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Mexican Private Power Sector Finds Alternative to Canceled Clean Energy Power Bids

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On January 31, 2019 the Mexican power regulatory entity — *Centro Nacional de Control de Energia* ("Cenace") canceled the fourth public bid for the purchase and sale of clean energy, capacity and clean energy certificates ("CEL"). This decision was extremely controversial, given that the first three bids were very successful and incentivized clean energy investment and project development in Mexico, particularly for solar and wind projects. The new administration has taken certain actions that have had the effect of slowing down the execution of agreements with the state utility, CFE. However, applicable law establishes two obligations that will continue to foster the development of new electricity projects in Mexico and the execution of power purchase agreements between private parties: i) the obligation to obtain CELs and ii) the obligation for utilities to execute power purchase agreements to guarantee the estimated consumption of their load points. Such obligations apply to all wholesale electricity market participants and, therefore, opportunities for investments in power projects in Mexico must continue.

The Obligation to Obtain Clean Energy Certificates

CELs are instruments issued by the Energy Regulatory Commission — *Comisión Nacional de Energia* ("CRE") that evidence the generation of a specific amount of energy from clean energy sources. A generator will receive one CEL per each MWh of clean energy. Pursuant to Mexican law, power utilities and certain users ("Obligated Parties") must comply with CEL obligations, which means that they must buy a certain amount of CELs every year. CELs can be purchased at the wholesale electricity market or through bilateral agreements. The obligation to obtain CELs falls upon the Obligated Parties, not the generators. That is, Obligated Parties must acquire an amount of CELs equivalent to a certain percentage of the yearly consumption of the load points that they serve.

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If an Obligated Party fails to comply with its CEL obligations, CRE may impose sanctions and the payment of such sanctions does not exempt the Obligated Party from the obligation to buy the amount of CELs not liquidated in due time. So, if sanctioned, the relevant party must cover the outstanding CELs and pay the applicable fine. Since Obligated Parties need to purchase CELs and only generators with clean energy projects will obtain CELs, Obligated Parties will need to execute power purchase agreements with generators to secure CELs and to avoid sanctions. Also, the purchase of CELs will generate additional revenue for generators, who can use such cash flow to potentially secure project finance and develop new projects.

The Obligation for Utilities to Execute Power Purchase Agreements

Mexican law establishes that utilities must enter into power purchase agreements for the purchase of energy, capacity and CELs with generators in order to secure a certain percentage of the estimated consumption of their load points. If a utility fails to comply with its energy, capacity or CEL requirements, CRE can impose sanctions.

The criteria to impose sanctions on utilities depending on the percentage of noncompliance with the requirement to purchase capacity is as follows:

	0% to 25% of capacity requirement	26% to 50% of capacity requirement	51% to 75% of capacity requirement	76% to 100% of capacity requirement
First time	8 minimum wages (approx. 42.4 USD) per MW per hour	10 minimum wages (approx. 53 USD) per MW per hour	12 minimum wages (approx. 63.6 USD) per MW per hour	15 minimum wages (approx. 79.5 USD) per MW per hour
Second time	16 minimum wages (approx. 84.8 USD) per MW per hour	20 minimum wages (approx. 106 USD) per MW per hour	24 minimum wages (approx. 127.2 USD) per MW per hour	30 minimum wages (approx. 159 USD) per MW per hour
Third time or more	24 minimum wages (approx. 127.2 USD) per MW per hour	30 minimum wages (approx. 159 USD) per MW per hour	36 minimum wages (approx. 190.8 USD) per MW per hour	45 minimum wages (approx. 238.5 USD) per MW per hour

Similar sanctions apply to utilities that fail to comply with their CEL requirements, incentivizing them to secure their CELs and capacity requirements through the execution of long-term power purchase agreements to avoid being fined by CRE.

Before cancellation of the fourth bid by the new Mexican administration, long-term public auctions were the main instrument to obtain long-term power purchase agreements to secure CELs, capacity and power obligations. The cancellation forced the private sector to search for alternatives to comply with the obligations to obtain CELs and execute long term power purchase agreements. As a result, a new energy long term tender process was announced by Bravos Energia. This is a new platform to manage bids between private parties that would not need the participation of the government.

Bravos Energia, whose partner Jeff Pavlovic was key in developing the regulations for the wholesale electricity market, and Aklara, the company responsible for the online platform used in the now canceled public bids, will coordinate the new private bids. In such bids, power purchase agreements for CELs, power and capacity will be awarded with a term of five, 10 or 15 years. Any wholesale electricity market participant, including the state utility, may participate. The bids were officially launched on June 27 and it is expected that the agreements will be awarded this year.

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