Mexican Energy and Projects Landscape Within a New Federal Administration Era

On December 1, 2018, a new President in Mexico was sworn in. Andrés Manuel López Obrador is not only the new head of the Executive Branch, but he is also the architect of a new left-oriented Mexico in which there will be many changes from the way things have been happening for the last 35 years. In the energy and projects landscape, new challenges and new opportunities are coming.

I. Background

An Energy Reform was instituted by the previous administration (Enrique Peña Nieto). In December 2013, articles 25, 27, and 28 of the Mexican Federal Constitution were amended, which started a regulatory revolution called the Mexican Energy Reform. Under the Energy Reform, among other activities, the National Center of Energy Control and the National Hydrocarbons Commission, respectively, conducted several power auctions and awarded approximately 107 exploration and production contracts. These contracts represent billions of dollars in new investments from both local and global players.

However, as promised during the recent political campaign, the new Administration has sent a clear message that both the Energy Reform and all of the contracts awarded under it will undergo an extensive review by the Ministry of Energy. While the review will be thorough, the Ministry of Energy has indicated that it will honor existing exploration and production contracts and their investments. Notwithstanding this reassurance, it remains to be seen if new contracts will be awarded in the near future. The new Administration will base its energy policy on an “Energetic Sovereign Principle,” which basically means the Mexican State will focus on achieving its aggressive energy sector goals primarily through *Petroleos Mexicanos* (PEMEX) and the Federal Electricity Commission (CFE), which have been transformed into productive state companies as a result of the Energy Reform, and additional players within their relevant markets. To such end, for instance, an additional budget of US$3.7 billion will be devoted to PEMEX, which will invest in new projects, fields, and abandoned areas, such as refineries. CFE will have an additional US$1 billion.

With regard to energy infrastructure projects, several schemes have been utilized in connection with the Energy Reform, including concessions, public-private partnerships, and public works under federal or state public procurement laws. Private financing has been available for such projects, much of which has been backed by guarantees of both the federal government and state governments. The new Administration has indicated that this may change in light of the fact that federal resources are by law distributed between the Mexican Federation and the Mexican States, including Mexico City. However, it is clear that some major projects will be structured under public-private partnerships.

II. New Energy Policy

It is clear that although the Energy Reform apparently will not be cancelled nor the Constitution amended to return to the principles in effect before the Reform, the role of the Mexican State in the energy sector will be dramatically increased. Both PEMEX and CFE will again dictate, along with the Ministry of Energy, the path to follow, controlling both the oil and power sectors.

In the oil sector, the new Administration has indicated that it will first review the awarded exploration and production contracts that reach significant commercial production, then decide whether to solicit new bids and award additional contracts. In power, which is an industrial product rather than a natural national resource, the new Administration will likely protect the CFE and the final user tariffs within a socially sensitive agenda. In other words, we believe the new Administration will not interfere with the Mexican Wholesale Power Market as long as the pockets of Mexican families and the CFE are not being adversely affected. Moreover, the CFE will devote financial resources in the construction, updating, and modernization of power production facilities mainly under thermal and hydro technologies.

One sensitive concern refers to the autonomy of the regulatory bodies. It has been discussed that such autonomy, gained during the last 25 years in the case of the Mexican Energy Regulatory Commission, might be reduced within the new Administration. The independence of the legislative branch will be imperative if the autonomy of the regulatory bodies is to be maintained.

III. PROJECTS AND OPPORTUNITIES

The new Administration has announced that the energy matrix will be based mainly in hydropower and, only as a reserve, gas-fired technologies, including combined-cycle. Hydropower will be reactivated using both small and micro facilities owned by the Mexican Federal Electricity Commission. New facilities will be built in order to achieve the goal of 7 TWh. The strategy contemplates the installation of 125 hydropower plants, 112 of which will be privately owned. Operation and Maintenance will be a hard driver of the new policy as the CFE looks to update existing facilities. Contractual schemes and coordination mechanisms with private investment are still to be defined.

Renewables will still be promoted, mainly photovoltaic, efficient cogeneration and hydropower, but not with the same emphasis to include all technologies as in the previous administration, which means that long-term power auctions might continue as long as Mexican families are realizing their positive effects. Gas-fired technologies will be included in the National Electric System Program, which will include the modernization of existing state-owned gas-fired plants. These plants will eventually be replaced by privately owned plants utilizing cleaner technologies. Transmission projects will continue.

Because the price of gasoline is a major component in the political agenda, existing refineries will be upgraded and new refineries will be built, including the construction of one large refinery in Dos Bocas, Tabasco. Six existing refineries (*e.g.*, Salamanca) will be updated to increase capacity, which will require more than US$2.5 billion in investments. Major equipment companies will see new areas of opportunity.

It is likely that EPC companies will increase their presence in Mexico significantly, not only for energy-related projects, but also for other ventures such as ports, rail projects (including the famous "Maya Train"), roads, and social infrastructure. Likewise, operation and maintenance companies might see new opportunities in Mexico.

In any and all cases, emphasis on national contents principles will be increased in order to promote the participation of Mexican companies, which means that synergies will be increased and indirectly promoted by the new policies.

If you have any questions about the information contained in this Client Alert, please contact the Thompson & Knight attorney with whom you regularly work or one of the attorneys listed below.

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