Mexico’s energy needs: The AMLO era

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The Mexican energy sector is currently at an energy policy crossroads. Under the current administration of President López Obrador (popularly known as AMLO), several the energy reforms instituted by the prior administration of President Peña Nieto have been suspended or, in some cases, reversed. The country’s energy policies have been realigned, and some would argue regressed, to provide for a more nationalist self-determination posture which allows for increased federal government development of energy sector assets for both electricity and hydrocarbon production and supply within the country.

Under the previous administration, Mexico’s energy sector had moved towards a liberalized open market at a record pace. The hydrocarbon sector experienced a paradigm shift when the Mexican constitution was amended to allow for private sector investment in the exploration and exploitation of Mexico’s enormous hydrocarbon resources. The prior administration had also permitted the liberalization of the retail gasoline and natural gas markets throughout the country. The reforms had provided industrial and retail consumers with competitive options in what had previously been a monopolistic state-controlled market.

AMLO energy development

President López Obrador’s election on a platform of nationalistic rhetoric and proposed sweeping social programs have emboldened the AMLO administration to roll back many of the previous administration’s energy reforms and reestablish the federal government as the primary architect of energy development within Mexico’s boundaries. The last 2 years have seen numerous cancellations of previously announced and gravely needed energy infrastructure expansions (including many pipeline projects targeting transportation congested areas). The cancellation of needed natural gas pipelines seems at odds with the need to alleviate natural gas transportation congestion in the central and southern portions of the country but market forces will likely compel the AMLO government to reintroduce pipeline expansion projects under its own redesigned scheme. Huge transportation cost differentials amongst the various parts of the country are a clear market signal that market congestion exists and this congestion has a negative effect on moving natural gas from northern supply markets, including the Gulf Coast and west Texas, to Mexico’s gas starved markets in the central and southern areas of the country.

The AMLO administration’s recent announcement of the build out of more natural gas-fired power plants throughout the country also will place added pressure on Mexico’s already congested pipeline system. This announcement aims at providing cost competitive baseload power to the country's electricity grid as a means of meeting the power sector's growth demands, which in some regions are estimated to increase between 10-15% annually. Despite the government's desire to develop and fund all these proposed projects through its own efforts, there will likely come an inflection point where the government looks to the private sector again to develop and operate large scale power projects with the government's national electricity utility, la Comisión Federal de Electricidad (CFE), as power off-taker. Another successful model which may reemerge will be build-lease-transfer projects (BLTs) with the government as lessee. These structures have worked well for developers and the government alike during the last 25 years and will likely provide for a high percentage of the power sector's development opportunities during the reminder of the AMLO administration. The same structures will likely reemerge in the petroleum and natural gas sector as the government looks to leverage its development capital while meeting the need to fund increased social and education programs. These development models give the central government the ability to demonstrate to the public that it has reverted to the previous paradigm of having central government control over energy assets and market pricing while utilizing the technology achievements and operational efficiencies of the private sector and availing itself of development bank and commercial financing which can be secured on a project finance basis by private developers that does not negatively impact Mexico's credit rating.

New opportunities

During Mexico's upcoming period of market realignment and regulatory uncertainty, new opportunities are presenting themselves. For developers eager to explore the Mexican market, they will find a constantly shifting regulatory landscape and would be well advised to surround themselves with seasoned advisors who know the market well and can navigate the perils not evident to newcomers. One recommended strategy would be to approach one of the numerous Mexican industrial conglomerate groups and structure a joint venture arrangement to benefit from their market knowledge and diversification within the local market. Strong local partners can also serve as anchor clients in key markets which can then provide jump-off platforms to expand projects with additional clients as opportunities present themselves. Key considerations for successful ventures, particularly given divergent interests, will include tax and corporate structuring considerations and dispute resolution mechanisms. There have been a number of innovative structures which have been developed over the years to incentivize both foreign and domestic partners to joint venture, such as power offtake models guaranteeing the matching of private pricing with local power tariff pricing while maintaining the creditworthiness of a project for prospective lenders and economic viability for equity investors.

Investment activity by private equity and opportunity funds has also been increasing in recent months. In the past, during the recent "gold rush days" in the Mexican energy market, there was a "race to the bottom" for pricing, making the internal rates of return for many projects unattractive to PE investors. With the recent legislative changes in energy policy making the Mexican energy market riskier, many conservative investors have suspended their development activities and the competition amongst developers has subsided. This has resulted in an uptick in pricing and more robust returns for successful projects. Opportunistic investors are now able to purchase development rights to projects at extremely competitive prices and are able to either (1) continue development efforts with fresh capital, after having deeply discounted sunk capital already expended, or (2) shelve the development opportunity until the market rebounds or there is more clarity in the direction of the AMLO administration's energy policy making.

The energy demands of Mexico shows no signs of slowing down despite changes in energy policy projects negatively affecting private sector participation in the Mexican energy sector and a potential economic slowdown on both sides of the US-Mexican border. Instead, Mexico has now surpassed Canada as the United States' largest trading partner and the Mexican industrial and power sectors have continuously increased their need for US natural gas imports. Given the cost competitiveness of US gas imports, these imports remain the most viable option for Mexico to maintain stable energy pricing, for both natural gas supplies and power production, given that Pemex continues to struggle to increase cost competitive domestic natural gas supplies. Although Pemex has been able to slow, and perhaps stabilize, the declining rate of production of petroleum and associated gas at its facilities through increased capital investment and maintenance, Mexico's near-term dependence on imported natural gas will continue to inextricably tie both markets together as a necessary supplier and consumer.

Author Information

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