February 7, 2022

Mexico's CRE amends previous ruling that limited CFE's ability to book natural gas capacity for commercialization activities

On February 4, 2022, Mexico's Energy Regulatory Commission (*Comisión Reguladora de Energía*) ("**CRE**") held an Ordinary Meeting of its Governing Body. Included in the order of business of the aforesaid Meeting was the *Ruling of the Energy Regulatory Commission amending Ruling number RES/968/2016, establishing the use of pipeline transportation capacity in the Natural Gas National Integrated Storage and Transportation System, by Comisión Federal de Electricidad as State productive enterprise for electricity generation operations* (the "**Ruling**").[1]

The full content of the Ruling in Spanish may be reviewed here.

I. Regulatory context: what does Ruling number RES/968/2016 say?

I.1 CENAGAS and SISTRANGAS.

The Hydrocarbons Law (*Ley de Hidrocarburos*) created the Natural Gas National Integrated Storage and Transportation System (*Sistema de Transporte y Almacenamiento Nacional Integrado de Gas Natural*) commonly referred to as "**SISTRANGAS**", thereby grating CRE the authority to approve the natural gas infrastructure that may become part of SISTRANGAS.

At the core of the SISTRANGAS is the national pipeline system (*sistema nacional de gasoductos*) previously owned by Petróleos Mexicanos ("**Pemex**") and that was transferred to the National Centre of Natural Gas Control (*Centro Nacional de Control de*

[1] *Resolución de la Comisión Reguladora de Energía por la que se modifica la Resolución número RES/968/2016, que establece el uso de la capacidad de transporte por ducto en el Sistema de Transporte y Almacenamiento Nacional Integrado de Gas Natural, por la Comisión Federal de Electricidad como empresa productiva del Estado para las operaciones de generación de energía eléctrica.*

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Gas Natural) ("**CENAGAS**")[2] by operation of law as part of the implementation of the 2013 Energy Reform.

Pursuant to the fifth paragraph of the Twelfth Transitory Provision of the Hydrocarbons Law, both the transfer of natural gas assets/infrastructure as well as existing capacity reserve contracts/agreements in favor of the CENAGAS would be subject to Pemex and Comisión Federal de Electricidad ("**CFE**") being able to reserve and/or maintain the capacity reserve contracts that were required for their operations of electricity generation and industrial transformation of hydrocarbons, as the case may be. This provision currently establishes:

> "*(…)*
>
> *The legal acts that are necessary for the National Center of Natural Gas Control to administer and manage the capacity of the contracts indicated in this transitory provision, shall be carried out without prejudice to the State productive enterprises, its subsidiary entities and the companies where the former hold a direct or indirect participation reserve and/or maintain the capacity reserve contacts that they require for their electricity generation and hydrocarbons' industrial transformation operations, as the case may be.*
>
> *(…).*" [Translation is ours.]

I.2 Ruling number RES/968/2016 being amended.

Ruling number RES/968/2016 titled *Ruling of the Energy Regulatory Commission that determines the pipeline transportation capacity that State productive enterprises, its subsidiary entities y and the companies where the former hold a direct or indirect participation may reserve in the Natural Gas National Integrated Storage and Transportation System for its operations of electricity generation and industrial transformation of hydrocarbons, as the case may be, pursuant to the provisions of the Twelfth Transitory Provision of the Hydrocarbons Law*,[3] was issued by the

[2] CENAGAS is a public instrumentality under the control of the Ministry of Energy (*Secretaría de Energía*) and is responsible for, among others, oversight, management and operation of the SISTRANGAS.

[3] *Resolución de la Comisión Reguladora de Energía que determina la capacidad de transporte por ducto que las Empresas Productivas del Estado, sus Organismos Subsidiarios y la Empresas en las que los primeros cuenten con participación directa o indirecta pueden reservar en el Sistema de Transporte y Almacenamiento Nacional Integrado de Gas Natural para sus Operaciones de Generación Eléctrica y Transformación Industrial de Hidrocarburos, según sea el caso, de conformidad con lo establecido en el Artículo Transitorio Décimo Segundo de la Ley de Hidrocarburos.*

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Governing Body of the CRE on September 21, 2016 ("**968 Ruling**"). This is the previous CRE ruling being amended by the Ruling in question.

In essence, the 968 Ruling establishes:

(i) An interpretation by the CRE of the intent of the legislator when enacting the Twelfth Transitory Provision of the Hydrocarbons Law, including: (**a**) optimizing the use of SISTRANGAS' infrastructure; (**b**) acknowledging in favor of Pemex and CFE the right to reserve the capacity they require for their respective operations; (**c**) allow Pemex and CFE to reserve excess capacity (*i.e.*, for purposes different to the industrial transformation of hydrocarbons and power generation) on equal terms than any other user of SISTRANGAS; (**d**) guarantying open access to those seeking to book capacity in the SISTRANGAS; and (**e**) avoid creating advantageous conditions to Pemex and CFE that prevent the efficient and competitive development of the natural gas market, to the prejudice of the rest of the economic agents;

(ii) What should be understood by hydrocarbons' industrial transformation and power generation;

(iii) The criteria to be followed by CENAGAS when making available to the CFE and Pemex the capacity subject to reservation during the so-called "*EPE Round*";[4] and

(iv) That the capacity reservation destined for hydrocarbons' industrial transformation and power generation could neither be used under any circumstance to natural gas commercialization activities, nor for other activities.

II. The Ruling.

According to the Ruling, on January 10, 2022, CENAGAS requested the CRE to confirm whether CENAGAS, in its capacity as Independent Operator (*Gestor Independiente*) of the SISTRANGAS, is allowed to enter into amendment agreements in order to incorporate

[4] The "*EPE Round*" refers to the first round of capacity allocation to Pemex and CFE as provided in the public policy for natural gas published by the Ministry of Energy. "*EPE*" is the acronym in Spanish for State productive enterprises (*empresas productivas del Estado*).

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additional points to those indicated in the firm base transportation agreements executed with Pemex and CFE as a result of the "*EPE Round*".

A few days after, the CFE, through its affiliate *CFEnergía, S.A. de C.V.* informed the CRE that it confirmed that the unused (idle) capacity in the SISTRANGAS could be used for natural gas commercialization activities and such activity did not "*(…) put the capacity necessary for essential electricity generation activities of the CFE at risk*".

According to the CFE, it holds a firm-base transportation service contract with CENAGAS for a "*Maximum Daily Quantity of 1,881,172.21 GJ/day*" out of which, as of October 2021, it has used an average of 633,572.41 GJ/day that is equivalent to 33.68% of the reserved capacity. CFE admits that the development of its own network of natural gas pipelines has led to the substitution of the source of supply of natural gas of 12 power centrals; thus, the capacity originally booked by CFE and *CFEnergia, S.A. de C.V.* in the SISTRANGAS is no longer used to supply such power centrals.

The CFE uses the aforesaid underuse of its reserved capacity to argue that such idle capacity could directly contribute to the federal administration's policy to "*Rescue the energy sector*" and the principle that the "*market does not substitute the State*".

The CRE considered the following arguments presented by CENAGAS and CFE to issue the Ruling: (**a**) CFE's underuse of about 66% of its reserved capacity (ensuing from the "*EPE Round*") in the SISTRANGAS; (**b**) the favorable opinion issued by the Ministry of Energy through official communication 500.SSH.013/22 (which content is summarized by the CRE in the Ruling); and (**c**) CFE's confirmation (without much evidence other than multiple statements to that effect) that the use of said unused capacity for commercialization purposes will not endanger (put at risk) the capacity necessary for the essential activity of electricity generation by the CFE.

Considering the above, the CRE moved to rule as follows:

1. The CRE amends the 968 Ruling with respect to the nature of reserved capacity by CFE so that any unused reserved capacity in the SISTRANGAS is "*used by such State Productive Enterprise, its Subsidiary Productive Enterprises or affiliates **for natural gas commercialization purposes**, provided the essential electricity generation operation is not affected.*" [Translation and emphasis are ours.]

2. The CRE authorizes CENAGAS to carry out the amendments to the transportation services agreements executed under the 968 Ruling so that CFE

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may use such idle capacity for natural gas commercialization activities, thereby granting CENAGAS a ten (10) business day period to submit the amendment agreements following their execution;

3. CFE, its subsidiaries and affiliates that commercialize the relevant idle capacity are ordered by the CRE to prioritize and guarantee at all times electricity generation operations; and

4. CENAGAS is ordered to submit before the CRE on a semester basis, the monthly breakdown of the firm-base capacity that is being destined in secondary points for commercialization purposes, as well as informing the CRE which primary points are being used for electricity generation purposes.

It should be noted that despite the fact that the Ruling amends the 968 Ruling it neither affects nor covers Pemex and its subsidiaries and affiliates. Therefore, as of this date, Pemex does not have the right to use any idle capacity in the SISTRANGAS (originally destined for oil and gas industrial transformation activities) for commercialization activities. Based on the legal and regulatory arguments used by the CRE in the Ruling, however, if at any point Pemex has any idle capacity in the SISTRANGAS, it may apply for and obtain the same exception granted to CFE.

The Ruling does not require publication in the Federal Register (*Diario Oficial de la Federación*). Thus, upon its notice to CENAGAS, the same becomes (or will become) effective.

Given that the Ruling does not have a general application nature and thus it is not published in the Federal Register, it is not entirely clear whether parties different to Pemex and CFE may challenge its content. However, given its potential effect in the natural gas market, holders of natural gas commercialization permits (and other participants in such market) are likely to hold legal standing in any potential claim to challenge the validity of the Ruling on grounds of economic competition and hierarchy of law (*i.e.*, a Ruling by the CRE cannot amend a federal statute).

In our opinion, the Twelfth Transitory Provision of the Hydrocarbon Law is clear that the capacity reservation by Pemex and CFE in their capacity as State productive enterprises may only be destined for power generation and oil and gas industrial transformation activities, as the case may be.

While it is true that it was the CRE that included an express limitation on commercialization activities through the 968 Ruling (*i.e.*, such limitation is not expressly

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included in the fifth paragraph of the aforesaid Transitory Provision of the Hydrocarbons Law), it will be up to the relevant courts, if the Ruling ends up being challenged, to determine whether CRE's interpretation of other legal and regulatory provisions (*e.g.*, the National Development Plan) is sufficient to grant this exception to the CFE.

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If you have any questions or comments on the matter, please contact us.

This document does not constitute legal advice.

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