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Competition in Energy Markets – Note by Mexico

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More documents related to this discussion can be found at
www.oecd.org/competition/competition-in-energy-markets.htm

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1. Introduction

1. Article 28 of the Mexican Constitution, as well as Article 10 of the Federal Economic Competition Law (LFCE), establish that the Mexican Federal Economic Competition Commission (COFECE or Commission) is an autonomous constitutional body, with legal personality and its own patrimony, which has the purpose of guaranteeing free competition and market access, as well as preventing, investigating and fighting monopolies, monopolistic practices, illicit concentrations and other restrictions to the efficient operation of the markets

2. The aforementioned constitutional provision and article 11 of the LFCE establish that COFECE will have the necessary powers to effectively comply with its purpose, including the power to order measures to eliminate barriers to competition and free market access, regulate access to essential inputs and order the divestiture of assets in the proportions necessary to eliminate anticompetitive effects.¹

3. To fulfill its attributions, the Commission establishes a prioritization of sectors to direct its efforts towards those where competition can generate the greatest benefits in terms of consumer welfare. In this context, the energy sector is considered a priority sector for COFECE, which is constantly monitored in order to exercise the powers mentioned in the previous paragraphs.²

4. This document is divided into the following four sections which:

- Provide a brief explanation of the regulatory evolution of the energy sector in Mexico and its relationship with the competition process.
- Identify the main competition challenges and problems that characterize this sector in Mexico.
- Present some actions implemented by COFECE.
- Describe cooperation frameworks with energy market regulators.

2. Regulatory framework evolution of energy markets

5. In Mexico, for several decades the markets related to the energy sector operated under a regulatory scheme that granted State-Owned Enterprises (SOEs) exclusive control over several segments of the value chain – in particular, *Petróleos Mexicanos* (PEMEX), in the hydrocarbon markets, and the Federal Electricity Commission (CFE), in the electricity markets. This implied a development of infrastructure owned by these SOEs that did not observe the rationale of competitive markets.

6. In 2013, an energy reform was enacted becoming a milestone in the functioning electricity and hydrocarbon markets. In the context of this reform, in August 2014, the

¹ In this sense, the Commission does not have the power to reduce prices, fight scarcity or support any kind of supply in the markets.

² COFECE (2022). Plan Estratégico 2022-2025.

secondary laws on hydrocarbons and electricity were published in the Official Gazette of the Federation (DOF).³

7. This reform entailed a major transformation in the operation and structures of the different links in the value chain of these markets. Particularly, among other things, the reform consisted of the: (i) opening to private participation in import, production and/or generation activities, as well as commercialization of hydrocarbons, (ii) modification of the methodology for determining wholesale prices, (iii) liberalization of prices to the final consumer, (iv) a greater participation of electricity generation from clean sources of energy was promoted,⁴ v) implementation of an asymmetric regulation on first-hand sale prices for PEMEX, vi) implementation of the vertical separation of CFE,⁵ and vii) granting of powers to different related regulatory authorities to oversee, supervise and monitor the new obligations imposed to ensure the generation of competitive spaces in the markets.

8. Accordingly, the reform allowed the Commission to exercise a more decisive role in the analysis of the competitive conditions of such markets, as well as the analysis of possible anticompetitive behavior that may arise in markets that were recently opened to competition.

3. Main competition issues and identified challenges

9. The energy reform sought a transition towards more competitive markets, where the entry of private participation would promote market dynamism, cost reductions in production processes, investment in better quality products, as well as the development of more efficient processes and projects. However, the legacy of traditionally monopolistic structures where the State had an almost absolute control of the markets, the creation of infrastructure, and the infrastructure owned by third parties (suitable for the operation of SOEs) determined and continue to determine the operation of the markets in question, which has brought about a series of challenges in terms of competition and has resulted in different problems that are still persistent.

10. Among the main problems that persist in these markets stand out the low introduction and effective participation of third parties (private companies). Although the regulatory change initially laid the foundations to ensure their participation, the frictions that have arisen in the markets have not allowed the entry of new participants, mainly due to:

- High investments for the development of infrastructure, as well as the presence of significant sunk costs.

³ In particular, the Electricity Industry Law (LIE) and the Hydrocarbons Law (LH) were developed.

⁴ With the Energy Reform of 2013, the electricity generation market was opened to stimulate the generation of electricity from renewable sources on a large scale. For this, a Wholesale Electricity Market (MEM) was implemented for the purchase and sale of electricity. Also, Clean Energy Certificates (CELs) were created to certify the production of a certain amount of electricity from clean energies. These were intended to promote diversification in energy production using wind, geothermal, hydro, biomass and solar energy.

⁵ In 2016 and derived from the 2013 Energy Reform, the Ministry of Energy (SENER) issued the terms of the vertical separation between each of the chain links of CFE (generation, transmission, distribution and commercialization) and the horizontal separation (between generation assets) of this SOE with the purpose of generating a competitive dynamic and incentivizing it to be more efficient and productive.

- SOEs still have a strong position in the market. Mainly because they: (i) have extensive knowledge of the market, (ii) have the necessary infrastructure to operate, and (iii) operate in the presence of economies of scale and scope, among others. All this has given them advantages in the market over other competitors in different links of the value chain.⁶

11. Besides these problems, there are others related to the regulation itself and its recent modifications that could have adverse effects, potentially obstructing the process of competition in the energy sector. Some of them consist of:

- Long waiting times due to the lack of a single window to obtain permits, limited resources of the authorities to deal with applications and, in some cases, non-homogeneous requirements among market participants seeking to obtain the same permit, may represent barriers for new competitors that seek to participate in energy markets.⁷
- Recent counter-reforms and draft reforms to the law have strengthen SOEs and these changes discourage the creation of new private initiative projects and investments, including those based on clean energy sources, which may jeopardize competition in the markets, as well as generate higher prices and/or greater government subsidies.

12. In this regard, the Commission has faced several challenges, seeking not only to benefit the productive process of the markets, but also the welfare of the users of these markets. Therefore, the following section details some of the measures implemented by this Commission in order to ensure the competitive process in these markets.

4. COFECE's actions in the energy markets

13. Regarding investigation proceedings, COFECE has conducted, some of these related to: determination of competition conditions in the LP Gas distribution market;⁸ possible abuse of dominance in the commercialization of regular gasoline, premium gasoline and diesel;⁹ abuse of dominance in the import, commercialization, transportation, storage, distribution and retail of LP Gas;¹⁰ possible cartel conducts in the distribution and

⁶ Even one of these companies has been investigated for abuse of dominance. The Commission has issued Statement of Objections for abuse of dominance for the case file IO-001-2018 (in the market of oil products) and in the case file DE-044-2018 (in the market of LP Gas). Both cases are currently in the trial like proceeding.

⁷ In the case of the declaration of lack of competition conditions in the gas market (DC-001-2021), some regulatory barriers were found (i.e., the requirement to interact with different authorities in order to operate as a distributor). While in the investigation IEBC-002-2019, the Investigating Authority established that in the turbosine market, several regulatory barriers were detected (i.e., asymmetric requirements for distributors).

⁸ Case file: DC-001-2021.

⁹ Case file: IO-001-2018.

¹⁰ Case file: DE-044-2018.

commercialization of LP Gas;¹¹ and barriers to competition in the market of aircraft fuels (turbosine).¹²

14. In addition, COFECE continuously monitors the preliminary drafts, regulatory projects or any other measures issued by the sector regulators and, as a result of this, the Commission has made frequent use of its power to issue opinions with recommendations to promote that the regulatory frameworks in the energy markets observe the principles of competition and free market access.¹³ Specifically, COFECE has issued eight opinions related to the issuance or modification of regulations in these markets to ensure that both, SOEs and private companies, compete under equal conditions.¹⁴ In addition, it has published five studies with competition recommendations for energy markets.¹⁵

15. Moreover, in the process of regulatory improvement before the National Commission for Regulatory Improvement (CONAMER), COFECE continuously monitors, analyzes and, if necessary, issues comments on the preliminary drafts that it considers undermine the process of competition and free market access.

16. Furthermore, COFECE has filed before the Supreme Court of Justice of the Nation (SCJN) two constitutional controversies against measures that are considered contrary to the principles of competition and free market access safeguarded in the Constitution and that they affected the Commission's sphere of competence.¹⁶ Regarding the first controversy filed in 2020, the SCJN resolved to invalidate most of the provisions that were challenged by COFECE. The second controversy was dismissed on the grounds that COFECE did not have standing to present it against a newly enacted electricity law. Nevertheless, private market participants can appeal the aforementioned law at the specialized competition courts.

17. Regarding natural gas, the Commission warned competition risks derived from a modification to a regulation established by the Ministry of Energy (SENER). The modification proposed that users or those interested in receiving natural gas transportation services at internal points of the Integrated National Natural Gas Transportation and Storage System (Sistrangas) must prove that they receive supply from PEMEX and CFE. Likewise, they must guarantee that the provision of the service is ensured through the contracting of capacity in pipelines of these State companies. COFECE issued an opinion in July 2022 stating that the regulatory modification would:¹⁷ (i) prevent users (distributors and industrial users) from contracting private companies, artificially benefiting SOEs; (ii) discourage the entry of potential natural gas distributors and nullify the ability to compete

¹¹ Case file: DE-022-2017.

¹² Case file: IEBC-002-2019.

¹³ Article 12, subsections XI, XII, XIII, XIV, XV, XVIII, XX y XXI of the LFCE.

¹⁴ See case files: OPN-003-2019, OPN-003-2020, OPN-006-2020, OPN-007-2020, OPN-011-2020, OPN-001-2021, OPN-002-2021 y OPN-002-2022.

¹⁵ See studies: *Transición hacia mercados competidos de energía: Los Certificados de Energías Limpias en la industria eléctrica mexicana; Cuadernos de Promoción de la Competencia. Transición hacia Mercados Competidos de Energía: Gasolinas y Diésel; Cuadernos de Promoción de la Competencia. Transición hacia Mercados Competidos de Energía: Gas LP; El papel de la COFECE durante la transición hacia Mercados Competidos de Energía: Gasolinas y Diésel. El papel de la COFECE durante de la transición a un mercado competido de gasolinas y diésel (2016).*

¹⁶ COFECE-023-2020 y COFECE-012-2021.

¹⁷ Case file: OPN-006-2022.

of current market participants; and (iii) generate distortions for SOEs competitors in the electricity production market, since natural gas users that require it to produce electricity and need transportation services would have to contract the SOE. COFECE filed a constitutional controversy against this regulation. In this regard, the SCJN granted the suspension of the regulation while it decides on the controversy.

5. Cooperation frameworks with energy market regulators

18. The Commission has been able to establish collaboration agreements with sectoral regulators in order to strengthen information exchange mechanisms that make the process of obtaining relevant information for enforcement or advocacy actions more efficient, as well as a more continuous monitoring of variables such as the prices of the products in these markets, especially in those recently liberalized markets.¹⁸ This collaboration agreements are very important because:

- competition policy alone cannot fully preserve competitive conditions and free market access in domestic markets if regulation is not adequate to create and build these conditions;
- regulators have technical and specialized knowledge on the functioning of these markets;¹⁹ and
- under the 2013 Reform, regulators may receive advice from the Commission in order for these markets to effectively transition to free markets.

19. Regarding the latter point, there is sectoral regulation that provides for the collaboration of COFECE with sectoral regulators. For example, according to Article 24 of the Hydrocarbons Law, the Commission must give its opinion on the bidding and awarding terms for "Hydrocarbon Exploration and Extraction Contracts" regarding prequalification criteria and awarding mechanisms.

20. Likewise, according to Article 83 of the same law, the Energy Regulatory Commission (CRE) will issue regulations for activities related to hydrocarbons (except for the sale to the public of LP Gas, gasoline and diesel whose prices will be determined according to market conditions). The regulation for each market will be applicable unless COFECE determines the lack of effective competition conditions, and in such case the corresponding prices and tariffs will be determined in accordance with market conditions.²⁰

¹⁸ COFECE has more than 50 cooperation agreements with other authorities, including the Ministry of Economy (SE), the Bank of Mexico, the Tax Administration Service (SAT), the Ministry of Energy (SENER), the CRE, among others.

¹⁹ As part of the regulatory framework, the economic agents that participate in this sector are required to submit to these regulators, information about their operation in the market, such as their shareholding structure, market prices, sales volumes, among others.

²⁰ In October 2022, COFECE determined the lack of effective competition conditions in 213 of 220 relevant markets in the distribution of LP Gas to final users (Case file: DC-001-2021). As it is established in the Hydrocarbons Law to regulate LP Gas prices, a resolution of lack of competition conditions by COFECE is a necessary and prior condition to a price regulation. However, in July 2021, without having a final resolution from COFECE, SENER published in the Federal Official Gazette the "Directriz de Emergencia para el bienestar del Consumidor de Gas Licuado de Petróleo" ["Emergency Directive for the welfare of the Liquefied Petroleum Gas Consumer"], valid for 6 months, in which it exhorts the CRE to establish a methodology to fix maximum prices for the final consumers of LP Gas. In January 2022, SENER extended the validity of the Emergency Directive

21. According to the aforementioned article, CRE, with the opinion of COFECE, will establish the provisions to which permit holders for the transportation, storage, distribution, retailing and commercialization of hydrocarbons, oil products and petrochemicals, as well as the users of such services must adhere in terms of cross participation in these markets.

for a period of 6 months counted from January 29, 2022. In addition, in July 2022, the CRE issued the “Acuerdo por el que la Comisión Reguladora de Energía emite las Disposiciones Administrativas de Carácter General que establecen la metodología para la determinación de precios máximos de gas licuado de petróleo objeto de venta al usuario final” [“Agreement by which the Energy Regulatory Commission issues the General Administrative Provisions that establish the methodology for determining the maximum prices of liquefied petroleum gas for sale to the end user”]