in the oil and gas sector, under a Constitutional mandate to maximize profits from such activities. The CRE is charged with the grant of permits or concessions (through bidding processes) on refining, processing, storage, transportation and distribution of oil and gas.

PEMEX is not reorganized, but its subsidiaries are permitted to form partnerships with private investors or compete directly with private investors in the areas of storage, transportation, refinement, etc.

Power

The State, through an independent agency that is not a market participant, will retain exclusive control over the electrical grid pursuant to a transitory article in the proposed reforms. The CRE will act as the coordinating agency on the granting, authorization and revocation of permits or concessions for the generation or distribution of power by private market participants. Furthermore, the CRE will regulate the generation, operational control, transmission, distribution, sale and efficient development of the supply and sale of electricity.

The power segment is opened to private investment in generation and distribution with the intention of creating an efficient market with lower costs to the end user (industrial or otherwise).

Matters Reserved to the State

Under the proposal, radioactive materials and nuclear energy remain within the exclusive purview of the State.

The National Development Plan

The National Development Plan has set out ambitious guiding principles for much-needed social, political, educational and infrastructure development in Mexico. The National Infrastructure Program has applied those principles across all sectors–power, telecommunications, pipelines, toll roads, ports and airports, among others, with planned spending of approximately MX$4 trillion (US$316 billion).

SCT Project Pipeline

In transportation infrastructure alone, SCT’s infrastructure plans contemplate the development of 15 highways, 29 toll roads, 16 crossings, seven bridges, three passenger train lines, six urban transportation systems, four freight train line segments, seven maritime ports, seven airports and the narrowing of the digital divide among the Mexican population.

CFE Project Pipeline

In the power sector, CFE has proposed an investment program in generation assets for the remainder of 2013 equal to 3,145 MW (a projected investment of US$4 billion), including Los Humeros III (geothermal), Guerrero Negro IV (internal combustion), Baja California Sur V (internal combustion), Norte III (combined cycle), Centro II (combined cycle), Chicoasén II (hydroelectric), Valle de México (combined cycle) and Noreste (combined cycle). These projects provide further diversification in Mexico’s generation capacity: hydroelectric power, combined cycle, etc.

In the oil and gas sector, the expansion of the national pipeline system and further exploration (including deep sea exploration) are key to PEMEX's near-term plans, as evidenced by the two phases of the Los Ramones project and the Chicontepec exploration activities. Additionally, CFE has conducted its own bidding processes for natural gas transportation to satisfy its demand for natural gas in connection with power generation.

Final Comments

It is premature to conclude the precise scope and impact of these reforms until a final package of reforms is consolidated and the necessary enabling laws and regulations are proposed in this regard. It is notable that the Presidential proposal plays to the rooted national sentiment regarding ownership of petroleum resources and, with very broad strokes, paints a picture of more competitive (and by proxy efficient) markets in the energy sector. It does not provide many details into the manner in which those markets will necessarily operate, failing to address what private investors have all along indicated is key to their investment in the oil and gas segment—reserve booking and ownership (or quasi-ownership?) of petroleum resources. The purpose of the petroleum industry's nationalization in the 1940s was to enhance and maximize revenue from petroleum resources; ownership was viewed as the means to that end. Concessions are another such means, and this is where the PAN proposal seems to get it right—a quasi-ownership of oil resources in exchange for efficient and competitive pricing to extract the highest value from such resources, with profits being channeled into a sovereign investment fund.

Although the presidential proposal is not specific in this area, the PAN proposal creates or reorganizes existing agencies of the federal government (National Hydrocarbon Commission and Energy Regulatory Commission) in an effort, in part, to create a more transparent, efficient and effective regulatory environment and concession- and permit-granting system in the oil and gas and power sectors alike. It may be that the presidential proposal intends to address these matters in secondary legislation and regulations, though that is not clear at this time.

What is clear in the grand scheme of things, however, is that the drive towards liberalization and greater private sector involvement is imminent and a key component of the National Development Plan, President Enrique Peña Nieto's vision for Mexico and the proposal of PAN. Opportunities in Mexico in infrastructure development will abound – so, watch this space and get ready, get set . . .

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