

RITCH

M U E L L E R

COFECE issues an opinion on the amendment to the terms for the legal separation of CFE

Since the Energy Reform of December 2013, Mexican law allows the participation of the private sector in electricity generation and commercialization activities for the purpose of promoting investment, introducing new technologies and achieving better supply at competitive prices for the benefit of consumers.

In January of 2016, the Ministry of Energy (“SENER”) published the “Terms for the strict legal separation of the CFE” (*Términos para la estricta separación legal de la CFE*, “TESL”), under the Law of the Electricity Industry and the Law of the Federal Electricity Commission, which set forth the accounting, operational, functional and legal separation between each of the generation, transmission, distribution and commercialization activities of the Federal Electricity Commission (“CFE”) and the horizontal separation of CFE’s generation assets into six productive subsidiary companies (“Gencos”). On March 25, 2019, SENER published a resolution amending the TESL (the “Resolution”).

On May 2, 2019, the Mexican Federal Commission of Economic Competition (“COFECE”) issued an opinion regarding the Resolution, whereby it highlighted the importance of the vertical and horizontal separation of CFE, considering lessons learned from international experience in the liberalization process of the electricity industry. COFECE noted that some of the new provisions of the Resolution could threaten competition and free access in the electricity industry in Mexico, and included some recommendations in this regard.

Following please find the principal competition risks and recommendations identified and proposed by COFECE:

Risks on horizontal separation:

An amendment to the horizontal separation of CFE could lead to the following anticompetitive effects: (i) manipulation of cost and price information; (ii) cross-subsidies; (iii) loss of incentives to invest; (iv) manipulation of available capacity to raise prices; and (v) negative impact on qualified supply.

Risks on functional separation between Gencos:

An amendment to the functional separation between Gencos could lead to the following anticompetitive effects: (i) disruption of competition; (ii) coordinated anticompetitive behavior; and (iii) trading and undue use of privileged information.

Risks on vertical separation:

An amendment to the vertical separation of CFE could lead to the following anticompetitive effects: (i) decreased migration to qualified supply; (ii) restrictions or limitations on free and equal access to general distribution networks; (iii) refusal to contract with suppliers other than CFE; (iv) entry barriers for new competitors; and (v) limitations on the interconnection capacity and to priority investments in generation.

Recommendations

COFECE makes the following principal recommendations:

- The proposal for the reallocation of assets and generation contracts between CFE companies to be sent by CFE to SENER should take into account the considerations in COFECE's opinion, especially in connection with maintaining the horizontal separation of CFE in generation, as well as the functional separation of CFE companies participating in this activity, to avoid exchange of privileged information and of employees.
- CFE should maintain the vertical separation between distribution and commercialization activities.
- SENER and CRE should oversee and ensure the strict separation of CFE, and issue appropriate regulation in case of a dominant agent.
- The legal separation of CFE, and its amendments if any, should be reviewed to quantify and publicly report the efficiency gains resulting from such restructuring in order to ensure transparency and accountability taking into consideration not only the consequences in the electricity market but also in other related markets.

The complete text of COFECE's opinion is available in the following link:

<https://www.cofece.mx/CFCResoluciones/docs/Opiniones/V112/4/4791684.pdf>

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