GONZALEZ CALVILLO

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Client Alert
Energy and Antitrust Practice Groups

Challenges in the liberalization of the downstream oil & gas industry in Mexico

Insights to the antitrust commission's report on gasoline & diesel

Background

The 2013 Constitutional Energy Reform was the cornerstone of a massive transformation to allow private (domestic and foreign) investment in all segments of the oil & gas industry, including gasoline and diesel, in Mexico, after eight decades of State monopoly held by Petróleos Mexicanos ("Pemex").

Pre-reform, Pemex produced or imported, transported, stored, marketed, distributed and delivered all fuels in Mexico. Pemex was also the sole supplier and franchisor of the more than 11,000 retail stations in the country, which were owned and operated mostly by individuals or very small enterprises, with few exceptions of larger groups of a few hundred stations. Pemex determined the size of the station, the distance among them (complying with local regulations where applicable), the quality of the products, the duration of the contract, provided a manual for the operation

of the station, including ancillary products and services to be offered, and guaranteed a margin to retailers. Additionally, both the wholesale and consumer price was set by the Ministry of Finance (Secretaría de Hacienda y Crédito Público, or "SHCP") following budgetary and political criteria and at a national level. In sum, there were no market forces at play behind the retail sales of gasoline and diesel.

The energy reform: implications in downstream

Under the reform, Pemex' supply agreement is separated from the franchise agreement and are both susceptible of early termination. Imports of gasoline and diesel were liberalized and the Energy Regulatory Commission (Comisión Reguladora de Energía, or "CRE") began granting permits. Pemex's first hand sales price (ventas de primera mano, or "VPM") was re-calculated under a new formula to better reflect costs, and discounts for volume are now a reality. A maximum national retail price within a band was set by SHCP as of 2016, also allowing for discounts to street prices, and a total liberalization of the price has been scheduled for January 1, 2018, at the latest.

Challenges ahead

This new scenario has resulted in exciting business opportunities for Mexican and foreign investors. However, many regulatory and practical challenges and questions remain for a smooth transition from a State monopoly in the supply of fuels and a highly diluted and relatively unsophisticated retail side, to an efficient market.

Examples of roadblocks to be removed include Pemex's control of virtually all of the existing –and clearly insufficient—transport and storage infrastructure in the country, including access to key ports; regulations imposing high barriers to entry; a pricing system that does not correctly signal scarcity and investment opportunities; very high levels of fuel robbery and an active black markets; trade barriers; formation of buyers' clubs, street pricing and eventual risk of high concentration of the larger existing and upcoming retailer groups, among others.

In this context, Mexico's Antitrust Regulator, the Comisión Federal de Competencia Económica, or "Cofece", has issued a report on the Transition to Competitive Markets of Gasoline and Diesel (the "Report"). The Report identifies 25 specific issues and proposes concrete recommendations to different Federal, State and municipal authorities referring to (1) pricing; (2) infrastructure and logistics; (3) quality; and (4) retail sales.

Although Cofece's recommendations are not binding, they provide valuable insights into the views of the antitrust regulator and their concerns and focus areas, providing actual and potential participants in the market and regulators alike, with useful input for better planning business models and regulations in compliance with competition principles. We expect an intense process of interaction among all actors to ensue.

Bear in mind that Cofece has ample powers for investigating anticompetitive behavior, which may result in hefty administrative and criminal penalties (including prison time for severe offenses). We strongly suggest our clients and friends to carefully design business strategies under pro-competitive guidelines and to adopt preventive to ensure compliance with statutory provisions and avoid prosecution.

If you wish to obtain a summary of the Report, kindly request it by e-mail at antitrust@gcsc.com.mx

Cofece´s Report is available in Spanish at:
https://www.cofece.mx/cofece/attachments/article/583/DOC-GASOLINAS-FINAL.pdf.

Contact

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