
Constitutional Reform in the Electricity Sector

Mexico City

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On October 1st, the Mexican Chamber of Deputies published in its Parliamentary Gazette an initiative with draft decree reforming articles 25, 27 and 28 of the Political Constitution of the United Mexican States, regarding energy matters, sent by the Mexican President (the "**Reform Initiative**").

In general terms, the Reform Initiative reverses the 2013 Energy Reform and consolidates the dominant position of the Federal Electricity Commission ("**CFE**", per its acronym in Spanish) within the country's electricity industry to the detriment of other participants in the sector. While primarily focused on the electricity sector, the Reform Initiative also impacts the hydrocarbons and mining industries as well.

The Initiative will be discussed and voted in the Mexican Congress and, if approved, will take effect on the day of its publication in the Official Gazette of the Federation ("**DOF**"), as provided in its transitory articles.

The following *legal flash* analyzes the most relevant aspects of the Reform Initiative.



Relevance

- The Reform Initiative is presented as a counter-reform to the 2013 Energy Reform, which is described as "regressive" in its explanatory memorandum.¹
- In line with the foregoing, the Reform Initiative is based on the same grounds and justifications as previous legislative and regulatory reforms in the energy sector by the current administration: energy sovereignty, national security, continuity, reliability and stability of the country's electric service.
- Thus, as will be explained below, the Reform Initiative undoes the National Electric System ("SEN") model designed in 2013, in order to consolidate the CFE as the dominant actor in charge of controlling the SEN, relegating the private sector to a position of subordination and dependence with respect to CFE.
- The purpose of this constitutional reform is to establish a mixed economy regime in the electricity sector, in which CFE will exercise control and planning of the sector.

Main aspects and modifications

As indicated before, the Reform Initiative consolidates the political purpose of the Federal Government for the CFE to recover the leading role it enjoyed prior to the Energy Reform of 2013. To this end, the Reform Initiative intends to amend three articles of the Constitution:

Amendments to Article 25

- The concept of "State productive companies" and the criteria for its regulation are eliminated, substituting them with the "State agencies".
- The obligation of the State to preserve energy security and self-sufficiency, as well as the continuous supply of electric energy to the entire population, in order to guarantee national security and the human right to a dignified life, is elevated to constitutional rank.

¹ It is common legal practice in the country to divide a reform initiative into two sections: the first, the explanatory memorandum; the second, the draft decree in particular.



- The criteria of social equity, productivity and sustainability are eliminated as axes of the support to social and private enterprises, as well as the legal duty to adhere to the modalities that best conserve productive resources and the environment.²

Amendments to Article 27

- The concept of "Energy Transition" is introduced, and the State assumes its direction.
- Lithium and "other strategic minerals for the Energy Transition" are added to the list of assets over which the State may establish national reserves and whose ownership by the Nation is inalienable and imprescriptible.
- The scope of the electricity sector as a strategic area under the responsibility of the State is modified to include the entire industry: generation, conduction, transformation, distribution and supply of electricity.³

Amendments to Article 28

- The strategic areas of the State are modified: (i) the concept of electricity is reinstated, conceived as an indissoluble unit⁴; and (ii) lithium and other strategic minerals for the Energy Transition are incorporated.
- The "*industries required for the Energy Transition*" are added as priority areas for national development.⁵
- The CFE is designated as the state agency responsible for electricity and the SEN, as well as for the execution of the Energy Transition. It will have legal personality and its own assets and will be autonomous in the exercise of its functions and administration.
- It is established that the CFE will guarantee the generation of at least 54% of the country's energy, while the private sector will participate in up to 46% of this generation. CFE would acquire the electric energy and capacity generated by the private sector, required in the short term, through competition for its dispatch due to its lower production costs.

² By the CFE taking the reins of the national electricity sector and eliminating the legal duty to adhere to the modalities that best conserve productive resources and the environment, the country's international environmental protection obligations, such as those stipulated in the Paris Agreement and the Kyoto Protocol, are put in jeopardy.

³ Today, only the planning and control of the SEN, as well as the public service of transmission and distribution of electric energy, are considered strategic areas under the control of the State.

⁴ i.e. generation, transmission, transformation, distribution and supply of electric power.

⁵ It is worth mentioning that the draft decree does not elaborate on this aspect. It only limits itself to stating that these industries will be priority areas, that the State will use all available energy sources and that "scientific, technological and industrial policies for this transition" will be established. However, it is not specific in the attribution of powers or in the stipulation of obligations.



- The National Hydrocarbons Commission ("**CNH**") and the Energy Regulatory Commission ("**CRE**") (the Coordinated Energy Regulatory Commissions) are eliminated. These would be organically absorbed by the Ministry of Energy ("**SENER**") with a clear confusion of roles between the definition of the policy and the regulation and operation in the case of the CNH. The CNH itself has no relationship whatsoever with the electricity sector, so its disappearance would affect the execution of the Hydrocarbon Exploration and Extraction Contracts in force.

A new electricity industry in Mexico

As a consequence of the reforms to the constitutional articles mentioned in the previous section, the Reform Initiative foresees multiple and profound changes within the SEN in its transitory articles, particularly in the Second Transitory Article. In said provision, it is indicated that the SEN will be in charge of the State through the CFE. The following aspects stand out:

- **Unilateral cancellation of permits and contracts:** granted electricity generation permits and electricity purchase and sale contracts with the private sector would be cancelled, as well as applications pending resolution.
- **CFE's new nature:** it loses its character as a state-owned productive enterprise and becomes the agency in charge of the strategic area of electricity.⁶ It is worth noting that this transformation is extended to Petróleos Mexicanos ("Pemex"), which has no relation whatsoever with the purpose of this Reform Initiative.
- **Total unity of the CFE:** the legal separation of the subsidiaries and affiliates of the CFE⁷ is eliminated in order to integrate it as a single State agency, both vertically and horizontally.
- **Absorption of the National Energy Control Center ("CENACE"):** CENACE is reincorporated to CFE with its functions and attributions.
- **Electricity dispatch:** CFE will be in charge of the procedures to dispatch electricity. It is established that at least 54% of the electricity required by the country will be dispatched by CFE, while private sector power plants will dispatch up to 46%.
- **Cancellation of models:** independent production, long-term auctions, self-supply power plants and those built after the 2013 Energy Reform are cancelled. However, the plants

⁶ Here, it is important to emphasize that paragraph b) of the Second Transitory Article provides that the CFE "[w]ill adopt the necessary measures for the implementation of the provisions of this Decree", which leaves the door open to arbitrary measures without legal basis by the CFE.

⁷ The subsidiary CFE Telecomunicaciones e Internet para Todos and the affiliates CF Energía, CFE International and CFE Capital will continue to exist, and those deemed convenient may be created.



associated with such models will be able to continue generating electricity to be purchased by the CFE.

- **Special contractual regime:** contracts entered into between the CFE and private parties for the acquisition of electricity and capacity generated by private parties will not be governed by Article 134 of the Mexican Constitution.⁸
- **Hedging contracts:** CFE will enter into long-term bilateral financial hedging contracts for the acquisition of energy and capacity generated by the private sector.
- **Unrecognized electricity generation:** generation resulting from modifications to self-supply permits "*that were granted in contravention of the provisions of the Public Electricity Service Law (...) will not be recognized or acquired by the CFE*". Neither will the surplus generation of the Independent Power Producers derived from permits superimposed on the original permit of the power plant.
- **Determination of tariffs:** the CFE will determine the respective tariffs for the transmission and distribution networks and those referring to end users will be determined by the CFE.
- **Clean Energy Certificates ("CELS")** would be cancelled.

Furthermore, the Sixth Transitory Article determines that the mining concessions already granted by the Mexican State and for which gold, silver, copper and other minerals are already being explored and/or exploited, are maintained under the terms in which they were granted. However, these concessions do not cover the exploitation and production of lithium. Only those mining concessions already granted by the State with a history of lithium exploration duly endorsed by the Ministry of Economy may continue exploring and producing lithium.

Finally, the objective of the Reform Initiative is to consolidate a new SEN in which the State, through the CFE, retakes its control and planning. With this, the objective of the reform is to strengthen CFE, turning it into a State agency with its own legal personality and assets, which will be autonomous in the exercise of its functions and administration, responsible for planning and control of the SEN. However, its design involves confusion of roles and functions of the authorities and agents participating in the electricity sector, while at the same time it inserts decisions that affect other market participants without respecting the fundamental rights of legality, legal certainty and due process, without taking into account the principles of conventionality and progressiveness in the defense of human rights.

⁸ Article 134. The economic resources available to the Federation, the federal entities, the Municipalities and the territorial districts of Mexico City shall be administered with efficiency, efficacy, economy, transparency and honesty to meet the objectives for which they are intended. (...)"



The changes proposed in the Reform Initiative would seriously affect private investments made in the electricity sector, which could qualify as indirect expropriation in terms of the Agreements for the Promotion and Reciprocal Protection of Investments ("APPRI") and breach of the terms of Free Trade Agreements.

In addition, the implementation of the reform would affect the fundamental right to a healthy environment and would lead to non-compliance with the principles and commitments adopted in the Paris Agreement and the Kyoto Protocol.

Reform procedure and perspectives

The Reform Initiative was sent to the Chamber of Deputies on September 30 and published in the Parliamentary Gazette on October 1. In order to materialize itself, the Reform Initiative must advance through a rigid constitutional reform procedure which, in a simplified manner, is outlined below:

- **First**, the Reform Initiative must be discussed and approved by 2/3 of the members present in the Chamber of Origin (in this case, the Chamber of Deputies).
- **If approved in the Chamber of Deputies**, it will pass to the Chamber of Senators (in this case, the Revising Chamber), where it must be discussed and approved by 2/3 of the members present.
- **Once approved by the qualified majority of the Congress of the Union**, the Reform Initiative would be submitted to the local legislatures for approval or rejection of the Project. Here, a simple majority (50% + 1) is required, which means that the favorable vote of 17 out of 32 states would be necessary to approve the Reform Initiative.⁹
- **If approved by the Congress of the Union**, the Reform Initiative would be sent to the Executive Branch for its enactment. It would then take effect the day after its publication in the DOF.

As of the writing of this *legal flash*, several political opposition parties (among them, the National Action Party -"PAN"- and the Party of the Democratic Revolution -"PRD"- have spoken out against the Reform Initiative. However, the Institutional Revolutionary Party ("PRI") has remained neutral, raising questions about the position it might adopt in the vote.¹⁰

⁹ Morena has a majority in 18 local legislatures, so the crux of the matter lies in the approval or rejection of the Initiative in the Congress of the Union.

¹⁰ This is important because the PRI has 71 votes in the Chamber of Deputies, where the party of the Executive Branch (Morena) needs 56 more votes to reach the qualified majority required for the approval of the Reform Initiative in said Chamber of Origin.



Means of defense

Violations of international law

Mexico is a party to multiple international treaties and agreements that offer protection to foreign investments made within the country.¹¹

Such international instruments generally protect, among others, against fair and inequitable treatment, discriminatory treatment, sudden and unilateral change in market conditions and direct and indirect expropriations (as well as any act with similar consequences); they also generally provide procedural protections.

In the event that the Reform Initiative is approved, and its implementation contravenes the provisions of the APPRIs or any international treaty on investment protection, it would be possible for foreign investors to trigger international arbitration proceedings under the applicable international treaty.

Local means of defense

In Mexico, the Amparo Law states that the amparo proceeding is inadmissible against constitutional amendments.¹² In its transitory articles, the Reform Initiative establishes the revocation of permits and termination of Contracts, which constitutes a materially irregular norm from a constitutional perspective, in violation of constitutional rights that include the non-retroactivity of the law, due process and legal certainty.

By elevating the revocation mandate to constitutional rank, individuals are disqualified from filing an amparo proceeding, thus limiting the possibilities of obtaining a substantive judgment.

¹¹ Among others, we find the 30 APPRIs in force with Germany, China, United Arab Emirates, Spain, Hong Kong, the Netherlands, Switzerland, etc., the North American Free Trade Agreement (“NAFTA”) and the United States- Mexico- Canada Agreement.

¹² The amparo proceeding is inadmissible: I. Against additions or reforms to the Political Constitution of the United Mexican States;



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