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Mexican Governmental Recent Measures in the Private Renewable Energy Industry

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Introduction

In the heat of the pandemic, the Mexican authorities have recently passed two resolutions and pursued related measures to strengthen the state control over the energy industry at the expense of the private renewable energy industry. These actions further the Mexican President's goal to gain "energy sovereignty."

It is incontestable that every state has a right to amend its legal framework as deemed necessary. It is also undeniable that extraordinary times require extraordinary measures. However, a state's prerogatives are not absolute. The Mexican state is constrained to exercise its regulatory powers within certain limits. When the boundaries are exceeded, the affected parties have the possibility to challenge the measures under various available avenues. Therefore, all interested parties may wish to perform a thorough comprehensive study, including under national and international law, to identify their rights, weigh their options, and move forward accordingly.

I. The Measures

The first resolution was published by the National Center for Energy Control (*CENACE* by its acronym in Spanish) ("CENACE Resolution") on 29 April 2020.[1] The CENACE Resolution has an explanatory section on the justification of the measures contained in a technical annex.

The CENACE Resolution points to two problems. First, the explanatory section mentions the impact that the COVID-19 health emergency has had on the energy demand. Second, the technical annex enumerates a series of failures and features of the wind and photovoltaic energy industries that affects the reliability, sufficiency, and continuity of the national electric system. The link between these two problems is not clearly explained.

The technical annex contains a list of the measures including, *inter alia*, the following:

- Preferential grid access to non-renewable electricity generation facilities;
- Indefinite suspension of all preoperative testing on wind and photovoltaic farms as of 3 May 2020; and,
- Analysis on the feasibility of pending licenses.

All these measures are designed to combat the second problem, which predates the COVID-19 outbreak and was foreseeable at the time when most of the investments in the renewable energy industry were made. Moreover, the CENACE Resolution does not expressly state when the measures will end, nor that their effects will cease when the pandemic emergency declaration is lifted by the competent authorities.

Doubts over the CENACE Resolution's true connection with COVID-19 increased when Mexico's President stated during his daily morning conference on 6 May 2020 that the CENACE Resolution aims to protect the financial interests of the Federal Electricity Commission (*CFE* by its acronym in Spanish) ("CFE") by giving CFE priority access to the electric grid.[2]

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[1] *Acuerdo para Garantizar la Eficiencia, Calidad, Confiabilidad, Continuidad y Seguridad del Sistema Eléctrico Nacional, con motivo del reconocimiento de la epidemia de enfermedad por el virus SARS-CoV2 (COVID-19)*, published on 29 April 2020, available at https://www.cenace.gob.mx/Docs/MarcoRegulatorio/AcuerdosCENACE/Acuerdo%20para%20garantizar%20la%20eficiencia,%20Calidad,%20Confiabilidad,%20Continuidad%20y%20seguridad%20del%20SEN%202020%2005%2001.pdf (last visited 24 May 2020)

[2] Reforma website, https://www.reforma.com/aplicacioneslibre/preacceso/articulo/default.aspx?__rval=1&urlredirect=https://www.reforma.com/la-mananera-de-amlo-6-de-mayo/ar1936365?referer=--7d616165662f3a3a6262623b727a7a7279703b767a783a--

As a follow-up of the CENACE Resolution, a second resolution was published in the Mexican Official Gazette on 15 May 2020 by the Ministry of Energy (*SENER* by its acronym in Spanish) ("SENER Resolution").[3] The SENER Resolution established a new policy on the reliability, safety, continuity, and quality for the national electric system comprised by various additional measures. This resolution allegedly aims to guarantee the continuous, efficient, and safe operation of the electric system for the benefit of users. This new policy abrogates many aspects of the reliability policy published by SENER in 2017.[4]

Some of the policy's main aspects are that it:

- Establishes a series of rules and criteria to grant SENER and CENACE broad discretionary powers to limit the interconnection and entry into operation of new renewable energy projects;
- Sets the basis to grant priority to strategic projects and flexible power plants over intermittent renewable energy projects concerning the interconnection to the national grid;
- Turns the element of reliability into the key element of the energy market policy;
- Authorizes CENACE to deny feasibility studies on interconnection for renewable energy projects;
- Imposes new grounds for revocation or early termination of new generation permits and agreements on interconnection pending to be concluded or renewed;
- Prioritizes supply security over economic efficiency; and,
- Imposes the obligation on renewable energy power plants to guarantee a permanent voltage control.

The foregoing measures established by the SENER Resolution will allegedly protect the national electric system's reliability which, according to the Ministry of Energy, is being compromised due to the intermittency of supply that characterizes renewable energy power plants. However, the measures have been subject to strong criticism, including those raised by other governmental institutions such as the Mexican Federal Commission for Economic Competition (*COFECE* by its acronym in Spanish). In fact, the COFECE published an opinion holding that the CENACE Resolution violates provisions of the Federal Law of Economic Competition.

Similarly, the European Union and the Canadian Government expressed their concerns about the effects that the CENACE Resolution would have on foreign investment in the energy industry. Such criticisms have focused on the fact that the measures' purpose, far from being the protection of the electric system's reliability, will actually be to halt current and future development of renewable and private sustainable energy generators in the country, as well as to manipulate the market spot price of energy to the detriment of private investors, as a way to consolidate CFE (a state-owned power company) monopoly over the power market in Mexico.

Following a declaration by CFE's Director, Manuel Bartlett, in the sense that renewable operators had not contributed to the infrastructure that sustains their operations because they were not paying transmission costs, CRE approved an adjustment to the charges made by CFE to private companies for using the transmission lines.[5] This increase will apply to all "legacy contracts" which concern energy projects built before the energy reform in 2013. This measure will likely increase the price that final consumers pay for their energy consumption.

II. Judicial and Administrative Domestic Proceedings

The measures contained in the CENACE Resolution have been challenged on a number of grounds before Mexico's judicial authorities. In particular, a large number of companies have started *amparo* proceedings before antitrust federal courts, and obtained suspension orders against the effect of the measures. This suspension will enable the *amparo* petitioners to continue with pre-operative testing needed to achieve commercial operations. According to the court that granted the suspension order, the petitioners established a *prima facie* case on the merits because the CENACE Resolution: (i) compromises free competition in the electric wholesale market because it conditions the participation of the petitioners in the market to the approval by certain authorities, (ii) seems inconsistent with the transition of Mexico to renewable energy according to the Energy Transition Law and the expectations of the petitioners within such transition process, (iii) possibly does not take into account environmental risks, among other reasons. Moreover, according to the court, suspending the effect of the

[3] *Política de Confiabilidad, Seguridad, Continuidad y Calidad en el Sistema Eléctrico Nacional*, published on 15 May 2020 in the Mexican Official Gazette.

[4] SENER Resolution, Second Transitory Article.

[5] Milenio website, https://www.milenio.com/negocios/cfe-empresas-renovables-pagaran-red-electrica-bartlett (last visited 24 May 2020)

CENACE Resolution would be beneficial to society at large because it could lead to the inefficient provision of the public service and to an increase in the energy price.

The NGO Greenpeace Mexico filed an *amparo* against the SENER Resolution. On 29 May 2020, the court granted the provisional suspension of the new policy effects.[6] According to the court's decision, the petitioner established a *prima facie* case on the merits because the SENER Resolution: (i) has a negative impact on the environment; (ii) affects Mexico's possibility to comply with its international obligations; and, (iii) compromises free competition in the electric wholesale market affecting final users. Likewise, on 11 June 2020, the collective partnership Defensa Colectiva obtained a suspension of the new policy effects. [7]

Companies affected by the measures can also seek monetary relief in Mexican courts. Under the Federal State Liability Law (*Ley Federal de Responsabilidad Patrimonial del Estado*), individuals that suffer the effects of harmful state activity may file a petition to the governmental authorities that caused the harm seeking damages. If the authority dismisses the petition, then the affected party can bring an administrative proceeding challenging such resolution. If successful, the court will order the authority to compensate the damage suffered by the plaintiff.

A case-by-case analysis must be made to determine whether the commencement of proceedings before domestic courts could have a relevance on a potential investment arbitration. In most cases, *amparo* proceedings will have a different cause of action and thus they will not preclude the possibility of investment arbitration. In contrast, claims seeking damages from CENACE, SENER or other governmental entity might have an impact on the pursuit of such claim before an arbitral tribunal.

III. International Investment Arbitration

A large number of private companies in the field of renewable energies are foreign investors. Mexico has concluded bilateral or multilateral investment treaties with most of its commercial partners. Traditionally, these treaties provide for investment arbitration under the ICSID Convention, the ICSID Additional Facility Rules, and the UNCITRAL Rules.[8]

The availability of this dispute resolution mechanism will depend on a series of jurisdictional requirements, including the nationality of the investor. Their access could also be subject to preconditions, such as cooling off periods or, in certain cases, exhaustion of local remedies.

Most treaties in essence contain similar protection standards. However, it is necessary to perform a thorough analysis on the text of the applicable treaty to determine the exact scope of protection.

The main protection standards are the following:

1. Fair and Equitable Treatment

The Fair and Equitable Treatment (FET) standard imposes the obligation on the host state to create stable, equitable, favorable and transparent conditions for investments.[9] This standard has different elements. Among the most important ones is the protection of legitimate expectations arisen at the time the investment was made.

The 2012 study by the UNCTAD on FET notes that: "*arbitral decisions suggest [...] that an investor may derive legitimate expectations […] from […] rules that are not specifically addressed to a particular investor, but which*

[6] Reforma Website, https://www.reforma.com/suspende-juez-politica-electrica-de-nahle/gr/ar1954270?md5=7fd03e593b4d06c7568342019dad010d&ta=0dfdbac11765226904c16cb9ad1b2efe&lcmd5=6320fc2ad6fdcb1d570d0fc3ddc5391e (last visited 29 May 2020)

[7] El Universal Website https://www.eluniversal.com.mx/nacion/politica/juez-suspende-acuerdo-de-sener-que-frena-energias-renovables (last visited 11 June 2020)

[8] Agreement on the Reciprocal Promotion and Protection of Investments between the United Mexican States and the Kingdom of Spain, signed on 10 November 2006, entered into force 3 March 2008, Article XI; Agreement on the Reciprocal Promotion and Protection of Investments between the United Mexican States and the Netherlands, signed on 13 May 1998, entered into force 1 October 1999, Article Three of the Schedule. Agreement on the Reciprocal Promotion and Protection of Investments between the United Mexican States and Germany, signed on 29 August 1998, entered into force 23 February 2001, Article 12.

[9] *Charanne and Construction Investments v. Spain*, SCC Case No. V 062/2012, Award, para 477.

are put in place with a specific aim to induce foreign investment and on which the foreign investor relied in making his investment."[10]

The tribunal in *Charanne v Spain* noted that "*to be in violation of the legitimate expectations of the investor, regulatory measures must not have been reasonably foreseeable at the time of the investment*".[11] The elements of 'reasonableness' and 'proportionality' in the state's amendments to the regulatory framework have been key matters for tribunals to rule on the existence of a breach to the FET standard.[12]

Furthermore, tribunals have underscored that a host-state's reference to a *bona fide* public policy in taking actions in alleged violation of its FET obligations does not obviate its need to adhere to and respect obligations to investors' legitimate expectations or to act in good faith.

2. Expropriation

A host state shall not expropriate or nationalize an investment either directly or indirectly through measures tantamount to expropriation.

Traditionally, an expropriation is deemed legal if it is:

(i) For a public purpose;
(ii) On a non-discriminatory basis;
(iii) In accordance with due process; and,
(iv) Accompanied by payment of due compensation.

On the scope of an indirect expropriation, the tribunal in *Bayindir v Pakistan*, quoting *Tecmed v Mexico* stated that:

> *"[A]n expropriation might occur even if the title of property is not affected, depending on the level of deprivation of the owner: '[I]t is understood that the measures adopted by a State, whether regulatory or not, are an indirect* de facto *expropriation if they are irreversible and permanent and if the assets or rights subject to such measure have been affected in such a way that '…any form of exploitation thereof…' has disappeared …'"*[13]

The temporality of the measures is a relevant factor to determine if a measure could amount to an indirect expropriation. As to date, the temporal scope of the measures imposed by the Mexican government remains unclear.

It is too soon to evaluate the economic impact the measures will have on the renewable energy companies. However, assuming for example that the suspension of preoperative testing is not lifted, the economic affectation would very likely become irreversible and lethal to the economic value of the investments.

3. National Treatment

Under the national treatment standard, the host state must grant treatment to foreign investments which is no less favorable than that which it accords to investments of its own investors. In other words, this standard prohibits discrimination based on nationality. There are two main requirements that have to be analyzed, whether: (i) the parties involved were in like circumstances; and, (ii) whether the treatment of foreign investments was less favorable than the treatment received by national investors.[14] The compliance with these two element has to be

[10] United Nations Conference on Trade and Development, *Fair and Equitable Treatment* (UNCTAD Series on Issues in International Investment Agreement II), p. 69.

[11] *Charanne and Construction Investments v. Spain*, SCC Case No. V 062/2012, Award, para 505.

[12] *Eiser Infrastructure Limited and Energía Solar Luxembourg S.à r.l. v. Kingdom of Spain*, ICSID Case No. ARB/13/36, para 382. *Charanne and Construction Investments v. Spain*, SCC Case No. V 062/2012, Award, para 517: "*the Arbitral Tribunal considers that [the proportionality] criterion is satisfied as long as the changes are not capricious or unnecessary and do not amount to suddenly and unpredictably eliminate the essential characteristics of the existing regulatory framework*".

[13] *Bayindir Insaat Turizm Ticaret Ve Sanayi A.S. v. Islamic Republic of Pakistan*, ICSID Case No. ARB/03/29, Award, 27 August 2009, para. 443.

[14] *Gavrilovic and Gavrilovic d.o.o. v. Republic of Croatia*, ICSID Case No. ARB/12/39, Award, 26 July 2018, para 1170.

made on a case-by-case basis. However, competitors in the same industry and in the same territory would *prima facie* comply with the first requirement.[15]

Furthermore, investment tribunals have also analyzed whether the differentiation was based on valid policy reasons.[16]

In the case at hand, the measures are directed against private renewable energy investors. One of the underlying justifications for the measures is the intermittence of renewable energy generation. However, there are also governmental projects in the pipeline on renewable energy.[17] It remains to be seen whether the measures will also be applied to governmental projects on renewable energy to the same extent.

4. State Defenses

States commonly have limited defenses or exceptions that are contained in the treaties. However, new investment treaties have started to include provisions that have sought to provide states with certain defenses in specific cases. Some of these cases have for example taken place when expropriatory measures have been taken to protect, among other things, public health[18] or when regulatory actions are directed to protect legitimate public welfare objectives, such as health, safety, and the environment.[19]

Furthermore, a state may be able to invoke a range of defenses available under customary international law. For example, the International Law Commission's Articles on Responsibility of States for Internationally Wrongful Acts establish a series of defenses that states may invoke to avoid responsibility, such as necessity, force majeure and distress.[20]

In any event, the state will have to provide objective justification of the measures and comply with the thresholds required by each invoked defense.

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This article is not legal advice and is generic in nature. If you would like to discuss any aspect of this commentary, please contact:

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[15] *Olin Holdings Limited v. State of Libya*, ICC Case No. 20355/MCP, Final Award, 25 May 2018, paras 205-208.

[16] *Rusoro Mining Ltd. v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/12/5, Award, 22 August 2016, para 563.

[17] Federal Electricity Commission website https://www.cfe.mx/licitaciones/Principalesproyectos/Pages/Principales-Proyectos.aspx (last visited 26 May 2020)

[18] Model BIT of the Netherlands, published on 22 March 2019, available at https://www.rijksoverheid.nl/ministeries/ministerie-van-buitenlandse-zaken/documenten/publicaties/2019/03/22/nieuwe-modeltekst-investeringsakkoorden (last visited 27 May 2020)

[19] Agreement between the United States of America, the United Mexican States, and Canada (USMCA), Annex 14-B Expropriation, para. 3(b).

[20] International Law Commission, *Draft articles on Responsibility of States for Internationally Wrongful Acts*, with commentaries 2001, Yearbook of the International Law Commission, 2001, vol. II, Part Two, as corrected, Articles 20-25.