Modification to divestiture conditions of the Federal Electricity Commission may generate risks to competition in the electricity industry

- *Proposed changes to the Agreement create the possibility for eliminating the horizontal divestiture and compromise vertical divestiture of the Federal Electricity Commission (CFE).*
- *The current divestiture model stimulates electricity market participants towards efficiency, productivity and cost-reduction, thus confirming it is advisable to keep it.*
- *COFECE recommends that CFE upholds horizontal divestiture and effective competition, amongst its different electricity generation companies, in case of modification of asset allocation. The Commission also recommends upholding vertical divestiture of distribution and commercial operations.*
- *COFECE calls on the Ministry of Energy (SENER) and the Energy Regulatory Commission (CRE) to enforce the Electricity Industry Law and the CFE Law to establish and monitor conditions for the legal divestiture of the energy sector members.*

Mexico City, May 8th, 2019.- On March 25th, 2019, the Ministry of Energy (SENER) published in the Federal Official Gazette the *Agreement modifying conditions for the strict legal divestiture of the Federal Electricity Commission (CFE) published on January 11th, 2016* (Agreement). The Federal Economic Competition Commission (COFECE or Commission) considers some of the modifications may jeopardize competition conditions and free market access in Mexico's electricity sector, and therefore issues an opinion concerning the Agreement.

In January 2016, SENER published the *Conditions for the strict legal divestiture of the CFE* (TESL) to comply with the Electricity Industry Law (LIE) and the Federal Electricity Commission Law (LCFE). Said conditions defined vertical divestiture amongst each of the links of the chain (Generation, Transmission, Distribution and Commercial) and horizontal divestiture of assets of Generation into six CFE subsidiary productive companies.

Horizontal divestiture stimulates CFE Subsidiary Generation Companies (Gencos) to be more efficient and productive because competition between them and other generators drives them to use generation technologies to provide electricity at the lowest possible costs. Among the benefits are the transparent management of resources, the promotion of investment and reduced incentives for cross-subsidies.

The March 2019 Agreement compromises horizontal and vertical divestiture of CFE, which may be counterproductive regarding the efficiency of the electricity industry as a whole and, therefore, detrimental to service users.

The legal or even functional integration of CFE's generators, as currently allowed by the Agreement may promote de creation of one or few generation companies with market power. This would compromise competition in this link because: i) it may favor cross-subsidization between plants of the same Genco to sustain less efficient plants, and ii) it may create incentives for anticompetitive behavior, restricting the capacity for available electricity at more efficient plants to relieve less efficient plants. Both actions result in rising electricity production costs, harming consumers.

Furthermore, vertical divestiture between distribution and commercial links seeks to favor equal access to the electrical grid for all sector agents (mainly new generators) and to foster the presence of multiple qualified electricity suppliers in addition to CFE, who offer large consumers the best possible conditions to contract the service.

Compromising the vertical divestiture, as is allowed in the Agreement may: i) disincentivize CFE from expanding interconnection infrastructure at the Distribution link, thus limiting entry of new qualified suppliers capable of competing at the Commercial link, and ii) affect equal access to general Distribution grids for third parties and CFE subsidiaries to compete under the same conditions in Generation and Commercial links.

Subsequently, COFECE calls SENER and the Energy Regulatory Commission (CRE) to guarantee compliance with the LIE and the LCFE to establish and monitor the conditions for legal divestiture of agents in the electricity industry. Similarly, the Commission recommends:

1) In case the CFE restructures asset composition of its Gencos, it should maintain some degree of horizontal divestiture in the Generation link, as well as functional separation of companies participating in this sector, pursuant to the LIE and the LCFE. Besides upholding the functional separation of Generation companies, thus avoiding exchanges of protected information and human resources.
2) For the CFE to maintain vertical divestiture between Distribution and Commercial links, pursuant to the LIE and the LCFE
3) That SENER and CRE supervise and guarantee strict divestiture of the CFE, pursuant to the powers vested by the LIE.
4) As per the TESL, to conduct an audit two years after the original divestiture to verify compliance with conditions and, subsequently, every four years. Successively, as an

exercise of transparency and accountability, evaluate the effects on the electricity market and related markets.

COFECE agrees with the Federal Government on the need to offer consumers electricity services at the lowest possible prices. Hence, the Commission restates its commitment to collaborate with authorities and regulators in this transitional period from a closed market to a contested one, to stimulate economic competition in the electricity industry, for the benefit of Mexicans.

See the opinion in Spanish

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The Federal Economic Competition Commission is entrusted with safeguarding competition and free market access. Through this, it contributes to consumer welfare and the efficient functioning of markets. Through its work, COFECE seeks better conditions for consumers, greater output, better services and a "level playing field" for businesses.