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Issuance of recommendations by the COFECE in energy matters

On October 7, 2020, the Federal Economic Competition Commission ("**COFECE**" or "**Commission**") issued comments and recommendations to the National Regulatory Improvement Commission ("**CONAMER**") regarding the regulation issued by the Energy Regulatory Commission ("**CRE**"), which modifies the electric power self-supply and cogeneration permit system.[1]

BACKGROUND

On February 13, 2020 the CRE submitted before the CONAMER the draft "Ruling of the Energy Regulatory Commission amending the General Administrative Provisions that establish the terms for requesting the authorization for the modification or transfer of electric power generation or electricity supply permits, contained in Resolution Number RES/390/2017" (the "**Amendments to the Provisions**") requesting the exemption from the regulatory impact analysis ("**RIA**"), which was rejected by the CONAMER on February 17, 2020.

Subsequently, on October 5, 2020 the CRE submitted again the Amendments to the Provisions before the CONAMER, again requesting their exemption from the RIA; however, the next day the Governing Body of the CRE approved the Regulation without the CONAMER having decided on the exemption for the RIA and without having received the corresponding final opinion.

LEGAL FRAMEWORK APPLICABLE TO THE SELF-SUPPLY AND COGENERATION REGIME

1. *Legal framework prior to the issuance of the Electric Industry Law*

   Before the issuance of the Electric Industry Law (*Ley de la Industria Eléctrica*) ("**LIE**") the law that governed the sector was the Electric Power Public Service Law (*Ley del Servicio Público de Energía Eléctrica*) ("**LSPEE**"), which was reformed on December 23, 1992 in order to expand and define the participation of private parties in the activities of generation, import and export of electric power. In particular, its article 3 permitted the generation of electricity for self-supply, cogeneration or small production, which gave rise to the regime of electric power generation permits under the modes of self-supply and cogeneration, among others, by private parties.

   Thus, in order to establish a regulatory framework for the granting and functioning of those permits, on May 31, 1993 the Regulation of the Electric Power Public Service Law (the "**Regulation**") was published in the Official Federal Gazette ("**DOF**"), which established that private parties that have self-supply permits could generate

[1] https://www.cofece.mx/cofece-emitio-recomendaciones-a-regulacion-que-modifica-el-esquema-autoabastecimiento-y-cogeneracion-de-energia-electrica/.

energy *(i)* to be consumed by the private parties themselves (self-supply) or *(ii)* to sell their excess to the Federal Electricity Commission (*Comisión Federal de Electricidad*) ("**CFE**").

Article 101 of the Regulation defined self-supply as "*the utilization of electric power for purposes of self-supply provided that such power comes from plants intended to satisfy the needs of the group of co-owners or partners*"[2]. Furthermore, article 36 of the LSPEE established a limitation on the permit holders to prevent them from delivering electric power to third parties that were not partners of the permit-holding company unless they were included, by prior authorization, in the expansion plans associated with the permits or through an assignment of rights.

In relation to the sale of surplus, the LSPEE established that the holders of self-supply permits must make their surplus generation of electric power available to the CFE, for which the permit holders whose surplus was 20 megawatts ("**MW**") or less executed agreements with the CFE for the acquisition of the surplus power, and a power purchase agreement was executed with those that had surpluses greater than that.

2. *Legal framework after the issuance of the LIE*

With the publication of the LIE in the DOF on August 11, 2014 the LSPEE was abrogated. In the second transitory article of the LIE it was established that the permits for self-supply and cogeneration granted or processed according to the LSPEE would be respected according to their terms; however, in transitory article ten it is mentioned that such permits will preserve their original duration and they may not be extended. Furthermore, the possibility was established that the holders of self-supply and cogeneration permits request the migration to single generation permits so they can be regulated pursuant the LIE.

In line with the above, in conformance with the LIE and the Coordinated Energy Regulatory Bodies Law (*Ley de los Órganos Reguladores Coordinados en Materia Energética*) ("**LORCME**") it was established that the CRE had the power to revise and authorize the modifications to the expansion plan and entry and exit of partners. In relation to the sale of surplus to the CFE, with the issuance of the LIE the Legacy Interconnection Contracts were created, which are contracts executed based on the LSPEE, which can be amended with respect to the inclusion and exclusion of load centers, provided it does not imply a modification of their duration.

3. *The General Administrative Provisions that establish the terms for requesting the authorization for the modification of electric power generation permits (RES/390/2017)*

In function of the attributions granted by the LIE, the CRE has the power to authorize and resolve the modifications to the permits granted under the LSPEE. Thus, to establish a normative framework applicable to those modifications, on April 17, 2017 the CRE published in the DOF the Resolution RES/390/2017, by means of which it issued the General Administrative Provisions that establish the requisites for processing before the CRE the modifications and transfers of self-supply permits (the "**Provisions**").

The Provisions established: *(i)* the premises for which the permits could not be modified, *(ii)* the requirements to be met to modify the persons authorized as beneficiaries of the electric power or establishments associated with the cogeneration, and *(iii)* that the load centers that are not obligated to be included in the Qualified Users Registry (*Registro de Usuarios Calificados*) ("**RUC**") may be included in the permits granted in the LSPEE.

In this regard, based on the LIE and the Provisions only the following can be included as partners of the self-supply and cogeneration permit holders: *(i)* the load centers that already received the public service of electric

[2] According to article 36 of the LSPEE, in the cases in which there were various petitioners for a self-supply permit with respect to an electrical plant, they will have the status of co-owners or partners, when their purpose is the generation of electric power to satisfy the self-supply needs of the members of such company.

power at the entrance into force of the LIE, regardless of their demand; and *(ii)* the load centers that did not receive the public service before the LIE, provided that, given their level of demand, they are not obligated to be included in the RUC, which is to say, the Basic Users.[3]

It must be emphasized that according to the Provisions, the self-supply permits have a fixed generation capacity determined in the Legacy Interconnection Contracts, as well as a defined term, which implies that once the original term of the permits concludes, the permit holders could migrate to the regime established in the LIE or leave the market.

MODIFICATIONS CONTEMPLATED IN THE AMENDMENTS TO THE PROVISIONS

As mentioned before, on February 5 the CRE requested from CONAMER an exemption from the RIA. Thus, the main objectives of the Amendments to the Provisions centered on: *(i)* facilitating the transition of the price regime regulated by the LSPEE to the regime established in the LIE, *(ii)* favoring the supply of electric power under the legal framework of the LIE, and *(iii)* permitting a coexistence between the two legal frameworks without generating adverse conditions between the permit holders of the two systems.

With the above objectives the CRE included in the sixth provision a fourth section that establishes that the generation permits may not be modified in the case of new load centers that have executed a basic supply contract under the LIE. Similarly, numeral "i" was eliminated, changes were made to numerals "ii", "iii" and "iv" and numeral "v" was added, all of subsection "e)" of the ninth provision related to the permits granted under the LSPEE. These changes related to the change of the persons authorized as beneficiaries of the electric power or establishments associated with the cogeneration can be summarized in the following points:

a) Numeral "i".- The possibility was eliminated of including new persons as partners that have not been authorized previously in the permit, through a request for inclusion in the corresponding expansion plans.
b) Numeral "ii".- The documentation required in this numeral for making the modification of the permit was limited so that it is only applicable to the partners included in the expansion plans.
c) Numeral "iii".- The section was adjusted to refer to the need to provide the information relative to the maximum demands of the load centers.
d) Numeral "iv".- The following modifications were made:
    i. The requirement was added to submit the information the CRE requests to prove that it is not a load center that has executed supply contracts under the LIE.
    ii. For the load centers that have a contract under the LIE and for those that are obligated to be registered in the RUC, once their term is concluded they may not be included in self-supply and cogeneration permits granted under the LSPEE, and must be subject to the rules applicable to the Basic or Qualified Supply.
    iii. It is established that the load centers that are already in the RUC and have requested their removal from it, may not be included in these permits and must be subject to the rules applicable to Basic or Qualified Supply.
e) Numeral "v".- The numeral "v" was added establishing that the partners already approved or in plans of expansion, that have been merged or spun-off, must prove their status of partner or beneficiary of the electric power, provided that new load centers are not included.

The above modifications imply the elimination of the possibility of adding in the generation permits load centers that have a Basic Supply contract under the LIE, favoring that they remain with the sole provider of this service, as well as users that, without being obligated by the LIE, have migrated to the qualified service and wanted to leave that system, being obligated to remain in it or contract the basic supply service with CFE, as the only offeror of this service.

[3] Basic Users are those load centers with a demand less than 1 MW, while the Qualified Users are those load centers that report a demand equal to or greater than 1 MW.

COMMENTS OF THE COMMISSION ON THE AMENDMENTS TO THE PROVISIONS

Based on the above, the Commission detected three problems derived from the possible effects on competition and free concurrence that the Amendments to the Provisions could generated and issued recommendations in that respect.

1. *Uncertainty generated by the reduction of the incentives to invest and the limitation on the possibility of competing in the market*

   As indicated by the COFECE, the Amendments to the Provisions imply a substantive change of the rules of operation of the permits granted under the LSPEE which, according to the second and tenth transitory articles of the LIE, must be respected. This could affect the terms and conditions of the Legacy Interconnection Contracts, discouraging investment and participation in this market.

   In addition, considering that these permits constituted an alternative supply for the industry in the context of an electricity sector that operated under an integrated vertical monopoly, its design generated an adequate scenario for investors to recover their investments.

   Preventing the permit holders from attracting new partners or substituting those that leave will complicate the recovery of the investment and the costs, discouraging investments in expansion, maintenance and technological substitution, which could have generated better conditions for their users, thereby hindering the operation of the National Electrical System as a whole.

2. *Limitation of the options of users of the basic service*

   The Commission considered that the Amendments to the Provisions could limit the options of the basic service users, since those that did not receive the supply before the entrance into force of the LIE cannot be registered in the self-supply contracts and they would be obligated to contract the service with the CFE Suministro Básico, which currently is the only offeror of services in that market.

   In particular, the addition of numeral "iv" of the sixth provision and the modification of subsection "iv" of section I of the ninth provision, contemplate the elimination of the possibility of the load centers that have contracted CFE Suministro Básico from obtaining electricity from any self-supply or cogeneration permit holder, leaving them with a single option to cover their needs.

   This inhibits the need for CFE Suministro Básicoto compete to attract and retain those users through improvements in conditions of supply, which would imply granting an advantage to the CFE by artificially ensuring the permanency of the users in the basic supply.

   As a result, the possibility of users being able to choose more convenient options to acquire the electricity would be eliminated, increasing their costs and artificially diminishing competition in the markets in which CFE participates.

3. *Granting exclusive advantages to CFE Basic Supply*

   Finally, the COFECE considered that the Amendments to the Provisions could confer to CFE Suministro Básico, as the sole offeror of the service, exclusive advantages, since it could benefit from retaining as clients those new users with demands less than 1 MW that would be prevented from associating with self-supply or cogeneration permit holders.

Furthermore, the excesses of electric power generated by the self-supply permit holders that are not assigned must be made available to the CFE according to the terms and conditions of the Legacy Interconnection Contracts, which leads us to infer that CFE could make use of such excesses of the permit holders at a price lower than the market price.

4. *Granting of exclusive advantages to CFE Basic Supply*

Based on the three problems described above and detected by the Commission, it considers that given the regulatory framework of the permits granted under the LSPEE they would have to be extinguished gradually because of the impossibility of extending them, but this does not mean that the rationality of these permits should not be recognized, respecting the conditions under which they operate.

Therefore, the Commission esteems that if the CRE considers it necessary to modify the transition regime, it was recommended that the changes that are implemented should respect the terms of the transitory articles of the LIE, to thereby permit the recovery of the investments made and planned, avoiding granting exclusive advantages to other participants of the industry.

In this regard, the Commission considered that the analysis established in the General Law for Regulatory Improvement (*Ley General de Mejora Regulatoria*) is fundamental to identify and implement the regulatory improvements, and therefore the Amendments to the Provisions should be submitted to the RIA procedure of the CONAMER prior to their publication in the DOF.

ALTERNATIVES REGARDING THE IMPLEMENTATION OF THE AMENDMENTS TO THE PROVISIONS

In terms of the Federal Economic Competition Law (*Ley Federal de Competencia Económica*) ("**LFCE**"), there are two means – not exclusive – that those affected by the Amendments to the Provisions could use against the possible effects generated by their implementation, as well as recurring to the Judicial Branch through an amparo proceeding for the issuance of the Amendments to the Provisions and/or for not having the RIA of the CONAMER.

We understand that today there is no actual and direct affect as a result of the issuance of the Amendments to the Provisions; however, considering the possible implications, it is suggested to approach the Commission under either of the following routes: *(i)* the presentation of a denouncement for the committing of relative monopolistic practices; and/or, *(ii)* the informal presentation of a report that could give rise to the initiation of an investigation for the probable existence of barriers to competition and free enterprise.

These two proceedings have different conditions regarding their nature, times and results, and therefore below a brief explanation of each of them is offered.

1. *Denouncement of relative monopolistic practices*

Under this route a formal denouncement will be made against the CRE for possibly committing relative monopolistic practices consisting of: *(i)* discriminatory treatment[4] against the permit holders subject to the LSPEE and *(ii)* the establishment of an action[5] with the purpose and effect of obstructing the productive process.

The denouncement can be presented before the COFECE by any person, whether or not they are an affected party. If the denouncement is admitted, an investigation proceeding would be processed that can last up to thirty months, in an administrative proceeding that regularly takes eight months and culminates with the issuance of a ruling in which the economic agent that engaged in anticompetitive conduct can be sanctioned.

[4] Art. 56 section V of the LFCE.
[5] Art. 56 section XI of the LFCE.

The sanction that the Commission can impose for engaging in monopolistic practices can be the elimination of the conduct and the imposing of a fine. If a fine is imposed and it could be proven that one of the permit holders was affected as a result of the denounced actions, the restitution of the damages and losses could be sought.

There are challenges associated with this route, since to conclude this proceeding successfully it would have to be demonstrated that the CRE is an economic agent that is subject to economic competition regulation, and prove that the powers that are contemplated in the Amendments to the Provisions are not strategic activities in terms of article 28 of the Political Constitution of the United Mexican States ("**CPEUM**"), since otherwise such acts would not be subject to the LFCE.

In summary, by this route the permission holders have the possibility of formally urging the COFECE to initiate a proceeding against CRE that could benefit them, currently or potentially, against the implementation of the Amendments to the Provisions; however, it is a proceeding that can last approximately 30 months; in which various questions must be resolved on the validity of the regulation in competition matters.

2. *Informal report of the existence of barriers to the competitive process*

Under a new proceeding[6] created under the latest constitutional reform in economic competition matters, there is a possibility for permit holders to present, informally, a report through which they show that conditions do not exist for effective competition in the market as a consequence of the Amendments to the Provisions, in order to determine the existence of barriers to competition and free concurrence as a result of the issuance of the Amendments to the Provisions.

It is relevant to mention that these types of proceedings cannot be requested formally by a private party, and therefore sufficient elements would have to be presented to motivate the Commission to initiate the investigation ex officio; but this would not guarantee that the COFECE will have a formal obligation to initiate that proceeding.

These types of proceeding are composed of an investigation proceeding that can last up to eighteen months and an administrative proceeding that lasts approximately six months.

In contrast to the above proceeding, under this one no sanction would be issued against the CRE; rather a resolution would be issued through which recommendations could be presented to the public authorities, in this case CRE and/or CONAMER (as body responsible for regulatory improvement); or the elimination of the barrier to the process of competition identified could be ordered, if the CRE can be considered an economic agent in terms of the LFCE.

Under this proceeding the challenge persists of demonstrating that the powers under which CRE is acting are not identified as strategic activities in terms of the CPEUM. Nevertheless, it is probable that the COFECE is not going to pronounce on such determination, letting the Judicial Branch decide the situation.

This proceeding, briefer than the other, would seem to come closer to the particularities contained in the Amendments to the Provisions; however, sufficient elements must be collected that permit the Commission to start this investigation ex officio. In this respect, it should be indicated that our firm has been able to promote them on more than one occasion.

[6] Art. 94 of the LFCE.

3. *Filing of an amparo against the issuance of the Amendment to the Provisions and/or the lack of pronouncement of the CONAMER*

   As an additional alternative, the permit holders that consider that their legal interests are affected as a result of the issuance of the Amendments to the Provisions can appear before the Judicial Branch through the amparo to request the protection of their rights acquired in the permits granted based on the LSPEE and the applicable transitory articles of the LIE.

   In addition, the aggrieved permit holders could initiate an amparo proceeding based on the grounds of violation that the Amendments to the Provisions do not have the final opinion of the CONAMER on the exemption from the RIA, which is a mandatory requirement in the drafting of laws, legislative decrees and general acts that generate compliance costs for private parties.

   Based on the above, the permit holders are fully authorized to file an amparo lawsuit based on the above two premises, which could confer to them short term interim measures (provisional stay of the challenged act) and a possible final ruling that exempts them from complying with the Amendments to the Provisions.

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