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Bill to amend and supplement the Electricity Industry Law

Energy – February 4th, 2021

Commentary on the Bill introduced on February 1st, 2021 to amend and supplement Mexico's Electricity Industry Law

On February 1st, 2021, the first day of the first ordinary legislative period of 2021[1], Mexican President Andrés Manuel López Obrador introduced to the House of Representatives (*Cámara de Diputados*) a bill with preferential character (the "Bill") to amend and supplement the Electricity Industry Law (*Ley de la Industria Eléctrica*) (the "EIL").

The Bill includes a number of provisions that the current administration had already tried to implement through diverse administrative actions – such as the "Resolution modifying the guidelines that establish the requirements for the granting of Clean Energy Certificates" or the "Policy of Reliability, Safety, Continuity and Quality in the National Electric System", issued by the Ministry of Energy ("SENER" for its acronym in Spanish) on October 28, 2019 and May 15, 2020, respectively -, and that align with the current government's views, as stated in the Memorandum issued by the Mexican President to the industry regulators (SENER, the Energy Regulatory Commission ("CRE") and the National Energy Control Center ("CENACE", for its acronym in Spanish)), which mainly seeks to favor the state utility *Comisión Federal de Electricidad* ("CFE" for its acronym in Spanish).

Following is an analysis of the amendments to the EIL that are proposed by the Bill:

I. Dispatch order

The Bill introduces three changes to these concepts, as presently regulated by the EIL:

- The introduction of Power Purchase Agreements with a Commitment of Delivery of Physical Electricity ("Physical PPAs") as a new concept, defining them as the agreement between a Basic

[1] Mexico's Congress holds two ordinary legislative periods per year. The first period starts on February 1st and ends on April 30; the second period starts on September 1st and ends on December 15.

Supplier (such as *CFE Suministrador de Servicios Básicos*) and a Generator, whereby the Basic Supplier commits the purchase of electricity or related products at a future time, and the Generator commits to make a physical delivery of such products; for purposes of the foregoing, the Generator shall provide CENACE with its generation program through fixed offers in the Wholesale Electricity Market.

- The concept of Legacy Agreements for Basic Supply ("Basic Supply Legacy PPAs") is amended, to hereafter consists of a type of Physical PPA executed at the option of Basic Suppliers with Legacy Power Plants.

- Finally, the EIL currently defines "Legacy Power Plants" as power plants that as of the effectiveness of such law (i) were not included in self-supply, cogeneration, small production, independent production or self-use permits ("Private Legacy Power Plants"), and (ii) (x) are owned by government bodies or entities or State owned companies and are in operative conditions, or (y) which construction and delivery has been included in the expenditure budget on the modality of direct investment".

  The Bill proposes to amend this definition to provide that, from now on, Legacy Power Plants shall be any power plant that (i) is not a Private Legacy Power Plant and (ii) (x) that is owned by government bodies or entities or State-owned companies (such as CFE or its affiliates) or (y) "which construction and delivery is unrelated to its financing modality".

The latter amendment entails that Legacy Power Plants would consist of any CFE-owned power plant, regardless of when it was constructed and became operational, or of how it was financed, and not only of CFE-owned power plants that were operational prior to the EIL becoming effective.

In connection with the above, the Bill provides that in the use of the transmission and distribution grids, CENACE shall give dispatch priority to Legacy Power Plants (i.e., CFE's power plants) that have a commitment for the delivery of physical energy (through Physical PPAs), and that CENACE shall be authorized to receive generation and consumption programs linked to Physical PPAs.

Furthermore, the Bill gives authority to CENACE to determine the order of dispatch not only to satisfy electricity demand (as is the case under the current provisions of the EIL), but also to ensure the security of dispatch and the reliability, quality and continuity of the grid.

While the provisions of the Bill amending the EIL do not specify the order of dispatch, the explanatory statements to the Bill (*exposición de motivos*) implies that the following priority would be set in place:

- In first place, CFE's hydroelectric power plants;

- In second place, other power plants owned by CFE such as nuclear, geothermal, combined cycles and thermo, followed by combined cycles that service CFE under legacy independent producer contracts;

- In third place, private wind and solar power plants; and

- Finally, private combined cycles and any other power plant owned by private generators.

In our view, these changes proposed by the Bill are in violation of the antitrust principles imbedded in Mexico's Constitution, and the environmental sustainability principles imbedded in Mexico's Constitution and in several climate change-related treaties of which Mexico is a signatory.

II. Regulation of the market

While the EIL presently provides that the generation and marketing of electricity are services provided under a free-market regime, the Bill eliminates this provision.

In line with above, while the EILs sets forth that electricity, capacity and ancillary services may be offered in the market, the Bill subjects such offers to giving priority, first, to Physical PPAs and, secondly, to clean energies.

The above is in violation of antitrust principles imbedded in Mexico's Constitution.

Finally, the Bill eliminates the restriction in the EIL requiring Basic Suppliers (basically CFE's affiliate, *CFE Suministrador de Servicios Básicos*) to execute electric coverage agreements for the purchase of electricity and related products only through auctions organized by CENACE, opening the door for Basic Suppliers to execute private PPAs with any generator (probably meant to enable *CFE Suministrador de Servicios Básicos* to purchase electricity and products from CFE's various electricity generating subsidiaries, irrespective of the price being offered).

These changes contravene the environmental sustainability principles and the general principles of public procurement imbedded in Mexico's Constitution and international treaties of which Mexico is a signatory.

III. Open access; interconnection

The Bill provides that in the granting of permits, CRE shall consider the planning criteria defined by SENER for the National Grid. The Bill also provides that interconnection with the National Grid will be only allowed when technically feasible.[2]

Presently, under the EIL, interconnection to the Grid can take one of two forms: (i) by network upgrades included in programs to modernize the National Grid, ordered by CENACE (where the generator has to wait for the network upgrades to be undertaken in its intended interconnection area in accordance with the timeframes set forth in the relevant program); or (ii) by each individual generator applying to CENACE for interconnection studies and carrying out the network upgrades by itself and at its own cost.

The Bill seems to propose that the latter form (i.e. independent interconnection) shall be available only to generators acting as a group (as opposed to individually). This seems to suggest that individual power plants will not be allowed interconnection through the independent modality and, instead, that several projects will have to group for this purpose in a given interconnection area.

These changes are in violation of the open access principles applicable to essential assets, and of antirust principles imbedded in Mexico's Constitution.

IV. Legacy projects

IV.1. Self-Supply Permits. Regarding legacy projects, the transitory provisions of the Bill provide that self-supply permits granted under the electricity statute preceding the EIL may be revoked by CRE, without specifying anything further. While the authority to revoke permits is already afforded to CRE by the EIL and its Regulations in the case of serious offenses by permit-holders, the Bill seems to afford this authority without specifying when would CRE be authorized to exercise it. In this regard, the explanatory statements (*exposición de motivos*) of the Bill explain that CRE shall be "obligated" to revoke self-supply permits that were obtained fraudulently (which, according to the explanatory statements, include self-supply companies (*sociedades de autoabasto*) that have their off-takers as shareholders and sell their energy to such shareholders).

The above is in violation of the legality, acquired rights and legitimate expectations principles imbedded in Mexico's Constitution.

IV.2. Independent Power Producers. As to generators holding independent power producer permits, the Bill provides that independent producer legacy contracts (i.e. those executed by the holder of an independent power producer permit and CFE) shall be "reviewed" to ensure that they are "profitable" to the Federal Government and, in case they are not, they shall be either renegotiated or be subject to early

[2] Under the EIL and the existing regulations, interconnection with the grid cannot be denied based on "technical reasons", as CENACE must always allow the interconnection if the applicant is willing to build the facilities required to make the interconnection technically feasible.

termination. The Bill fails to mention if, in the latter case, CFE would pay compensation or, to the very least, if the advance termination provisions in such contracts shall apply.

As a principle of Mexican law, contracts are subject to the will of the parties thereto. Thus, CFE cannot unilaterally terminate these contracts unless a cause for termination provided in the contract or by law occurs, or CFE's counterparty consents to its early termination. Likewise, CFE cannot force its counterparties to renegotiate the contracts, unless expressly provided therein (e.g. in a change in law provision).

As a result, this new right that the Bill purports to grant to CFE is in violation of the legality and acquired rights principles imbedded in Mexico's Constitution, as well as the "takings clause" contained therein.

V. Clean energy certificates (CELs)

The Bill provides that SENER shall have authority to determine the requirements for the granting of clean energy credits (CELs), regardless of when a power plant became operational. This provision aims to grant clean energy certificates to CFE in connection with its legacy hydroelectric power plants.

The above is in violation of the antitrust principles imbedded in Mexico's Constitution, and of the environmental sustainability principles imbedded in the Mexican Constitution and the various climate-change treaties to which Mexico is a signatory.

What's next?

The Bill has a preferential character – on each legislative period, the President may introduce two preferential bills. Such character implies that the bill must be analyzed and discussed by the Chamber of Origin (in this case, the House of Representatives) within 30 days, and passed on to the Chamber of Review (in this case, the Senate) to be discussed and resolved upon (whether approving it or requesting changes) within 30 days as well. In this case, because the President's party (*MORENA*) holds the simple majority which is required to pass a bill of this type, we expect that both houses of Congress will approve the Bill within the required time periods.

The Bill provides that, within the six months following its approval and enactment as a law, SENER, CRE and CENACE shall make the necessary adjustments to the existing regulations (i.e. Grid Code, general rules, Market Rules, or Interconnection Rules) so as to make them conform with the changes contemplated in the Bill.

Once the Bill is approved by Congress and enacted into law, it may be challenged by any affected person through a constitutional remedy (*amparo)* before a Federal District Court, where the antitrust, regulatory, environmental and constitutional arguments described herein, amongst others, may be raised. Further, it

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may be challenged by COFECE (Mexico's independent antitrust agency) and the opposition in Congress (through constitutional challenges filed with Mexico's Supreme Court).

Depending on the special circumstances of each case, *amparo* lawsuits would have to be filed within 30 business days of the Bill being passed into law, or within the 15 business days following the formal notice of the first act of authority that is based on the Bill's provisions. As part of the amparo proceedings, companies may request injunctive relief to the Federal District Court.

Likewise, Mexico's counterparties in USMCA and the various investment protection treaties executed by Mexico could bring formal claims against the Mexican Government, based on the protections provided by such treaties (no undue discriminatory treatment and no expropriation without compensation, among others). Investors from countries signatories to the USMCA and the above-mentioned investment protection treaties could also commence investment protection arbitrations under such treaties.

For any additional information, do not hesitate to contact our expert team, who can be of assistance.

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