

## MIDSTREAM REFORM

### *No plans to privatize midstream assets*

The design of midstream reforms in the electricity, natural gas, and oil liquids sectors may make needed changes to the sector difficult. Midstream assets, along with all other existing state assets, were deemed off limits for privatization as such a move was seen as posing a serious obstacle to overall energy reform. However, under state control, the midstream has faced chronic underinvestment. A political call was made regarding privatization and the sale of assets was deemed to pose serious obstacles to overall energy reform. Other additional decisions regarding the structuring of the midstream might also prove to be problematic. In the case of electricity, the existing transmission and distribution grids will continue to be owned by the CFE, the dominant player in power generation, or other wholly owned state-owned affiliates.

A new independent system operator (ISO) will be established.<sup>1</sup> It will be a decentralized state entity that will have operational control of the electricity system, dispatch electricity on a merit order, operate the wholesale electricity market, and guarantee open access to transmission and distribution grids. Private parties in the electricity industry will form an evaluation committee that will periodically review the performance of the ISO and the wholesale market, and publish a report. The CFE and its affiliates, the Department of Energy, or the ISO may contract third parties to upgrade and expand these grids through some form of build, lease, and transfer mechanism. However, it is the state that is responsible for the operation and growth of the transmission and distribution grids.

The Pemex natural gas transport pipelines, as well as its supply contracts, will be transferred to a state-owned ISO.<sup>2</sup> Privately held pipelines may be voluntarily integrated into the grid. Even if they only serve large consumers, they would be subject to open access discipline. In this way, expansions of the grid can be carried out privately. With respect to the transport and distribution of crude oil and oil products by pipeline, the law currently provides little guidance, stating only that permits for these activities will be required and that the Energy Regulatory Commission (CRE) will grant them. This implicitly leaves these grids under the control of the incumbent and to private road transport companies. This may be a sign that the state is having difficulties dealing with natural monopolies, and more generally

---

<sup>1</sup> Centro Nacional de Control de Energía (CENACE).

<sup>2</sup> Centro Nacional de Control de Gas Natural.

with network industries. In the energy sector, where the incumbent has a predominant position, potential problems can have significant effects on private investment decisions.

### *Ongoing challenges for the midstream*

The midstream, both in electricity and in oil, has suffered from secular underinvestment. Agglomeration in key electricity nodes and corridors has been frequent and important. Transport constraints due to pipeline bottlenecks have provoked a natural gas supply crisis. Inadequate transport and storage capacity has increased the risk of supply interruptions in oil products, while raising the volume transported by trucks and tank cars. Collusion in setting tariffs by the large road transport companies has been the norm. Crude transport and storage shortages affect the quality of crudes and do not allow the flow of segregated batches. Will Pemex, CFE, their affiliates, and the new state ISOs be able to solve these problems effectively? Is the responsibility for capacity expansion clearly defined? Can the private sector be given a more active role in these matters? These are important questions that must be addressed given the history of both state companies underinvesting in the midstream.

Changes in the geographical origin and destination of energy products require more extensive and denser electricity and pipeline grids, as well as storage capacity. Demographic trends, industrial growth, a greater reliance on imports, and the creation of new markets drive the need for expansion. A large natural gas pipeline construction program is being executed. A similar effort must be launched in liquids pipelines and storage capacity, and in electricity transmission and distribution networks. These are critical decisions that will affect the liberalization of the final product markets.