

Mexico City, March 9, 2009

New Mexican Law for the Use of Renewable Energy and for the Financing of Energy Transition

The Mexican Congress approved the Law for the Use of Renewable Energy and for the Financing of Energy Transition (*Ley para el Aprovechamiento de Energías Renovables y el Financiamiento de la Transición Energética*) which came into force on November 29, 2008. It is the first law to regulate renewable energy and to substantially improve the legal framework for private investment in renewable energy projects.

I. Scope: Private Projects for Power Generation from Renewable Energy

The Law regulates the use of renewable energy to generate power that is not dedicated to public supply. According to the Law, renewable energy is defined as energy whose source lies in the natural phenomena, in processes or materials that can be converted into energy and which regenerate naturally, so that they are continuously or periodically available. The Law specifies the renewable energy sources as follows: a) wind; b) solar radiation in all its forms; c) movement of water in natural or artificial channels; d) ocean energy in its various forms (energy provided by surface waves and tides, thermal and osmotic energy); e) geothermal energy; f) bioenergetics; and others as determined by the Secretary of Energy.

Regarding the requirement „not dedicated to public supply“, the Law refers to Article 27 of the Mexican Constitution, which establishes that power generation for public supply is exclusively reserved to the State, as well as to the modalities of private power generation under the Law of Public Power Supply. With this reference, the lawmaker expresses that the Law applies to private power projects and that the use of renewable energy for power supply should be developed through private investment. In this spirit, in the

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explanatory memorandum, the lawmaker pointed out the purpose to strengthen legal certainty for private investment. Given the political confrontations as regards power generation in recent years, the Law represents a clear commitment of the lawmaker to promote private investment.

The modalities “independent power producer” and “self-supply” are of interest to private investors. The external power generators provide electricity exclusively to the state electricity supplier *Comisión Federal de Electricidad* (Federal Electricity Commission – CFE). The independent power producer and CFE execute long-term purchase agreements which may not exceed a period of thirty years. Due to the obligation of the CFE to purchase electricity at the lowest possible cost (stated in Article 36-BIS of the Law of Public Power Supply), projects of power generation from renewable energy sources under the modality of external power generation have not yet been implemented.

The self-supply modality is usually applied by a self-supply entity. The project developer/operator/investor is the majority stakeholder of the supply entity and invites the power consumers holding a minority stake. The supply entity producing the power is exclusively authorized to provide its own stakeholders with power. The major issue with a renewable energy project under the modality of self-supply is the contractual relation with CFE. The viability of such a project depends on the contract with CFE, which is indispensable for the grid interconnection and the transmission of power to the consumers, and determines the charging of services. The profitability of renewable energy projects under the self-supply modality results from the high energy prices of CFE for industry and commerce.

II. Targets and financing

The Law does not provide specific targets for the proportion of renewable energy within the power sector, but refers this matter to the Special Program for the Use of Renewable Energy as established in the Law. The responsibility

for the Program lies with the Ministry of Energy. The transitional provisions of the Law provide that within a period of six months from the date of adoption, the Ministry of Energy is to submit the Program to the President for approval. The Program is to establish the minimum percentage of renewable energy in installed capacity and consumed power. Likewise, the Law stipulates that the Ministry of Energy is to consider both economic efficiency and potential economic benefits when determining the minimum percentage of renewables. However, the lawmaker does not define what is meant by the potential economic benefits. The Law creates a Fund for Energy Transition and the Sustainable Use of Energy. In 2009, the Fund has been endowed with USD 195,000,000 (3,000 million Mexican pesos).

III. Strengthening of the private sector versus CFE

The private sector is strengthened versus CFE by the expansion of competencies of the *Comisión Reguladora de Energía* (Energy Regulatory Commission – CRE) in the field of renewable energy. The CRE, as the energy sector regulator, is the relevant authority to grant permits to independent power generators and self-suppliers. Already in the past, the CRE has been involved in the regulation process of contractual relations between independent power generators/self-suppliers and CFE. However, the Law extends CRE’S authorities and shifts part of the responsibilities from CFE to CRE. In the field of renewable energies, the CRE now has the following responsibilities:

1. To issue the rules, guidelines, methodologies and other administrative instructions governing the power generation from renewable energies.
2. To establish the charges for the various services between private generators and CFE.
3. To ask the CFE to review and, where necessary, to change the rules for release to comply with the provisions of this Law.
4. To issue the methodologies to determine the proportion renewable energy technologies within the power generation capacities.

5. To issue the general rules of interconnection to the national electricity system, at the suggestions of the public suppliers.
6. To set the procedures for the exchange of power and the corresponding compensation rules.
7. To issue the guidelines that are stipulated between CFE and private suppliers using renewable energy.
8. To establish, upon the advice of the Ministry of Treasure and the Ministry of Energy, the maximum amount to be paid by CFE to private generators.
9. To approve the calculation method adopted for the payment of surplus power. Surplus power refers to the power generated by self-suppliers which exceeds the needs of their (authorized) consumers.
10. To develop the guidelines (basic terms and conditions) according to which the CFE is obligated to conclude long-term contracts with private generators.

The competencies of the CRE in the field of renewable energies apply to cogeneration¹, which leads to an efficient use of electricity if the cogeneration system complies with energy efficiency standards issued by CRE.

IV. Consideration

Article 36-BIS of the Law of Public Power Supply contains the obligation of the CFE to purchase power for public supply at the lowest possible cost. In the past, this provision prevented private generators from the implementation of renewable energy projects, as a result of higher investment costs of renewable energy technologies in comparison with conventional power generation.

The Law opens up the possibility to consider the „potential economic benefits“

¹ Cogeneration means power generation with steam or other secondary thermal energy or both.

in the economic assessment of renewable energy projects. Therefore, power from renewable energy may get a higher consideration than power from conventional energy sources. The compensation is to include the costs of generation capacity and of generated electricity. The consideration may vary depending on technology and geography. The different investment costs for the various technologies of electricity from renewable energy sources may be considered to calculate the compensation. Therefore, particularly solar projects will benefit.

V. Transmission of electricity from renewable energy sources

The CFE is also obligated to purchase the excess power from private generators according to the reasonable operating conditions and economics of the electricity system, taking into account the geographical distribution and the variability in the timing of different technologies of renewable energy.

VI. Obligations of the project operators

Operators of projects with a capacity exceeding 2.5 MW have the following obligations:

1. The local and regional communities may be integrated through public meetings and interviews provided by the municipality, Ejido or Community Councils administrations.
2. To pay the agreed rent to the owners of the land where the renewable energy project is located; the frequency of payments may be agreed with the owners, but in no case may be less than twice a year.
3. Where the projects with renewable energy generation are implemented, the social development of the community is to be promoted in line with international best practices. The standards

applicable to sustainable rural development, environmental protection and land rights must be met.

The Law does not include a deeper analysis of the obligations mentioned in paragraphs 1 and 2. The Law must be published by no later than July 28, 2009. In the meantime, we recommend that project developers document meetings and their contributions to the development of the respective communities.

VII. Impacts

The Law substantially improves the legal certainty for self-suppliers, since it strengthens their position towards the CFE. Special mention has to be made of the extension of the responsibilities of the CRE and the commitment of the CFE in the context of the requirements of the CFE to conclude agreements with the self-suppliers.

The Law is the first to provide the conditions for projects of renewable energy to be implemented successfully under the modality of independent power producers. It is expected that in addition to the already announced public bids related to wind farms under the modality of independent power producers in 2009, many other public bids for the generation of renewable energy through other technologies will be held.

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