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PRODUCTION AND DISTRIBUTION OF ELECTRIC POWER IN MEXICO: TODAY AND TOMORROW

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The proposed reforms in the Mexican electrical sector have created a great deal of debate both in the United States and in Mexico. Nearly everyone agrees that there is desperate need for improvement in the production and distribution of electricity in Mexico. Exactly how to go about meeting the need for more electricity while improving the quality of delivery is the issue at hand. In February 1999, Mexican President Ernesto Zedillo announced an ambitious proposal that would eventually change the role of the government from owner and operator of the electrical utility to that of regulator. Here, I will outline the current and future electric need in Mexico, summarize the current service and analyze the proposed reforms for new and improved services. Because the issue is so politically sensitive in Mexico, a thorough analysis requires a look at the positions the various players have taken. I will then conclude with a brief discussion of the options for financing the needed improvements.

There is a desperate need for upgrading and overhauling the country's electrical infrastructure from generating plants to transmission and distribution networks. Mexico in this century has created 36,600 MW of installed electrical capacity. It is estimated that over the next six years Mexico will need an additional 13,190 MW, an increase of more than one-third of current capacity.1 To insure their own future viability, Mexican conglomerates have already commenced development of their own self-supply plants.

Mexico is experiencing problems in the fluctuation of voltage. There have been numerous interruptions in supply and other quality and deliverability problems, evidenced by the mounting backlog of unmet service needs, deferred maintenance and obsolete infrastructure. As many as half a million energy consumers obtain their electrical power by furtive or fraudulent means. An article in the Houston Chronicle included a photo of a street vendor utilizing a street lamp rigged to provide electricity to a street vendor.2 Despite some problems with this type of theft, what plagues the Federal Electricity Commission (CFE) to a greater extent is the large industrial illicit expropriation of electricity.

Energy in Mexico is subsidized. It is difficult to get a completely accurate picture, but it is estimated that US$2.2 billion is spent to subsidize the supply of electricity, principally for the rural population.3 In order to meet the 13,190 MW needed over the next six years, it is estimated that US$25 billion will be required

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for generation alone. Transmission and distribution, infrastructure that is over 15 years old, could require an additional US$10 billion according to some sources.4

By far the principal supplier of electricity in Mexico is the CFE. The giant government-owned entity generates about 90% of the country’s power, transmits 98% and distributes approximately 90%.5 Luz y Fuerza del Centro (LFC, Central Light and Power), also government-owned, generates 2.3% of the country’s electricity—principally in central Mexico.6 It is not known precisely how much power PEMEX (Petroleos Mexicanos, Mexican Petroleum) generates, but it is believed to be around 4% of the national production.7 However, this amount is almost exclusively used by PEMEX itself, negating it as a national supplier. The private sector’s contribution to the national supply, 3.3%, might be surprising to some.8 That amount, of course, compared to the government’s combined national output (CFE 90%, LFC 2.3%, PEMEX 4%) is still a relatively small portion.

Under La Ley de Servicio Público de Energía Eléctrica (the Public Service Electric Energy Law) there are currently four legal means by which the private sector may supply electricity: self-generation, co-generation, small production (up to 30 MW) and independent power production (greater than 30 MW).9 Independent power producers must comply with the government’s regulatory structure and can only sell their electricity to the CFE.

President Zedillo’s Carta Iniciativa to the Mexican Congress on February 2, 1999 proposing specific amendments to Articles 27 and 28 of the Mexican Constitution, and advocating the reorganization of the Mexican energy sector in general, pursuant to a three-step program was exciting news.10 It was a dramatic statement about the infrastructure of Mexico and the privatization of oil, electricity and the nation’s banks. Regarding electricity, the President proposed that Congress start at the top and amend Articles 27 and 28 of the Mexican Constitution to permit investment in the generation, transmission and distribution of electricity. The three proposed phases are lengthy, so I will summarize below.

In phase one, the CFE and LFC would be split into various specialized state-owned, service-oriented companies, including generating companies, distribution companies and a single transmission company, the Red Eléctrica Nacional (REN, National Electric Network). Next, a basic regulatory framework to create an open, competitive wholesale electricity market, the Mercado Eléctrico Mayorista (MEM, Majority Electric Market), would be created as a precursor to the creation of an open electricity market. A new decentralized federal government agency, the Centro de Operación del Sistema Eléctrico (COSEN, Electrical System Center of Operation), would also be created to control and operate the dispatch of power on
the national grid in the national interest. Those in this field recognize that dispatch is an important factor. It is there that decisions are made regarding who gets the electricity and when, and who does not when there is not enough to go around.

In phase two the reforms begin to take hold. Operations on the MEM would begin. Generation and marketing would be open to private investment (foreign and domestic). There has been a reflex reaction in the Mexican and U.S. press that opening electrical generation to the private sector necessarily means opening it to foreigners. History supports this reaction. While it is true that the capital initially will have to come from external sources, the capacity to build, own, operate and develop power generation companies exists in the Mexican private sector. I believe that industry underestimates the number of Mexican players that will participate in the privatization of electrical generation if these reforms are implemented.

Under the proposed plan, private generating companies will not only be able to sell to the market, but they will also be able to enter into direct contracts with usuarios calificados (qualified users). These are the industries that consume more than 5 GW per year. Also, new long-term (30-year) concessions (rather than outright ownership) would be granted to private-sector transmission companies for the purpose of constructing and operating transmission systems that are not interconnected with the national grid. These two phases are proposed to take place during the administration of President Zedillo.

The third phase, which gets the biggest coverage in the press, calls for the progressive privatization of the CFE and LFC (although selected assets, including several important hydroelectric plants, would be retained by the government). By the time this is to take place, several service-oriented companies will have already been privatized. Some of the older, less attractive plants will probably not be privatized. President Zedillo, in what appeared to be a masterful stroke of political genius, has left these types of details to subsequent administrations. While perhaps he thought he was defusing the sensitive issue of the privatization of the CFE to the next administration, the issue instantly raised the hackles of those who have something to lose from the reforms.

Passage of these reforms would create many opportunities for lawyers. Congress would have to amend Articles 27 and 28 of the Mexican Constitution and create a new electricity law, La Ley de Industria Eléctrica (Electric Industry Law), with appropriate regulations. The Mexican Congress will have to amend foreign investment laws to permit external investment in these facilities. They will have to change the "organic" laws of the CFE, LFC and the CRE, entailing a wholesale legal reorganization. Needed also will be an implementation of permits and concessions, particularly for the 30-year electricity transmission concessions. The Mexican Congress will have to create COSEN, which will regulate the MEM. Also, there will have to be rules and regulations created for the operation of MEM.

14. Id.
15. "Organic laws" in the civil law system are the organizational laws or constituting laws.
16. Id.
Mexico, under Chapter 6 of NAFTA, reserved the authority to regulate its own industries. Therefore, if Mexico unilaterally elects to deregulate its electric industry, it does not appear that an amendment of NAFTA will be necessary.

President Zedillo's public announcement of his proposed reforms ignited a furor. The PRD (Partido Revolucionario Democratico, Revolutionary Democratic Party), not surprisingly opposed the proposition, claiming that the proposals are a sellout to foreign interests and a move to auction off Mexico's sovereignty to the highest bidder. PRD member, and Chamber of Deputies Energy Commission President, Sergio Benito Osorio said, "Simply stated, the [President's] proposal is a political ploy meant to bring more investor confidence to Mexico and appease U.S. and multilateral lending organization demands." Suspicions of U.S. and foreign involvement in the Mexican economy run deep. The comments illustrate the sensitive nature of discussions about privatizing the electrical industry in Mexico. The issue is one of national sovereignty to many. As such, the proposed reforms, if they are to succeed, must overcome significant opposition. Mexicans must be convinced that they have much more to gain than lose with the President's proposal.

The response of the PAN (Partido Acci6n Nacional, National Action Party) was indicative of their skepticism of privatization schemes in general as well as their desire to win the next election. The party has used the opportunity to criticize the government's prior privatization process. The PAN points to the mishandled bank privatization, which is estimated to have cost Mexican taxpayers US$65 billion and is purported to have been full of special deals for the well connected. But, PAN members believe that if the electrical reforms are to succeed, it needs to be very clear that the risks taken are the sole responsibility of the investors to whom the industry is privatized. Otherwise, Mexico would have the worst of all possible worlds, privatization of profits and assets in the energy sector but a socialization of the losses. Several PAN senators remain resolute that the reforms simply will not be approved in this year's Congress. It appears, however, that with so much at stake, the struggle is not over. Even the PRI, Zedillo's party, which has been in power since 1917, was apprehensive and concerned about a nationalistic backlash in the forthcoming elections. Many Mexicans fear that the privatization of the CFE is a prelude to the eventual private control of PEMEX—another "sellout" of the national patrimony to foreign investors. Accordingly, not even all of the PRI was completely on board with the proposed reforms.

Labor in Mexico has historically had a great deal of influence in the political process. There are 100,000 unionized electrical workers in Mexico. Perhaps surprisingly, the largest electrical worker's union, SUTERM (Sindicato Unico de Trabajadores Electricos de la Republica Mexicana, Singular Union of Electrical Workers of the Mexican Republic) with 70,000 members, is with the president,
supporting the proposed reforms. The SME (Sindicato Mexicano de Electricistas, Mexican Electrician’s Union) with 30,000 members, is opposed to the plan. They hit the streets in the Zócalo on March 15 and 18, 1999 to express their disapproval of the proposed reforms. March 18 is the anniversary of Mexico’s petroleum nationalization. In their protests, the electrical workers proclaimed, “We nationalized the oil, we nationalized electricity, don’t give away our patrimony.”

The reforms have received the support of a number of influential politicians as well as that of a majority of union members. Disappointingly, many academicians weighed in with what appeared to be populist ideas such as the slippery slope leading to the privatization of PEMEX. Needless to say, this does not play well in Mexico. To many, the nationalization of the oil industry in 1938 was one of Mexico’s proudest moments. For those people, returning it to private hands would be like selling the national birthright. So, when some warn of the “slippery slope,” of privatization, it resonates with the populace.

One concern with privatization is the loss of jobs in the electric sector. The Mexican government has responded by pointing out that Mexico’s sovereignty will be strengthened by an efficient electrical utility that does not sap public resources. Zedillo has said that there simply is not enough money to sink into the needed upgrades. The need is too great. If the investment comes from the private sector, the nation can spend its money on social welfare, education and the needs of its people. With the elections coming in 2000, this is a very sensitive time. Political parties are jockeying, and there is a lot of jingoism going on, playing on the fears that the electrical reforms will lead to the privatization of PEMEX. A charge flatly denied by the government. A public poll taken on May 7, 1999 stated that 73% of the Mexican population is opposed to the President’s initiative regarding electrical reforms. Yet, the Zedillo administration continues with its plan. As evidence of the sensitive nature of the topic, however, President Zedillo went on to make no mention of the electric reforms in his Informe.

Despite the controversy, there is great deal of interest among the international private sector in investing in Mexico. As previously mentioned, it will take US$25 billion to meet the anticipated need in Mexico. How much of that can be funded by the private sector? Enron, Electricité de France, Shell, Repsol and others demonstrate their interest by stating that Mexico’s electricity market is lucrative and untapped.

There are several questions that concern those interested in this topic. Questions about the level of risk investors will face and whether the returns will justify entry into the market must be answered. There are also questions about the source of fuel needed to generate the electricity, about the competition and regulation newcomers might face. If the proposed reforms are not enacted, where will Mexico get the

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24. Propuesta, supra note 5.
26. Ernesto Zedillo Ponce de Leon, Quinto Informe de Gobierno, September 1, 1999 5th State of the Union Address.
27. Electric Industry Reforms Offered, supra note 4.
28. supra note 22.
money to meet future electrical demands? Conversely, if privatization takes place, what will Mexico do with the proceeds?

Whether the reforms will actually take place is perhaps the biggest question. Also, it will be a very delicate situation when the time comes to finance the expansion of the electrical sector in a manner that the nation requires and can afford. Come election time and thereafter, the PRI’s attempts to solve the problem could benefit it politically. For now, the PRI might be saying to the PRD and the PAN, that if the opposition parties do not want these reforms, and problems come to bear, at least the PRI can claim that they attempted to find a solution.