

Resolution of the constitutional trial number 64/2021 filed by a group of Senators against the LIE Reform

Mexico City, April 11, 2022

On April 7, 2022, the Mexican Supreme Court (the “Supreme Court”) discussed and resolved the constitutional trial 64/2021 (*acción de inconstitucionalidad*) filed by a group of Senators against the reform of the Power Industry Law (“LIE Reform”) published on March 9, 2021. Below please find a brief analysis of the most relevant issues in connection with the foregoing.

What did the Supreme Court discuss?

The LIE Reform modified the following aspects of the Power Industry Law enacted on August 11, 2014:

1. Electricity Dispatch. The LIE Reform modified the dispatch rules (i) establishing a new order of priority under which **the power plants owned by, or at the service of, the Federal Electricity Commission (“CFE”)** –also known as grandfathered power plants or external grandfathered plants- **shall be dispatched in first place**, and private power plants (including those plants with clean energy sources), **regardless of the cost of production and the technology they use**, will be dispatched subsequently, and (ii) replacing “marginal” cost of production (generation costs) for “unit” production cost (which include the amortization of the investment) as the new criterion for dispatch in the wholesale electricity market. Such changes are expected to result in:
 - a. increased electricity rates, since power plants with higher generation costs will be dispatched in first place; and
 - b. greater environmental pollution, since most plants owned by CFE are fuel-based.
2. Auction Requirement. The mandatory competitive process to acquire electric energy and other products known as “auction” was eliminated. **During the last auction held in 2018, participants offered the lowest prices in the world.** With this change, CFE

is free to purchase such electric energy and products from its own and less efficient power plants, without public bids, regardless of cost and technology.

Elimination of auctions are expected to result in:

- a. increased rates, since auctions ensured better contracting terms and lower prices; and
 - b. greater pollution, since most plants owned by CFE are fuel-based.
3. New Criterion for CELs. The rules for granting Clean Energy Certificates ("CELs") were changed so that clean power plants that had been built before enacting the LIE (i.e. August 2014), mainly CFE plants, can receive these certificates without having to invest in a project to expand their clean energy production. This change is expected to disproportionately increase the number of CELs on the market, destroying their value and, together with the economic incentive for the development of renewable plants.
4. Revocation of self-supply permits and termination of IPPs under the former Public Power Service Law ("LSPEE"). In its transitory articles, the LIE Reform orders the revocation of self-supply permits granted through acts constituting "fraud against the law". Likewise, it orders a review of the profitability of the contracts entered into by CFE with independent energy producers ("IPPs") and, where appropriate, its renegotiation or early termination.
5. Granting of permits. The granting of permits by the Energy Regulatory Commission ("CRE") was restricted to the planning criteria of the National Electric System issued by the Ministry of Energy (*Secretaría de Energía*) ("*SENER*").
6. Technical feasibility for network access. Consistent with the provisions of article 33 of the LIE, the LIE Reform establishes that open access to the National Transmission Network and the General Distribution Networks will be in terms that are not unduly discriminatory, as long as it is technically feasible.
7. Group of applicants for interconnection and connection. The LIE Reform recognizes the right of a group of applicants to carry out or jointly assume the costs of the works required for their interconnection/connection.

The SCJN discussed the LIE Reform to define if they could be considered unconstitutional from a general perspective.

What does it take to declare the LIE Reform unconstitutional in the constitutional trial?

In accordance with article 72 of the Regulatory Law of Sections I and II of Article 105 of the Mexican Constitution, **it is required the vote of eight (8)** of the eleven (11) Justices **to declare a law unconstitutional in order to invalidate it**. If at least eight (8) votes are not obtained, the unconstitutionality action is dismissed and the law in question remains in force. However, it is important to clarify that such dismissal **does not imply a declaration of constitutionality** of the law being reviewed, so the analysis of the constitutionality of the law may still be subject to review by other means of constitutional controls such as an *amparo* proceeding (specific case) or constitutional controversy (invasion of powers).

In the case of the LIE Reform, as described in greater detail in the following sections, **the eight (8) votes necessary to invalidate the fundamental provisions of the LIE Reform were not obtained, but neither it was resolved that the LIE Reform is constitutional**, so it can still be analyzed by the courts of the Judicial Power of the Federation.

What did the Supreme Court resolve?

The Supreme Court discussed the constitutionality of the articles that were modified by the LIE Reform, which regulate the issues mentioned in the first section of this note, and resolved each of them as follows:

1. Electricity dispatch. **The Supreme Court dismissed the unconstitutionality action** regarding the change in the dispatch order, as it did not obtain the eight (8) votes necessary for the declaration of unconstitutionality. Seven (7) Justices voted that the LIE Reform in relation to this matter is unconstitutional, considering that it harms economic competition and/or the environment.
2. Auction requirement. In the same way, **the Supreme Court dismissed the unconstitutionality action** regarding the elimination of the obligation of CFE Basic Services Supplier (*CFE Suministrador de Servicios Básicos*) to purchase its products through auctions. However, there were seven (7) Justices who voted the LIE Reform to be declared unconstitutional because it contravenes the constitutional principles of economic competition and environmental protection.
3. New Criterion for Granting CELs. Similarly, **the Supreme Court dismissed the unconstitutionality action** regarding the new rules for granting CELs. Again, seven (7)

of the eleven (11) Justices ruled for the unconstitutionality of the new rule on the granting of CELs, specifically, based on arguments of protection of a healthy environment.

4. Revocation of permits issued before the LIE enactment and termination of IPPs contracts. A majority of six (6) Justices resolved that the CRE's power to revoke self-supply permits granted through acts constituting "fraud against the law" is constitutional. Likewise, **nine (9) Justices also resolved on the constitutionality** of the transitory article ordering the renegotiation and, where appropriate, termination of the IPPs contracts derived from the review of their profitability in accordance with the applicable laws.
5. Granting of permits. Unanimously, the Justices voted in favor of the constitutionality of subjecting the granting of permits by the CRE to the planning criteria of SENER.
6. Technical feasibility for network access. Nine (9) Justices considered that it is constitutional to limit open and not unduly discriminatory access to networks to technical feasibility. This was already included in article 33 of the LIE itself before its reform.
7. Group of applicants for interconnection and connection. Ten (10) of the eleven (11) Justices validated the constitutionality of the right of a group of applicants for interconnection and connection purposes –which was already recognized in the Market Rules.
8. International Treaties. The Supreme Court resolved that the constitutional trial is not the procedure to analyze the violation of international treaties in commercial matters, but only to analyze the violation of international treaties in matters of human rights. This does not imply that the LIE Reform does not contravene international treaties on commercial matters, but rather that such violation must be studied through other procedures.

What are the consequences of this result?

The manner in which the aforementioned matters were discussed and voted by the Supreme Court generated some confusion about the consequences of such decisions and the reasons why some Justices resolved on the unconstitutionality of some articles of the LIE Reform. Below is a brief explanation of the scope of such conclusions:

1. Dispatch, Auctions, and CELs. The constitutional trial was dismissed, so **the LIE Reform remains in force**, specifically the provisions regarding electricity dispatch, auctions, and CELs. However, **there is no declaration of the constitutionality** of these provisions. Consequently, the definitive suspensions granted with general effects and **the amparos**

that are pending to be resolved in courts against the LIE Reform (particularly against the dispatch rules) **remain in force, as well as the new *amparos*** that are filed against the first acts of application of the LIE Reform (e.g. the dispatch of CFE power plants with priority over other power plants with lower production costs or the signing of contracts by CFE Basic Services Supplier without auctions), **must be resolved by the corresponding courts or tribunals in accordance with the Mexican Constitution**, considering judicial precedents and other evaluating elements. Among the relevant precedents is the resolution issued in that constitutional controversy 89/2020 by which the Second Chamber of the Supreme Court declared the unconstitutionality of the so-called “SENER Reliability Policy” regarding, among others, changes in the dispatch order under similar provisions to those contained in the LIE Reform. Likewise, **the legal analysis and the conclusions of the seven (7) Justices who voted to declare the LIE Reform unconstitutional, and who constitute a clear majority of the Supreme Court, will have an important weight in the considerations of the courts and tribunals that resolve such *amparos*.**

2. Permit revocation procedures or contract review are subject to rules and deadlines set forth in the applicable regulations. In these procedures, **the authorities must comply with constitutional principles such as the right to be heard, “non-retroactivity” of the law, legal certainty** that ensures the right of all governed not to be affected in their rights without a trial before the competent courts and in accordance with applicable laws, and **“legitimate trust”**, among others, which constitute solid defenses against arbitrary acts of the authorities. Any procedures to revoke self-supply permits, as well as to early terminate IPP contracts, must comply with the aforementioned constitutional principles.
3. International treaties. **The Supreme Court did not resolve on whether the LIE Reform implies (or not) a violation of international treaties entered into by Mexico**, including the Treaty between Mexico, the United States of America and Canada (T-MEC), and other similar trade treaties (“FTAs”), such as those entered into with the European Union, Japan or with the countries of the Pacific zone, and the multiple Agreements for the Promotion and Reciprocal Protection of Investments (“APPRIs”). In fact, the constitutional trial does not have the purpose of analyzing whether or not the individuals protected under a FTA or an APPRI suffer violations of the standards protected by such type of agreements before the issuance or application of a law in the contracting country. By virtue of the foregoing, **the companies affected by the LIE Reform preserve their rights under FTAs and APPRI**s against acts that damage the value of their investments.

What is pending?

It is still important to follow up on various judicial and legal actions derived from the recent resolution of the Supreme Court. The most relevant are:

1. Publication of the final resolution. The Supreme Court must publish the final document in which it describes in detail the analysis of the different issues resolved, which will be relevant to understand more clearly the arguments of the different Justices.
2. Constitutional controversies. In addition, in the following days, the Supreme Court must resolve the constitutional controversies filed against the LIE Reform by the Federal Commission of Economic Competition ("COFECE") and the State of Colima for the alleged invasion of powers. Although it is expected that these controversies will be resolved in the same way as the constitutional trial, they must be publicly discussed and voted on by the Justices so that, at least in theory, there is the possibility that some of the Justices can change their vote.
3. Injunctions that prevent the application of the LIE Reform. It is important to remember that there are still current definitive suspensions –with general effects– granted in favor of private parties in multiple *amparo* trials. Until the last of these suspensions with general effects is revoked by the joint circuit courts, **the LIE Reform could not be applied by the Federal Government**, regardless of what was resolved on April 7 by the Supreme Court.
4. Existing and new Amparo trials. Some companies have obtained favorable sentences in the first instance against the LIE Reform. Such *amparos* will continue with their processes until they are definitively resolved. In the event that the responsible authorities challenge these decisions, and the corresponding appeals for review are brought for resolution by the Supreme Court, such *amparos* would be resolved by one of the Chambers of the Supreme Court, where only a simple majority of votes (that is, by 3 of the 5 Justices that conform each Chamber and not by a qualified majority of eight (8) votes), therefore, **considering the votes and the arguments of the Justices in the recent session of the Supreme Court when they discussed the unconstitutional action, there is a high probability that the LIE Reform will be declared unconstitutional.**

What should industry participants affected by the LIE Reform do?

The participants of the power industry must continue with the normal process of the *amparo* lawsuits that they have initiated, and **be alert to acts of application** in relation to the dispatch

of their plants, purchase of electric energy or products by CFE without auctions, refusals to grant permits, initiation of procedures for the revocation of grandfathered self-supply permits revocation or renegotiation of IPPs contracts, **in order to maintain their rights to challenge such acts. The *amparo* lawsuit against the first act of application act of the LIE Reform must be filed within the next fifteen (15) business days** after the affected party became aware of such act of application or was formally served with the official communication.

At Galicia we are prepared to assist you in relation to any procedure related to the effects of the resolution of the Supreme Court that is discussed in this note.

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