

Mexico: Mexican Government Proposes a Bill to Amend the Constitution Impacting the Energy Sector

In brief

On 30 September 2021, the President presented to the House of Representatives (Cámara de Diputados) a Bill seeking to amend articles 25, 27 and 28 of the Constitution of the United Mexican States (the "Constitution"), in energy matters ("Bill" or "Proposed Amendments").

Background

The Bill to amend the Constitution proposes the following: (i) substantial changes in both public policies, and the regulation of the electricity and hydrocarbon industries; (ii) nationalizing the right to the exploration, use, and exploitation of lithium, and, (iii) establishing that no future concessions will be granted.

If this Bill is approved, it would establish a major structural change, and a dramatic shift in the country's vision for the electricity sector, which is currently operating under open market rules, allowing for private investment from different participants. However, until the full legislative process takes place, it is difficult to know if the proposed constitutional amendments will be approved under these terms, and whether they will be binding. The Constitution would have to be reformed, and the Proposed Amendments would have to be enacted, including the Secondary legislation which regulates the Constitutional provisions contained in articles 25, 27 and 28.

Key Takeaways

The legislative process for the Proposed Amendments to be enacted, and issued in the Official Gazette of the Federation, consists of its review, analysis, and respective approval by a qualified majority (two-thirds) of the House of Representatives, and later, by the same proportion of the Senate. It would require 334 votes from the 500 deputies that make up the House, and 85 of the 128 that make up the Senate. In addition, an approval process must be carried out by a simple majority, in each of the local legislatures of the 31 States of the Mexican Republic, and Mexico City.

The Bill to Amend the Constitution in Energy Matters, proposes the following principle provisions:

Five Key Provisions

1. The State, preserves the right, and shall be responsible for energy security and sufficiency, and in charge of the continuous supply of electricity to the Mexican population. (It should be noted, that this could be interpreted as elevating the right to receive electricity to a basic human right and therefore, subject to the protection of individual rights/guarantees. If that were the case, in the event of a denial, or lack thereof, of electricity supply, a legal recourse could be sought)
2. The State is in charge of all activities related to the energy transition, utilizing all the energy sources available to the State in a sustainable manner. However, it is known that the State intends to comply with the generation and supply of electricity utilizing non-renewable resources (i.e., fossil fuel, carbon based). Furthermore, the Bill proposes to eliminate the Clean Energy Certificates ("CELS"), all which seem contradictory to this provision.
3. The status of State productive enterprises will be eliminated, emphasizing that these enterprises will now return to a State owned enterprise (returning to a government instrumentality). This change implies, in principle, that they will no longer be

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independent, autonomous, commercially driven companies. They will once again be agencies dependent on the centralized federal government, and subordinate to the governmental agency heads, i.e., the Ministry of Energy (SENER).

4. SENER will assume control over the formerly coordinated regulators of the sector: the Energy Regulatory Commission (CRE) and the National Hydrocarbons Commission (CNH). CRE and CNH will be eliminated in their capacity as coordinated regulatory bodies in energy matters, integrating their structure and powers under SENER.
5. Nationalize the strategic areas of: (i) lithium and other strategic and necessary minerals, and (ii) the industries required for the energy transition.

Within 180 days from the entry into force of the Bill, the Congress will make the necessary modifications. This includes, but is not limited to, secondary and subsequent legislation that would be affected by the Proposed Constitutional Amendments (e.g. the Electricity Industry Law, the Energy Regulatory Commission Law, and Law of Coordinated Regulatory Bodies, among others).

In depth

1. Electricity Industry

- The State, preserves the right, and shall be responsible for energy security and sufficiency, and in charge of the continuous supply of electricity to the Mexican population.
- The generation, conduction, transformation, distribution, and supply of electricity corresponds exclusively to the State. Based on this proposed amendment, the commercialization and supply activities by private participants would be eliminated.
- The Federal Electricity Commission ("CFE"), as a State body with autonomy in exercising its functions and administration, will have legal character and will be responsible for: (i) electricity; (ii) of the National Electric System (SEN); (iii) of the planning and control of the SEN; and (iv) the energy transition relating to electricity. However, as previously mentioned, in practice and operation, CFE will remain subordinate to the planning, guidelines and policies that the SENER dictates.
- **CFE will generate at least 54% of the electricity required by the country and the private sector will participate in up to 46%.** CFE will be in charge of the economic dispatch, considering the participation of private generators and their power plants, guaranteeing the lowest costs for the public service.
- The National Center for Energy Control ("CENACE") rejoins the CFE, with its functions. The CFE is in charge of the procedures to dispatch electricity, in compliance with reliability, continuity and stability. The preference of dispatch granted to the CFE, based on economic merit, raises uncertainties. Various questions arise as to order of a realistic economic dispatch, when confronted with a scenario in which a CFE plant and a private-owned plant would compete.
- **All current electricity generation permits granted are canceled - without distinction of modality, technology, conditions, capacity or object (for example, derived from electricity auction projects, distributed generation, etc.), including the power purchase agreements from private sector, and all pending permit applications.** This provision is questionable, since the issue arises as to how would the generation by private parties for exclusive purchase by CFE be regulated, and yet still be able to hold a market share of 46%, as indicated by the Bill.
- With respect to the generation from the private sector, the following schemes will be allowed to continue operations, under the Proposed Constitutional Amendments:
 - i. independent energy producers, from the regime prior to 2013;
 - ii. long-term auctions (which, could be inferred as only to those auctions that have already taken place, and those who have signed long-term contracts - not necessarily new auctions);
 - iii. power plants built after the 2013 reform (this provision is inconsistent if, as noted above, there will be a cancellation of all generation permits granted prior to the Proposed Amendments to the Constitutional enter into force); and
 - iv. Self-supply power plants, from the regime prior to 2013 (same comment as above).
- These schemes will be able to continue generating and competing under lower production costs so that all energy is acquired by CFE through CENACE. Important to note, although the electricity market is not mentioned, but rather it is implied that this would be carried out through bilateral operations.



- The Bill proposes that CFE be vertically and horizontally integrated as a single body of the State, eliminating the legal separation of its subsidiaries and affiliates, except CFE Telecomunicaciones and Internet para Todos, CF Energía, CFE International and CFE Capital, and others can be created.
 - **For the purchase of electricity and capacity from the private sector, CFE exclusively (i) will enter into long-term bilateral financial hedging contracts, and (ii) will carry out the economic dispatch of lower cost electricity for the short term.** It is unclear how these long-term purchases will take place. As mentioned, this Bill proposes many structural changes which would result in drastically changing the open market, and would create challenges for private participation in the Mexican energy sector. In essence, many of the provisions would return the powers to the State. Therefore, there is still uncertainty as to how these changes will play out.
 - CFE will establish the types of the contracts necessary for the acquisition of electrical energy, which is distinct from that established in 134 of the Constitution. To date, CFE already has a special contracting regime recognized under its own law, although ambiguous under what terms CFE will be bound
 - CFE will determine the transmission and distribution rates, as well as for all end users.
 - **Clean energy certificates would be canceled.** This is also contradictory and questionable as to how would the country achieve its objectives, toward energy transition, and to which the State assumed an obligation (this could lead to non-compliance with international commitments, such as, the Paris Agreement adopted within the Framework Convention of the United Nations on Climate Change).
2. **Hydrocarbons industry**
- CNH and the CRE, in their capacity as coordinated regulatory bodies in energy matters, would be eliminated, incorporating their structure and powers to SENER. Once again, the impact leads to a centralization of the technical, economic and regulatory leadership in the sector by the SENER.
 - The State productive enterprises would be eliminated, emphasizing that said companies will be "State owned enterprises" (government instrumentalities). As with CFE, Petróleos Mexicanos (PEMEX) would cease to be an independent, autonomous commercially driven companies.
3. **Mining Industry**
- The exploration, use and exploitation of lithium, which is considered strategic for the energy transition, this right, will accrue exclusively to the State. Additionally, no concessions will be granted.
 - Mining concessions originally granted for the exploitation of lithium by the Mexican State, may not be kept under the terms that were granted. As an exemption, the above restriction will not apply to those concessions in which there is a history of lithium exploration.

Recommendations

We have identified a series of legal actions that could be exercised, including, alleging the unconstitutionality of said Proposed Amendments, invoking the investment protection under international treaties and bilateral agreements to which Mexico is a party, and/or requesting an international arbitration against the Mexican State.

Investment arbitration under the International Center for Settlement of Investment Disputes (ICSID), is an attractive option for investors harmed by governments. This procedure provides a specialized and neutral forum in which to present disputes against a State for its sovereign acts, such as, unfair and inequitable treatment, direct or indirect expropriations, among others. Foreign investors and nationals of a country, that have an International Investment Agreement (IIA) in force with Mexico, may be able to file for an investment arbitration against the Mexican State, claiming compensation for damages caused by the violation.

It is important for our clients to review their business strategies, particularly areas where they could be affected by these Proposed Constitutional Amendments, if they were to go into effect. We will continue to monitor the Bill, and all proposed actions, and initiatives undertaken with regards to this matter, and we will provide pertinent updates. In the interim, we are available to respond to any specific questions you have about how the Proposed Amendments to the Constitution may affect your business.



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