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Blog Post

Mexican Energy Infrastructure Plan Expected to be Released; Will Shape Energy Infrastructure Investment Post-COVID-19

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While much of the world's attention is focused on COVID-19, big energy news is expected out of Mexico in the near future. Recently, the Mexican government reiterated that it still intends to issue its long-awaited energy infrastructure plan despite the COVID-19 crisis, and in fact sees the release of the plan at this time as a countercyclical measure to counteract any deceleration of the Mexican economy caused by COVID-19. The plan is expected to involve approximately 275 oil, natural gas and electricity projects with an aggregate value of $92 billion — a staggering sum that would require the participation of private sector investors, many of whom are cautiously evaluating the Mexican energy sector following a series of administrative actions that impacted the Mexican energy infrastructure sector during the first year-and-a-half of the Andrés Manuel López Obrador ("AMLO") presidency.

Background: Administrative Reform of the Mexican Energy Sector

Since taking office in December 2018, AMLO has initiated reforms to the Mexican energy and infrastructure sector through administrative powers rather than major constitutional or legislative changes — implementing a series of measures intended to preserve and increase Pemex's and Comisión Federal de Electricidad's ("CFE") (the Mexican state-owned power utility) presence in their respective markets. For instance, the Mexican government has canceled energy auctions (for both oil and gas, and renewable power generation), announced a ban on hydraulic fracturing, replaced the leadership of energy regulators, pressed for the renegotiation of certain natural gas pipeline construction contracts awarded by CFE, and repealed certain price regulation and transparency rules.

Recent Administrative Actions and Update on the Mexican Energy Infrastructure Market

Some of the most significant administrative actions have come over the last several months:

- Last October the Ministry of Energy decided to amend the rules on bankable clean energy certificates ("CELs") to extend CELs to projects built by CFE before 2014. Numerous CEL holders initiated injunction proceedings against the measure, as it would dilute the value of their CELs. In December, a federal court ordered the suspension of the amendment pending its ruling. The ruling is expected to test the view of the Mexican judiciary with respect to investors' rights in the private sector.
- In February, the Mexican Energy Regulatory Commission ("CRE") proposed a regulatory change that would prevent sponsors of self-supply power generation projects from making changes to their power generation or supply permits (e.g., adding load points or customers) or transferring such permits. Self-supply permits entitle the permit holder (usually a special purposes entity formed by the generator and its consumers) to generate power and deliver it to its members through the national grid. Comisión Nacional de Mejora Regulatoria ("CONAMER"), the reviewing agency tasked with improving the efficiency of Mexico's regulatory framework, stopped CRE's proposal and recommended that CRE conduct a regulatory impact analysis given that the amendment could create additional compliance costs for permit holders. More than 300 power plants operate under self-supply permits. CRE has not confirmed whether it will conduct the recommended analysis or backtrack on its proposal. In the meantime, CRE is withholding amendments to self-supply permits (relating to the addition of load points or customers or transfers of permits), which has created a backlog on pending applications (some of which have been pending for up to eight months).
- Last month, the operator of Mexico's wholesale electricity market ("CENACE") also announced *"las únicas transacciones reconocidas por la LIE vinculadas con el MEM, son las que opera el CENACE"* (the only transactions recognized by the Electricity Industry Law in connection with the wholesale electricity market are those administered by CENACE). If taken at face value, this could be interpreted as CENACE suggesting that it will not legally acknowledge bilateral power purchase agreements among private parties to contract to sell or buy power, capacity or CELs

— though industry experts have suggested that the language of the statement may be broader than its intent. Nonetheless, CENACE has not yet issued a clarification.
- Although not related to the energy sector, just this week Mexican officials announced that the permits for a $1.4 billion brewery would be revoked after putting the issue to a local referendum.

These administrative actions coincided with a pre-COVID-19 slow-down in private sector development across Mexico in recent months. However, investment in the renewable energy sector remained robust during this period. Close to a dozen renewable power generation M&A and asset acquisition deals, for both greenfield and operational projects, signed or reached financial close between November 2019 and January 2020 (for more than $1.8 billion). Nearly all of those closed deals and projects have been financed through loans and credit facilities from national and international banks, with a minority partially funded through the sale of securities offered in a local stock exchange. However, at least one major sale process was reportedly canceled in view of CRE's attempt to modify CEL rules.

Looking Ahead

The pending energy infrastructure plan has the potential to provide clarity to partnering investors, whose financial backing will be necessary to satisfy a growing demand for energy, including helping Mexico achieve its legally mandated target of 35% of clean energy by 2024. Sending the right signals to investors could help spur investments into the country at a time when Mexico faces the possibility of a deep economic contraction from the fallout of COVID-19. One open question among investors is how many of the projects included in the plan are new projects — the previous year's energy infrastructure plan presented many existing development projects as part of the plan. Investors would like to see more new projects this year. We'll be watching this space as the new rules of the game, together with planned new opportunities, take shape.

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