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Energy Reform in Mexico

In December 2013, the most important constitutional reform on energy in Mexico in several decades was published in the Official Journal of the Federation. This reform intends to implement radical changes by promoting competition in a sector that has been historically characterized by the concentration of productive activities in the hands of the Mexican government since the 1930s. This sector began to open up to private investment just two decades ago.

This holds true for the hydrocarbon industry, given that oil production has always dominated public debate in Mexico. Nevertheless, it is also the case that the electricity sector is quietly undergoing its greatest transformation since its nationalization in 1960. Since then, and until the 2013 reform, the generation, transformation, transmission, distribution and sale of electrical energy for public consumption has been the exclusive province of the federal government. By means of a creative constitutional interpretation, the reforms

to the 1992 Public Service Electrical Energy Act broadened the opportunities for self-supply and gave way to a vigorous framework for the independent production of electricity, among other achievements. However, such reforms did not allow the generation of electrical energy for sale between private parties.

As a result of the alarming financial situation faced by the public utility Federal Electricity Commission (*Comisión Federal de Electricidad, CFE*), the opacity, politicization and cross-subsidization in determining electricity fees, the lack of investment in networks and the urgency to meet ambitious goals in the reduction of greenhouse gases, the need for a far reaching reform became indispensable. In their respective initiatives, Mexico's President and the senators of the National Action Party (*Partido Acción Nacional, PAN*) proposed to move toward an institutional framework that would allow for the creation of a true electricity market.

The result is a model in which planning and control of the national electricity

system will continue to rest in the hands of the federal government by means of an operator that is independent of other parties in the industry, specifically, the CFE. Electricity transmission and distribution will be considered public utility services, which will also be entrusted to the State, and the remaining activities in the electricity industry will be opened to participation from private industry, in accordance with the terms established by the new laws. Nevertheless, all of the above activities will continue to be subject to oversight by the Energy Regulatory Commission (*Comisión Reguladora de Energía, CRE*) with renewed autonomy for such an agency.

Thus, although much work remains in order to bring about a duly integrated legal framework, we now have a solid constitutional basis from which to work. To begin with, on April 30, the President submitted to Congress the bills of the regulatory statutes which will contain the detailed rules of the new model. Subsequently, presidential



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regulations will be forthcoming, which will provide due observance of the law at the administrative level. Next, general administrative provisions will be issued by the regulatory agency. Lastly, we will see the specific permits and contracts. The path will consist of pursuing effective competitive conditions and promoting strong regulations as needed in accordance with the model conceived by the substantive and transitory articles of the constitutional reform.

Meanwhile, those working on the energy reform's regulations should consider the following:

1. The tenth transitory article, paragraph (c) of the decree of constitutional reforms grants the CRE the power to regulate the generation of electricity and wheeling fees for the transmission and distribution of electricity. There is no room for confusion: the Department of Finance and Public Credit should no longer determine the fees that the CFE charges for its network services or for electricity as a product. Finally, a technical specialized regulatory agency will be in charge of such work based on a meticulous cost analysis. Nevertheless, the CFE will continue to be a dominant player in the generation and marketing of electricity, and the regulations should treat it as such if we desire a strong market to flourish in the mid-term. Furthermore, consumer subsidies should be granted to those who truly need them in accordance with energy and social policy, and not as a result of regulatory considerations.
2. Paragraph (a) of the eleventh transitory article leaves the Department of Energy (*Secretaría de Energía*, SENER) as coordinator of the sector and grants it the power to establish the terms of the strict legal separation that will be required to promote open access and efficient operation of the electricity sector, and to oversee compliance. The intent was for SENER to construct the so-called "Chinese walls." Nevertheless, such a mandate will be exhausted when the rules for the operation of at least
- two State-owned companies are established: the first one in charge of the generation and marketing of electricity, and the second in charge of transmission and distribution. As a result, responsibility for the true and effective regulation of open access to the network should belong to the CRE through the issuance of terms and conditions and economic regulation of electricity transmission and distribution services, and the approval of the rules for dispatch and other instruments to be applied by the new system's independent operator.
3. The National Energy Control Center (*Centro Nacional de Control de Energía*, CENACE) will play a key role in the new model. As an independent operator, it will ensure that the CFE does not unduly discriminate in providing access to the electricity grid for its own generation purposes. The basis for this is found in transitory article sixteen, subsection (b) of the reform decree. In any case, since the CENACE is being created as a decentralized organism, as part of the Federal Public Administration, it must be ensured that the various interested parties participating in the industry have a voice according to the international best practices.
4. The law shall regulate the procedures for contracting so that individuals may participate in the financing, installation, maintenance, management, operation and expansion of transmission and distribution infrastructure. Perhaps a permits system would have been more appropriate to encourage private participation in these activities, as had been proposed by the PAN. Given that there was not much success in the drafting of the eleventh transitory article of the decree for constitutional reform, the law must be very clear on the scope of the exclusivity of the State in transmission and distribution, and what activities will be done "on behalf of the nation," in addition to what should be understood by operation and management for hiring
- purposes. At issue is how to establish the appropriate incentives to grow the infrastructure of the national electricity system, particularly to develop the enormous potential for renewable energy.
5. A big question is what kind of obligations with respect to clean energy and reduction of pollutants will be established under the law for participants in the electricity industry, as ordered by the seventeenth transitory of the reform decree. Hopefully, the drafters are thinking of what has been called in the United States "renewable portfolio standards," by means of which various states force suppliers to provide a certain percentage of their electricity from renewable sources. In a best case scenario, this could be accompanied by strict federal controls on emissions of greenhouse gases and the corresponding emissions rights markets which help to optimize the energy mix as a whole. The mature technology of some renewable energy, such as wind and, more recently, solar photovoltaic, suggests that subsidies may not be required in Mexico (on the contrary, the new framework seems to encourage abandoning prevalent general subsidies on gasoline, diesel and propane).

In its electricity sector restructuring, Mexico is at least 20 years behind most countries in the Organization for Economic Cooperation and Development (OECD). Mexico should use this lag in implementation to its advantage and learn lessons from the international experience of other countries that have already reformed their electricity sectors. For now, Congress will be in charge of building a good electricity market with strong regulations aimed at benefiting the end consumer and regulations which presuppose that the electric industry is the industry that most contributes to climate change. 