

Ariel Ramos on the Proposed Changes to Mexico's Electric Industry Legislation and the Response from Investors

By Ariel Ramos and Jose L. Valera

Jose Valera, a partner in Mayer Brown's Global Energy industry group, interviews Ariel Ramos on President Andrés Manuel López Obrador's (aka AMLO) proposed changes to Mexico's electric industry legislation, the impact they will have on new private investment and the response from current investors. Based in Mayer Brown's Mexico City office, Ariel is a partner in the Global Energy group and the Banking & Finance practice.

JOSE Hi, Ariel. Could you tell us about Mayer Brown's Mexico City office and your professional background and practice?

ARIEL Thank you Jose. I am a partner in the Banking & Finance practice of the Firm's Mexico City office. I have a broad energy background and my practice focuses on energy transactions related to power, oil and gas, energy-related infrastructure and the Mexican energy reform. My clients include domestic and international companies as well as government entities, developers and sponsors, financial institutions, investment bankers and private equity funds.

"The protection of investor rights has national and international dimensions."

The firm's Mexico City Office was opened to serve clients in the Mexican energy market back in 2015. Since then, we have expanded our service offering to cover finance and corporate and securities with an in-depth focus on oil and gas, power, renewable energy, projects and project finance.

ARIEL In addition, we regularly advise on innovative transactions, both domestic and international, involving M&A, acquisition finance and acquisition leverage, fintech, asset and project finance, securitization/structured finance and derivatives, supply chain finance, trade finance, project finance, bank lending, cross-border lending and regulatory finance.

JOSE Proposed changes to electric industry legislation in Mexico are making headlines. Could you please start by giving us a broad overview of the industry's legal framework immediately prior to AMLO taking office in December 2018?

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ARIEL Like other Latin American countries, Mexico has a long history of legal conflicts over its natural resources and private participation in the energy industry. But in the years previous to López Obrador taking office, the trend had been reversed to give way to new laws and regulations that gave private investors the opportunity to participate in the energy industry. The most transformative was the 2013 Reform, in which Mexico adopted a constitutional model of economic regulation in specific strategic sectors; it created a constitutional framework in which the electric industry would face market competition in the generation and commercialization of energy. All of this effectively suppressed the state monopoly. As a result, CFE would only stay involved in the electrical system with respect to transmission and distribution of electrical energy but not as a generator. This separation opened the market to competition, which led to more renewable generation connecting to the grid.

JOSE And then what changed under AMLO? What actions did he take?

ARIEL During the first three years of the current administration, we have witnessed various modifications to the regulatory framework of the energy sector, to the point of being considered a sector of investment risk. The central theme of these changes followed a narrative of supposed energy security and sovereignty over natural resources and energy sources. The first significant blow, with drastic consequences, came when the Ministry of Energy published the Reliability, Security, Continuity and Quality Policy in the National Electric System, which used energy security as an excuse to limit the participation of private generators of renewable energy. The policy, supposedly motivated by the COVID-19 pandemic, stopped the dispatch of renewable energy to the National Electric System indefinitely due to its allegedly low reliability, which gave priority to CFE's electricity generation even though it meant more pollution and higher cost to the end user. But, fortunately, the tribunals who specialized in competition suspended the policy shortly after publication.

After the failed attempt to limit private generation through changes in administrative regulation, the executive branch sent a preferential bill to reform the Electricity Industry Law with similar effect. The law was enacted, but it is being challenged by COFECE, the antitrust watchdog. The resolution is expected to be in line with previous resolutions from the courts, which have ruled in favor of a pollution-free environment and market competition thus far.

JOSE AMLO has also proposed to Mexico's Congress a constitutional amendment relating to the electric industry. What does the proposed amendment provide?

ARIEL This bill has been the most drastic to date since it threatens to exclude private investment from practically any activity related to the electricity industry and, in addition, fosters uncertainty in the hydrocarbon sector. Moreover, the changes effectively exclude private sector investments that were made possible by the 2013 Reform and the reforms of 1992 and 1995. The bill's text noted that CFE would be in charge of the purchase of energy and other products generated by private companies to meet the energy demand. In addition, the electric public service would be provided exclusively by CFE, eliminating the regime of free competition in generation and commercialization. For this, the bill proposes a generation quota in which private generators might supply a maximum of 46% of the national demand. However, canceling permits to private companies would raise new problems, and further questions would arise. Therefore, the private generation's restructuring would probably happen under secondary legislation.

JOSE What is the effect on the electric industry of all the actions taken by AMLO, and what would be the further effect if the constitutional amendment is approved as proposed?

ARIEL The explanatory memorandum of the bill airs the intention of reversing the energy reforms that have opened up the participation of the private sector in the electricity industry—and

canceling not only the 2013 Reform but also the 1992 Reform. The bill reverses some of the most significant changes of the 2013 Reform that made CFE a decentralized body. The drafters of the bill argue that the growing demand for electricity in the national economy has been met by private companies, which puts the affordability of energy prices at risk in the long term. To avoid this alleged risk, the bill proposes that CFE become a single state agency without vertical or horizontal separation.

JOSE What are privately owned electric generation companies doing about all this?

ARIEL The protection of investor rights has national and international dimensions. At the national level, investors can promote Amparos, a legal process to challenge the legality of actions and protect constitutional rights (habeas corpus equivalent); from the international perspective, investors are

looking into the possibility of invoking the legal protection provided under bilateral investment and free trade treaties and agreements. These treaties provide strong protections for investors suffering from indirect expropriation, and the investor claims will have to be assessed by an arbitral tribunal.

One last thing to consider is that there are efforts by various political parties in Congress to revise the proposed reform, and there are ongoing discussions between Mexico and its principal trade and investment partners. I hope that the government would reconsider its position or at least enter into an open process to allow a legislative reform that would allow CFE to become more efficient and financially sound without undermining the benefits that the private sector would bring from the financial and technological perspectives.

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