

## Proposed Constitutional Reform in Mexican Power Sector

November 1, 2021

On October 1, 2021, Mexico's President Andrés Manuel López Obrador submitted to the House of Representatives a bill to amend the Mexican constitution in respect of the electric power sector. The bill aims to reassert the Mexican government's control over the electric power sector following almost a decade of decentralization and semi-privatization that has seen extensive foreign and domestic private investment. The proposed constitutional amendment comes on the heels of amendments to Mexico's Hydrocarbons Law that took effect May 5, 2021 and expanded governmental authority in the hydrocarbons industry.

In December 2013, the Mexican constitution was amended to allow the creation of a regulatory framework that ended a 75-year state monopoly in the oil and gas industry, opened the electric power sector to participation by private investors to promote competition, investment and development and decentralized governmental control and regulation of the electric power industry through the establishment of independent governmental institutions. Domestic and foreign investors responded to the 2013 energy reform by investing billions of dollars in Mexican power projects and infrastructure.

The proposed new constitutional amendment would reverse certain changes in Mexico's electric power sector introduced by the 2013 energy reform and reestablish the Mexican government's control over that industry. If enacted in its current form, the proposed amendment would:

1. Reclassify the electric power industry as a "strategic" sector under the Mexican constitution, thereby granting the Mexican government control over power generation, transmission, transformation, distribution, marketing and supply. Currently, only the transmission and distribution segments of the power industry are classified as "strategic" sectors under the constitution. If the proposed amendments were to pass, private investors would no longer be permitted to participate in the generation, transformation, marketing or supply of electricity to the public.
2. Require that 54 percent of all electricity in Mexico be generated by the state-owned power utility, the Comision Federal de Electricidad (CFE), with independent private companies being limited to 46 percent. Currently, there are

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no prescribed requirements or limits with respect to public or private power generation, and CFE generates approximately 38 percent of Mexico's electricity.

3. Require that all electricity generated by private companies be sold directly to CFE pursuant to power purchase agreements on terms and conditions determined by CFE. Currently, there is no such directive with respect to the sale of electricity by private companies. Under current law, in order to acquire electricity from private companies, CFE is required to conduct public auctions.
4. Cancel all existing power generation permits, power purchase agreements and private power generation arrangements. Existing power plants operating under such arrangements would be allowed to generate and compete to offer electricity for purchase exclusively by CFE. Once these arrangements are canceled, the power plants would have no such rights. Power generation permits issued prior to the 2013 energy reform would be unaffected and would remain in effect except for (a) self-supply permits where the end user is not a "true affiliate" of the power generator and (b) permits for excess capacity and associated power generated by independent private companies.
5. Dissolve the following governmental institutions: (a) the Energy Regulatory Commission (CRE), which is responsible for regulating and promoting the development of the midstream and downstream power sectors as well as power generation, transmission and distribution; (b) the National Hydrocarbon Commission (CNH), which is responsible for regulating and promoting the development of Mexico's hydrocarbon resources in the upstream sector; and (c) the National Center for Energy Control (CENACE), which is responsible for operating the National Electric System and the Wholesale Power Market and for promoting impartial access to the National Transmission Grid and the General Distribution Grids. The authority and operations of CRE and CNH would be transferred to the Ministry of Energy (SENER), and the authority and operations of CENACE would be transferred to CFE. CFE would become a fully integrated state-owned utility in charge of planning, regulating and operating the electric power industry, generating at least 54 percent of all electricity in Mexico and supplying all electricity in Mexico to end users.

Currently, the bill is being discussed in the Mexican Congress and the proposed amendment is subject to revision. Because it would amend the Mexican constitution, in order to be enacted, the amendment must be approved by two-thirds of the House of Representatives (335 votes), two-thirds of the Senate (85 votes) and a majority of the States (17 State Congresses). Although there is no set timeframe for review of and voting on the proposed amendment to take place, the executive branch has expressed its desire for the amendment to be considered during the current congressional session, which ends on December 1, 2021. It is unclear whether there is sufficient support to pass the bill; President López Obrador's ruling party, Movimiento Regeneración Nacional (MORENA) (together with its political allied parties), has a narrow majority in each of the House of Representatives and the Senate and has a majority in 19 State Congresses. While the current numbers would not be sufficient to approve the proposed amendment, MORENA continues to lobby members of other political parties to obtain the necessary votes.

If the proposed amendment is enacted in its current form, it will drastically change the regulatory framework and landscape of the electric power sector in Mexico, with

adverse effects on the contractual and constitutional rights of private investors in the industry.

The proposed amendment does not specify whether the rights of affected parties would be upheld or grandfathered, and it does not specify any rights of indemnification or other recourse parties may have. If the proposed amendment is enacted, there may be limited recourse available to affected parties within the Mexican legal system inasmuch as its provisions would be part of the Mexican constitution, which is the highest-ranking law in Mexico. Notwithstanding this, parties could avail themselves of certain rights and protections granted under multilateral trade agreements or international investment treaties, such as the U.S.-Mexico-Canada Trade Agreement or the Trans-Pacific Partnership. Such rights and protections include investor-state arbitration and government-to-government dispute resolution mechanisms that the United States or other governments could employ. The U.S. or other governments may also engage the Mexican government directly and utilize political pressure to seek changes to the proposed amendment in the short term.

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