

Relevant events in the electricity sector: Initiative to reform the Power Industry Law and the Supreme Court's decision of the Constitutional Controversy

In recent days the following events have impacted the Mexican power industry: **(i)** on February 1, 2021, the filing before the House of Representatives (*Cámara de Diputados*) of a “*preferential*” initiative by the office of the Mexican President (the “**Initiative**”), which aims to modify the Power Industry Law (“**LIE**”, for its initials in Spanish) and **(ii)** the decision of the Second Chamber of the Supreme Court of Justice of the Nation (“**SCJN**”) in Constitutional Controversy 89/2020 that the Federal Competition Commission (“**COFECE**”, for its acronym in Spanish) filed against the Reliability Policy that the Ministry of Energy (“**SENER**”, for its acronym in Spanish) issued in May of last year.

These events should not be analyzed independently as they are closely related and could generate/will generate a significant impact on the national power industry. Thus, below, we present a brief analysis of the aforementioned events, as well as an analysis of the legal alternatives that could be implemented if any of the events violates any right or impacts the fulfillment of obligations of any of the players in the power industry¹.

(i) LIE Reform Initiative

On February 1, 2021, the office of the Mexican President filed a “*preferential*” initiative before the House of Representatives. This implies that the legislative process must give it priority. Therefore, its discussion and the vote on its approval in both chambers of the Congress of the Union will be carried out within a maximum period of thirty calendar days, respectively².

The core aspects of this initiative are the following:

- Modification of the order of economic dispatch of power plants to favor dispatch by physical delivery, benefiting conventional generation plants: **(i)** the hydroelectric plants of the Federal Electricity Commission (“**CFE**”, for its initials in Spanish), **(ii)** followed by the other plants of the CFE (nuclear, geothermal, combined cycles and thermoelectric plants), **(iii)** Combined Cycle Power Plants owned by Independent Producers, **(iv)** private wind and solar plants and, lastly, **(v)** private combined cycle plants.
- It establishes the granting of Clean Energy Certificates (“**CELS**” for their initials in Spanish) to clean energy generation plants³, regardless of their date of entry into operation. The foregoing facilitates CFE's compliance with its obligations to acquire said CELs.

¹ Developers, Generators, Suppliers, Users (Qualified, Basic Services and Self-supplied Partners).

² Articles 71 and 72 of the Political Constitution of the United Mexican States.

³ Including nuclear power and hydroelectric (greater than 30 MW).

- It eliminates the obligation of the CFE Supplier of Basic Services to acquire energy and products through auctions called by the National Energy Control Center (“**CENACE**”, for its acronym in Spanish). This is to enable said company to acquire energy (from fossil/conventional sources) from CFE’s subsidiary generation companies.
- The provisional articles of the Initiative establish the authority of the Energy Regulatory Commission (“**CRE**”, for its initials in Spanish) to revoke self-supply permits “obtained by carrying out acts that constitute legal fraud [fraude a la ley]”⁴.
- It establishes the obligation of the CRE to grant the permits provided for in the LIE in accordance with the planning criteria of the National Power System that SENER issues.
- Modification of the eminently financial/virtual scheme of the Wholesale Electricity Market to a hybrid scheme that allows the execution of Power Coverage Contracts with Physical Delivery Commitments, to be exclusively executed by Basic Service Suppliers, favoring the dispatch of this type of contract.
- Review of Electric Power Purchase and Sale Contracts with Independent Power Products (“**IPPs**”) regulated under the Electric Power Public Service Law in order to “guarantee” profitability in favor of the Federal Government.
- Elimination of the “free competition” in generation matters, evidently to strengthen CFE in the area of power generation, contrary to the provisions of Article 28 of the Federal Constitution, 4 of the LIE, and the decision of the SCJN in Constitutional Controversy 89/2020.

It is important to note that at the moment, the Initiative does not generate legal effects to the detriment of any person. This is because it must first be approved, enacted and published in the Official Federal Gazette and later, in terms of the Second Provisional Article of the Initiative, SENER, CRE and CENACE would have a period of 6 months from the date of entry into force of the reform to modify the administrative provisions that are necessary to implement and give effect to the reform.

Therefore, at the appropriate time and depending on the particular case, the legal strategy that those affected may implement against said reform should be analyzed. From a preliminary analysis, the reform would affect developers, generators, end users (Basic and Qualified Service), permit holders (self-supply/cogeneration) and their self-supplied partners, permit holders/contractors (independent production) and in general various sectors of society, the environment and the national economy.

Considering the type of measures and their potential consequences, legal actions may result before the CRE, the Federal Court of Administrative Justice, District Courts, and COFECE; as well as investment arbitrations.

(ii) Constitutional Controversy Decision 89/2020

On February 3, 2021, the Second Chamber of the SCJN issued the decision in Constitutional Controversy 89/2020, which COFECE filed against various aspects of the Reliability Policy issued by SENER in May of last year.

⁴ This authority is already provided for in the LIE, however, what is established in the Initiative seeks to legitimize that the CRE can revoke the permits that it considers are legal fraud “*fraude a la ley*”.

In the current context, the decision of the SCJN has relevance in the event the Initiative is approved. What the SCJN has determined will be the basis of the rulings when challenging the changes resulting from the reform.

Through the issued ruling, the SCJN declared valid and invalid various aspects of the Reliability Policy, among which the following stand out:

VALID	INVALID
<ul style="list-style-type: none"> • CFE will have a proactive participation in the planning proposal of the Expansion and Modernization programs of the National Transmission Network (“RNT”, for its initials in Spanish) and General Distribution Networks (“RGD”, for its initials in Spanish). 	<ul style="list-style-type: none"> • Obtain an interconnection feasibility opinion issued by CENACE for the interconnection of power plants. Being able to reject the requests for Interconnection Studies, without this representing a breach of open access under conditions that are not unduly discriminatory.
<ul style="list-style-type: none"> • Inclusion of new related services to guarantee quality, reliability, continuity and security of the National Electric System. 	<ul style="list-style-type: none"> • CENACE will evaluate the viability of Interconnection Studies requests based on: (i) The demand and consumption of the area, (ii) The geographic dispersion of the Clean Energy Power Plants; in other aspects.
<ul style="list-style-type: none"> • Generators that represent power plants with intermittent clean energy, whose characteristics cause an increase in related services, must cover the cost associated with said increase. 	<ul style="list-style-type: none"> • In granting generation permits, the CRE must take into account the information from the RNT and RGD Expansion and Modernization Programs (“PRODESEN”, for its acronym in Spanish).

The SCJN based its determination on the following main arguments:

- Any provision in favor of the CFE cannot, under the justification of fulfilling the purpose of its strengthening, ignore the other objectives of the power industry sector, among which is to make the generation and supply of energy more competitive.
- The Reliability Policy argues that SENER’s strategic projects should have priority in interconnection, which is incompatible with open access under conditions that are not unduly discriminatory to the networks.
- It is necessary to recognize and comprehensively include greenhouse gas reduction objectives and obligations which are provided for by the Federal Constitution, as well as by secondary laws and regulations⁵.
- The Reliability Policy constitutes a barrier to competition and free market participation, since it cancels the possibility of entering the market for power plants that operate with clean energy - specifically wind and photovoltaic.
- Mexico has assumed various commitments, at the national and international level, to provide for a gradual increase in clean energy and to reduce dependence on fossil fuels, under criteria of economic viability. Although clean energies present certain disadvantages, the truth is that precisely by attending to them and with the stated purpose, the Energy Transition Law provides for the need to encourage investment for generation with Clean Energies and meet, in turn, the country’s goals for this purpose.

⁵ Organic Law of the Federal Public Administration, the Power Industry Law, the Energy Transition Law and its Regulations.

- If the merit is no longer considered, the dispatch of Power Plant Units with Intermittent Clean Energy would be limited. Given this, conventional power plants would be benefiting, regardless of whether they represent higher production costs, a scenario in which these costs would later be reflected in the price that consumers will have to pay for electricity supply. This is contrary to the mandate contained in article 25 of the Constitution, which requires that the stewardship of national development guarantee, among other aspects, that it is sustainable.

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