

ENERGY REFORM LEGISLATION IN MEXICO GIVES THE PRIVATE SECTOR UNPRECEDENTED OPPORTUNITIES IN THE MEXICAN ELECTRICAL POWER INDUSTRY

This article was originally published in the October 2014 issue of Pratt's *Energy Law Report*.

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Mexico's President recently signed into law a historic package of legislation to restructure the nation's electrical power sector. This article discusses the legislation, which will create a more open and competitive power industry in Mexico, giving the private sector unprecedented opportunities to (i) generate power in Mexico for sale in a competitive wholesale electricity market and/or under long-term contracts with marketers or qualified users, (ii) market electricity service to large-scale consumers in Mexico, and (iii) enter into joint ventures, public-private partnerships, and service contracts with the state or the state-owned utility for the financing, construction and operation of infrastructure needed for the transmission, distribution, and generation of electrical power.

Background

Eight months after Mexico amended its Constitution to reform and restructure the nation's energy industry (the "Energy Reform"), President Enrique Peña Nieto signed into law a much-anticipated package of legislation to implement the Constitutional amendments (the "Implementing Legislation"). This Implementing Legislation, which went into effect on August 12, 2014, includes eight new laws, as well as amendments to thirteen existing laws, covering both the oil and gas industry

and the electrical power sector in Mexico.

The portions of the Implementing Legislation that relate to the electrical power industry, including the new Law of the Electrical Industry (*Ley de la Industria Eléctrica*) (the "Electricity Law") and the new Law of the Federal Electricity Commission (*Ley de la Comisión Federal de Electricidad*) (the "CFE Law"), establish a framework for a more open and competitive electrical power industry in Mexico, and set forth the next steps in the transition to a new industry structure.

In order to paint a clear picture of the restructured Mexican electrical power industry and the opportunities that the restructuring could unlock for the private sector, this article provides:

- An overview of the preexisting structure of the electrical power industry in Mexico and its challenges;
- A discussion of the new industry structure established under the Implementing Legislation;
- A summary of the national priorities advanced under the Implementing Legislation;
- A review of the timeline for transition to the restructured power sector; and

- A conclusion focusing on the immediate next steps in the reform effort.

The Pre-existing Industry Structure and Its Challenges

The Mexican electrical power sector for many years has been dominated by the CFE (*Comisión Federal de Electricidad*), a state-owned, vertically integrated electric utility serving all of Mexico. In addition to being the only entity that could legally undertake the transmission, distribution and marketing of electrical power in the country prior to the passage of the Implementing Legislation, CFE has maintained a dominant position in power generation (with approximately 85 percent of generation owned or controlled by CFE). Under preexisting law, CFE also controlled the planning for new generation projects and expansion of the transmission grid.

Although some private sector involvement in generation was allowed prior to the passage of the Implementing Legislation through special permits for self-supply (generating electricity for the generator's own use), cogeneration, production for export, small production, or independent power production (for sale of electricity solely to CFE), private sector generation up to now has been significantly limited in Mexico, primarily for three reasons:

- Large scale generation projects have depended on CFE planning and have been limited by the restrictions of the federal budget, resulting in a bottleneck of potential new projects;
- The fact that CFE has been the sole buyer of a new generation plant's

output, as well as the absence of a competitive market for the acquisition of new capacity, have limited the economic attractiveness of building new generation other than for self-supply; and

- An aging and insufficiently integrated national transmission network has resulted in substantial barriers to the interconnection of potential new generation projects, most importantly in the relatively remote areas of Mexico that have great potential for the use of clean energy sources, such as wind and solar.

As a consequence, a disproportionate amount of electricity in Mexico is generated from fuel oil and diesel, which are relatively high-cost sources when compared to other energy sources, particularly natural gas. This fact has contributed to the excessively high cost of electricity in Mexico, where average rates are more than 25 percent higher than in the U.S., despite significant government subsidies, without which it is estimated that average rates would be 73 percent higher than in the U.S. These high costs constitute a serious hurdle for the growth of Mexico's economy across all industry sectors.

CFE also has faced significant challenges because of the lack of private sector participation in the development of transmission infrastructure and the distribution of electrical power to end users, including billing and collection. The expected rate of growth in demand for electricity in Mexico in the next decade far exceeds the rate of expansion of the transmission grid that CFE could have funded, built and operated on its own. CFE, which has had to work within federal

budgetary constraints while at the same time bearing sole responsibility for the development of transmission infrastructure in all of Mexico, has struggled to build a sufficiently interconnected and modern national transmission network covering the entire country. To illustrate this problem, President Peña Nieto noted earlier this year that 47 percent of national transmission lines in Mexico are more than 20 years old and only eight percent have been built in the last five years.

With respect to the distribution of electrical energy to end users, and billing and collection, the Mexican government has emphasized that CFE has suffered from serious inefficiencies in the distribution networks, including a high level of losses due to nonpayment and energy theft. As a result, the Mexican government estimates that 21 percent of the energy delivered by CFE is never paid for by end users. This gap has contributed to CFE's losses (339 billion pesos from 2007 to 2013), which were projected to accelerate in the coming years absent reform. These losses has made CFE less able to make the investments necessary to fulfill its mandate of providing reasonably priced electricity service to a growing Mexican economy.

Finally, CFE's capacity to address these issues and improve its productivity and profitability as an enterprise has been further challenged by the role of the government in the management of CFE's operations. In contrast to other countries where ownership and management of state-owned energy companies are more clearly separated, in Mexico, CFE, like the national oil and gas company (Pemex), up to now has

been a state-run enterprise, subject to a significant amount of government control over its day-to-day operations.

The New Industry Structure

The Implementing Legislation establishes a legal framework to foster greater competition and private sector participation in all aspects of the Mexican electrical power industry. It also provides for the transformation of CFE into a “productive state enterprise” that will enjoy greater management autonomy and flexibility, while remaining a state-owned entity and a key industry participant.

A Disaggregated Industry with Strict Legal Separation Among Its Functional Segments

Under the new industry structure, CFE will continue to be the supplier of electrical service at regulated rates to residential users and small and medium-sized commercial and industrial users (collectively referred to in the Electricity Law as “Basic Users”). And CFE will continue to participate in each other segment of the industry through a series of new operating subsidiaries and affiliates that will be strictly separated from each other and run as independent business units, while ultimately remaining state-owned. For example, the companies that operate and maintain the national transmission network (“Transmission Companies”) and those that operate and maintain the general distribution networks (“Distribution Companies”) will be separate, independent subsidiaries of CFE, and will not be permitted to buy or sell electrical energy, so as to avoid any possible conflict of interest that could impact the network access that these companies provide to other market participants. CFE will not be privatized. The Implementing

Legislation reiterates that the public service of transmission and distribution of electricity, as well as the planning and control of the national electrical system, will remain within the exclusive purview of the state.

Private parties now have the opportunity to compete with CFE and/or with each other in (i) generating electricity for sale in a competitive, open wholesale market or under long-term contracts with qualified users or marketers (and not solely for sale to CFE or self-supply); (ii) entering into public-private partnerships with the federal government with respect to the generation of electrical power; (iii) acting as marketers of electricity service to large-scale end users, competing on equal terms with the marketing subsidiaries or affiliates of CFE; and (iv) entering into contracts and joint ventures with the state (including with CFE’s subsidiaries) for the construction, financing, operation and/or maintenance of transmission and distribution network infrastructure, as well as contracts to provide services relating to billing and collection, and relating to the operation of the wholesale electricity market.

The government believes that greater private sector investment in power generation in Mexico will lead to new and more diverse generation sources, including more generation from cleaner and lower-cost sources, so as to ultimately reduce electricity prices. Meanwhile competition in the supply of electricity to large-scale users is intended to result in better and less expensive options for these users to meet their energy needs. And the assistance of private companies in building networks, billing users

and operating the wholesale market is intended to increase investment, and make these processes more efficient and less of a burden on the government and CFE.

In order to ensure open access and efficient operation of the electrical power industry, without undue aggregation of market power, the Electricity Law establishes a general principle that the functions of generation, transmission, distribution, marketing and supplying primary inputs (such as fuel oil and natural gas) to power plants, each must be carried out independently and with strict legal separation from the other functions. Without limiting the general authority of Mexico’s antitrust regulator the Federal Economic Competition Commission (*Comisión Federal de Competencia Económica*) with respect to monopolistic and anti-competitive practices in Mexico, the Ministry of Energy (*Secretaría de Energía*) will now be required to establish legal separation among the various power industry functions, and to monitor compliance and enforce these rules, including by ordering the divestiture of assets, rights or equity interests.

In addition, the Electricity Law grants authority to the Energy Regulatory Commission (*Comisión Reguladora de Energía* or “CRE”), the primary regulator of the energy industry in Mexico, to issue rules governing transactions between generators of electricity and their affiliates that sell electricity, as well as to impose its own rules on market participants regarding accounting, operational or functional separation. Consistent with the principle of preventing conflicts of interest and ensuring open access, the new Hydrocarbons Law (*Ley de*

Hidrocarburos), a key component of the Implementing Legislation for the oil and gas industry, further provides that generators of electricity will not be permitted to own equity interests directly or indirectly in entities that operate oil and gas pipelines and storage facilities within the same markets where the generators operate.

CENACE and the Wholesale Electricity Market

In order to allow all generators of electricity to offer their output for sale in open competition under fair and impartial rules, the Electricity Law requires the establishment of a wholesale market for electricity in Mexico (the “Wholesale Electricity Market”) to be operated by the National Energy Control Center (*Centro Nacional de Control de Energía* or “CENACE”) pursuant to a new set of market rules (the “Market Rules”). CENACE will set the spot price for electricity in the Wholesale Electricity Market based on information regarding supply and demand provided by market participants, and will be responsible for ensuring that the demand for electricity is met at the lowest possible cost in accordance with the Market Rules. CENACE will also be the operator of the national electrical system, controlling the dispatch of electrical power and the operation of the national transmission grid and general distribution networks.

Under the preexisting industry structure, CENACE was a division of CFE. Now, pursuant to the Electricity Law and a presidential decree issued just two weeks after the Electricity Law went into effect (the “CENACE Decree”), CENACE has been recast as a separate and independent governmental entity, and will be spun out

from CFE. The new CENACE will be charged with ensuring open and nondiscriminatory access to the transmission and distribution networks, maintaining system reliability, and proposing plans for transmission and distribution expansion to the Ministry of Energy, among other activities. Its function will be similar to that of an independent system operator (“ISO”) in the United States. CENACE will be permitted to enter into agreements with private parties for the provision of services relating to the operation of the Wholesale Electricity Market.

Three types of entities will be permitted to participate in the Wholesale Electricity Market by entering into market participant agreements with CENACE and posting the security that will be required under the Market Rules:

- *Generators.* Generators, including both private sector generators and CFE, will be able to offer electricity for sale through the Wholesale Electricity Market by submitting bids based on their operating costs.¹
- *Qualified Users.* “Qualified Users” will include entities whose electricity consumption and demand exceeds a threshold² to be set by the Ministry of Energy, as well as existing self-supply, cogeneration and importation users. Qualified Users will be able to purchase electrical power directly in the Wholesale Electricity Market and will be required to report their demand for electricity to CENACE. In addition, Qualified Users will have the option of acquiring electrical power indirectly through a “Supplier” of electricity service, as discussed below.

- *Commercializers (Including Suppliers and Non-Supplier Commercializers).* Entities that provide electricity to end users and “represent” Qualified Users in the Wholesale Electricity Market are referred to in the Electricity Law as “Suppliers” and now include both (A) private sector companies that supply Qualified Users, and (B) CFE or its commercialization subsidiaries, which will provide this service to Qualified Users and Basic Users. These Suppliers will be able to purchase electrical power in the Wholesale Electricity Market to satisfy the requirements of their customers and will be required to report their demand for electricity to CENACE. In addition to Suppliers, other “Non-Supplier Commercializers” will be permitted to buy and sell the other products and services that will be traded through the Wholesale Electricity Market, as discussed below.

In addition to electrical energy itself, the Wholesale Electricity Market will also facilitate the purchase and sale of other products and services (“Associated Products”), including, among other things, (i) capacity, (ii) transmission and distribution services, (iii) financial transmission rights,³ and (iv) certain “Ancillary Services” required in order to ensure the reliability and security of the national electrical system, such as frequency regulation, voltage regulation, operating reserves, spinning reserves (i.e., reserve capacity from units that are already on-line), black start (i.e., emergency start) services, and demand response (i.e., controlled reduction of consumption by end users), among other services, as these services will be defined in the

Market Rules. CENACE will acquire these Ancillary Services through the Wholesale Electricity Market from the market participants who are able to provide them, as and to the extent needed to maintain system reliability and security.

Bilateral Contracts

In addition to engaging in transactions through the Wholesale Electricity Market as described above, generators, Qualified Users and Commercializers also are permitted under the Implementing Legislation to enter into bilateral contracts relating to electricity, including contracts for differences and other types of financial contracts, under which the parties will agree on the purchase and sale of electrical energy and the making of payments based on the contract price. The parties will be obligated under the Market Rules to inform CENACE of any such contracts. These contracts will provide an alternative to the spot market for industry participants, offering some insulation from price fluctuations in the Wholesale Electricity Market and helping to facilitate long-term planning.

A New CFE

The CFE Law will transform CFE into a “productive state enterprise” with a series of subsidiary companies and affiliates, all of which will be subject to the requirements of functional separation and independence mentioned above.

As a productive state enterprise, CFE’s governance will be more in line with international best practices for an independently managed power company, with a board of directors that will have very broad powers

to oversee the operations of the company. The board will include five independent directors (out of a total of 10 directors) and will have four support committees, including an Audit Committee, a Human Resources and Compensation Committee, a Strategy and Investments Committee, and a Committee on Acquisitions, Leases, Works and Services.

The CFE Law also contemplates that CFE and its subsidiaries will have a special compensation regime, which will be different from the general regime governing federal employees and which will permit a greater degree of incentive compensation than is currently allowed, equivalent to the incentive compensation that is typically payable in the industry or industry segment in question.

In addition, CFE will have greater budgetary autonomy consistent with the principle of separation of ownership from management. This will occur, in part, by means of a new regime under which CFE will pay an annual “dividend” to the state, in an amount to be determined by the Ministry of Finance and Public Credit (*Secretaría de Hacienda y Crédito Público*), taking into account a financial report and five-year forecast to be provided annually by CFE, together with CFE’s proposal as to the amount of the dividend for the year in question. The remainder of CFE’s profits will be reinvested as determined by CFE’s Board of Directors.

The CFE Law also requires greater transparency and public disclosure of information by CFE, based generally on the disclosure requirements that are imposed on publicly traded

companies under the Mexican Securities Market Law (*Ley del Mercado de Valores*).

In addition to these changes relating to governance, compensation, budgetary autonomy and transparency, the CFE Law, together with the Electricity Law, seek to further strengthen CFE by allowing it, through its various subsidiaries, to enter into agreements and joint ventures with private parties for the financing, installation, maintenance, management, operation and expansion of the transmission and distribution networks, as well as for the provision of collection and billing services in connection with the commercialization of electrical energy. The contracts are required to be awarded by means of competitive bidding processes that guarantee open and free competition, as well as complete transparency.

This potential involvement of private parties in transmission infrastructure, distribution and commercialization is intended to give CFE and its subsidiaries access to experience and technology in these areas that do not exist or are in short supply in the Mexican public sector, so as to reduce the debilitating losses that CFE has suffered and improve the efficiency of the transmission and distribution systems.

A Stronger CRE

In a disaggregated electrical power industry with a large number of new participants and increasingly complex transactions to be regulated, the CRE will have an expanded mandate and workload. In order to better position the CRE to fulfill its new role, the Implementing Legislation

strengthens the CRE by (i) increasing its budgetary, technical and management autonomy; (ii) making it more difficult for regulated entities to initiate legal challenges against CRE actions; (iii) increasing the number of commissioners from five to seven; (iv) requiring greater openness and transparency with respect to the CRE's regulatory decision-making; and (v) establishing mechanisms to ensure the CRE's efforts reflect Mexico's national energy policies.

For this purpose, the Implementing Legislation includes a new Law of the Coordinated Regulatory Bodies for Energy (*Ley de los Organos Reguladores Coordinados en Materia de Energía*) (the "Proposed Regulatory Bodies Law"). This law creates a new legal, financial and administrative regime for both the CRE and the National Hydrocarbons Commission (*Comisión Nacional de Hidrocarburos* or "CNH"), which will have a similarly expanded role in the restructured oil and gas industry. It also establishes a new Coordinating Board for the Energy Sector (*Consejo de Coordinación del Sector Energético*) to include the CRE, the CNH, representatives of the Ministry of Energy, and the presidents of CENACE and the equivalent control center for the natural gas transport system. This Coordinating Board will help ensure that the CRE and CNH work in a coordinated fashion to advance the national energy policies formulated by the Ministry of Energy.

National Priorities Advanced by the Implementing Legislation

In addition to opening up the electrical power industry to a greater number of participants, promoting competition for the ultimate benefit of electricity

consumers, transforming CFE so as to strengthen it, and revamping the CRE, the Implementing Legislation also is designed to advance certain technical and public policy imperatives, including, among others, the following:

Promoting the Mexican Domestic Power Industry

The Electricity Law requires that the Ministry of the Economy (*Secretaría de Economía*), in consultation with the Ministry of Energy, define strategies to promote local industrial supply chains and to promote direct investment in the power industry, with a focus on small and medium-sized companies. These efforts will be supported by a new Public Trust to Promote the Development of National Suppliers and Contractors in the Energy Industry (*Fideicomiso Público para Promover el Desarrollo de Proveedores y Contratistas Nacionales de la Industria Energética*), which will promote the domestic industry through financing programs and other support programs for training, research and certification.

Expanding and Modernizing the Grid

The Electricity Law requires the Ministry of Energy to develop programs for the expansion and modernization of the national transmission network and the general distribution networks, taking into account (i) the CRE's views with respect to such proposals, and (ii) input from participants in the Wholesale Electricity Market and other parties interested in developing electrical infrastructure projects.⁴ For those networks that are determined by CENACE to correspond to the Wholesale Electricity Market (as opposed to local transmission networks), such expansion and

modernization programs will be based on proposals formulated by CENACE.

These programs, together with the Ministry of Energy's indicative planning for the construction and retirement of particular generation facilities, are to be included in a Development Program for the National Electrical System (*Programa de Desarrollo del Sistema Eléctrico Nacional*) issued by the Ministry of Energy. The Transmission Companies and Distribution Companies, in turn, will be required to carry out the expansion and modernization projects that are included in these programs, pursuant to the Ministry of Energy's instructions.

Financing Electrification Projects for Rural and Marginalized Communities

The Electricity Law requires the Ministry of Energy to establish and oversee a Universal Electrical Service Fund (*Fondo de Servicio Universal Eléctrico*) to finance electrification projects in rural communities and marginalized urban areas, and to finance the supply of efficient lighting and electricity supply to marginalized end users. The expansion projects in the Ministry of Energy's Development Program for the National Electrical System mentioned above are required to be developed in coordination with such electrification projects.

The Universal Electrical Service Fund will be endowed with the surplus resulting from the management of technical losses in the Wholesale Electricity Market, pursuant to the terms of the Market Rules. The fund also will be permitted to receive donations from third parties. Funds from the market that are not used by

the Universal Electrical Service Fund for electrification projects will be remitted to CENACE, to be returned to market participants in accordance with the Market Rules.

Promoting Sustainability and Respect for Human Rights

The Electricity Law establishes a general principle of promoting sustainability and respect for human rights in indigenous communities in regard to infrastructure projects for the power industry. It requires the Ministry of Energy, in coordination with the Interior Ministry (*Secretaría de Gobernación*), to look into the social impact of proposed infrastructure projects and requires applicants for permits to develop such projects to submit social impact assessments to the Ministry of Energy.

Promoting the Use of Clean Energy

The Electricity Law requires the Ministry of Energy to implement measures to comply with policies on diversification of energy sources, energy security and the promotion of clean sources of energy. It also requires the Ministry of Energy to establish obligations for the acquisition of clean energy certificates, and allows the Ministry to enter into agreements to permit the recognition of equivalent instruments from other jurisdictions. The regulations in regard to such clean energy certificates, which are expected to be issued in October, 2014, will allow the clean energy certificates to be negotiable, promote the execution of long-term financial contracts (of the kind described above under the heading “Bilateral Contracts”) that include such certificates, and permit the transfer of excess or needed certificates between periods to promote price

stability. The Ministry of Energy is also required to put in place all other mechanisms that are required to comply with the government’s clean energy policy.

The Ministry of Energy will impose obligations to acquire clean energy certificates on Suppliers, Qualified Users that participate in the Wholesale Electricity Market, end users that receive power from isolated supply sources⁵ and the parties to legacy interconnection agreements (those in effect prior to the passage of the Implementing Legislation) that cover load centers,⁶ whether public or private, excluding any such load centers that already produce energy from clean energy sources in sufficient quantity to fully cover their consumption of electricity. Such obligations to acquire clean energy certificates will be set as a proportion of the total electrical energy consumed at all load centers. During the first quarter of each year, the Ministry of Energy will establish the requirements for acquisition of clean energy certificates that will be applicable for the following three years, and such requirements for future years cannot subsequently be reduced.

The Ministry of Energy will also establish criteria for the issuance of such certificates to generators that produce electrical energy from renewable sources or clean technologies. But it will be the CRE that grants these clean energy certificates, issues the regulations to validate ownership thereof, and verifies compliance with such obligations.

In addition to the clean energy certificate requirements, the Electricity Law also requires the

Ministry of Energy and CRE to promote and facilitate distributed generation from clean energy sources, by means of credits and other financing programs, as well as specialized training programs.

We note that the definition of “clean energy” for purposes of the provisions discussed above is quite broad, as it includes, among other categories, “technologies considered to cause low carbon emissions in accordance with international standards” and any other technology that the Ministry of Energy and the Ministry of the Environment and Natural Resources may determine. This could result in the issuance of clean energy certificates from a much wider range of sources than those that are normally considered renewable energy sources in the United States and other countries.

Finally, we note that some observers and legislators have argued that the Implementing Legislation did not do enough to promote the development of renewable energy projects in Mexico, and did not sufficiently address the issues of whether new subsidies and benefits for such projects will be established, and the extent to which existing subsidies and benefits will be available for new projects.⁷ Some analysts and stakeholders maintain that new and/or additional subsidies to promote renewable energy projects will be required in view of the fact that, at least initially, such projects will not be cost competitive with generation from conventional energy sources in an open wholesale electricity market.

In an apparent acknowledgment of the importance of this issue, Senator David Penchyna, the President of the

Energy Commission in the Mexican Senate, announced at the end of May that there would be a package of seven additional laws presented to the Mexican Congress (a “Green Package” (Paquete Verde)), specifically to deal with renewable energy, which would include certain “targeted” subsidies to promote renewable energy. In June, the National Action Party (*Partido de Acción Nacional* or “PAN”), an important center-right opposition party, submitted a proposed bill on this same topic to the Mexican Senate entitled the Law of the Energy

Transition (*Ley de la Transición Energética*), which would replace Mexico’s existing renewable energy promotion law per the PAN’s proposal. In the final weeks before the passage of the Implementing Legislation, however, there was little further discussion of the PAN’s proposed law and no further information from the government regarding the proposed Green Package legislation. Although some in the Mexican Congress have indicated recently that the Green Package legislation will be proposed in October or at some other point

during the Mexican Congress’ current legislative session, it is not clear when or if any such renewable energy legislation, or the PAN’s proposed law, will be proposed or discussed.

Timeline for Transition to the Restructured Power Sector

The transitional provisions of the Electricity Law, the CFE Law and the Regulatory Bodies Law, as well as the provisions of the CENACE Decree, establish the following timeline for the transition period:

Date, Deadline or Time Period	Transitional Step or Action
August 12, 2014	The Implementing Legislation took effect
Beginning on August 12, 2014	Importation of electrical energy and Associated Products allowed under certain circumstances
August 29, 2014	CENACE Decree took effect, creating the CENACE as a separate governmental body; the appointment of Eduardo Meraz Ateca as Director General of the new CENACE took effect
September 18, 2014	The approved President Peña Nieto’s nominations for the new CRE commissioner positions and the CFE independent director positions September 18, 2014 With the new Board of Directors of CFE appointed on this day, the CFE Law went into effect, per its terms, but not the special CFE regime established under the CFE Law for budget, debt, acquisitions, leases, services and works, administrative responsibilities, assets and compensations (see below)
September 28, 2014	The Board of Directors of the new CENACE was appointed
By September 28, 2014 (30 days after the CENACE Decree effective date)	The Director General of CENACE must prepare and deliver to the Ministry of Energy and the CRE, a timeline and a list of actions for the transfer of human, material and financial resources from the CFE to the independent CENACE (for the spin-off of CENACE from CFE)
During the month of October	Expected: Issuance by the government of (i) all regulations (<i>reglamentos</i>) relating to the Implementing Legislation (including the Regulations of the Electricity Law, but not including the Market Rules), and (ii) the guidelines for the issuance of clean energy certificates
Within 30 days after the issuance of the Regulations (Reglamento) of the Electricity Law	The Director General of CENACE must present to the CENACE Board for its approval the proposed internal bylaws (<i>estatuto orgánico</i>) of CENACE
By November 29, 2014 (three months after the CENACE Decree effective date)	Transfer of human, material and financial resources, and other assets and functions, from CFE to the independent CENACE

The date on which the CFE Board of Directors notifies the Ministry of Energy that the mechanisms required under the CFE Law with respect to audits, transparency and accountability are in place (the “CFE Notice”)	The special CFE regime established under the CFE Law for budget, debt, acquisitions, leases, services and works, administrative responsibilities, assets and compensations will go into effect; and the two year period for splitting CFE into distinct subsidiaries and affiliates will begin
January 1, 2015	The provisions of the CFE Law regarding an annual dividend payable by CFE to the state will go into effect
By February 8, 2015 (within 180 days after the Implementing Legislation effective date)	The CRE must issue its internal regulations, as a coordinated regulatory body
By May 12, 2015 (within nine months after the Implementing Legislation effective date)	The CRE will issue or authorize the contractual models for the agreements called for under the Electricity Law (including CENACE’s agreements with market participants and Transmission and Distribution Companies) (referred to in this timeline as the “Contract Model Date”)
Within three months after the Contract Model Date or the date of request from the market participant or Transmission/ Distribution Company	CENACE must enter into the contracts required for parties to become participants in the Wholesale Electricity Market, and the contracts with Transmission Companies and Distribution Companies
Until August 29, 2015 (for twelve months after the CENACE Decree effective date)	CENACE to provide support to CFE as needed to permit CFE to continue providing the public service of transmission and distribution under conditions of continuity, efficiency and security
Prior to the initiation of transactions through the Wholesale Electricity Market	Issuance of the first Market Rules by the Ministry of Energy
Date of the Ministry of Energy’s declaration that the Wholesale Electricity Market is in operation	The provisions of the Electricity Law that are needed for the Wholesale Electricity Market will take effect
One year after the commencement of operations of the Wholesale Electricity Market	Responsibility for monitoring the Wholesale Electricity Market will switch from the Ministry of Energy to the CRE
Within two years after the date of the CFE Notice mentioned above	CFE must carry out the legal, accounting, functional and structural separation of the activities of generation, transmission, distribution and commercialization

Immediate Next Steps

Now that the Implementing Legislation has become law, the Ministry of Energy and the CRE are required to develop and announce a large number of important policies, rules and regulations for the restructuring of the electrical power industry.

While the above timeline sets forth some of the key dates, requirements

and milestones identified in the Implementing Legislation for the transition period, we note that the Ministry of Energy has broad authority under the Electricity Law to establish additional time periods, policies and rules for the restructuring, and to oversee the transition process as a whole, including, among other items, creating (i) the initial Market Rules that will govern the

operation of the Wholesale Electricity Market; (ii) the exact timing, method and process for splitting CFE into multiple subsidiaries and transferring assets and contracts to these subsidiaries; (iii) the rules for granting and acquiring clean energy certificates; and (iv) the initial Development Program for the National Electrical System (as described above under the heading “Expanding and

Modernizing the Grid”). The Ministry of Energy, through its representatives on the CENACE Board, will also play an important role in the spin-off of CENACE from CFE and the establishment of the internal bylaws (*estatuto orgánico*) of CENACE.

The CRE in turn will have to develop, among other items, (i) the rate regime for transmission, distribution, electricity service to Basic Users, the operation of CENACE and the Ancillary Services not included within the Wholesale Electricity Market; (ii) the terms governing the bids that generators of electricity will have to make through CENACE based on their operating costs; (iii) the contractual models for the agreements that CENACE will enter into with participants in the Wholesale Electricity Market, and with Transmission Companies and

Distribution Companies; and (iv) the rules governing transactions between generators of electricity and their affiliates that provide electricity service to end users.

The careful design and implementation of the additional rules and policies mentioned above will be critical to the success of the Energy Reform initiative, because they will set forth the details regarding the type of Wholesale Electricity Market to be established, the roll-out of the new market, the regime for clean energy certificates, and the day-to-day operations of the restructured power sector.

Accordingly, in addition to being familiar with the Implementing Legislation described in this article, it will be important for industry participants to understand the rules

and policies to be issued by the Ministry of Energy and the CRE in the coming months.

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Endnotes

- 1 The new Electricity Law states that permits for self-supply, cogeneration, small production, independent production, import, export and own use that were issued before the Implementing Legislation took effect will remain valid and in effect for their original terms, and will be governed by the preexisting law that governed such permits: the Law of the Public Service of Electrical Energy (*Ley del Servicio Público de Energía Eléctrica*) and regulations issued thereunder, and by the new Electricity Law to the extent it does not contradict the above.
- 2 The transitional provisions of the Electricity Law set this threshold initially at 3 MW for the first year in which the Electricity Law is in effect (the one-year period beginning August 12, 2014), with a requirement that the threshold be reduced at least to 2 MW for the second year and at least to 1 MW for the third year.
- 3 Financial transmission rights are financial instruments that provide compensation for the costs that market participants can incur in the spot market when there is congestion in the transmission network. In order to ameliorate such congestion, power from generators in low-price areas is dispatched to high-price areas. As a result, generators in the low-price area are paid less through the wholesale electricity market than the amount collected from purchasers in the high-price area, and end users in the high-price area likewise are paid more than the price in effect at the low-price area. Financial transmission rights give the holder thereof the right to receive the amount of such price difference.
- 4 The Implementing Legislation requires that such expansion and modernization programs include smart grid programs.
- 5 Users of “isolated supply” are those that generate or import electricity for their own use without transmission of power over the Mexican national transmission grid or general distribution networks.
- 6 A “load center” is defined as those facilities and equipment, at a specified site, that permit a final user of electricity to receive the energy products and services required to satisfy the electricity demand and consumption of such final user.
- 7 With respect to existing clean energy projects, the transitional provisions of the Electricity Law do clearly provide that any benefits set forth in a legacy interconnection agreement for a clean energy project, including, without limitation, low-cost “postage stamp” transmission charges, the availability of the “energy bank” (i.e. the ability to deposit renewable energy into the grid at one point in time, and withdraw an equal amount of energy, deemed to be renewable energy, at a later time), and the availability of back-up power from the CFE for intermittent sources (this will be administered by CENACE going forward), will remain in place.