

Energy Alert

August 3, 2015

Mexico's Energy Industry: Midstream Regulations

Midstream Regulations

On July 27, 2015, the Comision Reguladora de Energia (**CRE**) issued its proposed regulations for the pipeline transportation and storage of petroleum, LNG and petrochemicals (**Midstream Regulations**). They are currently under review and open for public comments at the Comision Federal de Mejora Regulatoria ("**COFEMER**"), a federal entity in charge of managing all procedural aspects of any federal regulatory proposals. Based on the timeline established in the Ley de Hidrocarburos enacted on December 2013, the Midstream Regulations must be published and enacted by August 11, 2015.

These Midstream Regulations' main goals are (i) to provide open, nondiscriminatory access to existing transportation and storage infrastructure and (ii) to establish a legal framework that will promote the development of the midstream market. They will apply equally to all new or existing pipeline and storage operators, regardless whether they are State-Owned or private companies, foreign or Mexican. Overall, the Regulations provide the CRE vast authority to regulate the Mexican midstream sector to complete the transition from a state-owned and operated monopoly to a competitive and vibrant market-driven industry. Moreover, Petroleos Mexicanos is required to carry out a complete inventory of all its midstream assets and present market-driven Terms and Conditions for all its Transportation Systems and Storage Facilities within 90-days from the final publication of the Midstream Regulations.

The following summary presents some of the more relevant aspects of the Midstream Regulations including a clear distinction between transportation and storage, different midstream service modalities, cap on Carriers' Reserved Capacity, open seasons, interconnectivity, expansion/extension, quality banks, guidelines for Carriers to prepare their Terms and Conditions, and their Rates/Tariffs schemes.

Services

Transportation

Scope: Includes (i) reception of petroleum and petrochemicals (**P&P**) at a designated entry point; (ii) their shipment through the pipelines; (iii) measurement and analysis of the quantity and quality of P&P; and (iv) delivery at a designated exit point.

Components: Transportation Systems may include "buffer facilities" like temporary storage or processing tanks as long as these buffer facilities are directly and exclusively necessary for the transportation of P&P. Buffer facilities cannot be used only for storage purposes and their capacity must reflect the "temporary" requirement.

Carriers:

- Must obtain a Transportation Permit from the CRE. The Permit shall include the Terms and Conditions ("**TCPS**") for the Transportation System (similar to the Rules Tariff in the U.S.).
- Must limit their "corporate purpose" to the transportation of hydrocarbons.
- Must provide (i) Firm Commitment Services and (ii) Open Access Services.

- May only transport a limited quantity of their own P&P through their Transportation System.
- Must certify the Transportation System's Capacity, Firm Commitment Capacity, Available Capacity and Open Access Capacity (if any).

Storage:

Scope: Includes (i) reception of P&P at a designated point for storage or depository purposes; (ii) measurement and analysis of the quantity and quality of P&P; (iii) any processing and mixing necessary to meet necessary quality standards; and (iv) delivery at a designated point.

Storage Providers:

- Must obtain a Storage Permit from the CRE. The Permit shall include TCPS for the Storage Facilities (similar to the Rules Tariff in the U.S.).
- Must limit their "corporate purpose" to the storage of hydrocarbons.
- Must provide (i) Firm Commitment Services and (ii) Open Access Services.
- May only store a limited quantity of their own P&P in their Storage Facilities.
- Must certify the Storage Facility's Capacity, Firm Commitment Capacity, Available Capacity and Open Access Capacity (if any).

Service Formats

Firm Commitment

As a general rule, transportation and storage services of P&P will be offered under a Firm Commitment scheme, whereby Shippers enter into medium to long term fixed volume and frequency agreements with Carriers and Storage Providers (**Midstream Companies**). The Firm Commitment scheme has priority over the Open Access or Common Use schemes because it allows Shipper to guaranty capacity and access to the Transportation System and Storage Facilities.

Open Access

Midstream Companies must include in their TCPS the necessary conditions to guaranty open access to all the services they provide. Shippers interested in hiring P&P transportation and storage services must send an application to the corresponding Midstream Company, who must provide a formal response within 30 days. Midstream Companies may only deny requested services when there is no Available Capacity or it is determined that the service request is not **technically feasible**. If the Shipper believes Midstream Companies are not providing open, non-discriminatory access to their Systems/Facilities, they may file a complaint with the CRE.

Common Use

Midstream Companies may offer P&P transportation and storage services based on the Common Use scheme together with the Firm Commitment and Open Access schemes. Midstream Companies may allot a percentage of their Available Capacity to provide services on a pro-rata basis which must include the following considerations: (i) Shipper's historic volume profile; (ii) regularity or frequency of services provided to Shipper; (iii) Shipper's nomination requirements; and (iv) minimum work commitments, among others. Midstream Companies may offer Unconfirmed Capacity under the Firm Commitment scheme to Common Use Shippers.

Main Characteristics

Rates/Tariffs

The CRE will determine, based on the existing market conditions for a particular Transportation System or Storage Facility, whether it will establish a maximum rate/tariff. If market conditions indicate there will be a competitive environment, no maximum rates/tariffs will be established. Otherwise, the CRE will impose maximum rate/tariff schemes to protect Shippers and mitigate any anticompetitive practices. The CRE will evaluate the Midstream Companies' rates/tariffs based on the following: operating, sunk and recoverable costs; likely Shippers' characteristics; current market conditions; operating efficiency; reasonable risk allocation between Shippers and Midstream Companies; and adequate profitability, among others.

Batching

Midstream Companies may offer Batching services based on P&P's quality and specifications. Any additional requirements, quality ranges and costs involved in Batching must be included in the Permit Terms and Conditions.

Open Season

Midstream Companies must hold Open Seasons every time they have Permanent Available Capacity, get a new Transportation/Storage Permit, decide to build new or expand existing pipelines and storage facilities, or are asked by Shippers to build or expand existing pipelines and storage facilities. Open Seasons will help identify interested parties, scope of services required and the characteristics of the TCPS.

Quality Banks

Midstream Companies may establish quality banks to identify and compensate for any discrepancies in the quality of the P&P introduced vs. received. Any quality bank provisions must be included in the TCPS.

Interconnection

Carriers must facilitate Shipper's interconnection to their Transportation System by providing technical support and paying for such interconnection. All interconnection-related costs can be incorporated into the transportation rates. Interconnection is limited to a maximum distance of 100 meters from the existing Transportation System; otherwise it would be considered an expansion/extension.

Expansion and Extension

Midstream Companies may enter into investment/development agreements with Shippers to expand or extend existing Systems/Facilities to cover Shippers' needs. Midstream Companies should establish terms and conditions under which they will agree to such agreements. Otherwise, Shippers may undertake the expansion or extension, apply independently for a Permit and request interconnection with the existing Transportation System.

Electronic Bulletin

Midstream Companies must create Electronic Bulletins for all Systems/Facilities. They will have to post the following information: System/Facility Capacity, Firm Commitment Capacity, Available Capacity, Open Access Capacity, TCPS, Open Seasons, existing Transportation and Storage Agreements, among other relevant matters.

Capacity Assignment/Transfer

Shippers may assign or transfer the Firm Commitment capacity they have acquired. If any Firm Commitment capacity goes unused for a long period of time, Shipper will be forced to forgo or sell it.

Title

Shippers must certify to the Midstream Companies that the P&P they are putting in the System/Facility is free of liens or encumbrances, and that they are the rightful owners. The P&P may not be sold, assigned or transferred while in transit.

Contact Information

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