

ENERGY OUTLOOK: MEXICO'S AMLO MAKES AN ABRUPT INVITATION

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In less than four months, Mexico's new administration has sent a clear message to energy investors by signaling cancellations and renegotiation of contracts. Can the resulting dialogue prevent the Mexican market moving backwards, asks Jonathan Carmody

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Since President Andrés Manuel López Obrador (AMLO) took power on 1 December 2018, the government has announced it intends to review and potentially renegotiate existing pipeline concessions, prohibit the future tender of energy and power transmission assets as PPPs and has cancelled the country's fourth renewable capacity tender and plans for all future auctions.

"What we have is a very abrupt invitation to discuss key contractual terms," says Alexandro Padrés, a partner at law firm Shearman & Sterling.

Statements by AMLO in recent months indicate that the administration views existing generation and gas transmission contracts as unfair and overly beneficial to the investors. A document sent from the energy ministry SENER confirms that the ministry does not intend to tender any more energy or power transmission contracts as PPPs.

In the six-year term of President Enrique Peña Nieto (2012-2018), the government advanced an energy reform that permitted private investment in a sector that had previously been a state-owned monopoly.

Peña Nieto's government tendered 25-year contracts to design, build, finance, operate and maintain gas pipelines and also ran three tenders to award clean

energy certificates and PPA contracts, backed by the Federal Electricity Commission (CFE), to renewable energy projects.

Companies such as Fermaca, IEnova, TransCanada and First Reserve were among the companies that won the pipeline contracts.

International companies like [Canadian Solar](#), Enel, [ENGIE](#), [Neoen](#) and X-Elio all won 20-year PPA contracts in the most recent Mexican renewable energy auction of November 2017, which awarded contracts to projects accounting for 2.7GW of capacity.

The government held the first auction in April 2016, awarding projects worth USD 2.6bn in investments, and the second auction of September 2016 awarded 2.87GW of capacity worth USD 4bn in investments.

A Mexico-based lawyer, who preferred to remain anonymous due to his involvement in Mexico's power sector, says that the government is in a position to review contracts, but to his knowledge pipeline and generation contractors have so far followed all rules established under the terms of the PPP tenders and auctions.

"After a detailed analysis (we have carried out), there has been no breach of contract found on the part of the developers," he says. "The administration doesn't like the contracts that were awarded but cancelling projects would be very authoritarian."

A critical eye

Investors must now convey to the government how contracts were structured, their legal basis and why they succeeded in winning those contracts. "These contracts represent common international practices for exclusive government offtake contracts," says Padrés. "We're not seeing enough people looking at the facts with a critical eye and there needs to be better dialogue about the terms, the manner in which they operate and the risk allocation of these contracts against the backdrop of the country's risk profile and the availability in the market for replacement offtakers."

One of the proposed transmission line PPP projects that the AMLO government has cancelled is necessary to transfer electricity generated by new renewable energy projects in Oaxaca. According to the Mexican lawyer, the new

administration no longer sees it as a priority. “There will be less of a focus on renewable projects and more on the development of power plants using coal and gas technologies,” he says, pointing to the recently announced [intention to tender two coal-fired power plants](#).

Investors are now questioning whether the transactions they’ve entered into will have permanence.

“The government wants to discuss the terms of contracts tendered under previous administrations, including take or pay and force majeure provisions and, while this is not foreign to project finance, initiating a conversation in the manner of the AMLO administration leads to queries over the government’s intentions,” says Padrés. “Whether the intention is to restructure or renegotiate, the actions will inevitably have adverse impacts on the existing investments and the valuation thereof.”

Yet for others, there may be opportunity in the current situation.

“In ongoing acquisition and divestiture processes there are PPAs and assets tied to auctions with a low-price for power and CELs, and power plants developed independently for private qualified offtakers or spot market sales,” says Padrés. “For the auction PPAs, some developers are seeking to sell and/or bring in a co-investor, but they will likely face difficulties in attracting buyers without greater clarity. For the second group, we are seeing business as usual, as qualified offtakers are increasingly seeking long-term stability in power pricing and continuity of service,” he said.

More merchant risk projects are now expected as the cancellation of the fourth renewables auction could offer private equity investors opportunities in acquiring generating assets to sell energy on the spot market, especially when considering recent brownouts in parts of the country.

Moving Mexico backwards

The Mexico City-based lawyer doesn’t envisage a full withdrawal of all investors but says: “Instead of moving forwards, Mexico is moving backwards.”

“The CFE could consider entering into alliances with private companies as it did before the energy reform with the government agency as owner and a turnkey EPC contract, what we refer to as ‘financed public-works contracts’,” he says.

Fuel and hydrocarbon storage projects could remain a viable investment opportunity as problems remain with the amount of storage capacity in the country, which is as low as three days currently. “There was a fire recently at a Houston Refinery from which Mexico imports a lot of fuel and this kind of event could cause stress on the system,” he says.

Until investors and government focus on the underlying principals behind these power contracts, it will be difficult to unpick the true extent of AMLO’s impact on Mexico’s power sector.

Both lawyers confirm that the government is expected to publish a National Development Plan in 2Q19, which will provide more detail and a formal written strategy on its intentions and potential investment opportunities. More change could be on the way.

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