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Energy and Climate Report

Afternoon Briefing - Your Preview of Today's News

The following news provides a snapshot of what Bloomberg BNA is working on today. Read the full version of all the stories in the final issue, published each night.

Transportation Officials Move to Scrap Obama Climate Rule

Posted October 04, 2017, 10:59 A.M. ET

By Abby Smith

The Trump administration is working to roll back another Obama-era climate regulation—this time a provision that would require state transportation planners to account for greenhouse gas emissions.

The Federal Highway Administration is quickly moving to repeal the greenhouse gas provision, tucked into a broader Obama administration rule that sets new requirements for tracking the performance and conditions of roads. Trump officials previously suspended the measure, then reinstated it late last month after environmental groups and a coalition of eight states sued, arguing that the administration couldn't suspend without taking notice and comment.

The provision at issue would require state transportation officials to track on-road greenhouse gas emissions and set "locally appropriate" emissions targets on national highways. State officials face an Oct. 1, 2018, reporting deadline.

The Oct. 5 [notice](#) seeking the provision's repeal notes Transportation Department officials reviewed existing and pending regulations and "identified the [greenhouse gas] measure ... as being potentially duplicative of existing efforts in some States, and burdensome" (RIN: 2125-AF76).

The Federal Highway Administration will accept comments for 30 days on the provision's repeal.

Will Paris Without the U.S. Scuttle Climate Change Measures?

Posted October 04, 2017, 8:19 A.M. ET

By Chisaki Watanabe

Will the U.S.'s decision to pull out of the groundbreaking Paris climate change deal deflate efforts by governments, the private sector and investors to combat global warming?

Members of a panel at a conference hosted by Japan's Ministry of Economy, Trade and Industry Oct. 4 discussed various policy options, trends, and what each party can do:

- Hiromichi Mizuno, chief investment officer for Japan's Government Pension Investment Fund, the world's largest pension fund, said the financial sector is committed to tackling climate change even after President Donald Trump said he'll pull the U.S. out of Paris. "So far, the impact of the decision has been zero or could be positive. Since his announcement, we received significantly more inquiries from other global asset owners including U.S. public pension funds. They want to work together with us to make sure the investor community continues to work in the same direction."
- Nobuo Tanaka, former executive director of the International Energy Agency, who moderated the panel, said of Trump's support for coal power, "I don't think that is feasible because there's so-cheap natural gas."
- Anneli Pauli, an adviser on climate action to the European Commission, said that coal has no future in Europe. "I think we go from low carbon to no carbon."
- Michael Liebreich, founder of Bloomberg New Energy Finance, said that Japan's private sector has enormous strength in technology related to electric vehicles, while he also questioned the outlook for hydrogen fuel cell vehicles. "Hydrogen for vehicles, I am not optimistic at all. Thinking about hydrogen when everybody else has already chosen the correct solution is a problem," Liebreich said. "If you do electrification of vehicles, it will free up the transformation of your electrical systems so Japan has an enormous amount to offer and I am also convinced Japan will be in the front row."

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Perry's Coal Proposal Seen Unlikely to Reverse Historic Decline

Posted October 04, 2017, 8:35 A.M. ET

By [Tim Loh](#)

U.S. Energy Secretary Rick Perry's plan to reward coal-fired power plants that keep large stockpiles of fuel won't be enough to reverse the industry's long-term decline, analysts say.

Perry has proposed extra payments for power generators with at least 90 days' worth of supplies on site, arguing that will make America's electric grid more "resilient" in the face of major supply disruptions.

While the measure will probably keep some coal plants open that would otherwise be forced to retire, it doesn't address the industry's core problem: namely, that overall U.S. electricity demand has flattened while natural gas, wind and solar power are stealing market share. To that end, industry experts doubt it'll be enough to make good on President Donald Trump's repeated vows to bring back coal.

"It doesn't solve some of the largest underlying structural challenges to coal demand in this country," Lucas Pipes, an analyst at FBR Capital Markets & Co., said in a phone interview. "We're in a no-growth market."

While any measure that prevents the further erosion of coal's market share would help the industry, Perry's proposal poses some complications for power generators. For one thing, utilities haven't been in the business of hoarding coal. With the U.S. coal sector oversupplied in recent years, power plant operators have preferred, when possible, to buy the fossil fuel "on-demand" rather than maintain large stockpiles, said Andrew Cosgrove, an analyst at Bloomberg Intelligence.

Environmental Costs

That's because stockpiling coal costs money. If left untreated, coal piles can spontaneously catch fire, something that's especially problematic for high-moisture coal from Wyoming and Montana's Powder River Basin, said [Andy Blumenfeld](#), head of market analytics at Doyle Trading Consultants. There are also environmental costs associated with suppressing coal dust and handling runoff. Finally, the quality of stored coal degrades over time, Blumenfeld said.

For utilities participating in Perry's program, costs would go up as it "might require more personnel and equipment," Blumenfeld said.

In July, coal accounted for 32 percent of U.S. electricity generation, down from 47 percent a decade earlier, [according to](#) the U.S. Energy Information Administration. Gas was king, at 36 percent, up from 25 percent in [July 2007](#).

In order to qualify, most power plants would also have to go out and buy coal. As of August, power plants holding Powder River Basin coal had an average of 75 days of supplies. Those with Illinois Basin coal had 91 days and those with Northern Appalachian coal had inventories in the low 70s, according to Pipes.

As long as the coal plants aren't expected to run all out, every day, then getting those stockpiles back over 90 days should be doable, said Matt Preston, a coal analyst at Wood Mackenzie Ltd. As recently as early 2016, America's coal plants had, on average, more than that on site.

It'd be much harder, though, if the plants were expected to have enough coal to run full-blast, around-the-clock, for three months straight. That would "require a significant increase in storage area at almost all plants," Preston said. "Some would definitely have to consider offsite storage which may or may not be economically feasible."

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Storms Spur \$22 Billion Investment in Battery-Backed Grids

Posted October 04, 2017, 8:47 A.M. ET

By [Christopher Martin](#)

Growing demand for more resilient power supplies will spur \$22.3 billion of global investment in battery-backed local energy systems over the next decade, according to Navigant Research.

Villages and homes in far-flung places will drive the expansion of microgrids, small-scale solar systems with batteries that can retain power until it's needed. Navigant expects 14.9 gigawatts to be in operation in 2026, up from 238 megawatts this year, according to a [report](#) Oct. 3.

North America and the Asia-Pacific region will get about three-quarters of the investment as developers find ways to use microgrids more efficiently, including providing energy-management services to utilities. North America will have 5.85 gigawatts of microgrid storage in operation by 2026 and Asia-Pacific will have 5.57 gigawatts. Declining battery costs and new financing methods will also boost deployment in areas like coastal communities in Florida and Texas exposed to flooding and frequent storms, said researcher Alex Eller.

"The storms helped raise awareness of what's available," Eller said in an interview. "For the next

couple years, remote microgrids will make up about half of global installations.”

Puerto Rico, where the utility grid was knocked out by Hurricane Maria Sept. 20, has become a target for developers eager to showcase microgrid designs. These include solar panels, small wind turbines and backup diesel or propane generators that may be needed if a string of cloudy days reduces solar production and doesn't fully charge the batteries.

Suppliers including Tesla Inc., battery-maker Sonnen GmbH, and solar rooftop supplier Sunnova Energy Corp. have each begun shipping micro-grid equipment to Puerto Rico to help re-power the island following the storm.

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Dawn of Solar Age Declared as Sun Power Beats All Others

Posted October 04, 2017, 8:49 A.M. ET

By [Anna Hirtenstein](#)

Solar power blossomed faster than for any other fuel for the first time in 2016, the International Energy Agency said in a report suggesting the technology will dominate renewables in the years ahead.

The institution established after the first major oil crisis in 1973 said 165 gigawatts of renewables were completed last year, which was two-thirds of the net expansion in electricity supply. Solar grew by 50 percent, with almost half new plants built in China.

“What we are witnessing is the birth of a new era in solar PV,” Fatih Birol, executive director of the IEA, said in a statement accompanying the report published Oct. 4 in Paris. “We expect that solar PV capacity growth will be higher than any other renewable technology through 2022.”

This marks the sixth consecutive year that clean energy has set records for installations. Mass manufacturing and a switch by governments away from fixed payments for renewables forced down the cost of wind and solar technology.

The IEA expects about 1,000 gigawatts of renewables will be installed in the next five years, a milestone that coal only accomplished after 80 years. That quantity of electricity surpasses what's consumed in China, India and Germany combined.

The surge of photovoltaics in China is largely due to government support for renewables, which are being demanded by a population concerned about air pollution and environmental degradation that has led to deadly smogs. The country is seeking to reduce its reliance on coal and has become the world's largest market for renewables, particularly solar.

“The solar PV story is a Chinese story,” said Paolo Frankl, head of the IEA's renewable energy division. “China has been for a long time the leader in manufacturing. What's new is the share in the market. This year, it was equivalent to the total installed capacity of PV in Germany.”

The U.S. and India are among other nations pushing renewables. They along with China are projected to make up two-thirds of the clean-energy expansion worldwide. Despite President Donald Trump's vow to bolster coal's position in the power market, the U.S. is expected to be the second-

largest market for renewables.

The IEA also expects biofuels to take a larger role in the transportation industry, surpassing gains by electric vehicles.

“A lot of attention has been given in recent months to electric vehicles, and rightly so. They are increasingly globally, exponentially,” Frankl said. “But I have to say, we should not forget the biofuels, which at the end of 2016 represented 96 percent of total renewable transport.”

Electric vehicles numbers will double by 2022, but biofuels will still make up 93 percent of renewables consumed in the transport industry, the IEA estimates. The fuels are needed especially for heavier vehicles including planes and ships.

The organization recommends that governments put incentives in place to spur the development of biofuels made from non-edible plants, which would avoid diverting food crops into fuel tanks. The cost of biofuels currently is about double the global price of gasoline, Frankl said.

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Japan Regulator Clears Restart of World’s Largest Nuclear Plant

Posted October 04, 2017, 9:07 A.M. ET

By [Stephen Stapczynski](#)

Tokyo Electric Power Co. Holdings Inc. moved a step closer to resuming operations of the world’s biggest nuclear facility after Japan’s atomic regulator gave its tacit approval, delivering a much-needed boost for a company still strapped with the cost to clean up its wrecked Fukushima plant.

Japan’s [Nuclear Regulation Authority](#) Oct. 4 approved a preliminary report saying Tokyo Electric’s No. 6 and 7 reactors at its Kashiwazaki-Kariwa power plant in Niigata prefecture meet post-Fukushima safety rules. Tepco, as the utility is known, must still get the endorsement of the prefecture’s government, which currently opposes the restart.

Resuming operations at the two reactors “should displace a lot of coal and LNG, and hence impact the bottom line,” Tom O’Sullivan, founder of Tokyo-based energy consultant Mathyos, said by email ahead of the decision. “The restarts would have additional significance as they improve the energy security of the east of Japan and Tokyo.”

This is the first time Tepco has been cleared to operate a nuclear reactor since its Fukushima Dai-ichi facility suffered a triple meltdown in 2011.

Under a turnaround plan released in May, Tepco said it expected the two units at Kashiwazaki-Kariwa to resume operations as soon as the fiscal year ending in March 2020. The No. 1 and 5 reactors at the plant could restart in 2022, while the No. 3 and 4 units could come online in 2025. The utility is aiming to restart the No. 2 unit a year later.

The Niigata plant, 220 kilometers (137 miles) northwest of Tokyo, consists of seven reactor units ranging from 20 years to 32 years in age, according to the NRA. The plant has a total operating capacity of about 8 gigawatts.

Four of Japan's 42 operable reactors are currently online.

Operating a single unit at Kashiwazaki-Kariwa would cut costs by as much as 90 billion yen (\$800 million) a year by reducing fuel imports, Tepco said in May.

The utility is seeking partnerships in its nuclear and electricity transmission and distribution operations to boost profitability as part of its latest 10-year turnaround plan.

After a 30-day public comment period, the report will then be subject to formal approval.

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Here's the Hot Canadian Oil Play You Probably Never Heard About

Posted October 04, 2017, 10:00 A.M. ET

By [Robert Tuttle](#)

There's a land grab quietly taking place in a little-known corner of the Canadian oil sands.

Just 200 kilometers (125 miles) southwest of the Fort McMurray oil-sands hub in northern Alberta, investors are rushing to secure rights to land that produces crude at much lower costs than the massive operations the region's known for. That's because beneath the area's characteristic oil-rich soil, which requires expensive extraction and refining techniques, there's crude trapped between layers of rock that can be pumped with conventional gear.

"It's definitely an emerging play," said Roger Tang, chief executive officer Deltastream Energy Corp., one of the companies that's producing oil in the area. "It's new and the production is quite respectable at this price."

The race to acquire drilling rights near the remote Slave Lake community comes as development of Canada's oil-sands, the world's third-largest crude reserves, grinds to a near halt with prices too low to justify the billions of dollars required to build new mines or steam-assisted production sites.

Located roughly between Alberta's Nipisi Lake and an area called Marten Hills, the drilling rights going for sale fall within the Clearwater shale and sandstone formation, with pockets of oil 600 to 700 meters (1,970-2,300 feet) below the ground, Tang said. Crude from the area can be produced for about C\$10 (\$8) a barrel.

The purchases have been flying under the radar because most of the buyers are closely held companies like Deltastream, which aren't required to disclose what they're up to like listed companies. But one purchase recently stood out.

Under the name Stomp Energy Ltd., the land company Scott Land & Lease Ltd. paid C\$10.15 million, or C\$1,101 per hectare, in a Sept. 13 provincial [land offering](#) for the rights to explore for hydrocarbons near Marten Hills for 15 years, along the far western edge of the Athabasca Oil Sands region.

While that may seem like very little when compared to the prohibitive prices paid for rights in the Permian Basin in Texas, it was the most paid for a single section of exploration land in Alberta since December 2011, provincial data show. And it came amid a flurry of other purchases in the same

area by other companies.

Companies including Deltastream, Cenovus Energy Inc. and Spur Petroleum Ltd. have begun drilling in the area over the past year.

Cenovus controls about a third of the play after acquiring drilling rights in the area over recent years, Harbir Chhina, executive vice president of oil-sands development, said in a conference call last June. While Cenovus has drilled a well in the area that produces about 300 barrels a day and plans to drill four or five wells in total, the company lists Marten Hills as a potential divestiture as it seeks to sell C\$4 billion to C\$5 billion by year end to help cover the cost of buying oil-sands assets from ConocoPhillips.

“We continue to assess what our drilling plans may look like for this property in the coming months,” Reg Curren, a Cenovus spokesman, said in an email. “No decision has been made at this time.”

Backed by a C\$100 million equity line of credit led by ARC Financial Corp. and Wells Fargo & Co., Calgary-based Deltastream has drilled nine wells there since the second quarter, three of which are producing between 150 and 200 barrels a day, Tang said. The company plans to continue drilling new wells into next year.

Well Costs

The advent of multilateral drilling, in which multiple bores are drilled out of a single well hole, has made exploiting the Clearwater formation economically viable, Tang said. Each well costs C\$1.1 million to C\$1.5 million to drill and produces as much as four times more crude as a conventional horizontal well, he said. That makes the play viable at today’s oil price of just over \$50 a barrel, Tang said. By contrast, wells in Alberta’s Duvernay Formation cost C\$6 million to C\$7 million.

Land companies such as Scott typically buy rights in oil-sands areas on behalf of energy producers who want to shield their names from the transaction. Scott declined to comment on the purchase when contacted by phone.

In addition to Scott and Deltastream, Synergy Land Services Ltd. also bought rights to a plot during the Sept. 13 bidding round. It paid C\$1,571 per hectare, the most per hectare in the province in more than two years. In July, land company Britt Resources Ltd. paid C\$2.99 million for three parcels in the same immediate area, and Scott bought three parcels nearby for C\$4.97 million in June of last year.

The drilling rights sales “show you that quiet acquisitions can get hot very quickly,” said Mark Oberstoetter, lead analyst for upstream research at Wood Mackenzie in Calgary.

But development of the Clearwater formation in the Marten Hills area is in its infancy and its full potential won’t be known until more drilling takes place, Tang said. The Lesser Slave Lake River area that includes Marten Hills pumped just 1.46 million barrels in all of 2015, according to the most recent Alberta [government data](#). But Tang says he’s optimistic.

Well results are “looking very good,” he said. “Although it’s still early stage, you get some indication that it’s very exciting.”

—With assistance from Dave Merrill.

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Army of Women Tackles Electricity Thieves in Indian Slums

Posted October 04, 2017, 10:42 A.M. ET

By Bhuma Shrivastava

India's power companies have a problem largely responsible for \$10 billion a year in losses. Slum dwellers steal electricity and refuse to pay their bills. But company officials often can't go in without being chased by mobs—and sometimes beaten, tied up, urinated on, even murdered.

So officials at Tata Power Co.'s joint venture with the Delhi state government came up with a solution that's turning out to be a model, not just for the rest of India, but for the world: It hired women living in the 223 slums it serves in the northern and northwest parts of the capital and called them "Abhas," from the Sanskrit word for light.

Tata Power Delhi Distribution Ltd.'s force of now 841 wives, mothers, and women as young as 20 go around the slums, knocking on neighbors' doors and persuading, coaxing, cajoling and nagging them to pay their power bills.

The result is a 183 percent increase in revenue over five years from the slums where Tata operates the project, with minimal cost to the company. Active power connections have risen 40 percent to 196,000—meaning that 56,000 previously freeloading homes have become active, bill-paying power customers.

"This gave us a way to get into these neighborhoods, rife with mafia and political influences," said Praveer Sinha, chief executive officer and managing director at Tata Power-DDL, which had started out operating literacy campaigns for slum women in 2010 as a way into the communities. "We thought educated women would give us a much better buy-in."

The success of Tata Power-DDL's initiative is inspiring imitation. Rival BSES Delhi, co-owned by the Delhi state government and Anil Ambani-controlled Reliance Infrastructure Ltd., engaged 40 women earlier this year in a pilot project in a west Delhi slum. Having resident women distribute bills and collect payment from neighbors produced "very encouraging results" that will now be used to expand the program, according to BSES spokesman Deepak Shankar.

The World Bank is trying out similar initiatives in Jamaica and Kenya, and is considering adapting it to other African countries. So far, Kenya Power & Lighting Co. has improved connection rates by doing more community engagement based on the Tata model that "has provided a lot of learning, which we are incorporating," Sunita Chikkatur Dubey, a Ghana-based World Bank consultant, said via email.

The slum in north Delhi known as Sanjay Basti, home to 4,000 people just 2 miles (3 kilometers) away from Tata Power-DDL headquarters, was once notorious for harassing power inspectors. Residents would threaten to pull away ladders when company officials climbed electricity poles to disconnect illegal hookups, said Amarjeet Kaur, who used to be an illiterate housewife before she was hired as an Abha in 2013.

"Residents would ask me: 'Why did you become a 'company person' when you are one of us?'" said Kaur, 39, as she walked through the slum's serpentine lanes filled with low-slung electricity cables that these days connect to almost all the brightly painted brick dwellings. "Now, women are in a

queue to take up this job. Even the boys want to become Abhas.”

Abhas, whose numbers are expected to swell to 1,000 by next year, do more than just hand-deliver electricity bills and collect payments. They advise slum dwellers on power conservation and safe practices: Use LED bulbs, don't use old motors to pump underground water or it will spike your electricity bill, and most importantly, don't use power cables as clotheslines. The Abhas' newest mandate, Tata Power-DDL's Sinha says, is to encourage slum residents to make mobile payments, which reduces the need to handle and safeguard large amounts of cash.

Abhas make about 4,000 rupees (\$60) a month on average, which is what some part-time domestic helpers can make. It includes a base salary plus extra pay based on securing full bill payment, partial payment or new meter installation. Abha managers, 25 in total, can make as much as 12,000 rupees a month—about the equivalent of a bus or van driver in Delhi.

Residents say they prefer dealing with women from their own communities—who personally deliver bills when they know neighbors are home and accept partial payment when money is tight—rather than outsiders. If their repeated cajoling and nagging doesn't result in payment, then power is disconnected. The Abhas have the support of the community leaders, known as pradhans, who weigh in if needed.

“Earlier if we weren't home when the company official came to deliver the bill, we'd miss paying and become defaulters,” said Usha, 38, who goes by one name and lives in a 90-square-foot room with six other family members. She likes the convenience of dealing with people she knows, and laughs off any questions about feeling nagged. “If we consume electricity, we're supposed to pay for it!”

The scarcity of resources in slums ensures an interdependence among residents that means they're more likely to listen to one of their own, said Purnima Singh, a psychology professor at the Indian Institute of Technology in New Delhi.

“The social fabric is much tighter in slum clusters,” said Singh. “An outsider will never match up in having this level of influence.”

Tata Power-DDL started zeroing in on slums in 2009, considering them the last hurdle to paring losses. India's power companies lose revenue on about a fifth of the electricity they supply, or about \$10.2 billion annually, due to problems including theft, meter tampering, billing issues and leakage due to faulty equipment, according to PricewaterhouseCoopers India estimates.

To thaw the hostility that Tata Power-DDL officials were encountering, it set up a special consumer group to start drug rehabilitation, provide medical vans, install drinking water stations and launch the women's literacy program. The idea to hire women surfaced in 2012 when, Sinha said, the women who had been studying to read and write started asking how to put their education to use.

“These women weren't allowed to go out and work by their families,” said Manisha Wadhwa who now heads the group. “But they could always work in their own communities, choose their own hours and still give us better reach in their neighborhoods.”

Wadhwa's group is still trying to tame 39 slums Tata Power-DDL serves that remain crime-prone and mafia-ridden, where the few Abhas the company has been able to hire haven't made much headway.

People pelt stones and pour hot water from the roofs” in one of the areas, Wadhwa said. “We are still trying to befriend them.”

Still Tata Power-DDL has come a long way from the days before 2012 when officials had to remove their badges to keep from being identified when visiting slums. Now women like Kaur insist on having Tata Power identity cards, as it gives them status.

“We have learned from this initiative that we can work closely with communities to improve economic outcomes,” said Sinha. “We don’t need to do charity.”

—With Rajesh Kumar Singh and Adrian Leung.

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Private Oil Made a Big Find in Mexico, Now State Oil Wants a Cut

Posted October 04, 2017, 10:37 A.M. ET

By Adam Williams

When private drillers struck oil off Mexico’s coast this year, they didn’t anticipate sharing it with the state oil company. It looks like they’ll have to.

The discovery of as much as 2 billion barrels in July, by a group led by Houston-based operator Talos Energy LLC, grabbed the oil world’s attention. Mexico’s energy reformers celebrated. It was the first big find since the government opened the industry to investors in 2014—a controversial move in a country that kicked out foreign oil companies in the 1930s, and had mixed feelings about letting them back in.

The reformers were vindicated: Private capital could get results where Pemex, the cash-strapped state operator, couldn’t. More would surely follow. Then a problem emerged. The crude deposit found by Talos, it turned out, spread beyond the boundary of the company’s exploration bloc and into a neighboring one—owned by Pemex.

Now the government is rushing to put together a rulebook for how this find, and subsequent ones, get shared out. It could shape the future of the whole energy plan. The group—which includes Sierra Oil & Gas S de RL de CV and Premier Oil PLC—is said to be holding off on further investment pending the decision. Other drillers who bought exploration rights also want to see the government ruling before making financial commitments. The rush of enthusiasm that followed the July find has turned into a nervous wait.

‘Most Important Issue’

“This is the single most important outstanding issue in the sector,” said Raymundo Pinones, director of Mexico’s Association of Hydrocarbon Companies. “It could delay activity until there is clarity. In place of drilling or continuing with development, the industry is waiting for this to be resolved.”

Almost 70 companies have been given leases to explore for crude in Mexico. One of them, Italy’s Eni SpA, reported a shallow-water find of at least 1.4 billion barrels this year, located beneath an existing Pemex well.

The field discovered by Talos, Sierra and Premier may be even bigger. From the start, in its July 12 press statement, the consortium said that the oil “could extend into a neighboring block.” Weeks

later, in an interview with El Financiero newspaper, Pemex Chief Executive Jose Antonio Gonzalez Anaya said that his company, which has rights to that block, would fight for a share of the proceeds.

The Talos-led consortium already has to pay 83 percent of profits from its field, known as Zama-1, to the Mexican government, according to the Energy Ministry. Sharing with Pemex could push the figure even higher. So the group has temporarily halted investment and development of the massive find, according to a person familiar with the plans.

The entire industry in Mexico is affected by the delay in establishing the rules, Pinones said. "All the companies that need to plan investment, all those that need to have certainty when they go to their boards to respond to questions, in order for the approval of hundreds of millions of dollars."

'Global Standards'

Like BHP Billiton Ltd, which won rights to operate the Trion field near Mexico's maritime border with the U.S., estimated to hold the equivalent of about 485 million barrels. The Australian driller has identified at least four locations on the block that have exploration potential.

The new rules on sharing "would be of key interest to us there," Tim Callahan, BHP's Mexico president, said in an Oct. 2 interview. Mexican officials have already circulated a draft version to oil companies, and discussions are ongoing, he said. "We've been working very hard to try to help influence the secretary of energy to come up with a proposal that's more in accordance with global standards."

Even if the government is inclined to cut the Talos-led group some slack, there's a political obstacle. Mexico has a presidential election next year, and the early frontrunner is a fiery populist, Andres Manuel Lopez Obrador, who's campaigning against the energy reforms. Last month he reiterated a promise to review oil contracts if he wins. Concessions to foreign capitalists will be grist to his mill.

Deputy Energy Minister Aldo Flores points out that the problem confronting his government isn't unique to Mexico. The process of dividing up an oil find that spans different jurisdictions is known in the industry as unitization, and there are plenty of international precedents.

'Rule of Capture'

"In Mexico, we don't have a rule of capture as they do in Texas. It's not first-come, first-served," Flores said in an interview last month. "If there's enough evidence and certainty that the discovery extends into Pemex's block, then it would have to be shared."

But the legislation won't be written just for the state company's benefit, he said. Future finds will likely require collaboration between private companies with neighboring blocks, and the same rules will apply to them.

Still, since the first case does involve Pemex, it's extra-sensitive.

The industry has already flagged concerns about preferential treatment. Pemex missed a three-year deadline to meet minimum investment or work requirements in some of the 108 fields that it operated. But in August it was granted a two-year extension for 101 of them - including the one next-door to Talos's patch - by the Energy Ministry, which cited low oil prices as reasoning for granting additional time.

So if the international oil community thinks the sharing deal isn't fair, it could spook investors hoping to tap Mexico's 9 billion barrels of reserves.

"This isn't going to be a one-off situation," said John Padilla, managing director of energy consulting firm IPD Latin America. "If they don't get this right, they are going to jeopardize a lot."

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