

## Mexican Utilities

# Takeaways from Galicia Abogados call: net constructive on MX regulatory outlook

Industry Overview

### '21 LIE reform unconstitutional: final, non-appealable

The Mar-2021, amended LIE – an AMLO-era electricity sector reform law passed by congress, previously held up from implementation by legal injunctions – was ruled unconstitutional on 31-Jan-2024 by Mexico's supreme court (SCJN). The resolution was made on violation of free competition principles, citing the amended LIE facilitated preferential dispatch of CFE plants over non-CFE plants, as well as CFE's purchase of power and products outside of an auction. As a result, the LIE remains as originally approved, pre-AMLO, with the SCJN resolution final and non-appealable. Galicia cited the ruling highlights the importance of legal checks and balances in Mexico.

### New constitutional amendment proposals: unlikely to pass

On 5-Feb-2024, Mexico's president submitted several initiatives for constitutional amendments, including elimination of Mexico's autonomous energy/electricity sector regulators, CRE and CNH, as well as a reinstatement of CFE as a state monopoly that would "prevail" over other private participants. Given the president's party and allies do not currently have a supramajority in congress required to approve constitutional amendments, these initiatives are not expected to pass. The initiatives are viewed as an action to inject these topics into the electoral debate.

### USMCA dispute: panel remains an option, opportunity

SCJN's striking down the amended LIE removed one item from the list of items cited in the U.S./Canada energy/electricity sector trade dispute against Mexico via the USMCA. However, a host of other grievances under the dispute continue, like extensive delays to grant permits (which have statutory timeframes to grant/reject) by Mexico's regulators, rejection of permits without legal justification, etc. As a result, the USMCA dispute is still open, with the option for the U.S./Canada to initiate a panel that could assign penalties and sanctions on Mexican exports. Galicia Abogados cited Mexico has a very weak case in the trade dispute. We view the USMCA panel option as simultaneously a disincentive to potential new, future aggressive sector regulatory initiatives in Mexico, as well as an opportunity for resolution of the dispute by Mexico's next president via clarification of future public policy towards the sector.

### Sector to grow, regardless of next Mex president winner

While Galicia Abogados believes Xótcil Gálvez could offer a clearer path for sector growth, it also expects growth if Claudia Sheinbaum wins, despite some variation in her campaign messaging. Galicia cited immense and increasing pressure on both candidates to address sector bottlenecks and underinvestment, given without electricity availability - especially renewables - new investment decisions by companies is simply a non-starter. Galicia cited +12.8 GW in new generation capacity required just to satisfy internal demand, and another +25 GW for nearshoring (or US\$40bn). Additionally, CFE's transmission/distribution budget is US\$2.5bn/yr for the coming years. Galicia cited exhaustion of Mexico's existing generation capacity reserve and increasing frequency of transmission problems are pushing the electricity system to its limit, while increasing the urgency to address sector bottlenecks for the next administration.

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Timestamp: 07 March 2024 09:20AM EST

07 March 2024

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**Peter Bowley**  
Research Analyst  
BofAS  
+1 646 855 2665  
[peter.bowley@bofa.com](mailto:peter.bowley@bofa.com)

**Anne Milne**  
Research Analyst  
BofAS  
+1 646 855 4096  
[anne.milne@bofa.com](mailto:anne.milne@bofa.com)

**GEMS Corporate Credit Rsch**  
BofAS  
+1 646 855 4096

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LIE = Electricity sector law (Ley  
Industria Eléctrica)

SCJN = Mexico supreme court

USMCA = U.S./Mexico/Canada free  
trade agreement

## Additional Takeaways

### **COFECE/anti-trust ruling on Iberdrola asset acquisitions**

In Jun-2023, Mexico's federal government (via a trust managed by Mexico Infrastructure Partners) signed a binding agreement to purchase 13 primarily natural gas CCGT plants (8.5 GW of capacity) from Spanish utility, Iberdrola, for around US\$6bn. The sale accounted for around 55% of Iberdrola's EBITDA in Mexico.

The transaction was controversial, given the government already had the right to use the capacity of the Iberdrola plants – as 3 plants were under a self-supply regime, but the rest were Independent Power Producers (IPPs), who sell their power exclusively to CFE.

An additional concern was that by the federal government acquiring +13 plants, CFE/federal government would concentrate additional assets, potentially generating anti-trust concerns, given CFE's existing dominant position in the sector.

COFECE – Mexico's anti-trust authority – recently ruled to approve the transaction, but subject to certain conditions, namely the implementation and on-going continuity of independence mechanisms. FONADIN – a government fund that mainly financed the acquisition – must maintain no more than its existing 51% stake. The entity board members must be independent and not have recently served as public officials/government employees. The entity administrators must also be independent. Transactions by the entity must be done at arms length. And there are a number of reporting requirements, to show COFECE that this entity is in compliance with the independent mechanisms.

Galicia Abogados views the COFECE ruling as consistent with other anti-trust rulings in Mexico.

### **Migration of legacy power permits is an obligation of the regulators**

Regarding future migration of "legacy" power plant permits – like self-supply and PIE/IPP (independent power producer) – Galicia cited that the regulator is obliged to migrate these permits to the newer LIE (pre-Mar-2021 amendment, which was ruled unconstitutional) regime. When the LIE regime was issued, legacy permits/contracts had to be grandfathered in, because Mexico's constitution does not allow new laws to be applied retroactively. According to Galicia, the LIE regime established two rules: (1) legacy permits would operate until their natural expiration date, or (2) they could migrate to the new LIE regime at any time. Migration was also to facilitate faster transfer to the new LIE regime, to simplify regulation via fewer regimes.

Galicia noted the current administration has been rejecting a number of permit migration applications, and in some cases, tried to cancel outright plant permits. This has resulted in lawsuits from the affected parties. Galicia noted this is a matter of public policy, given the right to migrate is stated under the law. Galicia mentioned that if the IPP/PIE permit term expires, and the plant still has a useful life remaining, the plant should be able to be used going forward.

### **Energy-hungry data centers: seeking to build out own electricity infrastructure**

Given Mexico's growing digitalization, Galicia cited the opportunity for investment in data centers is clear, with a number of data centers recently opening in central Mexico/Querétaro state. However, these facilities are high consumers of electricity. Given sector bottlenecks, new schemes at the state level are under consideration, that could allow private data center entities to develop certain sub-station and/or transmission lines, then contribute them to CFE and the national system, so power can be transported to the data centers. Galicia cited certain legislation allows data centers to build their own generation facilities, which can even be off-grid as an option. However, the initiatives are not seeing larger cooperation from the current federal administration.

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## Research Analysts

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**Anne Milne**

Research Analyst  
BofAS  
+1 646 855 4096  
[anne.milne@bofa.com](mailto:anne.milne@bofa.com)

**Peter Bowley**

Research Analyst  
BofAS  
+1 646 855 2665  
[peter.bowley@bofa.com](mailto:peter.bowley@bofa.com)

**Nicolas Riva, CFA**

Research Analyst  
BofAS  
+1 646 855-2594  
[nicolas.riva@bofa.com](mailto:nicolas.riva@bofa.com)

**Carlos Assumpcao, CFA**

Research Analyst  
Merrill Lynch (Brazil)  
+55 11 2188 4025  
[carlos.assumpcao@bofa.com](mailto:carlos.assumpcao@bofa.com)

**Jason Amoratis**

Research Analyst  
BofAS  
+1 646 556 0831  
[jason.amoratis@bofa.com](mailto:jason.amoratis@bofa.com)

**Kay Hope**

Research Analyst  
MLI (UK)  
+44 20 7995 9301  
[kay.hope@bofa.com](mailto:kay.hope@bofa.com)

**Ali Dhaloomal**

Research Analyst  
MLI (UK)  
+44 20 7996 9107  
[ali.dhaloomal@bofa.com](mailto:ali.dhaloomal@bofa.com)

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