

# An overview of the impact of Mexico's new Electric Power Industry Law on foreign investors operating in the power sector in Mexico

29 March 2021

Disputes involving statutory and regulatory changes are traditionally subject to litigation before local courts or local administrative bodies. Nonetheless, international investment arbitration offers foreign investors an additional avenue to seek relief in the form of damages when a government imposes measures that breach its international obligations.

Investors affected by regulatory measures should carefully consider their rights under international investment agreements and specifically assess their ability to seek monetary damages for the harm caused or to be caused by the new regulatory framework.

## **The amendments to the Electric Power Industry Law and their potential impact on foreign investment**

On 1 February 2021, the president of Mexico filed before Congress a bill to amend the Electric Power Industry Law, which Congress approved on 3 March 2021. The amendments threaten renewable and conventional power generators, holders of power self-supply permits, and independent power producers because they grant many exclusive prerogatives to the Comisión Federal de Electricidad (CFE), the state-owned electric utility company. The modifications include:

- The creation of a "Power Purchase Agreement with Physical Delivery Commitment," which may only be entered into by the CFE Suministrador de Servicios Básicos (SSB) and power generators, and which grants dispatch priority to CFE power plants that entered into these type of agreements.
- The substitution of the economic dispatch mechanism with another mechanism giving dispatch priority to CFE plants. According to the congressional declaration of purpose, it is expected that with this system, electric energy generated will be dispatched in this order:
  - Hydroelectric plants (most of which are owned by CFE)
  - Other CFE plants
  - Wind and solar power plants owned by private entities
  - Combined cycle and other technologies operated by private entities

- A modification of the dispatch regime of power plants, eliminating the economic dispatch system, which will negatively affect private renewable power plants and conventional power plants because they will be dispatched after the hydro and CFE-owned power plants.
- The issuance of generation permits, which shall be subject to the authority of the National Electric System planning criteria.
- The dispensation from competitive mechanisms that guarantee the *best prices* in the purchase of electricity by CFE SSB.
- The possibility of issuance of Clean Energy Certificates not only by eligible "new" power plants but also by "old" power plants, which could lead to distortion of the market, plunging down the prices of Clean Energy Certificates.
- The ability of the Energy Regulatory Commission to revoke self-supply power permits (grandfathered from the prior regulatory regime) if it finds that these permits were secured as a *fraude á la loi*.

Indeed, the potential negative implications of these amendments have been flagged by a number of authorities, including the Federal Economic Competition Commission (COFECE by its acronym in Spanish), which recommended that Congress not approve the bill on 15 February 2021, as it would severely harm competition conditions in the generation and commercialization of electric power. The main reasons provided by the Competition Commission were the following:

- The bill eliminates the rule for the dispatch of cheapest electricity **to artificially benefit CFE**, at the expense of other generators.
- It unjustifiably restricts open access to transmission and distribution grids.
- It allows CFE SSB to acquire electricity through non-competitive methods, eliminating the need for auctions.
- It grants the Energy Regulatory Commission broad discretion to decide whether to grant permits to operate as a generator or supplier.

According to the Federal Economic Competition Commission, these rules would affect the electric industry model envisaged in the Mexican Constitution, which establishes a robust competition regime in electric power generation. Also, the bill discourages clean or renewable energy projects. The bill threatens to impact supply conditions and electricity prices at the expense of Mexican companies and households.<sup>1</sup> One can see how the concerns expressed by the Federal Economic Competition Commission could similarly impact foreign investors that are active in the power sector in Mexico. Despite these concerns, the Chambers of Deputies and the Senate approved the bill on 23 February 2021, and on 3 March 2021, respectively. The reform to the Electric Power Industry Law was published in the Official Gazette on 9 March 2021, and it entered into force on 10 March 2021.

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<sup>1</sup> COFECE; Opinion to Congress, OPN-001-2021, 12 February 2021 <https://resoluciones.cofece.mx/CFCResoluciones/docs/Opiniones/V173/9/5363212.pdf>; See an English summary here [https://www.cofece.mx/wp-content/uploads/2021/02/COFECE-006-2021\\_ENG.pdf](https://www.cofece.mx/wp-content/uploads/2021/02/COFECE-006-2021_ENG.pdf)

Recently, federal courts granted injunctions and enjoined the implementation of the amendments in distinct constitutional challenges (amparos) filed by aggrieved parties. These injunctions will be in place until courts render their final decision within, approximately, six to eight months.

### These measures may give rise to investment claims

Foreign investors aggrieved by the measures described above and protected by an applicable investment treaty or free trade agreement (e.g., the United States-Mexico-Canada Agreement) may consider instituting investment arbitration. They may claim breaches to the following standards:

- **Fair and equitable treatment (FET):** Investment arbitral tribunals have found that six types of behaviors may breach FET:
  - Frustration of the legitimate expectations of investors
  - Deliberate repudiation of the principles on which the regulatory framework is based
  - Arbitrary, disproportionate, or unreasonable action
  - Lack of transparency
  - Violation of administrative due process
  - Bad faith<sup>2</sup>
- Aggrieved foreign investors may argue that the statutory and regulatory reform breaches FET because it deliberately repudiates constitutional principles of free competition enshrined in the constitution, and it is arbitrary because it unjustifiably restricts open access to transmission and distribution grids.
- **National treatment:** Under the national treatment standard, Mexico must extend to foreign investors treatment that is no less favorable than the treatment that it accords to domestic investors in like circumstances. The national treatment standard seeks to ensure a degree of competitive equality between national and foreign investors.<sup>3</sup> Aggrieved foreign investors may argue that Mexico breaches national treatment by granting many prerogatives to CFE, especially when CFE plants have a more favorable treatment for electric power dispatch.
- **Indirect expropriation** involves a governmental measure, whether administrative or legislative, that deprives the owner of an investment's substantial benefits but need not involve a direct taking of the investment. If the reform substantially impacts the value of an investment, then aggrieved investors may consider bringing a claim under this standard.<sup>4</sup>
- **Full protection and security (FPS):** Although FPS is traditionally associated with a due diligence obligation (rather than strict liability) of the state to provide physical security (e.g., police protection), depending on the wording of the treaty, the standard has also been interpreted as going beyond physical security to regulatory stability and legal protection.<sup>5</sup> In

<sup>2</sup> *Cervin Investissements S.A. y Rhone Investissements S.A. c. Costa Rica*, Caso CIADI No. ARB/13/2, Laudo final, 7 marzo 2017, ¶¶ 464-468

<sup>3</sup> UNCTAD, National Treatment, UNCTAD Series on Issues in International Investment Agreements (New York and Geneva, United Nations 1999) 1

<sup>4</sup> *PMI v Uruguay*, ICSID Case No. ARB/10/7, Award, 8 July 2016, ¶286.

<sup>5</sup> *Biwater v. Tanzania*, ICSID Case No. ARB/05/22, Award, 24 July 2008, ¶729.

this regard, investors may argue that Mexico's regulatory conduct amending the Electric Power Industry Law failed to provide that stability and thus violated the FPS obligation.

## Next steps

Mexico's new amendments may impact foreign investors' interests in the energy sector. The reform provides a path for transnational corporations to commence arbitration for damages involving regulatory changes that harm their investments in Mexico. The amendments are significant as tensions in the Mexican energy sector have increased in recent years, leading to several other measures that have already caused substantial harm to companies operating in the energy industry.

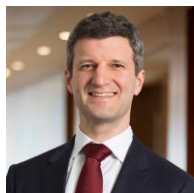
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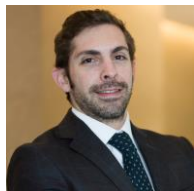
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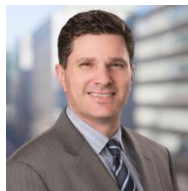
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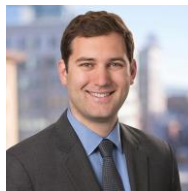
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