

PRESS RELEASE

Initiative to amend the Electric Industry Law: A setback for the electricity sector in Mexico.

On January 29th, 2021, the President of Mexico **sent a preferential law initiative to the Lower House that aims to amend the Electric Industry Law. This proposal must be analyzed and discussed by Congress within 30 days.** The effect of the bill is the *de facto* elimination of the Wholesale Electricity Market (MEM) through a series of regulatory changes that benefit the Federal Electricity Commission (CFE) at the expense of private electricity producers. If this bill is approved, it would not only violate existing constitutional provisions, but it would also set a dangerous precedent that would harm the investment climate and the Mexican economy by threatening legal certainty and the rule of law in the energy sector.

Passing this reform would have negative consequences for public finances, the environment and Mexican customers' welfare by making the electric system's services more expensive and by severely limiting opportunities for cleaner and cheaper electricity generation. This reform contravenes both the Mexican Constitution and several international trade agreements, among them, the United States-Mexico-Canada Agreement (USMCA). **If approved, the proposed change would also divert the country from the path to more sustainable energy generation by promoting operations that make it impossible to comply with the objectives established in the Paris Agreement and the Mexican Energy Transition Law.**

The debate and eventual vote in Congress should consider these issues, as well as the impact that the reform would have in the wellbeing of Mexicans and in the business environment. The initiative consists of four main elements:

- 1. It aims to alter the energy dispatch mechanism from an economic merit order to an ownership merit one. Currently, the system is operated, independently, by the National Energy Control Center (Cenace). The goal is to dispatch CFE plants first, regardless of the cost.** The main losers of this proposal, from a generation standpoint, are renewables and clean energy plants, which would be dispatched at the end. The pricing mechanism is completely altered and has not been revealed. Typical market pricing signals are blurred by the proposed dispatch merit order and are exceedingly difficult to infer. The initiative reforms Article XX to, as was discussed above, give priority to CFE generating plants; hydro first, then other thermal CFE plants, then private wind and solar generation and at the very last private combined cycle plants. As CFE's hydroelectric plants cannot satisfy the country's electricity demand, the main beneficiaries would be technologically obsolete, polluting plants of CFE that take second place

on the dispatch list. These plants generate mostly using fuel oil and coal, thus have higher costs and negative environmental implications both at the local and global levels.

Impact: Generation costs depend mostly on the technology and fuel used to produce the electricity. Inefficient plants and polluting fuels imply higher electricity prices for users and/or higher subsidies for consumers. CFE and public finances will certainly suffer, as the incentive for the electric system to buy and use the cheapest electricity first is removed. Efficiency from competition is halted, price signals are blurred, and certainty is eroded. The incentive to integrate renewables disappears since the amendment prioritizes fossil-fuel fired plants owned by CFE.

2. **The presidential initiative eliminates the requirement for power plants with operation start dates post 2014 for issuing Clean Energy Certificates (CELS).** In order to encourage the clean energy generation, the Energy Transition Law created a mechanism for CELs. A CEL is awarded for each megawatt-hour of energy generated by clean energy power plants that started operations after August 2014. The bill seeks to benefit CFE by granting certificates to plants with operations prior to 2014. Since climate change is a stock phenomenon thus, the current market design focuses on new clean energy power plants additions. The presidential bill destroys that incentive, disproportionately favors CFE and makes it impossible to comply with Mexico's domestic and international climate change goals and commitments.

Impact: CELs' mechanism to accelerate energy transition is destroyed. The new regulation would not encourage integration of new renewable power plants.

3. **It eliminates the obligation of CFE's Basic Supply subsidiary to buy energy through auctions or competitive processes.** CFE's subsidiary is responsible of supplying residential, rural, and low volume industrial and commercial users. It is currently obligated to buy its energy by a competitive process. The main objective is ensuring the lowest price of energy and the lowest possible impact both on consumer's bills and public finances.

Impact: The new regulation not only promotes opacity but creates a burden for both CFE's and Mexico's public finances. It does not give incentives to minimize prices. There is another aspect to consider; it gives the process an opacity that is not conducive to proper accountability and efficiency.

4. **The initiative gives CRE, the sectoral regulator, the ability to revoke permits for self-supply permits.** Self-supply permits (*autoabasto*) were issued prior to the liberalization of the sector. They allowed companies to produce their own electricity and supply their partners (self-supply partners). The bill establishes that self-supply permits grandfathered by the LIE may be revoked by the Energy Regulatory Commission (CRE) if they were found to have been "fraudulently assigned". This regulation opens an unnecessary front, since the self-supply model will disappear once permits expire. Generation capacity is limited by the original capacity established in the permits, the impact on the market is negligible. Especially, if the amendment's fundamental objective is to eliminate the market and its signals in the first place.

Impact: It affects legal and regulatory certainty by retroactively changing the rules under which investments were made.

This bill violates the USMCA by changing regulatory conditions. It represents an indirect expropriation; it makes it very difficult to operate the assets and significantly changes the conditions in which investments were made. Additionally, it violates the provisions regarding State-owned enterprises by benefiting a State participant over other participants in the market.

The electricity sector is covered by the investor-State dispute settlement mechanism between Mexico and the United States, together with six other sectors. Mexico will have to defend its energy policy before international panels.

At the Mexican Institute for Competitiveness (IMCO), we urge legislators to debate with data and evidence in an open parliament exercise for the next 30 days. **If approved, this initiative would represent an historical setback for the construction of a more competitive Mexico.** The damage to the country's competitiveness, economic growth and investment climate is real. It will take decades to rebuild the trust of domestic and international investors in Mexico. Mexicans, especially the young, will be directly affected by this and will suffer the loss of opportunities and welfare because of an absence of economic development.

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