Gas Regulation 2021

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Getting The Deal Through

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Lexology Getting The Deal Through is delighted to publish the nineteenth edition of *Gas Regulation*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Colombia and Iraq.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We also extend special thanks to the contributing editors, David Tennant and Adam Brown of Dentons UK and Middle East LLP, for their assistance with this volume.

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Mexico

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DOMESTIC SECTOR OVERVIEW

State of the market

1 Describe the domestic natural gas sector, including the natural gas production, liquefied natural gas (LNG) storage, pipeline transportation, distribution, commodity sales and trading segments and retail sales and usage.

For decades, Mexico was one of the few countries that had liberalised its natural gas midstream and downstream industry without liberalising and allowing competition in the production of such fuel. Natural gas production was exclusively reserved to the state through Petróleos Mexicanos and its operating subsidiaries (collectively, Pemex), and except for the natural gas midstream and downstream industry, all of the Mexican petroleum industry (oil, gas, refined products and basic petrochemicals) was subject to a vertically integrated monopoly established in favour of Pemex.

In 1995, Congress passed a bill amending the 1958 Petroleum Law, allowing private participation (national and foreign) in the transportation, storage (including LNG liquefaction or regasification terminals), distribution and marketing of natural gas in Mexico. Originally, such activities were exclusively reserved to Pemex-Gas y Petroquímica Básica (PGPB), one of the four operating subsidiaries of Pemex. In that same year, the Natural Gas Regulations were published by the government, implementing liberalisation. In 1998, new environmental norms calling for the use of low-sulphur fossil fuels became effective, making natural gas the best choice for end users, particularly for industrial customers. A new federal agency was created to enforce the natural gas and electricity laws and regulations: the Energy Regulatory Commission (CRE).

The exploration and production (E&P) of natural gas remained exclusively entrusted to Pemex, and the supply of domestic natural gas within Mexican territory was still monopolised by PGPB, which, in turn, used to compete with private entities in the natural gas transportation and marketing segments. Pemex does not participate in the natural gas distribution business. In 1995, when the government finally decided to use and consider natural gas as an efficient, safe, environmentally friendly fuel, the federal government decided to encourage the use of natural gas not only through the publication of clean air laws and norms, but also through the establishment of local distribution companies legally compelled to gasify a specific geographic zone in Mexico.

In 2008, Congress passed a series of amendments intended to modernise the Mexican oil and gas industry, including the creation of a new federal agency, the National Hydrocarbons Commission (CNH), in charge of regulating and supervising the upstream sector. However, these amendments proved to be insufficient to effectively modernise the Mexican energy sector. Thus, in December 2013, Congress made a historical decision by amending the Mexican Constitution to break the government's vertically integrated monopoly over oil, gas and electricity established for decades in favour of Pemex and the Federal Electricity Commission (CFE) (the state-owned national power utility), and opened the door for competition in most of the value chains of the Mexican energy industry. This reform has resulted in a large number of statutes and administrative regulations that have substantially changed the structure of the Mexican natural gas sector, as further described in this chapter.

The use of natural gas in Mexico, on the other hand, has been primarily prompted by the power sector over the last 20 years, which has forced an increase in natural gas production, and to that extent has been one of the elements that prompted the recent constitutional changes to open Mexico's upstream market in light of Pemex's inability to increase natural gas production. Over the past five years, Mexico met its demand with indigenous gas and imports through pipelines interconnected with the US market and three LNG regasification terminals that were anchored by the CFE. Efforts to increase the production of domestic natural gas have included the commencement of drilling programmes in shallow waters to compensate for the expected decrease of production in the Cantarell field, the initiation of exploration activities in deep waters and the allocation of E&P blocks to private operators under the new legal regime; however, gas imports are expected to continue in the long-term, particularly as a result of the low prices that are now available in south Texas, Pemex's inability to increase production, and the time that will still be needed to materialise production by private parties.

The CFE, nevertheless, is still the most important promoter of natural gas transportation infrastructure in Mexico, anchoring many of the most important gas transportation pipelines being developed by private companies, including trunk lines and border-crossing pipelines connected at the US-Mexico border, a huge submarine pipeline from Texas to Tuxpan and the Wahalajara pipeline (a bundle of interconnected systems that starts in Waha, Texas, and ends in the region of the state of Jalisco, Mexico). For these projects, the CFE has awarded, through competitive bidding processes, long-term firm transportation contracts to anchor the projects and make them feasible. Other important pipelines are now being or have been completed by private developers, including notably the Mayakan interconnection project, an 855km, 42-inch pipeline, which is expected to alleviate the lack of transportation capacity in the National Integrated Pipeline and Storage System that resulted in several critical alerts over the past years; and a 16km pipeline that will interconnect the National Integrated Transportation and Storage System (Sistrangas, which is the successor of the National Integrated Transportation System originally conceived by the CRE) to the Mayakan transportation system, in order for the Yucatan peninsula to benefit from the added capacity in the Sistrangas and the competitive gas being imported (mainly through the Texas-Tuxpan submarine pipeline).

Consumption

2 What percentage of the country's energy needs is met directly or indirectly with natural gas and LNG? What percentage of the country's natural gas needs is met through domestic production and imported production?

In July 2020, domestic natural gas production was in the order of 2,543 million cubic feet per day (mmcf/d). During the year, natural gas imports represented close to 90 per cent of the total amount of natural gas consumed in Mexico, other than Pemex. The Ministry of Energy (SENER) anticipates that by 2030, the expected natural gas production will be 4,045 mmcf/d, and imports will reach 5,479 mmcf/d, mainly coming from the US through pipelines, owing to upcoming cross-border infrastructure projects.

The import of natural gas does not require an import permit from SENER (only exports require a permit); anybody may import gas into Mexico. The largest importer-shipper of natural gas in Mexico is Pemex and the CFE. Currently, there are 19 pipeline interconnections across the US-Mexico border, and another interconnection will be commissioned over the next year. No import duties are payable for the importation of natural gas into Mexico.

Government policy

3 What is the government's policy for the domestic natural gas sector and which bodies set it?

Over the past decade, the federal government intended to foster the participation of the private sector in the natural gas industry, through the implementation of the new mechanisms and asymmetric rules resulting from the Mexican energy reform. However, the current administration has prioritised the role of Pemex and the CFE as key players in the natural gas industry.

In July 2016, SENER issued a document containing its public policy guidelines for the implementation of a new natural gas market in Mexico (the Natural Gas Market Policy), which is centred on three main objectives:

- access to reliable and timely market information;
- reservation of transportation capacity and effective open access; and
- effective competition conditions for natural gas marketers.

Furthermore, as part of the implementation of the Natural Gas Market Policy, in 2018, SENER enacted public policies allowing the country to hold strategic and operational inventories intended to ensure the supply of natural gas to the market. Therefore, in March 2018, SENER issued the Natural Gas Storage Policy, whereby reporting obligations for applicable permit holders and the creation and maintenance strategic and operational inventories were established.

To achieve the foregoing, the National Centre for Gas Control (CENAGAS) will be coordinating efforts to develop the necessary storage infrastructure (through, in principle, international tender processes) and the implementation of the necessary mechanisms to ensure the energy security in its system.

Important actions are being implemented in line with SENER's public policy guidelines. Notwithstanding the foregoing, although the current administration has expressed its intentions to reduce the importation of natural gas, given that it is a matter of national security (which, logically, would require a substantial increase in domestic production), there are certain players associated with the political party of the current administration (which holds the majority vote in both houses of Congress, at least until 2021) that have expressed their intention to prohibit fracking practices in Mexico, which would reduce the possibility of substantially increasing domestic production.

Regulatory authorities

4 Which authorities make regulatory policies and decisions in respect of the production, transmission, distribution and supply of natural gas?

Until now, government policy has been set by the President in compliance with the applicable laws and regulations, through SENER, the CRE and the Ministry of Finance. National energy policy is required to be set within the first six months of the beginning of each presidential term (namely, a six-year term). As a result of the 2013 energy reform, a new Energy Coordinating Council has been created whereby the energy policy established by SENER is communicated to the chair of the CNH and the CRE, as well as the Director General of CENAGAS and CENACE (Mexico's power dispatch and control centre). Additionally, policy recommendations are required to be made by these regulatory agencies and public instrumentalities. The CRE, through the publication of directives, norms and resolutions, and its regulation of prices, rates and services, is the most important policymaker in the natural gas midstream and downstream arena. The CRE's directives and norms are administrative regulations that do not require congressional action to be issued (not even presidential action is required). CRE norms include technical standards applicable to the gas industry, and the CRE itself may amend the directives and norms it issues. Such directives currently regulate specific activities such as transportation expansions, gas quality and pricing, rates, insurance, reporting obligations, accounting and asymmetric regulation to Pemex.

As a result of the legal changes introduced in 2014, SENER and the CRE were given broader authority to establish and conduct national energy policy, giving priority to energy safety and diversification, energy savings and protection of the environment. The CNH, on the other hand, provides the technical elements for the design and definition of the national policy on hydrocarbons, participates with SENER in the determination of policies for the restitution of hydrocarbon reservoirs, and establishes technical and safety guidelines and standards for the E&P of domestic hydrocarbons (along with the new National Agency for Industrial Safety and Environmental Protection for the Hydrocarbons Sector). As a result of the constitutional reform passed in December 2013, the CNH has been strengthened and vested with broad powers and authority to regulate the upstream oil and gas sector, and was expected to take a more active leadership role in future years, including the launching of international bids for the award of licences and production-sharing agreements to Pemex and private parties (alas, currently the federal government has suspended all these bids, and it is not expected to lift the suspension in the near future).

REGULATION OF NATURAL GAS PRODUCTION

Ownership and organisation

5 What is the ownership and organisational structure for production of natural gas (other than LNG)? How does the government derive value from natural gas production?

Since the state was the only entity allowed to pursue exploration and production (E&P) activities in Mexico until very recently, the organisational structure remains controlled by Pemex, and the value of natural gas is directly related to the income obtained from its sale. Nonetheless, Pemex was assisted in the development of the petroleum industry by numerous contractors under various contractual schemes, including incentive-based contracts, under which the compensation for the contractor is set on the basis of performance criteria such as production, productivity and efficiency.

The 2013 constitutional reform and subsequent statutes are aimed at allowing the participation of numerous operators in the E&P business, which represents a historical change in Mexico. For the first time in more

than 50 years, Mexican law allows risk contracts for E&P of oil and gas, both onshore and offshore, including production-sharing agreements, licence agreements and other type of contracts between the state and Pemex or private operators, as deemed convenient by the federal government in order to maximise the value of the exploitation of domestic hydrocarbons. Moreover, the reform recognises that, provided the agreements are clear that the hydrocarbons remain owned by the state while in situ (in the reservoir), the operators should be able to report in their books their rights to the revenues or to a percentage of the production once it is realised.

Pursuant to the 2013 constitutional reform, Pemex was given the right to a Round Zero, where it was bestowed with certain blocks and areas where it will continue to operate under 'allocations' (a sort of E&P concession that may only be granted to state-productive enterprises such as Pemex). Risk contracts for new blocks are being awarded through international tenders by the National Hydrocarbons Commission (CNH), primarily on the basis of the consideration offered to the state. Likewise, the CNH shall award, through international tenders, contracts to develop jointly with Pemex some of the blocks originally awarded to Pemex in Round Zero. As of December 2018, 103 blocks have been awarded to private operators under E&P licence agreements or production-sharing agreements, and BHP Billiton was awarded with the first farm-out with Pemex to develop the deep-water Trion field near the US border, in what constitutes a historic move towards the full reorganisation of Mexico's oil and gas industry. Additionally, further farm-outs have been awarded to Cheiron Holdings and Dea Deutsche for onshore projects.

Regulatory framework

6 Describe the statutory and regulatory framework and any relevant authorisations applicable to natural gas exploration and production.

By virtue of the legal monopoly established by the Constitution until 2013, Pemex was the only entity authorised to carry out the E&P of natural gas in Mexico. Nonetheless, as a result of the 2013 energy reform, this monopoly has been abolished, and the upstream industry has now been completely opened to private participation through E&P contracts to be signed with the federal government through a public bid process in which Pemex and private operators are welcome to compete.

E&P activities, on the other hand, are subject to the technical regulation and supervision of the CNH. Drilling and superficial exploration activities not undertaken under an E&P contract are subject to the CNH notification or authorisation.

Moreover, the National Agency for Industrial Safety and Environmental Protection for the Hydrocarbons Sector (ASEA) is in charge of regulating and overseeing the industrial safety and environmental protection aspects of E&P activities, as well as midstream and downstream activities, including the issuance of guidelines applicable to such activities and their enforcement, and the approval and supervision of all sorts of environmental authorisations for the oil and gas industry. ASEA began operations on 2 March 2015.

In addition, Pemex and private operators intending to undertake E&P activities must prepare and file a social impact assessment (SIA) before the Ministry of Energy (SENER). The SIA must contain the identification, characterisation, prediction and assessment of social impacts that might arise from the activities to be developed, as well as the relevant mitigation measures and a social management plan. Obtaining SENER's resolution concerning the SIA is a condition to obtain the necessary environmental impact authorisation from ASEA, and compliance with the recommendations established therein will be required in order to initiate the provision of services in the system. If an indigenous consultation procedure is required, SENER must carry out such consultation in coordination with the Ministry of the Interior.

Finally, E&P contracts include certain compliance covenants and obligations with applicable laws and regulations that, in turn, are issued by the CNH (among other regulators). Thus, in the event a contractor fails to comply with these obligations, it may be subject to steep penalties or, otherwise, an administrative rescission of the E&P contract. The Energy Regulatory Commission also has certain jurisdiction over E&P contractors since these contractors are mandated to obtain a marketing permit as well (in order to be able to transfer the ownership of the hydrocarbons produced in the relevant block).

Unconventional gas production

7 Are there different rules for, or any restrictions on, unconventional natural gas production (including fracking)?

Production of unconventional natural gas through hydraulic fracturing or otherwise is allowed but is subject to a few special rules and regulations. First, CNH requires that exploration and development plans for unconventional resources comply with specific requirements applicable pursuant to the Guidelines Regulating Exploration and Development for Extraction of Hydrocarbons Plans. Moreover, these projects generally pay a higher consideration to landowners as part of the consideration for commercial extraction provided by the Hydrocarbons Law and are further regulated by certain guidelines issued by SENER in 2018.

In addition, there are a handful of other regulations that are specific to this activity; these include the following:

- guidelines that are applicable to onshore hydrocarbons' unconventional exploration and production activities issued by ASEA; and
- guidelines for the protection and conservation of national waters in hydrocarbons' exploration and production activities in unconventional reservoirs, issued by National Water Commission.

Although Pemex holds significant unconventional natural gas resources, the current administration is opposed to the development of unconventional resources through techniques such as hydraulic fracturing (despite that Pemex currently has multiple projects in place which are based in this technique). Multiple bills have been introduced in Congress seeking to impose a nationwide ban on fracking activities; however, none of these bills has passed so far. Thus, current laws and regulations allow the development of unconventional natural gas resources (including through fracking) to the extent that the relevant producer complies with the subject matter-specific environmental and upstream regulations issued by Mexican regulators.

Required security and guarantees

8 Are participants required to provide security or any guarantees to be issued with a licence to explore for or to store gas?

No security or guarantees are required except for those established in the relevant E&P contract.

REGULATION OF NATURAL GAS PIPELINE TRANSPORTATION AND STORAGE

Ownership and infrastructure

9 Describe in general the ownership of natural gas pipeline transportation, and storage infrastructure.

For decades, most of the gas transportation pipelines in Mexico were owned and controlled by Pemex, which used to own and operate two pipeline systems: one comprising 8,704km of fully interconnected trunk lines (the National Pipeline System) and another isolated system in the north-western part of Mexico, known as the Naco-Hermosillo system,

whose 339km trunk line is interconnected to Kinder Morgan's pipeline system in Arizona, US. Nonetheless, and since the opening of the midstream industry in late 1995, many other transportation systems have been and are being developed by private players such as Carso Energy, Energy Transfer, Fermaca, Kinder Morgan, Mitsui, Sempra (IEnova), Engie and Transcanada, including private equity funds associated with local developers. Currently, there are approximately 17,210km of pipelines, which are expected to increase to approximately 18,889km in the coming years. Moreover, to promote the expansion of the country's gas transportation infrastructure, over the past five years the Energy Regulatory Commission (CRE)has developed guidelines through which new gas transportation pipelines representing a benefit to the whole pipeline system are allowed to operate in coordination with the National Pipeline System based on roll-in rates, forming the National Integrated Transportation and Storage System (Sistrangas, which is the successor of the National Integrated Transportation System originally conceived by the CRE).

As a result of the 2013 constitutional reform for the energy sector and subsequent statutes, important changes for the natural gas transportation industry have occurred. The most important of those changes is the creation of CENAGAS, a new public instrumentality that is not a subsidiary of Pemex and that has assumed Pemex's gas transportation assets and operations (including the Sistrangas) with the requirement of managing the Sistrangas. This move is intended to finally afford open access to the National Pipeline System, and the private pipelines that operate in coordination with it, on a non-discriminatory basis and without favouring Pemex's volumes.

No storage projects (either through salt caverns or exhausted fields) have been implemented yet in Mexico, other than the LNG regasification terminals in Altamira, Ensenada and Manzanillo, which are already in operation; however, 'guaranty of supply' (inventory) requirements applicable to gas marketers, transporters and storekeepers are expected to serve as an important incentive for the development of storage projects.

Furthermore, a number of LNG export projects are currently being developed, intended to import gas from the US in order to be liquified and exported abroad. For instance, Sempra has reported (through its Mexican affiliate) that it intends to re-convert a currently existing import terminal operated by Energia Costa Azul into a liquefaction facility for exports, and an import terminal located in Manzanillo is being currently reviewed to be converted also into an export facility for the same purposes using gas sourced from the Wahalajara system.

Regulatory framework

10 Describe the statutory and regulatory framework and any relevant authorisations applicable to the construction, ownership, operation and interconnection of natural gas transportation pipelines, and storage.

To build and operate a natural gas transportation system or a storage facility (eg, liquefaction or regasification terminals), different types of governmental permits and authorisations are required from federal and local authorities, the most important being the permit granted by the CRE, authorisations required under the environmental laws, social impact authorisations and real estate rights required by the project.

Natural gas transportation and storage permits

Pursuant to the Hydrocarbons Law, natural gas transportation and storage services are subject to a federal permit granted by the CRE, upon demonstrating to the agency the experience and capabilities of the relevant transportation company (both technical and financial), the feasibility of the pipeline project to be implemented and the approval of the proposed rates and terms of service.

Transportation permits operate as 30-year renewable quasi-concessions, and impose a series of regulatory obligations on the relevant transporter. As a general rule, transportation pipelines operate under open-access permits granted to those transmission systems that will serve very much like a utility: they are compelled to grant open access on a not-unduly discriminatory basis to any shipper that requests the service, provided there is available capacity in the system and the parties reach an agreement on the subject matter, as provided under the general terms of service of the relevant permit holder (GTS) approved by the CRE. Open-access transportation permit holders are mainly regulated and supervised by the CRE and by the National Agency for Industrial Safety and Environmental Protection for the Hydrocarbons Sector (ASEA) (the latter only from a safety and environmental point of view). Self-use transportation permits, on the other hand, are exclusively granted to end users whose transmission systems will not be providing open-access services.

The CRE, as the midstream regulator, has ample powers to establish special conditions for transportation and storage permit holders (including amending its GTS) in order to ensure that open-access principles are observed. Furthermore, in the event the permit holders fail to comply with the obligations established under the applicable permit, the GTS or applicable law, these entities may be subject to fines or early termination of the applicable permits by the CRE, or both.

Despite the natural monopoly that a transportation pipeline may entail, there are no restrictions in terms of the length and width of the pipeline or the capacity of the system. Since there are no local utility agencies or commissions in Mexico, the CRE is in charge of granting both interstate and intrastate gas transportation permits.

Transportation companies are not obliged to gasify any predetermined geographic zone or to connect any given number of users (although permit holders are obligated to provide service to any user pursuant to open access principles). Thus, gas transportation permits are granted by the CRE on a non-exclusive basis.

The regulations for natural gas storage are similar to those applicable to transportation.

The granting of an open-access transportation or storage permit (namely, the approval of the technical and safety aspects of the project, rate schedule and the GTS), takes from five to 10 months, depending on the complexity of the project.

Finally, if the new pipeline is intended to operate as part of the National Integrated Transportation and Storage System, the CRE shall approve the terms and conditions in which the new pipeline shall be integrated into the national integrated transportation system, including the resulting roll-in rates and applicable GTS (which shall be consistent with the GTS of CENAGAS's national pipeline system).

Environmental and social impact authorisations

The developer shall obtain the authorisation of an environmental impact assessment report and risk study from ASEA, which is responsible for industrial safety and environmental authorisations for the oil and gas industry. Moreover, before filing a permit application with the CRE, applicants are required to prepare and file an SIA with the Ministry of Energy (SENER). Likewise, if indigenous communities may be affected by the project, a public consultation procedure shall be carried out by SENER, in coordination with the Ministry of the Interior.

Lastly, the developer shall negotiate and obtain all rights of way (ROW), pipeline-crossing authorisations and real estate rights necessary for the construction and operation of the pipeline or the storage facility.

Land rights

11 How does a company obtain the land rights to construct a natural gas transportation or storage facility? Is the method for obtaining land rights to construct natural gas distribution network infrastructure broadly similar?

Through the negotiation and execution of ROW contracts or easement agreements with the respective servient tenements, or through the filing of an ROW permit application if the land is owned by the government. The same applies to securing a site for a storage facility or metering station (namely, option, purchase or lease agreements need to be negotiated, signed, notarised and registered), provided that possession of public land normally requires the granting of a concession, which in some instances is subject to public tender.

ROW contracts and easement agreements depend on the type of land to be affected: private, public or agrarian. Private property in Mexico is subject to state law. Accordingly, the civil codes of the relevant states where the facilities are to be built are the statutes that will govern the terms under which the developer will negotiate the corresponding ROW and real estate rights for the construction of the pipeline or the storage facility (eg, an LNG terminal). Public property is governed by different statutes depending on the type of owner (namely federal, state or municipal owner or public instrument). In this type of situation, and instead of executing an easement agreement, the developer will file and obtain an ROW permit. The ROW permit may be a pipeline-crossing permit or a right-of-way permit, or both.

Agrarian property is subject to federal law under the Agrarian Law. ROWs granted over agrarian property are documented through easement agreements or usufruct agreements; agrarian easement agreements and usufruct agreements are cumulatively subject to the Agrarian Law and the Federal Civil Code.

Under the new legal framework, the process to negotiate and execute the agreements necessary to obtain ROWs has become regulated, requiring, inter alia:

- the involvement of SENER and the Ministry of Agrarian, Territorial and Urban Development (who shall issue model contracts for the use, encumbrance or acquisition of land and real estate rights);
- the participation of social witnesses, if requested by any of the parties or if the social impact assessment shows that there are risk and vulnerability conditions in the relevant area, or if this is otherwise required under the guidelines to be issued by SENER (individuals, entities and NGOs may act as social witnesses, to the extent that they do not have a conflict of interests);
- the obtainment of appraisals; and
- the submission of the relevant agreement for the final validation of a district judge or agrarian tribunal.

Moreover, the Hydrocarbons Law contemplates mediation procedures that the parties may use to resolve their differences where they are unable to reach an agreement. As a general rule, ROWs and any other land rights shall be obtained using the model agreements that SENER has issued for the hydrocarbons industry.

The above-mentioned considerations are similarly applicable to transportation, storage and distribution systems.

Access

12 How is access to the natural gas transportation system and storage facilities arranged? How are tolls and tariffs established?

All transportation and storage companies (other than self-use transportation or storage companies) are obliged to provide open access to their systems on a non-discriminatory basis (provided there is available capacity in the system, among other criteria) to any person that requests their services, as required under the relevant GTS.

The GTS is an all-encompassing document, which includes the type of services offered by the transportation or storage company, the terms and conditions regarding the provision of such services (including imbalance procedures and gas quality provisions) and the rates approved by the CRE. Each GTS is available at the CRE's website and in the relevant permit holder's so-called electronic bulletin board, and can only be amended upon the prior approval of the CRE. Issues omitted or not adequately covered under the relevant GTS may be addressed in the gas transportation agreement or the gas storage, regasification or liquefaction agreement (in the case of LNG regasification terminals) entered by the permittee and the user. A template of such agreement is attached to the relevant GTS and incorporates by reference the provisions stipulated under the GTS.

All gas to be injected into a Mexican pipeline (transportation and distribution) is subject to a gas quality norm published by the CRE. This norm is subject to review every five years.

The rates of transportation and distribution systems are regulated very similarly. However, the pipelines that are part of Sistrangas (the national integrated natural gas transportation and storage system, operated by CENAGAS) or some other future integrated system, operate under roll-in rates that are determined based on specific methodologies issued by the CRE.

As a result of the 2013 constitutional reform, Pemex's gas transportation assets and operations have been transferred to CENAGAS, which operates Sistrangas as an integrated open access system.

Interconnection and expansion

13 Can customers, other natural gas suppliers or an authority require a pipeline or storage facilities owner or operator to expand its facilities to accommodate new customers? If so, who bears the costs of interconnection or expansion?

Transporters and storage companies are required to expand or extend their systems upon request by any potential shipper whenever the service being requested is technically and economically feasible (whether through pipeline expansion, through looping or by adding compression); and the shipper has guaranteed that the services will be contracted. Moreover, the transporter or storage company shall carry out an open season to obtain other requests for service to optimise the use of the expansion capacity. If the transporter decides that it is interested in implementing the requested expansion and covering its cost, the transporter may request an adjustment (increase) of its regulated service rates. If the transporter decides that the requested expansion is not sufficiently attractive, then the shipper that requested the expansion may choose to cover the cost of the expansion or carry out the expansion by itself through the execution of a co-investment agreement with the relevant transportation/storage company, in order to be able to obtain the requested services (in such a scenario, the project shall be considered economically feasible).

Under the co-investment agreement, the anchor shipper is guaranteed its firm capacity in the system and is allowed to recover its investment through the rates paid by third-party users of the facilities. Nonetheless, these facilities are still subject to open access obligations, and the parties under the co-investment agreement are mandated to increase the capacity of the proposed system in the event any third party shows interest during the performance of the relevant open season.

Processing

14 Describe any statutory and regulatory requirements applicable to the processing of natural gas to extract liquids and to prepare it for pipeline transportation.

Gas processing activities are subject to a permit by SENER; it is one of the activities that was liberalised and opened to private investment as a result of the 2013 constitutional reform, which eliminated the state monopoly over the oil and gas industry.

Contracts

15 Describe the contractual regime for transportation and storage.

In principle, gas transportation and storage service providers shall abide by the terms of service and model contracts established in their respective GTS, as approved by the CRE; however, service providers and shippers may include in their contracts special conditions that detour from the terms of service embodied in their GTS, to the extent those special conditions do not constitute unduly discriminatory practices or violations to public policy. Negotiated rates are also permitted to the extent they are not unduly discriminatory, but as a general rule, negotiated rates shall not exceed the maximum regulated rates approved by the CRE for each system. Moreover, additional flexibility is afforded for gas transportation and storage companies to enter into special conditions with anchor shippers, to the extent they are willing to accommodate the service requirements of other potential shippers interested in receiving services.

In addition, local distribution companies are required to register their model contracts with the Federal Consumer Protection Agency, which also verifies the adequacy of the proposed contractual terms.

Under the new structure, a single geographic zone was created to encompass the entire national territory. Thus, natural gas distribution permits are now granted on a non-exclusive basis (as transportation permits), and permit applicants are no longer required to predetermine the zone where they intend to carry out their services. This new structure is expected to promote competition in the distribution by pipeline sector, by means of reducing entry barriers and the time required to obtain the relevant permit, while also allowing current and future participants to offer more competitive services and rates to the end user.

REGULATION OF NATURAL GAS DISTRIBUTION

Ownership

16 Describe in general the ownership of natural gas distribution networks.

Gas distribution is subject to the issuance of a permit by, and supervision of, the Energy Regulatory Commission (CRE), and open access principles of such systems are also regulated by the CRE.

Transporters and distributors (as well as storage companies, retail sellers, marketers, shippers and consumers) are required to abide by the general administrative provisions to be issued by the CRE concerning legal, operational and accounting separation of their activities, codes of conduct, limitations in equity participation, the maximum participation that gas marketers may hold and the maximum capacity they may reserve in transportation pipelines or storage facilities, in the understanding that the direct or indirect shareholders of any gas consumers, producers or marketers that use the transportation or storage services of another company may only participate, directly or indirectly, in the equity capital of such transporters or storage companies when such participation does not affect competition, market efficiencies or effective open access, and subject to the approval of the CRE and the favourable opinion of the Federal Economic Competition Commission (COFECE, Mexico's antitrust agency).

A distribution permit for a geographic zone designated by the CRE may be awarded by the CRE through an international tender upon request of the federal government, any state or municipal government, the government of the federal district or its subdivisions, or any private party. The CRE has been successful in granting local distribution company (LDC) permits since 1996; to date, the CRE has awarded more than 38 LDC permits covering the most important cities in Mexico. The determination, expansion and modification of a geographic zone are established by the CRE in accordance with the CRE's Directive on Geographic Zones. In all cases, LDCs are private companies, as Pemex does not participate in the gas distribution sector. However, in 2017, the CRE substantially transitioned from the geographic zone allocation to a single distribution zone structure.

Under the new structure, a single geographic zone was created to encompass the entire national territory. Thus, natural gas distribution permits are now granted on a non-exclusive basis (as transportation permits), and permit applicants are no longer required to predetermine the zone where they intend to carry out their services. This new structure is expected to promote competition in the distribution by pipeline sector, by means of reducing entry barriers and the time required to obtain the relevant permit, while also allowing current and future participants to offer more competitive services and rates to the end user.

Regulatory framework

17 Describe the statutory and regulatory structure and authorisations required to operate a distribution network. To what extent are gas distribution utilities subject to public service obligations?

To build and operate a natural gas distribution system, different types of governmental permits and authorisations are required from federal and local authorities, the most important being the permit granted by the CRE, authorisations required under the environmental laws, social impact authorisations and real estate rights required by the project.

Natural gas distribution services are subject to a federal permit granted by the CRE, upon demonstrating to the agency the experience and capabilities of the relevant distribution company (both technical and financial), the feasibility of the pipeline project to be implemented and the approval of the proposed rates and terms of service.

As in the case of transportation permits, distribution permits operate as 30-year renewable quasi-concessions, and impose a series of regulatory obligations on the relevant distributor. As a general rule, distribution pipelines operate under open-access permits granted to those distribution systems that will serve very much like a utility: they are compelled to grant open access on a not-unduly discriminatory basis to any shipper that requests the service, provided there is available capacity in the system and the parties reach an agreement on the subject matter, as provided under the general terms of service (GTS) of the relevant permit holder approved by the CRE. Open-access distribution permit holders are mainly regulated and supervised by the CRE and by the National Agency for Industrial Safety and Environmental Protection for the Hydrocarbons Sector (ASEA) (the latter only from a safety and environmental point of view). However, and unlike transportation permit holders, distributors are also allowed to supply users with the molecule being distributed in its system (provided that the relevant distributor is required to offer both distribution and supply service on an unbundled basis, as required).

The CRE, as the midstream regulator, has ample powers to establish special conditions for distribution permit holders (including amending its GTS) in order to ensure that open-access principles are observed. Furthermore, in the event the permit holders fail to comply with the obligations established under the applicable permit, the GTS or applicable law, these entities may be subject to fines or early termination of the applicable permits by the CRE, or both.

Despite the creation of a natural monopoly that a distribution pipeline may entail, there are no restrictions in terms of the length and width of the pipeline or the capacity of the system. Since there are no local utility agencies or commissions in Mexico, the CRE is in charge of granting both interstate and intrastate gas transportation permits.

Distribution companies are no longer obliged to gasify any predetermined geographic zone or to connect any given number of users (although permit holders are obligated to provide service to any user pursuant to open access principles). Thus, gas distributon permits are granted by the CRE on a non-exclusive basis.

The granting of an open-access distribution or storage permit (namely, the approval of the technical and safety aspects of the project, rate schedule and the GTS), takes from five to 10 months, depending on the complexity of the project.

Regarding the ancillary environmental and social impact permits, the developer shall obtain the authorisation of an environmental impact assessment report and risk study from ASEA, which is responsible for industrial safety and environmental authorisations for the oil and gas industry. Moreover, before filing a permit application with the CRE, applicants are required to prepare and file a social impact assessment with the Ministry of Energy (SENER). Likewise, if indigenous communities may be affected by the project, a public consultation procedure shall be carried out by SENER, in coordination with the Ministry of the Interior.

Lastly, the developer shall negotiate and obtain all rights of way (ROW), pipeline-crossing authorisations and real estate rights necessary for the construction and operation of the pipeline or the storage facility.

Access and pricing

18 How is access to the natural gas distribution grid organised? Describe any regulation of the prices for distribution services. In which circumstances can a rate or term of service be changed?

All distribution companies are obliged to provide open access to their systems on a non-discriminatory basis (provided there is available capacity in the system, among other criteria) to any person that requests their services, as required under the relevant GTS.

The GTS is an all-encompassing document, which includes the type of services offered by the distribution company, the terms and conditions regarding the provision of such services (including gas quality provisions) and the rates approved by the CRE. Each GTS is available at the CRE's website and on the relevant permit holder's electronic bulletin board, and can only be amended upon the prior approval of the CRE. A template of the relevant distribution agreement is attached to the relevant GTS and incorporates by reference the provisions stipulated under the GTS, and model contracts must be registered with the Federal Consumer Protection Agency (Profeco), which also verifies the adequacy of the proposed contractual terms.

All gas to be injected into (and received from) a Mexican distribution pipeline is subject to a gas quality norm published by the CRE. This norm is subject to review every five years.

The rates of distribution systems are regulated very similarly to transportation. Furthermore, all users accessing a distribution system shall pay the respective LDC the corresponding interconnection fee, which is previously approved by the CRE and included in the relevant GTS, as part of the LDC's rate schedule. This rate schedule is published in Mexico's federal register, and is subject to the adjustment mechanisms provided under the Directive on Pass-through Prices and Rates. According to these mechanisms, regulated rates are subject to annual adjustments based on Mexico-US inflation and currency exchange variations and, after every five years of operation, the rate schedule shall be reviewed by the CRE and the LDC based on the methodology established under the CRE's Directive on Pass-through Prices and Rates (which includes efficiency factors), considering the business plan, investment commitments, efficiency factors and other considerations included in the distribution or transportation permit. Propane and fuel oil are still, and will continue to be, widely used in Mexico (Mexico is the largest residential consumer of LPG in the world); therefore, the CRE is keen to maintain natural gas transportation and distribution rates at a very competitive level with respect to other competing fossil fuels.

The rate schedule cannot be modified by the LDC unless it has been approved by the CRE. Evidently, the CRE is normally reluctant to accept the amendment of a rate schedule unless it is to lower such rates; however, the regulation embodied in the Directive on Pass-through Prices and Rates does contemplate a number of cases in which LDCs are allowed to request an increase of their maximum regulated rates, mainly as a result of regulatory and standardisation changes and unforeseen investments required to protect the integrity of their ROW or the safety of their systems. Changes in the applicable tax regime, on the other hand, are treated as pass-through costs.

Similarly to transportation and storage regulations, distribution permit holders may be subject to penalties or early termination of the applicable permit, or both, in the event the obligations under the permit or applicable law, or both, are not complied with.

Similarly to transportation and storage regulations, distribution permit holders may be subject to penalties or early termination of the applicable permit, or both, in the event the obligations under the permit or applicable law, or both, are not complied with.

System/service expansion and limitation

19 May the regulator require a distributor to expand its system to accommodate new customers? May the regulator require the distributor to limit service to existing customers so that new customers can be served?

Yes. LDCs have the obligation to expand or extend their grids whenever the requested expansion or extension is technically and economically feasible.

Under the applicable laws, the CRE has broad powers and authority to regulate the efficient development of the midstream and downstream natural gas industry; under such premise, and pursuant to other statutory provisions, the CRE may require an LDC to limit service to existing customers to serve new customers. This situation, however, has not occurred yet in Mexico.

Contracts

20 Describe the contractual regime in relation to natural gas distribution.

In principle distribution providers shall abide by the terms of service and model contracts established in their respective GTS, as approved by the CRE; however, service providers and shippers may include in their contracts special conditions that detour from the terms of service embodied in their GTS, to the extent those special conditions do not constitute unduly discriminatory practices or violations to public policy. Negotiated rates are also permitted to the extent they are not unduly discriminatory, but as a general rule, negotiated rates shall not exceed the maximum regulated rates approved by the CRE for each system.

In addition, local distribution companies are required to register their model contracts with Profeco, which also verifies the adequacy of the proposed contractual terms.

REGULATION OF NATURAL GAS SALES AND TRADING

Ownership and organisation

21 What is the ownership and organisational structure for the supply and trading of natural gas?

Gas trading is subject to a permit by the Energy Regulatory Commission (CRE). Gas marketers are only allowed to participate in the equity of a gas open access company that such marketer is using to the extent such participation complies with the vertical integration rules to be issued by the CRE (requiring, inter alia, separation of activities, adoption of codes of conduct and restrictions on interlocked directors) and the proposed vertical integration is approved by the CRE, with the favourable opinion of the Federal Economic Competition Commission (COFECE). Until June 2017, the price for Pemex's gas production was regulated by the CRE through pricing methodologies to set Pemex's maximum prices for domestic and imported gas, which were pegged to a liquid market price index (Henry Hub, HSC and the differential between such reference prices and quotations in south Texas), subject to a netback procedure; however, in June 2017 the CRE eliminated the pricing regulations that were applicable to Pemex's gas sales, and therefore, the marketing of imported or domestic gas by Pemex or private parties is not currently subject to pricing regulation under Mexican law. However, Pemex's gas marketing contracts and supply conditions continue being regulated by the CRE.

Pemex continues to be the largest gas marketer in Mexico, mainly because Pemex is currently also the largest producer of natural gas. However, the Federal Electricity Commission (CFE) is also undertaking an important role as a gas marketer supplying natural gas to independent power producers throughout the country.

Government oversight

22 To what extent are natural gas supply and trading activities subject to government oversight? What authorisations are required to engage in wholesale trading of gas?

Until recently, the oversight of governmental authorities has been negligible, except in the case of Pemex, owing to its evident market power and the fact that it was, for decades, the only producer and supplier of domestic natural gas in Mexico, and is the largest importer, trader and transporter. Pemex's gas trading activities are currently regulated by and subject to the scrutiny of the CRE through a number of administrative provisions and resolutions intended to limit Pemex's market power and promote the participation of new marketers (however, these restrictions are currently being repealed, as part of the federal government's intention to support Pemex and CFE). The success of these efforts also depends on a number of other aspects, including the ability of the National Centre for Gas Control (CENAGAS) to reorganise the operation of Sistrangas and effectively provide open access to the system.

Gas marketing activities (including wholesale trading and retail transactions) by private parties, on the other hand, are subject to permit and oversight by the CRE. This marketing permit does not limit the type of transactions that the permit holder may undertake; a permit holder may perform both retail and wholesale transactions upon the issuance of the relevant marketing permit. Moreover, both Pemex and private marketers are required to report detailed information about their gas trading transactions on a daily basis, through the electronic platform that the CRE has implemented for that purpose. These reporting obligations and electronic platform are part of the actions undertaken pursuant to the Natural Gas Market Policy, in an effort to provide adequate and timely information to the market and begin gathering the elements to eventually create a Mexican price index. In this context, the CRE has begun publishing, on a monthly basis, the Natural Gas National Reference Price Index, for informational purposes. This index reflects the average prices of the transaction undertaken by the natural gas marketers participating in the Mexican market.

Finally, as a result of the abolition of the Pemex monopoly over the oil and gas industry and the Pemex obligation to supply the national market, the Ministry of Energy is required to issue the national energy security rules with which gas and liquids marketers will be required to comply in order to participate in the Mexican market.

Trading processes

23 How are physical and financial trades of natural gas typically completed?

Domestic gas sales by Pemex are conducted pursuant to the model agreements that have been authorised by the CRE under Pemex's General Terms and Conditions for First-Hand Sales, which contemplate a series of service methods with different levels of flexibility in terms of gas supply scheduling and nominations. Gas supply contracts among the CFE or other gas marketers and the relevant purchasers are not subject to regulation yet, and, therefore, the parties are free to establish the applicable terms and conditions. Private marketers, on the other hand, are now reviewing their strategies and are often inclined to use North American Energy Standards Board-based contracts (despite the nature of the model being intended for wholesale or spot transactions), which now includes the Mexican Addendum, intended to harmonise the model terms and conditions under the model agreement to applicable Mexican laws.

Available services and products

24 Must wholesale and retail buyers of natural gas purchase a bundled product from a single provider? If not, describe the range of services and products that customers can procure from competing providers.

No. Under Mexican law, all users (wholesale or retail) are free to purchase gas on an unbundled or bundled basis. In other words, users and end users in Mexico are free to purchase from any supplier or marketer, and become shippers in, and retain the service from, any open-access transportation or distribution company, or purchase the natural gas from the distribution company. Note, however, that permit holders that unreasonably bundle their services (or tie sales) may be prosecuted by COFECE for exclusionary monopolistic practices.

REGULATION OF LNG

Ownership and organisation

25 What is the ownership and organisational structure for LNG, including liquefaction and export facilities, and receiving and regasification facilities?

Although Mexico is rich in natural gas reserves, there are currently no liquefaction export facilities (although some projects are being currently being assessed in order to undertake this activities) and, because of the increasing demand for natural gas, three major LNG regasification terminals are being operated or developed in Mexico. Moreover, LNG is now playing a crucial role in the National Centre for Gas Control's balancing operations of the Sistrangas, in light of the declining production of natural gas in Mexico. Liquefaction and regasification facilities have so far been subject to a storage permit by the Energy Regulatory Commission (CRE); however, new LNG terminals shall operate under the new permit modalities for liquefaction and regasification contemplated by the Hydrocarbons Law, which shall also be granted by the CRE. The design, construction, safety, operation and maintenance of LNG facilities are subject to a Mexican official norm issued by the CRE

and National Agency for Industrial Safety and Environmental Protection for the Hydrocarbons Sector (ASEA). These three LNG regasification terminals may eventually become liquefaction facilities in light of the recent commissioning of the Sur de Texas–Tuxpan and Wahalajara cross-border trunk lines and inasmuch as indigenous production begins to flow, allowing the import of continental gas from Texas and displacing expensive LNG imports from the Pacific coast.

Regulatory framework

26 | Describe the regulatory framework and any relevant authorisations required to build and operate LNG facilities.

To build and operate a natural gas liquefaction or regasification terminals, different types of governmental permits and authorisations are required from federal and local authorities, the most important being the permit granted by the CRE, authorisations required under the environmental laws, social impact authorisations and real estate rights required by the project.

Natural gas liquefaction or regasification services are subject to a federal permit granted by the CRE, upon demonstrating to the agency the experience and capabilities of the relevant applicant (both technical and financial), the feasibility of the project to be implemented and the approval of the proposed rates and terms of service (to the extent the provision of storage services is included as part of the project).

These permits operate as 30-year renewable quasi-concessions, and impose a series of regulatory obligations on the relevant operator to the extent that storage services are to be provided. As a general rule, storage terminals operate under open-access permits that will serve very much like a utility: they are compelled to grant open access on a not unduly discriminatory basis to any shipper that requests the service, provided there is available capacity in the system and the parties reach an agreement on the subject matter, as provided under the general terms of service of the relevant permit holder (GTS) approved by the CRE. Open-access storage permit holders are mainly regulated and supervised by the CRE and by ASEA (the latter only from a safety and environmental point of view).

The CRE, as the midstream regulator, has ample powers to establish special conditions for storage permit holders (including amending its GTS) in order to ensure that open-access principles are observed. Furthermore, in the event the permit holders fail to comply with the obligations established under the applicable permit, the GTS or applicable law, these entities may be subject to fines or early termination of the applicable permits by the CRE, or both.

The granting of an open-access transportation or storage permit (namely, the approval of the technical and safety aspects of the project, rate schedule and the GTS), takes from five to 10 months, depending on the complexity of the project.

Regarding the ancillary environmental and social impact permits, the developer shall obtain the authorisation of an environmental impact assessment report and risk study from ASEA, which is responsible for industrial safety and environmental authorisations for the oil and gas industry. Moreover, before filing a permit application with the CRE, applicants are required to prepare and file a social impact assessment with the Ministry of Energy (SENER). Likewise, if indigenous communities may be affected by the project, a public consultation procedure shall be carried out by SENER, in coordination with the Ministry of the Interior.

Lastly, the developer shall negotiate and obtain all rights of way, pipeline-crossing authorisations and real estate rights necessary for the construction and operation of the terminal.

Moreover, LNG regasification and liquefaction may require concessions granted by the Ministry of the Environment and Natural Resources and the Ministry of Transportation and Communications if they are not located within a pre-established industrial port.

Pricing

27 | Describe any regulation of the prices and terms of service in the LNG sector.

The applicant for an open-access gas storage permit is allowed to propose the methodology to be used for purposes of determining the rates that will be charged for the relevant storage services, but this methodology shall be consistent with the general principles followed by the rate methodology prescribed for open-access transportation permits, mutatis mutandis (eg, maximum rates, appropriate allocation of costs among the different services being offered, reasonableness of the proposed rate of return (which is not a guaranteed rate of return), periodic reviews and application of efficiency factors).

MERGERS AND COMPETITION

Competition authorities

28 | Which government body may prevent or punish anticompetitive or manipulative practices in the natural gas sector?

Unlike in some jurisdictions, antitrust matters in Mexico's natural gas midstream and downstream sectors are not exclusively regulated and enforced by the Energy Regulatory Commission (CRE); the Federal Economic Competition Commission (COFECE) has concurrent jurisdiction in most of the natural gas activities that may be punishable from the antitrust point of view.

The COFECE has concurrent jurisdiction with the CRE in five areas:

- operation of the system;
- regulated rates, merger control and refusal to deal;
- predatory and discriminatory pricing;
- cross-subsidies, tied sales and exclusive dealings, among other punishable exclusionary practices; and
- cross-participation of gas marketers, producers or consumers in transportation or storage companies (ie, vertical integration rules).

The transfer of an open-access pipeline or storage permit, or the transfer of their assets, is subject to the prior approval of the CRE. Authorisation from the COFECE may also be required if the relevant transaction exceeds one of the monetary thresholds established under Mexico's merger control rules. Both agencies may object to the transaction or impose conditions or performance requirements on the transfer. Finally, the COFECE may impose sanctions on open-access permit holders and other related parties (eg, an affiliated marketing company) upon determining the existence of a punishable conduct (such as a refusal to deal when the permittee unduly denies open access, or undertakes predatory pricing, imposes tie-in requirements or other kinds of monopolistic practices) causing harm to other economic agents vertically or horizontally located. Since its creation in 1993, the COFECE has gained expertise in the energy sector, and plays an important role in enforcing antitrust laws and regulations in a market that, by its very nature and condition, is per se monopolistic. More importantly, it also plays a significant role because of the unparalleled monopolistic situation that the Mexican energy industry had with two vertically integrated monopolies controlled by the government (Pemex (oil, gas and basic petrochemicals) and the Federal Electricity Commission (power)), and the decision to eliminate these monopolies and open the industry up to competition. As a result of a Constitutional amendment, COFECE has become constitutionally independent and one of the most powerful agencies in Mexico.

Competition standards

29 What substantive standards does that government body apply to determine whether conduct is anticompetitive or manipulative?

Two main sets of rules regulate whether a conduct is anticompetitive in the midstream and downstream natural gas arena: the Hydrocarbons Law and its regulations for the midstream industry (including all of the CRE directives, resolutions, norms and the applicable general terms of service and rate schedule), and the Competition Law, its implementing regulations and the COFECE's resolutions. On one hand, the Hydrocarbons Law sets out a series of competition principles for the oil and gas sector, while the Federal Economic Competition Law (the Competition Law) regulates, in general, mergers and acquisitions, monopolistic practices and entry barriers in the relevant Mexican markets.

COFECE is in charge of enforcing and applying the Competition Law, as well as dealing with competition issues embodied in other statutes governing specific industries. Notwithstanding that COFECE is an independent agency, it plays a quasi-judicial role in the system, as it is entrusted not only with investigations but also with the resolution of antitrust cases, although COFECE determinations can then be subject to judicial review by Mexican federal courts.

Mexico's competition laws contemplate jurisdiction over any anticompetitive practices undertaken by any 'economic agents' located either in Mexico or abroad, to the extent that such anticompetitive practices are intended to have, or have, effects in Mexico. The concept of economic agents goes beyond the more typically formalistic legal system of Mexican laws and refers to any persons, companies or groups of persons or companies participating under common control. Generally speaking, this includes companies and their affiliates, but it also extends to groups of companies operating together under contractual agreements.

Unlike other jurisdictions where monopolistic practices are classified in agreements and unilateral practices (eg, abuse of dominant position), the Competition Law emulates US antitrust law by defining certain collusive or exclusionary conducts in Mexico, which are defined as either absolute monopolistic practices (considered anticompetitive practices per se) or relative monopolistic practices (which are reviewed under the rule-of-reason principle).

These practices are punished through the assessment of economic fines and criminal penalties on perpetrators of anticompetitive behaviour. Furthermore, COFECE also has the authority to investigate anticompetitive mergers and acquisitions and any barriers to competition in relevant markets by imposing actions to promote effective competition (eg, ordering the divestiture of assets or stock ownership among market participants).

Enforcement

30 What authority does the government body have to preclude or remedy anticompetitive or manipulative practices?

Both the COFECE and the CRE may preclude or remedy anticompetitive practices in the natural gas sector within the scope of their jurisdiction. The main tool is the imposition of hefty fines and criminal penalties (for implicated officers) and, in some cases, even the revocation of the permit on the part of the CRE. In addition, the COFECE or the CRE may require the relevant economic agent or permittee to cease the anticompetitive practice, and the COFECE may even order the divestment of assets. Once such sanctions have been conclusively established by the COFECE, the relevant injured party may use this resolution for a prima facie case for the payment of actual damages and loss of profits before a Mexican court. The sanctioned party may also appeal a resolution imposed by the COFECE before the Mexican courts; alas, precedents indicate that the courts rarely overturn these resolutions (excluding reductions of the relevant fines).

End users, on the other hand, are entitled to cumulatively pursue a claim before the Federal Consumer Protection Agency if the pipeline or storage service provider violates the Federal Law of Consumer Protection.

Merger control

31 Does any government body have authority to approve or disapprove mergers or other changes in control over businesses in the sector or acquisition of production, transportation or distribution assets?

Mexico's Competition Law requires that certain mergers or transfers (known in Mexico as concentrations) be notified to the COFECE prior to closing. The transaction legally cannot occur until clearance is obtained from the COFECE. For the purposes of the Competition Law, a concentration includes any transaction or series of transactions that result in the accumulation or concentration of capital from two or more economic agents, and includes mergers, asset and stock acquisitions, as well as the formation of new companies, where the economic thresholds established by the Competition Law are met. The COFECE reviews the power over the relevant market of the parties involved, and the probable anticompetitive effects of the change in control or merger. Typically, the resolution of the COFECE takes two to three months to be issued (although this period is subject to the complexity of the transaction and the relevant market).

The CRE, on the other hand, has introduced provisions in gas permits whereby the CRE's prior authorisation is required to modify the upstream capital structure of the permit holder (ie, a change in control). Moreover, mergers or other changes in control that result in a cross-participation among participants in the natural gas market, and mergers or other changes in control that modify the cross-participation previously approved by the CRE, also require CRE approval and the favourable opinion of the COFECE, as previously discussed. In turn, the CRE and the COFECE may impose certain conditions on the relevant economic interest group, including restrictions on:

- the equity interest that the members may hold among them;
- the firm capacity that the marketer may hold in its affiliates' systems; and
- the market share that the marketing entity may have in the relevant sector.

Price restrictions

32 In the purchase of a regulated gas utility, are there any restrictions on the inclusion of the purchase cost in the price of services?

The purchase cost of a regulated gas utility cannot be included in the price of the service, as the regulated gas utility can only modify its rate schedule. If an entity acquires a regulated gas utility, said entity must live with its rate schedule and be subject to CRE reviews and adjustment mechanisms.

Corporate governance regulations

33 Are there any restrictions on the acquisition of shares in gas utilities? Do any corporate governance regulations or rules regarding the transfer of assets apply to gas utilities?

Subject to merger control approvals, there is no statutory restriction to acquire the controlling interest in a regulated gas utility, except if the transfer changes or results in the participation of a gas marketer,

producer or consumer in the gas utility, in which case, CRE approval and a favourable COFECE opinion are required. Nevertheless, the CRE has in some instances introduced within open-access permits a requirement to obtain the prior approval of the CRE in the event of a change in control of the permittee. Likewise, amendments to a natural gas-related permit requested as a result of a change in control of the permit holder, require the CRE's prior assessment and approval, which is another way that the CRE has to review a proposed transfer. Moreover, if the participation of a gas marketer is involved, CRE and COFECE approval may be required owing to the regulation applicable to cross-participation situations.

The CRE is keen to make sure that new owners of the utility meet the same technical, financial and legal requirements that the previous shareholders were required to prove to the CRE as part of the approval of its permit. On the other hand, the transfer of an open-access permit, or the assets used to provide the permitted services, requires the prior approval of the CRE and, depending on the characteristics of the transaction, the approval of the COFECE would also be required, and the transfer would then be subject to the requirements established under the Competition Law or the cross-participation rules under the Hydrocarbons Law, or both, as applicable.

INTERNATIONAL

Foreign participation

34 Are there any special requirements or limitations on foreign companies acquiring interests in any part of the natural gas sector?

There are no special requirements or limitations on acquisitions of interest in the natural gas sector by foreign companies, except where the foreign company intends to acquire more than 49 per cent of the capital of a Mexican company and the company has more than 16,816,200,000 Mexican pesos in assets, in which case the prior approval of the National Commission on Foreign Investments may be required.

International agreements

35 To what extent is regulatory policy affected by treaties or other multinational agreements?

The North American Free Trade Agreement (NAFTA) provided very general provisions regarding the liberalisation of the energy sector, the use of performance contracts for the exploration and exploitation of oil and natural gas and government procurement rules that may become relevant if providing services or selling goods to Pemex or the Federal Electricity Commission. Notwithstanding the foregoing, in light of the recently enacted and ratified trilateral free trade agreement, the United States-Mexico-Canada Agreement (USMCA), some special provisions thereof apply some nuances in relation to NAFTA. The most relevant provisions under the USMCA applicable to this sector is Chapter 8, whereby the parties recognise Mexico's 'inalienable and imprescriptible ownership of hydrocarbons' and its right to amend its constitution and domestic legislation in these matters; however, the consent of analysts is that the provisions under Chapter 8 are somewhat moot, in the understanding that the recognitions made by the parties therein are without prejudice to their rights and remedies available under the USMCA; in other words, despite its language, Chapter 8 would not interfere or carve out the parties' protections under the USMCA and, thus, its impact on foreign investment in Mexico is not material.

Moreover, Chapter 14 sees the investor-state dispute settlement (ISDS) system included in the USMCA, and reduces the protections available to US investors in Mexico, as the potential grounds for an investor-state claim are reduced. For Canadian investors in Mexico, the protections granted under the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) contain certain limitations on the types of disputes that can be resolved through the ISDS mechanism. For example, there are some situations for which Mexico has carved out its consent to investment arbitration under the CPTPP with respect to government contracts related to the development of infrastructure in the country. This could impact oil exploration and production contracts, as well as public-private partnerships and contracts of public works, and concessions over airports and maritime ports. Also, alleged violations of foreign investment protections by Mexican courts cannot be claimed in ISDS procedures.

Furthermore, under Chapter 14 of the USMCA, the limitations of ISDS between the US and Mexico could potentially restrict the activities of Mexican investors in the US, and US investors in Mexico, or change how these entities approach their investments. For example, a potential concern is the limitation on the ability to submit claims for indirect expropriation, which are expressly carved out from the protections that can be subject to an ISDS arbitration procedure. Chapter 14 of the USMCA also alters the scope of certain protections – for example, national treatment or minimum standard of treatment – attempting to establish different standards for proving violations to these protections when compared to the decisions rendered under NAFTA. Notwithstanding the foregoing, there is yet another scheme of protection for rights granted in government contracts in a 'covered sector', which includes the oil and gas industry.

In short, the current protections under NAFTA Chapter 11 would carry over under certain legacy provisions. Annex 14-C of the USMCA sets out the transitional provision for any 'legacy investment' claims, and gives the former NAFTA parties three years to bring a claim to arbitration for investments established or acquired while NAFTA was in force. The process and substantive protections under NAFTA would appear to apply to such claims. Investors will want to keep track of how NAFTA and the USMCA proceed, as aside from other relevant limitation periods, the status of these agreements could impact whether or when to bring a claim. The status of these agreements could also influence how investors might want to structure, or potentially restructure, their investments going forward.

On the other hand, Mexico is a member of the OECD, and is involved in the International Energy Agency through the Committee of Non-Member Countries; as a result, Mexico must follow the policies established by these organisations to the extent permitted by Mexican law. Mexico has signed or ratified more than 32 bilateral investment treaties, 13 free trade agreements (involving 46 countries) with investment protection chapters and 57 double taxation treaties, and is a signatory to the most important regional and multinational treaties on private international law.

Cross-border sales and deliveries

36 What rules apply to cross-border sales or deliveries of natural gas?

Unlike other jurisdictions, so far, no special permits (eg, a presidential permit) have been required in Mexico for the construction of a border-crossing pipeline, or the import of natural gas (exports, on the other hand, do require the obtainment of a prior export permit from the Ministry of Energy). However, if the border crossing is with the US (as is normally the case), the developers must obtain the authorisation of the Mexico-US International Boundaries and Waters Commission. Moreover, an authorisation by the Ministry of Finance is required in connection with the metering devices that will be used to determine the gas volumes being imported or exported. Gas exports, on the other hand, are subject to a prior export permit from the Ministry of Energy.

TRANSACTIONS BETWEEN AFFILIATES

Restrictions

37 What restrictions exist on transactions between a natural gas utility and its affiliates?

In addition to those requirements that may apply pursuant to the Competition Law, no specific affiliate marketing rules have been implemented yet with respect to gas utilities other than the cross-participation authorisation requirements. In that context, the Energy Regulatory Commission (CRE) now requires that any marketer participating directly or indirectly and at any level in a transportation or storage company establish Chinese-wall rules to prevent undue exchange of information and discriminatory practices.

Other transactions among affiliates, on the other hand, are subject to the general principle of no undue discrimination embodied in the regulations, and the general rules established in the antitrust laws to prevent anticompetitive practices. Under the Hydrocarbons Law, the CRE and the Federal Economic Competition Commission (COFECE) are required to issue the vertical integration rules that are necessary to promote an adequate legal, operational and accounting separation of the activities undertaken by affiliates in the areas of the natural gas industry.

Enforcement

38 Who enforces the affiliate restrictions and what are the sanctions for non-compliance?

This is mainly the CRE and COFECE, pursuant to the legal and functional separation requirements and the cross-participation authorisations contemplated under the Hydrocarbons Law.

UPDATE AND TRENDS

Gas sector-specific regulation

39 Describe recent trends and developments in the regulation of the domestic natural gas sector.

The National Centre for Gas Control (CENAGAS) recently published the five-year plan (2020 to 2024) regarding upcoming projects for the continued development of the Sistrangas, in order to foster the continuity, reliability and flexibility of the system. Generally speaking, this plan includes the list of priority projects intended to provide the creation of hubs (mainly in the northern and western region of Mexico) through a series of interconnections between the Sistrangas and privately owned transportation systems, and the installation of much overdue metering stations in key import locations (especially in the system operated by Kinder Morgan) in order to improve the monitoring of the operational balance of the system to better assess and provide real-time data to users regarding their injections and extractions.

Given the consistent problems related to imbalances in Sistrangas' day-to-day operations; CENAGAS released in Q4 2019 the Operational Balancing Rules (OBR), which were intended to strengthen the financial position of CENAGAS, foster shippers' compliance and increase the reliability of the system. For instance, before the release of the OBR, CENAGAS' general terms of service mainly provided for reimbursements and makeups to compensate the imbalances in the system (having cashouts as a last resort), which is industry standard. However, in light of the constant decline in the availability of domestic natural gas and CENAGAS' heavy reliance on LNG imports to maintain the operational balance of the Sistrangas, maintaining the status quo was becoming expensive. Under the OBR, CENAGAS is now allowed not only to enforce cashouts more easily, but is also granted a broader scope of authority to maintain the balance of the Sistrangas, such as:

- the possibility of amending confirmed nominations;
- directing interventions to the system via sales or purchases of natural gas and procurement of ancillary services in other systems; and
- most importantly, the imposition of escalated penalties for non-compliant users who repeatedly jeopardise the system, which may result in a temporary or permanent suspension of transportation services for the applicable user.

In principle, the validity of the OBR was provisional (which elapsed in February 2020) while CENAGAS improved the monitoring of the system to provide better and accurate information to its users; however, CENAGAS only recently commenced imposing the imbalance of liquidated damages in November 2020. The validity of such liquidated damages is currently being analysed by the affected parties, and legal challenges are expected.

CENAGAS has completed the development of the infrastructure announced in 2019 for the purpose of enhancing Sistrangas' reach in Mexico, mainly related to the interconnection of Sistrangas to the Mayakan system (a pipeline transportation system located in the south-eastern region of Mexico, owned and operated by Engie), which consisted of:

- the construction of a 16km pipeline from the Gulf of Mexico (which will harness the recently added capacity brought by the Texas–Tuxpan submarine pipeline); and
- the reconfiguration of the Cempoala compression station (which will allow the flow of gas from north to south).

Accordingly, CENAGAS is currently performing an open season to allocate the resulting additional capacity.

During 2019, both the president and director of the Federal Electricity Commission (CFE) questioned the fairness of the long-term transportation services agreements that anchored the development of several strategic pipelines in Mexico (such as the Texas–Tuxpan and Wahalajara systems). The administration stated that the terms and conditions of such agreements were not acceptable (including the CFE's obligation to pay the capacity charge, even if capacity was not available because of force majeure events) and, thus, the agreements had to be amended to restore the economic balance among the parties. This triggered a series of negotiations with the applicable private sector developers that resulted in a series of mutually agreed amendments involving a mix of changes in the service rate structure, increased transportation volume commitments and longer effective terms of the agreements. This has allowed the completion and commencement of commercial operation of some of the systems that were pending to initiate operations (such as the Texas–Tuxpan pipeline and the Wahalajara system).

Grupo Fermaca has recently announced the completion and successful commencement of commercial operations of the Villa de Reyes–Guadalajara system (anchored by CFE), which is the last leg of the Wahalajara system. In this respect, Fermaca's CEO has stated in the media that it is the intention to expand (and even double) the current transportation capacity of the system in the coming years, not only to meet the increasing industrial demand in the western region of Mexico, but to reach the southern region of Mexico (which has historically had a very limited supply of natural gas).

In light of the completion of the majority of the transportation systems anchored by CFE, the state utility has announced a series of auctions to allocate to interested third parties the 'excess' transportation capacity and supply of gas that such projects have brought. Although such allocations of gas and capacity would not be regulated (since, for instance, the allocation of transportation capacity in the secondary market does not require regulatory approval), CFE has not

ruled out that such auctions are performed directly by the applicable transportation permit holders through open seasons. Industry players should be mindful of any developments regarding the above, especially considering the strategic nature of some of the transportation systems (such as the Texas–Tuxpan and Wahalajara pipelines).

In light of the recent change in policy by the Energy Regulatory Commission (CRE) – eg, the presidential mandate to support state-owned enterprises – the CRE has enacted a series of changes that have affected the oil and gas market. Although the vast majority of these changes have impacted primarily the refined products and power sectors, the CRE repealed in 2020 the terms and conditions (part of the asymmetric regulation) that Petróleos Mexicanos and its operating subsidiaries (collectively, Pemex) would follow in the determination and publication of first-hand-sales of natural gas. In essence, these rules were intended to allow users to take informed decisions about their consumption of natural gas and ensure that the prices published by Pemex were offered on a non-discriminatory basis. However, with the repeal of this asymmetric regulation, Pemex is now not obligated to publish such prices on its website, nor to provide to the general public the rules and conditions on which the relevant formulas shall apply, which has been construed by analysts as an additional measure aimed to strengthen (and maintain) Pemex's predominant position in the natural gas market.

Other regulatory developments of particular relevance to the gas sector

40 | Describe any other recent regulatory trends and developments of particular interest to those operating in the domestic natural gas sector.

Related to the power sector, the Ministry of Energy (SENER) published in May 2020 a ruling establishing the new Policy on Reliability, Safety, Continuance and Quality of the National Electric System (the Policy). The Policy repeals and replaces a policy on reliability published by the previous federal administration in 2017, which was focused on determining parameters applicable to:

- maximum likelihood of non-supplied energy;
- value of non-supplied energy; and
- indicative values of minimum planning and efficient planning, parameters that were maintained in this new Policy.

In this new Policy, however, SENER argues that the previous policy was insufficient for what SENER believes is a proper policy on reliability related to 'dispatch security'; therefore, additional (overreaching) considerations and principles were included in the Policy.

The main purpose of the Policy is, in SENER's words, to establish guidelines that shall be followed by the competent authorities (namely, the CRE and CENACE, Mexico's power dispatch and control centre) to comply with the reliability principle established in the Electricity Industry Law (LIE), by contributing to a rational and complete planning and operation of the National Electric System (NES).

In addition to the CRE, CENACE and CFE, the Policy requires all state and municipal governments, autonomous constitutional bodies, all administrative units and offices of SENER, and all research institutions to abide by the principles set forth therein 'in order to guarantee the reliable supply of electricity'.

Notwithstanding its alleged formal purpose, the Policy is actually focused on establishing limitations on the development, commissioning and operation of upcoming and existing renewable energy generation facilities, particularly wind and solar; technologies where private investment is predominant. Moreover, the Policy also includes a series of guidelines that may eventually affect all sorts of private generation facilities, not only those based on renewable energies.

In a nutshell, the Policy determines and establishes the following:

- modifications to the current dispatch criteria, by giving priority to the 'security of dispatch' over the economic efficiency criteria provided in the implementing regulations of the LIE, while also including the possibility of curtailing dispatch instructions for wind and solar power facilities;
- new 'ancillary services' to cover the behaviour of wind and solar renewable generation facilities, establishing obligations for the latter to reimburse other generators (ie, CFE) for the provision of those new ancillary services;
- new requirements and restrictions to interconnect renewable energy generation facilities, essentially suspending all ongoing interconnection applications for solar and wind projects until further notice by SENER, and allowing CENACE to reject future interconnection applications on the grounds of congestion or reliability risks;
- new planning and control guidelines for the NES, instructing CENACE to submit before SENER any activity or planning proposal related to the NES, as well as amending existing interconnection criteria and procedures;
- new requirements to grant generation permits by the CRE, including the requirement to obtain an interconnection feasibility report from CENACE as part of the permitting application process;
- new criteria to assess the feasibility of interconnection of new generation facilities, including limitations to wind and solar renewable generation facilities, and backup capacity margins with conventional power plants (basically fossil-fuel-fired facilities);
- new priority criteria to interconnect the power plants designated by SENER as strategic facilities;
- new rules on the sufficiency of the NES, establishing parameters for operating reserves (primary, secondary and tertiary), requiring all existing and new generation facilities to participate in primary reserves; as well as criteria for planning reserves, including requirements on the variability of wind and solar renewable generation facilities; and
- a new concept called Reliable Distributed Generation, whereby certain additional technical requirements are introduced for distributed generation systems intended to be interconnected to the distribution grids, such as smart investors with the capability to regulate frequency and voltage.

While the Policy attempts to justify the legal grounds of CENACE's ruling (which had many legal deficiencies), there are multiple legal considerations to question its constitutionality and legality, which affected parties have used to seek local remedies before federal courts (eg, the Mexican Supreme Court has granted an indefinite injunction to the effects of the Policy, subject to review on the constitutionality grounds of such a ruling). Affected companies are also considering bringing a claim before investment arbitration panels (to the extent foreign investment is involved with respect to a country with which Mexico has a bilateral investment treaty in place).

On 26 December 2020, SENER and the Ministry of Economy published in the Federal Register an Order establishing which import and export goods are subject to regulation by SENER (the Order). The Order supersedes the previous regulation related to the application and granting of prior import and export permits of hydrocarbons, refined products and petrochemicals, as provided originally since 2014. In addition to regulating other materials and goods, such as nuclear and radioactive material, the Order:

- amends the terms and conditions to apply for a prior import or export permit;
- establishes a new process to be followed by SENER in order to review, approve and reject prior permit applications;

- repeals and supersedes the long-term prior permit modality;
- amends the lists of goods that will be subject to a prior permit, in respect to the refined products sector; and
- clarifies matters related to the revocation, expiration and termination of permits.

Natural gas import activities are still not subject to the obtainment of a prior permit by SENER; however, to the extent that a specific project entails the export of natural gas, a prior export permit is required and the terms and conditions under the Order shall apply.

Coronavirus

41 What emergency legislation, relief programmes and other initiatives specific to your practice area has your state implemented to address the pandemic? Have any existing government programmes, laws or regulations been amended to address these concerns? What best practices are advisable for clients?

Generally speaking, the federal government has not implemented any programme or similar instrument to address or mitigate the adverse effects of the covid-19 pandemic on the energy sector.

Upon the commencement of the pandemic, the totality of the federal government (including the regulators) declared the legal existence of a force majeure and, hence, suspended all administrative activities. The foregoing impacted, among others, the issuance of permits under the purview of the CRE and SENER.

Although the majority of the federal government resumed activities during Q3 2020, SENER has inexplicably maintained an indefinite suspension alleging the continued existence of the covid-19 pandemic. The foregoing has brought a major impact in the import/export activities of hydrocarbons, given that private entities require the issuance of prior permits to undertake these activities for certain commodities (primarily, in the import of gasoline and diesel). The natural gas sector has not yet been materially affected by these circumstances (because natural gas imports do not require a permit from SENER), but in projects involving natural gas exports, a permit from SENER is required and those few projects may indeed be affected.

In short, investors (and especially new participants) should be mindful that the standard periods to obtain approval of a relevant permit or authorisation are currently increasing, which should be considered in the planning and execution of the relevant projects and transactions in this sector.

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