

# **Regulating Public Utilities in the energy sector: Business as usual or a Game changer for Mexico in 2016?**

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# The ultimate purpose of regulation, hurdles and key aspects SENER SECRETARÍA DE ENERGÍA

## ❖ To align private behavior with the public interests.

➤ But of course, this is easier said than done:

- We must determine and state what the public interests are and how they change over time.
- By definition private behavior responds to a particular set of goals that frequently collide with other competitors as well as with public interests in a multi billion dollar industry.
- They have a powerful set of tools at hand in order to convince and some times even to capture the regulator in order to prevail (not to say corrupt).

➤ So in order to prevail in such a difficult situation regulators must:

- Have a clear **purpose**.
- Act **decisively** using the wide legal framework.
- Work for and safeguard the regulators' **independence**.
- Be **proficient** on the regulated industries. Since regulators can not know everything, they must rely on specialists who do.

# Regulation really is a funny thing =)

- ❖ The regulation of public utilities has a direct influence on the investment and on the best use of billions of the dollars needed to provide basic services on which every economy of the 21<sup>st</sup> century relays on (electricity, gas, oil, telecom and water).
- ❖ **But no school teaches you what regulation is and how to become a true professional in the field.**
- ❖ An ever increasing number of professions require certification (from doctors and lawyers to cab drivers and chiropractors). **But regulators don't.**
- ❖ Day to day utility regulation is done by a wide array of professionals, from lawyers and finance to economists, engineers and administrators.
- ❖ So... Nobody shows you how to be a regulator. We must learn from all the disciplines that complement each other in this very complex task.
- ❖ Regulating is not a science or a discipline, **its an art not fully appreciated by all.**

# Regulation, not for one but for everyone

## Is regulating a Sum Zero Game?

Regulators are not here to balance private interests, but rather to achieve economic efficacy, in a context of accountability.

### Effective regulators must be:

- ✓ **Independent**
- ✓ Transparent
- ✓ Purposeful
- ✓ Educated
- ✓ Decisive
- ✓ Disciplined
- ✓ Synthesizers
- ✓ Creative
- ✓ Practical
- ✓ Respectful



### Main threats:

1. Short term political interests.
2. Strong private interests.

In order to avoid them, regulators must have:

- a) Legal, budget and technical independence.
- b) Collegial governing body whose members are designated by the legislative with overlapping terms.

And yes, most of all:  
**Ethical**

### Transparency:

Mexico is following best international practices by joining EITI, and of course from places such as Alberta, the North Sea, Gulf of Mexico, Colombia and Brazil

# Regulating energy utilities in Mexico: Is it now the mother of all battles? Just wait and see...

- ❖ The comprehensive Energy Reform (from the Constitution to bylaws and rules) completely changed the name of the game.

- State owned monopolies (and thus, self regulation).
- National Energy Companies Regulators.



- Open markets that require independent, transparent and objective regulation for the entire value chain.
- Industry Regulators.

- ❖ Beginning last year the energy regulatory landscape has been changing dramatically and will continue to do so in the upcoming months:
  - From 1993 Mexico has gained wide experience regulating natural gas transportation and storage, as well as specific electricity aspects. Since 2009 CNH has established several performance standards for the exploration and production activities of Pemex (reservoirs, flaring and deep water regulation).
  - **But... The energy sector was a legal monopoly**, there were no wholesale markets, and operating security along with environmental protection were mostly auto-regulated by the State Companies.
  - So with the 2013-2014 Energy Reform, regulators now need to **develop independent capabilities** in this very important issues, **and it has to be fast**.

# Mexico's Regulatory Landscape in 2015. To infinity and beyond

## Mexico is not alone nor starting from scratch

- ❖ CRE (1993) and CNH (2009) have been evolving steadily since.
- ❖ This is a huge difference from what other countries had to do when they opened their energy sector. For instance Brazil and Colombia had to start from zero on technical and economic regulation, and although they now have outstanding regulators, it was an uphill job.
  - ❖ Round Zero took two years – in Mexico 9 months after the Reform.
  - ❖ Round One, two to three years – in Mexico 12 months.
- ❖ **But we are still a long way from true proficiency in all the new issues we must regulate as a result of the Energy Reform which we are enacting.**
- ❖ **And fortunately there is a wide body of knowledge and experience, and so “*We can use a little help from our friends.*”**

# The regulatory road ahead in Mexico: When the going gets tough, the tough...

- ❖ Regulators in Mexico have new Constitutional tools:
  - Experienced professionals in every field.
  - Legal standing.
  - Budget autonomy (new income sources and trusts).
  - Technical autonomy.
  
- ❖ Newly opened markets that must be regulated:
  - Design and follow-up of exploration and extraction contracts.
  - Operating safety and environmental protection (new Agency).
  - Crude transportation and storage.
  - Gasoline and diesel transportation, storage, distribution and final sales.
  - LPG transportation and distribution permits.
  - Wholesale electricity market.

**Regulators need to become fully engaged**

# Regulatory Operations and Strategic Planning: Are both possible within one single Commission?

- ❖ Well... YES, they are two distinct and complementary tasks of any leading regulator.
- ❖ Day to day operations regarding the issuing of permits, assessing petitions, in situ inspections, public hearings, rate calculations and technical opinions are the day to day business of a regulator.
  - If we only concentrate on operations, we are missing out on the long term, and thus, on the obligation to lead the way in the industry.
- ❖ Strategic thinking, and planning are as important as the former:
  - Vertical separation. How much is too much?
  - Rolled in tariffs (gas), Build in (electricity), RIIO\*. Are they the best options?
  - Independent System Operators, what is the best model for Mexico?
  - How should wholesale markets work?
  - Open access and the obligation to make public all special conditions.
  - Capacity reserves. How to allocate initial property rights?
  - Open seasons. For all kinds of infrastructure?
  - Public policy on strategic storage. How much is really needed?



1. Its the Geology... S
2. Its not all on Industry (Risk Distribution)
3. We can't bid on what we can't see (Data Quality)
4. Current prices are only relevant for budgeting (not for long term)

# Bidding process and contractual design

## 1. Contract design

### Selection of contractual areas



With technical support of:



Comisión Nacional de Hidrocarburos

### Contracts and Bidding Guidelines Technical Elements



### Economic and fiscal terms



## 2. Bidding process

### Geological Information



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### Bidding and award process



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### Contract signature



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with



## 3. Operation

### Technical approval of exploration and development plans



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### Authorization of surface exploration (seismic) and well-drilling



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### Contract technical oversight and management



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### Environmental and industrial safety regulation and oversight



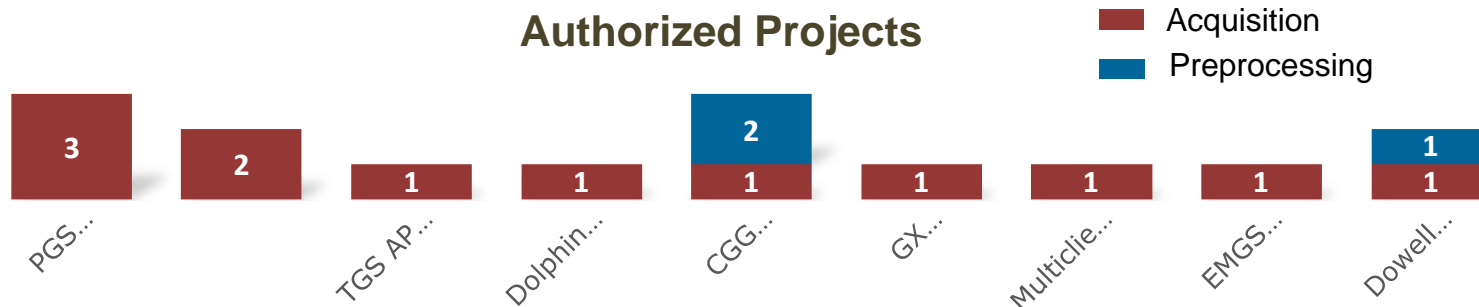
## 4. Oil income management

The Mexican Petroleum Fund for Stabilization and Development manages payments related to the contracts and the State's oil derived revenues.

# Some numbers on upstream regulation

| ARES Census                             |    |
|---|----|
| Companies with registration application | 33 |
| Registered Companies                    | 25 |
| Companies within the process            | 6  |
| Discarded Companies                     | 1  |
| Companies that have desisted            | 1  |

| Update Requests                     |    |
|-------------------------------------|----|
| Requests                            | 25 |
| -Projects for data acquisition      | 17 |
| -Information Reprocessing projects  | 8  |
| Authorized Acquisition Projects     | 12 |
| Reprocessing Authorization Projects | 3  |



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- Investment in 3D WAZ seismic is estimated to amount to approximately 1.4 billion USD

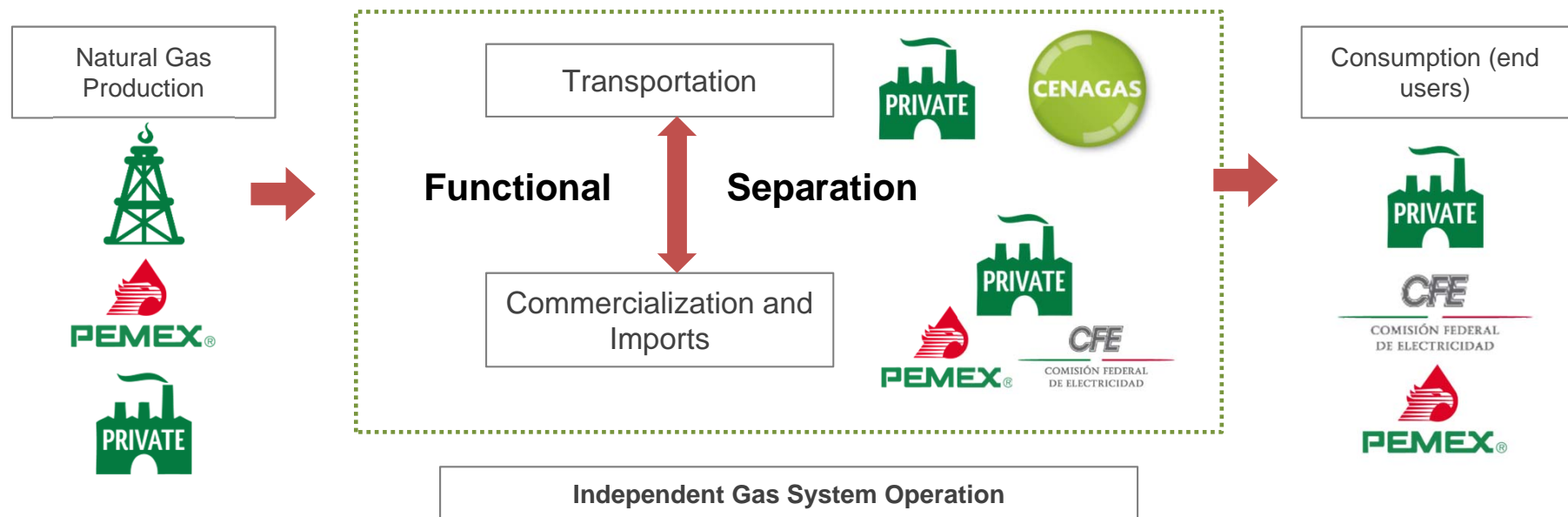
## And on the downstream...

### These are the numbers ladies and gents

| ACTIVITY   | OIL      | PETROLEUM     | PETROCHEMICALS | BIO-FUELS |
|--|----------|---------------|----------------|-----------|
| Pipeline Transportation                            | 8        | 10            | 2              |           |
| Transportation by other means other than pipelines |          | 1,505         |                |           |
| Tanker Transport                                   |          | 16            |                |           |
| Pipeline Distribution                              |          |               |                | 1         |
| Distribution by other means other than pipelines   |          | 218           |                |           |
| Storage  |          | 92            | 2              |           |
| Airfield Storage                                   |          | 60            |                |           |
| Storage (for consumption)                          |          | 296           |                |           |
| Retail in Service Stations                         |          | 10,855        |                | 45        |
| Retail in Airfields                                |          | 60            |                |           |
| Integrated System Management                       |          | nd            |                |           |
| <b>TOTAL</b>                                       | <b>8</b> | <b>13,112</b> | <b>4</b>       | <b>46</b> |

Up to date, CRE has issued 900 permits for service stations out a total of 13,122, that is, only 8%. On Jan 1<sup>st</sup> 2016 those without the permit will not receive gasoline nor diesel from Pemex

# The Natural Gas Market is **FINNALLY** becoming a true market SENER SECRETARÍA DE ENERGÍA



## Objectives

- Enhanced energy security.
- Promote Infrastructure development.
- Open access to producers and high end consumers.
- Competitive gas pricing.

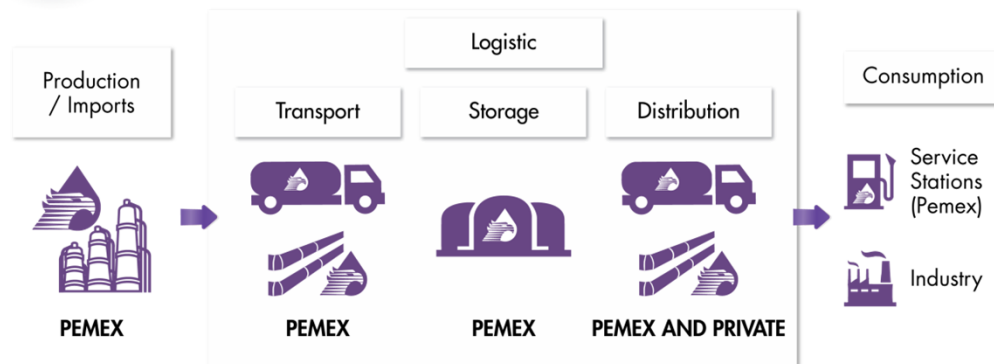
## CENAGAS

## New Rules

- Pemex's infrastructure will go to CENAGAS, and it will tender strategic projects through open and transparent bidding processes.
- Centralized planning, authorized by SENER in consultation with the Energy Regulatory Commission (CRE).
- Controls in order to prevent monopolistic behavior in gas transportation.

# The same thing is happening (more gradually) on refined products

BEFORE



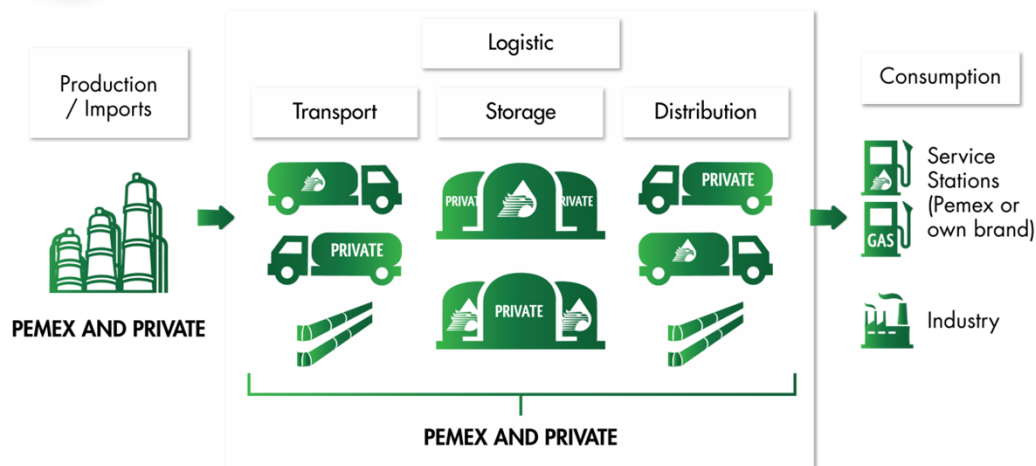
Energy Ministry

**SENER** designs and implements public policy aimed at ensuring an **adequate supply** of oil products.

Issues permits for:

- Oil refining
- Natural gas treatment
- Oil products imports/exports

AFTER



Energy Regulatory Commission

**CRE** issues regulation to **avoid discrimination, ensure fair and open access to infrastructure and fair pricing.**

Issues permits for:

- Sales, transportation, storage, distribution and retail of hydrocarbons and its products.

Establishes:

- Fees for regulated activities.
- Criteria for infrastructure to qualify as self use.
- End use retail activities' regulations if effective competitive markets don't exist, when determined as such by the Federal Commission for Economic Competition (COFEC).

SENER

(Permits)

CRE

(Permits)

Agency

(Operating safety)

# And YES, it is also taking place in the Electricity Market

