Mexico City, October 08, 2021

Press release

Electric reform:
Mexico needs competition in the electricity market

The **energy bill that amends articles 25, 27 and 28 of the Mexican Constitution favors** the Federal Electricity Commission (CFE) by limiting private participation in the electric power industry, dismantling sector regulators and independent system operator by eliminating their technical and financial independence.

The bill will negatively impact Mexico's competitiveness by increasing electricity costs for both Mexican households and businesses. It directly damages the environment and undermines the rule of law for the whole country. If approved, Mexicans would pay either through higher electricity rates or through taxes necessary to finance higher generation costs and subsidies. Likewise, they would have to bear the environmental cost of betting on fossil fuels in the global context of decarbonization as the norm i.e., the consequences of a country with fewer opportunities for growth and economic development.

The initiative attempts to reverse the liberalization of the power sector by fixing a figure of at least 54% of generation from CFE. It also aims to eliminate market regulation by dismantling their technical and financial independence – Energy Regulatory Commission (CRE) and National Hydrocarbons Commission (CNH)– and by merging the independent system operator: National Energy Control Center (Cenace) with CFE. This institutional framework reverses CFE's horizontal and vertical separation -subsidiaries and affiliates- to reconcentrate under one single all powerful self-regulated State monopoly effectively disappearing the wholesale electricity market.

The bill is the sum of all efforts to eliminate competition since the beginning of the Lopez Obrador administration e.g., LIE (Electric Industry Law) passed by Congress in March 2021 and **currently suspended by court rulings on unconstitutionality grounds.** However, the initiative goes further than past efforts eliminating regulators as stated before. **In sum, CFE would have the power to set rates, grant and revoke permits, as well as managing power plants dispatch to the grid for itself and its competitors.**

The bill alleges its objective as strengthening CFE. This objective will undoubtedly will not be met and will have serious economic, social and environmental negative impacts. A minimum generation threshold for CFE (54% of generation) will be a major source of economic and financial setbacks for the company's by forcing it to generate at more higher costs than its private counterparts but having to supply power to all users at lower or equal prices than the current ones.

Strengthening CFE entails the government to acknowledges the company does not have the sufficient resources to be the only player and supplier of electricity –generation, transmission, distribution and commercialization– and prioritize profitable businesses, such as its legal monopolies in electricity transmission and distribution. The bill, far from strengthening the company, weakens it by forcing it to operate with losses.

Six key amendments to reestablish CFE's monopoly:

1. **Modify the energy dispatch mechanism and cancel permits granted to all private sector participants**. The bill also limits generation by limiting private sector production to 46% of total generation. It is unclear how that 46% figure coexists with the cancelation of all permits and contracts.

   Impact: CFE generation costs are 40% to 252% higher than its private counterparts. Hence, this measure would translate into higher electricity prices for consumers and/or higher electricity subsidies from the Mexican federal government). In 2020, private clean energy generation reported average costs of USD 20.1 (MXN 401) per megawatt-hour, while the average costs of energy produced by CFE was USD 70.8 (MXN 1,413).

   CFE itself would incur in additional costs for the construction, operation and maintenance of power plants needed to offset private generators and keep up with demand growth. The cancellation of generation permits will affect the legal certainty of investors retroactively changing the legal and regulatory framework under which their investments were made.

2. **Eliminate CFE's horizontal and vertical separation**. The bill disappears all CFE subsidiaries and affiliates –except for CFE Telecomunicaciones and Internet para Todos, CFE Capital, CFEnergía and CFE Internacional–. Since 2016, CFE was forced to participate in each of the power industry activities (generation, transmission, distribution, commercialization and supply of primary inputs) independently through different subsidiaries and affiliates with the purpose of promoting open, non-discriminatory, access, efficient operation and competition in the sector.

   Impact: By reintegrating vertically and horizontally, CFE reconstitutes itself as the only player that can buy (monopsony) and supply (monopoly) energy. This effectively eliminates competition in the energy generation market. Thus, it will have the ability to discriminate private participants in transmission and distribution thus reducing options for consumers.

3. **Cancel Clean Energy Certificates (CELs)**. As an incentive to clean energy generation, the Energy Transition Law created the CEL mechanism. A CEL is awarded for each megawatt-hour of energy generated by renewable plants that initial operations after August 2014. These have represented the most powerful incentive to attract new investment in clean energy installed capacity in Mexico.

   Impact: Disappearing CELs eliminates the main incentive to expand installed renewable capacity in Mexico. CFE does not have clean installed capacity to increase the share of renewable energies to the extent that the country requires it. Without them, it becomes impossible for Mexico to comply with its Paris Agreement commitment to generate 35% of its energy from clean sources by 2024.

4. **Dismantle the Energy Regulatory Commission –CRE–and the National Hydrocarbons Commission –CNH–**.

Impact: Dismantling sector regulators is detrimental to consumers (quantity, quality and price), the development of the sector. It creates uncertainty among industry participants, both public and private.

5. **Merge the independent system operator -National Energy Control Center Cenace– with CFE**.

   Impact: Cenace was part of CFE until the liberalization of the energy sector in 2013/2014. Going back to a model in which the market is operated by CFE implies the company would control dispatch; prices and generation.

6. **Lithium mining as an exclusive activity of the Mexican State**. Mining concessions will be prohibited (except existing concessions) on the grounds of its strategic importance for the country's energy transition.

   Impact: Electricity storage represents a paradigm shift in the industry. Monopolizing the exploitation of lithium by the Mexican State reduces the possibilities of development by limiting the ability to attract resources and technology.

The congressional debate must be based on both data and science with the participation of all relevant stakeholders. **If approved, the bill will eliminate the possibility of competitive rates and clean energy for households and businesses. Moreover, it would represent an historical setback for the construction of a more competitive fair and sustainable Mexico**.