
Proposed Implementing Legislation for the Mexican Energy Reform Will Create an Open, Competitive Electrical Power Industry

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The Mexican Congress is debating a historic package of legislation to restructure the nation's electrical power sector. This legislation will create a more open and competitive power industry in Mexico, giving the private sector unprecedented opportunities to (i) generate power in Mexico for sale in a competitive wholesale electricity market, (ii) offer electricity service to large-scale consumers in Mexico, and (iii) enter into joint ventures, public-private partnerships and service contracts with the state or the state-owned utility for the financing, construction and operation of infrastructure needed for the transmission, distribution and generation of electrical power.

Four months after Mexico amended its Constitution to reform and restructure the nation's energy industry (the "Energy Reform"), President Enrique Peña Nieto submitted to the Mexican Congress a much-anticipated package of proposed legislation to implement the Constitutional amendments. The proposal includes eight new laws, as well as amendments to thirteen existing laws, covering both the oil and gas industry and the electrical power sector in Mexico.

The proposed implementing legislation for the Energy Reform (the "Proposed Implementing Legislation") will be voted on by legislators in the coming weeks, with the goal of passing the Energy Reform laws before their mid-year recess. President Peña Nieto has indicated that he expects the Proposed Implementing Legislation to be adopted into law by mid-July of this year.

The portions of the Proposed Implementing Legislation that relate to the electrical power industry, including the proposed new Law of the Electrical Industry (*Ley de la Industria Eléctrica*) (the "Proposed Electricity Law") and the proposed new Law of the Federal Electricity Commission (*Ley de la Comisión Federal de Electricidad*) (the "Proposed CFE Law"), reveal the framework that will be put in place for a more open and competitive electrical power industry in Mexico, as well as the next steps for completing the transition to a new industry structure.

On June 14, 2014, the committees in the Mexican Senate that are reviewing and debating the Proposed Implementing Legislation, known collectively as the Joint Commissions of Energy and Legislative Studies (the "Joint Senate Commissions"), issued their report on the Proposed Electricity Law (the "Senate Commissions Report"), which contained a number of changes to the Proposed Electricity Law. As the Mexican Congress continues to review the Proposed Implementing Legislation, it can be expected that additional changes will be made. So it will be important to monitor the legislative process and review the final form of the Proposed Implementing Legislation as it is ultimately adopted. Nevertheless, it is expected that the most important elements of the power industry restructuring as set forth in the Proposed Implementing Legislation, including the design of the restructured industry, ultimately will be adopted into law.

In order to paint a clear picture of the restructured Mexican electrical power industry and the opportunities that the restructuring could unlock for the private sector, this Advisory provides:

- I. An overview of the current structure of the electrical power industry in Mexico and its challenges;
- II. A discussion of the new industry structure contemplated under the Proposed Implementing Legislation;
- III. A summary of the national priorities that will be advanced under the Proposed Implementing Legislation;
- IV. A review of the proposed timeline for transition to the restructured power sector; and
- V. A conclusion focusing on the immediate next steps in the reform effort.

The Current Industry Structure and its Challenges

Currently the Mexican electrical power sector is dominated by the CFE (*Comisión Federal de Electricidad*), a state-owned, vertically integrated electric utility serving all of Mexico. In addition to being the only entity that can legally undertake the transmission, distribution and marketing of electrical power in the country, CFE maintains a dominant position in power generation (with approximately 85 percent of generation owned or controlled by CFE). CFE also controls the planning for new generation projects and expansion of the transmission grid.

Although some private sector involvement in generation is allowed through special permits for self-supply (generating electricity for the generator's own use), co-generation, production for export, small production, or independent power production (for sale of electricity solely to CFE), private sector generation is still significantly limited in Mexico, primarily for three reasons:

- (i) Large scale generation projects depend on CFE planning and are limited by the restrictions of the federal budget, resulting in a bottleneck of potential new projects;
- (ii) The fact that CFE is the sole buyer of a new generation plant's output, as well as the absence of a competitive market for the acquisition of new capacity, limit the economic attractiveness of building new generation other than for self-supply; and
- (iii) An aging and insufficiently integrated national transmission network has resulted in substantial barriers to the interconnection of potential new generation projects, most importantly in the relatively remote areas of Mexico that have great potential for the use of clean energy sources, such as wind and solar.

As a consequence, a disproportionate amount of electricity in Mexico is generated from fuel oil and diesel, which are relatively high-cost sources when compared to cleaner energy sources. This fact has contributed to the excessively high cost of electricity in Mexico, where average rates are more than 25 percent higher than in the U.S., despite significant government subsidies, without which it is estimated that average rates would be 73 percent higher than in the U.S. These high costs constitute a serious hurdle for the growth of Mexico's economy across all industry sectors.

CFE also faces significant challenges because of the lack of private sector participation in the development of transmission infrastructure and the distribution of electrical power to end users, including billing and collection. The expected rate of growth in demand for electricity in Mexico in the next decade far exceeds the rate of expansion of the transmission grid that CFE is expected to be able to fund, build and operate on its own. CFE, which must work within federal budgetary constraints while at the same time bearing sole responsibility for the development of transmission infrastructure in all of Mexico, has struggled to build a sufficiently interconnected and modern national transmission network covering the entire country. To illustrate this problem, President Peña Nieto, in his comments accompanying the Proposed Electricity Law, noted that 47 percent of national transmission lines in Mexico are more than 20 years old and only 8 percent have been built in the last five years.

With respect to the distribution of electrical energy to end users, and billing and collection, the Mexican government has emphasized that CFE currently suffers from serious inefficiencies in the distribution networks, including a high level of losses due to nonpayment and energy theft. As a result, the Mexican government estimates that 21.28 percent of the energy delivered by CFE is never paid for by end users. This gap has contributed to CFE's losses (339 billion pesos from 2007 to 2013), which are projected to accelerate in the coming years absent reform, leaving CFE less able to make the investments necessary to fulfill its mandate of providing reasonably priced electricity service to a growing Mexican economy.

Finally, the government believes that CFE's capacity to address these issues and improve its productivity and profitability as an enterprise is further challenged by the current role of the government in the management of CFE's operations. In contrast to other countries where ownership and management of state-owned energy companies are more clearly separated, in Mexico, CFE, like the national oil and gas company (Pemex), is a state-run enterprise, subject to a significant amount of government control over its day-to-day operations.

The Proposed New Industry Structure

The Proposed Implementing Legislation establishes a legal framework to foster greater competition and private sector participation in all aspects of the Mexican electrical power industry. It also provides for the transformation of CFE into a "productive state enterprise" that will enjoy greater management autonomy and flexibility, while remaining a state-owned entity and a key industry participant.

A Disaggregated Industry with Strict Legal Separation Among Its Functional Segments

Under the proposed new industry structure, CFE will continue to be the supplier of electrical service at regulated rates to residential users and small and medium-sized commercial and industrial users (collectively referred to in the Proposed Electricity Law as "Basic Users"). And CFE will continue to participate in each other segment of the industry through a series of new operating subsidiaries and affiliates that will be strictly separated from each other and run as independent business units, while ultimately remaining state-owned. For example, the companies that operate and maintain the national transmission network ("Transmission Companies") and those that operate and maintain the general distribution networks ("Distribution Companies") will be separate, independent subsidiaries of CFE, and will not be permitted to buy or sell electrical energy, so as to avoid any possible conflict of interest that could impact the network access that these companies provide to other market participants. CFE thus will not be privatized. The Proposed Implementing Legislation reiterates

that the public service of transmission and distribution of electricity, as well as the planning and control of the national electrical system, will remain within the exclusive purview of the state.

Private parties will have the opportunity to compete with CFE and/or with each other in (i) generating electricity for sale in a competitive, open market (and not solely for sale to CFE or self-supply); (ii) entering into public-private partnerships with the federal government with respect to the generation of electrical power; (iii) acting as suppliers of electricity service to large-scale end users, competing on equal terms with the marketing subsidiaries or affiliates of CFE; and (iv) entering into contracts and joint ventures with the state (including with CFE's subsidiaries) for the construction, financing, operation and/or maintenance of transmission and distribution network infrastructure, as well as contracts to provide services relating to billing and collection, and relating to the operation of the wholesale electricity market.

The government believes that greater private sector investment in power generation in Mexico will lead to new and more diverse generation sources, including more generation from cleaner and lower-cost sources, so as to ultimately reduce electricity prices. Meanwhile competition in the supply of electricity to large-scale users is intended to result in better and less expensive options for these users to meet their energy needs. And the assistance of private companies in building networks, billing users and operating the wholesale market is intended to increase investment, and make these processes more efficient and less of a burden on the government and CFE.

In order to ensure open access and efficient operation of the electrical power industry, without undue aggregation of market power, the Proposed Electricity Law establishes a general principle that the functions of generation, transmission, distribution, marketing and supplying primary inputs (such as fuel oil and natural gas) to power plants, each must be carried out independently and with strict legal separation from the other functions. Without limiting the general authority of Mexico's antitrust regulator the Federal Economic Competition Commission (*Comisión Federal de Competencia Económica*) with respect to monopolistic and anti-competitive practices in Mexico, the Ministry of Energy (*Secretaría de Energía*) will now be required to establish legal separation among the various power industry functions, and to monitor compliance and enforce these rules, including by ordering the divestiture of assets, rights or equity interests.

In addition, the Proposed Electricity Law grants authority to the Energy Regulatory Commission (*Comisión Reguladora de Energía* or "CRE"), the primary regulator of the energy industry in Mexico, to issue rules governing transactions between generators of electricity and their affiliates that sell electricity, as well as to impose its own rules on market participants regarding accounting, operational or functional separation. Consistent with the principle of preventing conflicts of interest and ensuring open access, the proposed Hydrocarbons Law (*Ley de Hidrocarburos*), a key component of the Proposed Implementing Legislation for the oil and gas industry, further provides that generators of electricity will not be permitted to own equity interests directly or indirectly in entities that operate oil and gas pipelines and storage facilities within the same markets where the generators operate.

CENACE and the Wholesale Electricity Market

In order to allow all generators of electricity to offer their output for sale in open competition under fair and impartial rules, the Proposed Electricity Law requires the establishment of a wholesale market for electricity in Mexico (the "Wholesale Electricity Market") to be operated by the National Energy Control Center (*Centro Nacional de Control de Energía* or "CENACE") pursuant to a new set of market rules (the "Market Rules"). CENACE will set the spot price for electricity in the Wholesale Electricity Market based on information regarding supply and demand provided by market participants, and will be responsible for ensuring that the demand for electricity is met at the lowest possible cost in accordance with the Market Rules. CENACE will

also be the operator of the national electrical system, controlling the dispatch of electrical power and the operation of the national transmission grid and general distribution networks.

CENACE is currently a division of CFE. However, CENACE will be spun out from CFE and recast as a separate, neutral and independent governmental entity. It will be charged with ensuring open and non-discriminatory access to the transmission and distribution networks, maintaining system reliability, and proposing plans for transmission and distribution expansion to the Ministry of Energy, among other activities. Its function will be similar to that of an independent system operator (ISO) in the United States. CENACE will be permitted to enter into agreements with private parties for the provision of services relating to the operation of the Wholesale Electricity Market.

Three types of entities will be permitted to participate in the Wholesale Electricity Market by entering into market participant agreements with CENACE and posting the security that will be required under the Market Rules:

- (i) **Generators.** Generators, including both private sector generators and CFE, will be able to offer electricity for sale through the Wholesale Electricity Market by submitting bids based on their operating costs.
- (ii) **Qualified Users.** “Qualified Users” will include entities whose electricity consumption and demand exceeds a threshold to be set by the Ministry of Energy, as well as existing self-supply, cogeneration and importation users. Qualified Users will be able to purchase electrical power directly in the Wholesale Electricity Market and will be required to report their demand for electricity to CENACE. In addition, Qualified Users will have the option of acquiring electrical power indirectly through a “Supplier” of electricity service, as discussed below.
- (iii) **Commercializers (Including Suppliers and Non-Supplier Commercializers).** Entities that provide electricity to end users and “represent” Qualified Users in the Wholesale Electricity Market are referred to in the Proposed Electricity Law as “Suppliers” and will now include both (A) private sector companies that supply Qualified Users, and (B) CFE or its commercialization subsidiaries, which will provide this service to Qualified Users and Basic Users. These Suppliers will be able to purchase electrical power in the Wholesale Electricity Market to satisfy the requirements of their customers and will be required to report their demand for electricity to CENACE. In addition to Suppliers, other “Commercializers” (referred to in the Senate Commissions Report as “Non-Supplier Commercializers”) will be permitted to buy and sell the other products and services that will be traded through the Wholesale Electricity Market, as discussed below.

In addition to electrical energy itself, the Wholesale Electricity Market will also facilitate the purchase and sale of other products and services (“Associated Products”), including, among other things, (i) capacity, (ii) transmission and distribution services, (iii) financial transmission rights¹ and (v) certain “Ancillary Services” required in order to ensure the reliability and security of the national electrical system, such as frequency regulation, voltage regulation, operating reserves, spinning reserves (i.e., reserve capacity from units that are already on-line), black start (i.e., emergency start) services, and demand response (i.e., controlled reduction of consumption by end users), among other services, as these services will be defined in the Market Rules. CENACE will acquire these

¹ Financial transmission rights are financial instruments that provide compensation for the costs that market participants can incur in the spot market when there is congestion in the transmission network. In order to ameliorate such congestion, power from generators in low-price areas is dispatched to high-price areas. As a result, generators in the low-price area are paid less through the wholesale electricity market than the amount collected from purchasers in the high-price area, and end users in the high-price area likewise are paid more than the price in effect at the low-price area. Financial transmission rights give the holder thereof the right to receive the amount of such price difference.

Ancillary Services through the Wholesale Electricity Market from the market participants who are able to provide them, as and to the extent needed to maintain system reliability and security.

Bilateral Contracts

In addition to engaging in transactions through the Wholesale Electricity Market as described above, generators, Qualified Users and Commercializers also will be permitted to enter into bilateral contracts relating to electricity, including contracts for differences and other types of financial contracts, under which the parties will agree on the purchase and sale of electrical energy and the making of payments based on the contract price. The parties will be obligated under the Market Rules to inform CENACE of any such contracts. These contracts will provide an alternative to the spot market for industry participants, offering some insulation from price fluctuations in the Wholesale Electricity Market and helping to facilitate long-term planning.

A New CFE

The Proposed CFE Law will transform CFE into a “productive state enterprise” with a series of subsidiary companies and affiliates, all of which will be subject to the requirements of functional separation and independence mentioned above.

As a productive state enterprise, CFE’s governance will be more in line with international best practices for an independently managed power company, with a board of directors that will have very broad powers to oversee the operations of the company. The board will include four independent directors (out of a total of 10 directors) and will have three support committees, including an Audit Committee, a Human Resources and Compensation Committee, and a Strategy and Investments Committee.

The Proposed CFE Law also contemplates that CFE and its subsidiaries will have a special compensation regime, which will be different from the general regime governing federal employees and which will permit a greater degree of incentive compensation than is currently allowed, equivalent to the incentive compensation that is typically payable in the industry or industry segment in question.

In addition, CFE will have greater budgetary autonomy consistent with the principle of separation of ownership from management. This will occur, in part, by means of a new regime under which CFE will pay an annual “dividend” to the state, in an amount to be determined by the Ministry of Finance and Public Credit (*Secretaría de Hacienda y Crédito Público*), taking into account a financial report and five-year forecast to be provided annually by CFE, together with CFE’s proposal as to the amount of the dividend for the year in question. The remainder of CFE’s profits will be reinvested as determined by CFE’s Board of Directors.

The Proposed CFE Law also requires greater transparency and public disclosure of information by CFE, based generally on the disclosure requirements that are imposed on publicly traded companies under the Mexican Securities Market Law (*Ley del Mercado de Valores*).

In addition to these changes relating to governance, compensation, budgetary autonomy and transparency, the Proposed CFE Law, together with the Proposed Electricity Law, seek to further strengthen CFE by allowing it, through its various subsidiaries, to enter into agreements and joint ventures with private parties for the financing, installation, maintenance, management, operation and expansion of the transmission and distribution networks, as well as for the provision of collection and billing services in connection with the commercialization of electrical energy. The contracts are required to be awarded by means of competitive bidding processes that guarantee open and free competition, as well as complete transparency.

This potential involvement of private parties in transmission infrastructure, distribution and commercialization is intended to give CFE and its subsidiaries access to experience and technology in these areas that do not exist

or are in short supply in the Mexican public sector, so as to reduce the debilitating losses that CFE has suffered and improve the efficiency of the transmission and distribution systems.

A Stronger CRE

In a disaggregated electrical power industry with a large number of new participants and increasingly complex transactions to be regulated, the CRE will have an expanded mandate and workload. In order to better position the CRE to fulfill its new role, the government seeks to strengthen the CRE by (i) increasing its budgetary, technical and management autonomy; (ii) making it more difficult for regulated entities to initiate legal challenges against CRE actions; (iii) requiring greater openness and transparency with respect to the CRE's regulatory decision-making; and (iv) establishing mechanisms to ensure the CRE's efforts reflect Mexico's national energy policies.

For this purpose, the Proposed Implementing Legislation includes a new Law of the Coordinated Regulatory Bodies for Energy (*Ley de los Organos Reguladores Coordinados en Materia de Energía*) (the "Proposed Regulatory Bodies Law"). This law creates a new legal, financial and administrative regime for both the CRE and the National Hydrocarbons Commission (*Comisión Nacional de Hidrocarburos* or "CNH"), which will have a similarly expanded role in the restructured oil and gas industry. It also establishes a new Coordinating Board for the Energy Sector (*Consejo de Coordinación del Sector Energético*) to include the CRE, the CNH, representatives of the Ministry of Energy, and the presidents of CENACE and the equivalent control center for the natural gas transport system. This Coordinating Board will help ensure that the CRE and CNH work in a coordinated fashion to advance the national energy policies formulated by the Ministry of Energy.

National Priorities Advanced by the Proposed Implementing Legislation

In addition to opening up the electrical power industry to a greater number of participants, promoting competition for the ultimate benefit of electricity consumers, transforming CFE so as to strengthen it, and revamping the CRE, the Proposed Implementing Legislation also is designed to advance certain technical and public policy imperatives, including, among others, the following:

Promoting the Mexican Domestic Power Industry

The Proposed Electricity Law requires that the Ministry of the Economy (*Secretaría de Economía*), in consultation with the Ministry of Energy, define strategies to promote local industrial supply chains and to promote direct investment in the power industry, with a focus on small and medium-sized companies. These efforts will be supported by a new Public Trust to Promote the Development of National Suppliers and Contractors in the Energy Industry (*Fideicomiso Público para Promover el Desarrollo de Proveedores y Contratistas Nacionales de la Industria Energética*), which will promote the domestic industry through financing programs and other support programs for training, research and certification.

Expanding and Modernizing the Grid

The Proposed Electricity Law requires the Ministry of Energy to develop programs for the expansion and modernization of the national transmission network and the general distribution networks, taking into account (i) the CRE's views with respect to such proposals, and (ii) input from participants in the Wholesale Electricity Market.² For those networks that are determined by CENACE to correspond to the Wholesale Electricity Market (as opposed to local transmission networks), such expansion and modernization programs will be based on proposals formulated by CENACE.



² The Joint Senate Commissions have proposed to require that such expansion and modernization programs include smart grid programs, and to require that the feedback of parties interested in developing electrical infrastructure projects also be obtained with respect to such programs.

These programs, together with the Ministry of Energy's indicative planning for the construction and retirement of particular generation facilities, are to be included in a Development Program for the National Electrical System (*Programa de Desarrollo del Sistema Eléctrico Nacional*) issued by the Ministry of Energy. The Transmission Companies and Distribution Companies, in turn, will be required to carry out the expansion and modernization projects that are included in these programs, pursuant to the Ministry of Energy's instructions.

Financing Electrification Projects for Rural and Marginalized Communities

The Proposed Electricity Law requires the Ministry of Energy to establish and oversee a Universal Electrical Service Fund (*Fondo de Servicio Universal Eléctrico*) to finance electrification projects in rural communities and marginalized urban areas, and to finance the supply of efficient lighting and electricity supply to marginalized end users. The expansion projects in the Ministry of Energy's Development Program for the National Electrical System mentioned above are required to be developed in coordination with such electrification projects.

The Universal Electrical Service Fund will be endowed with the surplus resulting from the management of technical losses in the Wholesale Electricity Market, pursuant to the terms of the Market Rules. The fund also will be permitted to receive donations from third parties. Funds from the market that are not used by the Universal Electrical Service Fund for electrification projects will be remitted to CENACE, to be returned to market participants in accordance with the Market Rules.

Promoting Sustainability and Respect for Human Rights

The Proposed Electricity Law establishes a general principle of promoting sustainability and respect for human rights in indigenous communities in regard to infrastructure projects for the power industry. It requires the Ministry of Energy, in coordination with the Interior Ministry (*Secretaría de Gobernación*), to look into the social impact of proposed infrastructure projects and requires applicants for permits to develop such projects to submit social impact assessments to the Ministry of Energy.

Promoting the Use of Clean Energy

The Proposed Electricity Law requires the Ministry of Energy to implement measures to comply with policies on diversification of energy sources, energy security and the promotion of clean sources of energy. It also requires the Ministry of Energy to establish obligations for the acquisition of clean energy certificates, and allows the Ministry to enter into agreements to permit the recognition of equivalent instruments from other jurisdictions. These certificates will be negotiable and the transfer of excess or needed certificates between periods will be permitted to promote price stability.

The Ministry of Energy will impose obligations to acquire such clean energy certificates on Suppliers, Qualified Users that participate in the Wholesale Electricity Market, and end users that generate or import electricity for their own use, in relation to the load facilities that these entities represent. The Ministry will also establish criteria for the issuance of such certificates to generators that produce electrical energy from renewable sources or clean technologies. But it will be the CRE that grants these clean energy certificates, issues the regulations to validate ownership thereof, and verifies compliance with such obligations.³

With respect to clean energy obligations, we note that some observers and legislators in Mexico believe that the Proposed Implementing Legislation does not do enough to promote the development of renewable



³ The draft Proposed Electricity Law also made reference to emissions certificates, but the Joint Senate Commissions proposed to leave in only the reference to clean energy certificates, reasoning that emissions certificates are a matter to be covered under environmental laws and regulations.

energy projects in Mexico, and does not address the issues of whether new subsidies and benefits for such projects will be established, and the extent to which existing subsidies will remain in place. Some analysts and stakeholders maintain that new and/or additional subsidies to promote renewable energy projects will be required in view of the fact that, at least initially, such projects will not be cost competitive with generation from conventional energy sources in an open wholesale electricity market.

In an apparent acknowledgment of the importance of this issue, Senator David Penchyna, the President of the Energy Commission in the Mexican Senate, recently stated that there will be a package of seven additional laws presented to the Mexican Congress, most likely in July, specifically to deal with renewable energy, which will include certain “targeted” subsidiaries to promote renewable energy. Furthermore, the National Action Party (*Partido de Acción Nacional* or “PAN”), an important center-right opposition party, recently submitted a proposed bill on this topic to the Mexican Senate entitled the Law of the Energy Transition (*Ley de la Transición Energética*), which would replace Mexico’s existing renewable energy promotion law per the PAN’s proposal. It is not clear whether Congress’ consideration of these new proposed laws on renewable energy will be combined with its review and debate of the existing package of Proposed Implementing Legislation that the government hopes to pass in the coming weeks, or whether they will be reviewed and adopted separately.

The Proposed Timeline for Transition to the Restructured Power Sector

The transitional provisions of the Proposed Electricity Law, the Proposed CFE Law and the Proposed Regulatory Bodies Law reveal the following timeline for the transition period: (this timeline reflects the changes proposed to be made to the Proposed Electricity Law in the Senate Commissions Report)

| Date, Deadline or Time Period | Transitional Step or Action |
|---|--|
| December 20, 2013 | The constitutional amendment for the Energy Reform took effect |
| April 30, 2014 | President Peña Nieto submitted the Proposed Implementing Legislation to the Mexican Congress, including the Proposed Electricity Law and the Proposed CFE Law |
| June 14, 2014 | The Joint Commissions of Energy and Legislative Studies issued their report on the Proposed Electricity Law, proposing a number of modifications to the Proposed Electricity Law |
| Expected by mid-July, 2014 | Adoption of the Proposed Implementing Legislation into law (the date on which this legislation goes into effect will be referred to in this timeline as the “Implementing Legislation Date”) |
| Implementing Legislation Date | CFE by operation of law becomes a “productive state enterprise” |
| Implementing Legislation Date | Importation of electrical energy and Associated Products allowed under the circumstances specified in the transitional provisions of the Proposed Electricity Law |
| Within 90 days after the Implementing Legislation Date | The members of the board of directors of CFE shall be designated as provided in the Proposed CFE Law |
| Within 180 days after the Implementing Legislation Date | The CRE must issue its internal regulations, as a coordinated regulatory body; and President Peña Nieto must present to the Mexican Senate for its consideration his nominations for the two new commissioner positions at the CRE |

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| Within 6 months after the Implementing Legislation Date | Issuance of the presidential decree to create CENACE as a decentralized public body of the Federal Public Administration (the date of issuance of this decree is referred to in this timeline as the "CENACE Decree Date") |
| Within 3 months after the CENACE Decree Date | Transfer of human, material and financial resources, and other assets and functions, from CFE to the reorganized CENACE as needed to permit CENACE to perform its new functions |
| Within 9 months after the Implementing Legislation Date | The CRE will issue or authorize the contractual models for the agreements called for under the Proposed Electricity Law (including CENACE's agreements with market participants and Transmission and Distribution Companies) (referred to in this timeline as the "Contract Model Date") |
| During the 12 months following the Implementing Legislation Date | Works and investment programs approved by the Ministry of Energy will be used in lieu of the programs for expansion and modernization of the national transmission network and the general distribution networks referred to in the Proposed Electricity Law, unless and until the Ministry of Energy authorizes such programs |
| Within 3 months after the Contract Model Date or the date of request from the market participant or Transmission/Distribution Company | CENACE must enter into the contracts required for parties to become participants in the Wholesale Electricity Market, and the contracts with Transmission Companies and Distribution Companies |
| For 12 months after the CENACE Decree Date | CENACE to provide support to CFE as needed to permit CFE to continue providing the public service of transmission and distribution under conditions of continuity, efficiency and security |
| Commencement of operations of the Wholesale Electricity Market | Holders of existing permits for self-supply, cogeneration, small production, independent power production, import, export, and own use granted under the Existing Electricity Law will be able to request that these permits be changed to generation permits under the new Proposed Implementing Legislation |
| One year after the commencement of operations of the Wholesale Electricity Market | Responsibility for monitoring the Wholesale Electricity Market will switch from the Ministry of Energy to the CRE |
| Within 2 years after the Implementing Legislation Date | CFE must carry out the legal, accounting, functional and structural separation of the activities of generation, transmission, distribution and commercialization |

Immediate Next Steps

Once the Proposed Implementing Legislation is passed by the Mexican Congress and adopted into law, the Ministry of Energy and the CRE will be required to develop and announce a large number of important policies, rules and regulations for the restructuring of the electrical power industry.

While the above timeline sets forth the key dates, requirements and milestones identified in the Proposed Implementing Legislation for the transition period, we note that the Ministry of Energy has broad authority under the Proposed Electricity Law to establish additional time periods, policies and rules for the restructuring, and to oversee the transition process as a whole, including, among other items, creating (i) the initial Market Rules that will govern the operation of the Wholesale Electricity Market; (ii) the exact timing, method and process for splitting CFE into multiple subsidiaries and transferring assets and contracts

to these subsidiaries; (iii) the rules for granting and acquiring clean energy certificates; and (iv) the initial Development Program for the National Electrical System (as described above under the heading “Expanding and Modernizing the Grid”).

The CRE in turn will have to develop, among other items, (i) the rate regime for transmission, distribution, electricity service to Basic Users, the operation of CENACE and the Ancillary Services not included within the Wholesale Electricity Market; (ii) the terms governing the bids that generators of electricity will have to make through CENACE based on their operating costs; (iii) the contractual models for the agreements that CENACE will enter into with participants in the Wholesale Electricity Market, and with Transmission Companies and Distribution Companies; and (iv) the rules governing transactions between generators of electricity and their affiliates that provide electricity service to end users.

The careful design and implementation of the additional rules and policies mentioned above will be critical to the success of the Energy Reform initiative, because they will set forth the details regarding the type of Wholesale Electricity Market to be established, the roll-out of the new market, and the day-to-day operations of the restructured power sector.

Accordingly, in addition to being familiar with the Proposed Implementing Legislation described in this Advisory, it will be important for industry participants to understand the rules and policies to be issued by the Ministry of Energy and the CRE in the coming months. We will continue to closely monitor the progress of the Proposed Implementing Legislation through the Mexican Congress, as well as the subsequent steps in the restructuring of the Mexican electrical power industry.

If you have any questions about the content of this advisory, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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