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Mexican Energy Reform a Slow Burn for Permian Firms

Roadblocks facing the massive Sur de Texas pipeline encapsulate where US-Mexico gas trade stands and is likely heading. And it's not good news for West Texas producers who desperately need another outlet for their gas.

Yet if a message that crystallized at last week's US-Mexico Gas Forum in San Antonio is any indication, energy policy reform south of the border is still moving forward, albeit glacially.

Optimism that Mexico would soon be a gold mine for Permian Basin gas consumption has waned since the first annual LDC Forums-sponsored conference in 2017, when the prospect of the leftist Morena party coming to power was seen as a speed bump to market reform (NGW Aug.21'17).

By the November 2018 conference, new President Andres Manuel Lopez Obrador was already beginning to wield power, dampening prospects that the cross-border gas trade facilitated by the prior administration would continue (NGW Nov.19'18).

Since taking the reins more than a year ago, Lopez Obrador has indeed turned away from the path of energy reform and turned back to policies of the 1970s and '80s that prioritize Mexico's national energy companies Pemex and CFEnergia, speakers said last week.

That was the political era that molded Lopez Obrador and key to why he is so opposed to opening up the gas market to the US and other suppliers, Tony Payan with Rice University's Baker Institute said in a panel discussion. "He's not going to reverse [energy reform], but he's going to reverse it in practice, because this is a guy who thinks 1970 and not 2020," Payan said.

Yet at some point -- perhaps 18 months to two years from now -- the administration will have to capitulate, Payan told Energy Intelligence. And that is when struggling US gas suppliers may begin to see their patience pay off.

"I simply think that if they insist on producing the gas in Mexico and reducing the imports of gas from Texas, they are going to be able to do it, but not as much as they want and they are going to do it much more expensively," Payan said. "This is going to translate into higher costs for the end consumer, higher prices for electricity and higher costs for manufacturing. Or they are going to subsidize electricity, distorting the market and distorting the federal budget.

"These are market forces they are simply not going to able to avoid," he added. "They are going to very quickly run into those obstacles and they are going ... to have to let the gas flow again."

While Lopez Obrador has already made moves to rein in reform by canceling bid rounds and the like, he has not canceled more than 100 energy sector contracts with US entities and is expected to honor most of them.

Analyst Eduardo Prud'homme said on the sidelines of the conference there are limits to how far the president can go in turning back the clock. Foremost, the reforms are "sealed" within the US-Mexico-Canada Agreement that is to replace the North American Free Trade Agreement and which Lopez Obrador is keen to see ratified.

And BP Energy CEO Orlando Alvarez said in his keynote address that "the Mexico gas market has progressed. And things are getting better."

For instance, Alvarez praised the implementation of a much more predictable gas import permitting process, but stressed that there are areas where change is still needed to create a robust gas system in the country.

Sur de Texas 'Work Around'

Political change over the past two years is key to understanding why TC Energy's 2.6 billion cubic foot per day undersea pipeline began operations in late June, yet it is still delivering just north of 700 million cubic feet per day at its terminus in Veracruz.

And the 500 mile marine pipeline is sure to remain well under its potential capacity for years to come for reasons that have come to epitomize Mexico's evolving energy sector under the Morena government.

Since early summer, Sur de Texas has been on the cusp of delivering as much as 1.7 Bcf/d of US-sourced gas, but the pipelines being built to flow gas to markets in Central Mexico -- TC Energy's Tuxpan-Tula and Tula-Villa de Reyes projects -- are mired in local conflicts that could take many more months to resolve.

Meanwhile, the Morena government, caught in the middle, is showing its more pragmatic side. It recently renegotiated payments on take-or-pay capacity contracts that essentially extended the financial terms for another five years, thus lowering what CFE has to pay for the capacity (NGW Sep.2'19).

However, there is another message embedded here, a source privy to the negotiations said on the conference sidelines. "What the government is saying is that we shouldn't worry about not completing pipelines as scheduled," he said. "What we need to do is work around the problem using the pipelines on the existing system as best we can."

In the case of Sur de Texas, that has meant flowing gas into TC Energy's existing Tamazunchale Pipeline, although there is a limit to how much pressure the aging Cenagas system can tolerate. Upgrades are in progress, but these ongoing constraints could keep Sur de Texas at 1.7 Bcf/d until work is completed reversing flow on the Cempoala Pipeline, which will allow gas to flow to Southern Mexico and the Yucatan. That project could be completed in late 2020 or 2021.

On a brighter note, Sur de Texas could soon begin flowing almost 200 million cubic feet per day of gas into Altamira, which will replace more expensive LNG at the Altamira import facility. A source in Mexico said project completion is imminent.

Mexico is expected to pipe in 5 Bcf/d of gas this year from the US and 5.8 Bcf/d by 2020, according to Energy Intelligence Research & Advisory data. And much more potential supply is still pent up in the Permian, where three takeaway gas pipelines -- Comanche Trail, Trans Pecos and Roadrunner pipelines -- could drain a combined 3 Bcf/d away from the glutted Waha Hub once infrastructure in Mexico is built out (NGW May13'19).

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