

**Mexican Energy Reform:**  
**The New Enacted Electric Industry Law.**

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The opening of the Mexican energy sector (the “Sector”) has been finally achieved with the approval by the Mexican Senate on August 5, 2014 of the energy bills which have been discussed in the Mexican Congress as a result of the Mexican Constitutional Reform previously published in December of 2013. The bills were sent to the Executive for its publication in the Official Gazette and the new era in the Sector will immediately begin.

The package of the proposed amendments which was submitted by President Enrique Peña Nieto last April has been the basis for the Legislative branch to deepen the reforms that were finally applied to the Mexican legal framework to give effect to the sweeping changes that have been made to the Sector, including among others the welcoming of domestic and foreign private investment in the Sector and the operation of new regulatory agencies.

This is a summary of the amendments made to Mexican energy legal framework:

<b>Industry</b>	<b>Proposed New Laws</b>	<b>Amended Laws</b>	<b>Abrogated Laws</b>
Hydrocarbons’ Industry	- Hydrocarbons Law	- Foreign Investment Law - Mining Law - Public-Private Associations Law	- Regulatory Law of Constitutional Article 27 Related to Oil Matters - Regulation on the Mining Law regarding Associated Gas of Coal Deposits
Electric Industry	- Electric Industry Law		- Electric Power System Public Service Law
PEMEX and CFE	- PEMEX Law - CFE Law	- Federal Law of State-Owned Entities - Acquisitions, Leasing and Public Sector Services’ Law - Public Works and Related Services Law - Public Debt Law - Federal Law on Budget and Treasury Responsibility	- Petroleos Mexicanos Law
Hydrocarbons’ Revenues	- Hydrocarbons Revenues Law	- Fiscal Coordination Law - Federal Law of Royalties	- Regulation on the Mining Law regarding Associated Gas of Coal Deposits
Industrial Security and Environmental Protection of the Sector	- Law of the National Agency of Industrial Security and Environment Protection of the Hydrocarbons Sector		
Sector’s Regulatory Agencies	- Law of the Coordinated Regulatory Agencies of the Energy Sector	- Organizational Law of the Federal Public Administration	- Energy Regulatory Commission Law - National Hydrocarbons Commission Law
Mexican Oil Fund	- Law of the Mexican Oil Fund		

	for Stabilization and Development		
Geothermal Energy	- Geothermal Energy Law	- National Waters Law	

We at JATA share the idea that the new structure of the Sector has the potential of encouraging the economic development of our country in the coming years. The upcoming participation of private investment in the two largest industries of the Sector (hydrocarbons and electricity) is mainly described in the Hydrocarbon Law and the Electric Industry Law, respectively, and for that reason their analysis is essential for any potential investor in those industries. Consequently, we have prepared a summary of the most relevant aspects of the approved Electric Industry Law and we are open and available to discuss with our clients and friends any particular aspects of these laws or any other rules related to the Sector.

**Electric Industry Law (the “Law”).**

The Law eliminates the Electric Power System Public Service Law, enacted in 1975. The new regime for the electric industry is detailed by the Law and complemented by the Law of the Federal Electricity Commission which establishes the new functions of the stated-owned company. Similarly, the changes to this industry are reflected in the amendments to several federal laws, such as the Federal Law of State-Owned Entities, the Acquisitions, Leasing and Public Sector Services’ Law and the Public Works and Related Services Law, among others.

**a. Scope**

The Law regulates the Mexican Electricity Industry’s activities, the rights and obligations of the participants and the corresponding role of the regulatory agencies. As provided in the constitutional reform passed in December of 2013, this Law modifies the electricity industry and details the different ways in which private parties will be allowed to participate in certain of its activities.

The Mexican State’s role in the electricity sector is significantly reduced and now limited to the operation of the National grid and as a public service provider to the activities of electricity transmission and distribution. The still state-owned Federal Electricity Commission or CFE, to be transformed into a “productive state company”, loses almost all of its monopolies in the sector, partially in favor of the new National Center of Energy Control (*Centro Nacional de Control de Energía*, or *CENACE*) and will now be competing against private generators and retailers.

**b. Wholesale electricity market**

Through this Law a new wholesale electricity market is created in Mexico, much like other markets currently existing in other countries. This wholesale electricity market will be operated by the CENACE, which acting also as the operator of the National grid, will be in charge of guaranteeing open access to the National grid to all the market participants. The Energy Regulatory Commission will issue the basis of the electricity market and CENACE will issue the operative provisions of the market.

Moreover, in the wholesale market, the power generators, retailers and qualified consumers who participate in the market will be able to enter into electricity purchase and sale transactions, as well as transactions regarding electricity’s related services, electric power, import/export of the aforesaid products, financial transmission rights and clean energies certificates. In essence, competing generators will offer their output through this wholesale market to different categories of retailers, which will then sell it directly to the public (basic consumer), or to qualified consumers.

### **c. Electricity's activities**

As previously analyzed, the Constitutional Reform lifted the restriction placed against the private sector regarding the generation of electricity for its direct sale to final consumers by removing the condition of such activity as a public service, and as a consequence, private entities will be able to fully participate and compete in the electricity generation in a free market environment, and not only through the schemes that we have previously analyzed; therefore, CFE will turn into another competitor in this activity. Pursuant to the Law, power plants with a capacity equal to 0.5 MW or more will require a permit issued by the Energy Regulatory Commission in order to participate and sell their output on the wholesale market.

On the other hand, the Mexican State preserves its exclusive role as a public service provider of electricity's transmission and distribution, activities that will be performed by the CFE and/or its subsidiaries, coordinated by the CENACE. Nevertheless, the Law provides that the State, directly or through the CFE and/or subsidiaries, may enter into contracts or partnerships with private parties for the financing, installation, maintenance, managing, operation and expansion of the infrastructure needed for the performance of the aforementioned public service.

Except for qualified consumers, a figure that we will briefly explore later, not all final consumers will be able to buy electricity directly from the wholesale electricity market. Instead, final basic consumers will receive their electric supply directly from the providers of basic services including the CFE at regulated tariffs, which in turn may acquire the electricity at the wholesale market through auction processes. The foregoing means that the CFE will continue serving most of the Mexican houses, which will be considered as final basic consumers. In contrast, qualified consumers will be able to purchase electricity directly at the wholesale market from any generator or supplier of qualified services. Both basic and qualified suppliers will require a permit issued by the Energy Regulatory Commission to offer their services. However, activities involving the sale of electricity from one final consumer to another party will not require permit, provided that the electricity is used in the facilities of the final consumer, nor the sale of electricity from a third party to a final consumer, as long as the power is generated from "distributed generation" in the facilities of the final consumer.

The Law introduces the term "distributed generation" as the generation of electricity to be made: (i) by an exempt generator; and (ii) in an electricity generation plant that is interconnected to a distribution circuit containing a high concentration of load centers. This generation will feature open and non-discriminatory access to markets and information general distribution networks.

### **d. Qualified consumers**

The Law introduces the figure of "qualified consumers", whom pursuant to the Law may participate freely at the wholesale electricity market and shall be registered before the Energy Regulatory Commission. In order to be considered as qualified consumers, the Ministry of Energy will determine the consumptions levels that will grant this characteristic; therefore, it is expected that industrial and large commercial consumers will receive this qualification.

### **e. Land use and occupancy**

Additionally, and consistent with the qualification of the activities of the Sector as strategic and of public interest, the Law allows the occupation of land, rights or other assets that may be needed for the performance of the industry's activities by the creation of "Legal Easement" (*Servidumbre Legal*).

Similar to the Hydrocarbons Law, the Law provides that the consideration, the terms and conditions for the use, enjoyment or allocation of land, assets or rights which are necessary to perform activities from the electric industry may be agreed between the owners (including the holders of property or communal rights) and the interested party, however, if the parties do not reach an agreement, the interested party may promote before a Civil District Judge or competent Unitary Agrarian Tribunal the establishment of the Legal Easement or

otherwise initiate before the Ministry of Agrarian, Territorial and Urban Development a mediation process by which the parties may agree on the methods of acquisitions, use, enjoyment or allocation of land, assets or rights and the corresponding consideration to be applied. Additionally, it provides that what is stipulated in the Law shall apply to the rights that the Constitution, laws and international treaties recognize to indigenous communities. It is therefore important that since years back the ILO Convention 169 (*Convention Concerning Indigenous and Tribal Peoples in Independent Countries*) has been the reference regarding the rights of indigenous and native communities in order to determine the appropriate applicable legal treatment when communal rights are involved.

The Law also provides that the consideration to be paid to the owners of land should be enough to cover, if applicable: (i) the payment affectation to property or rights other than land, as well as damages; and (ii) income derived from occupation, easement or land use; always considering the commercial value. Different forms of compensation, in addition to payment in cash, may be agreed, but all must be entered into an agreement subject to the guidelines issued by the Ministry of Agricultural, Regional and Urban Development. The agreements reached by the parties shall be submitted before a District Judge or competent Land Court to be validated.

**f. Other relevant aspects**

Notwithstanding the foregoing, we have identified the following important elements of the Law that are important for the study of the new legal framework of the Sector:

- The permissions shall be granted only by the Energy Regulatory Commission to natural persons or companies legally constituted under Mexican laws.
- The Law sets forth a minimum “national content” participation in the electric industry, same as in the Hydrocarbons Law. However, it is not as specific with an exact number as the latter.
- Nonetheless certain activities of the sector are reserved for the Mexican State and/or its state owned companies or productive state companies, the spirit of the Law is that private parties may also participate via joint ventures and/or by the execution of contracts with the State, in the activities that will continue to be reserved for the Mexican State.
- The Law defines clean energies as those sources and electricity generation processes whose emissions or wastes do not exceed a certain threshold, and lists a number of energies that will be considered as clean energies.
- The transitional articles of the Law contain a term of eighteen to twenty-four months in which most of the changes to the industry shall be performed.
- The transitional articles of the Law establish that the permits and contracts, granted or processed under the Public Service Law of Electric Power, for supply, cogeneration, independent production, small production, import, export and use own will continue to be ruled under the terms established by the mentioned law and what is not in violation to such law, by the provisions of the new Law. However, the holders of such permits and contracts may request their modification to make their activities under this new Law.
- As we mentioned in our review to the Hydrocarbons Law, no special anti-corruption framework was submitted along with the drafts in this case; however, the Law also contains a special chapter with the description of certain conducts that will be specifically sanctioned as corrupt practices within the Sector. This is an item of special relevance for the overall amendments and key for private Mexican and global companies seeking to become involved in the Sector.
- All of the Sector’s activities, including the generation, transmission, distribution and retailing of electricity must be considered as separate activities by the industry’s participants, in order to guarantee the open access and the efficient operation of the sector.
- The Law provides that the Ministry of Energy shall execute mechanisms for the diversification of energy sources, security and promotion of the use of clean energies. For these purposes, the

participants of the wholesale electricity market will be able to acquire clean energy certificates and pollution certificates.

JATA is a Mexican law firm with offices at Monterrey, Mexico and Houston, Texas. Please do not hesitate to contact us with any comments or concerns regarding the reform and its implementation in practice.

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Do not hesitate to contact us at our numbers below for professional legal advice on the subject matter of this memorandum or for any further information, comments or questions. We will be very glad to help you.

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