

Mexico's Guidelines for Clean Energy Certificates Will Support Renewable Energy Development

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As part of a historic restructuring of its electrical power sector, Mexico will create a market for tradable Clean Energy Certificates, which many industry participants will be required to obtain. Draft guidelines proposed by the Mexican Ministry of Energy set forth the criteria for granting these clean energy certificates, a framework for buying and selling them, and a procedure for establishing the obligations of market participants to obtain the certificates. Final guidelines will be issued shortly.

One of the objectives of the Mexican energy reform is to promote the use and development of clean energy. In 2012, Mexico set a goal of obtaining 35 percent of its electricity from clean sources by 2024.

The Law of the Electricity Industry (the "Electricity Law"), which became effective on August 12, 2014, established tradable Clean Energy Certificates (*Certificados de Energías Limpias*, or "CELs") as the primary mechanism for encouraging clean energy. President Enrique Peña Neto announced that the guidelines for CELs (the "Guidelines") would be issued in October of this year. Earlier this month, the Ministry of Energy (*Secretaría de Energía*, or "SENER") submitted draft Guidelines to the Federal Regulatory Improvement Commission (*Comisión Federal de Mejora Regulatoria*, or "COFEMER"). COFEMER published the draft Guidelines, and has now completed its initial regulatory review and issued "non-final" comments. Once finalized, the Guidelines will become effective on January 1, 2015.

CELs Will Be Issued to Clean Generators

As discussed in our prior publications regarding the Mexican power sector reforms¹, "Clean Energy" as defined in the Electricity Law includes not only renewable energy such as solar and wind, but also efficient

¹ See, e.g., Eric Save, Michael S. Hindus and John B. McNeece III, *Energy Reform Legislation in Mexico Gives the Private Sector Unprecedented Opportunities in the Mexican Electrical Power Industry*, 14-2 Pratt's Energy Law Report 59 (LexisNexis A.S. Pratt), available [at this link](#).

cogeneration, nuclear power, hydroelectric power, other low-carbon emission technologies (which could include highly efficient fossil fuel-based generation), and future clean energy technologies.

Under the draft Guidelines, each entity that represents a power plant or other facility that generates electricity from such “Clean Energy” sources (“Clean Generator”) will have the right to receive one (1) CEL for each megawatt-hour (“MWH”) of electricity that is generated at facilities that do **not** use fossil fuels. In addition, for each MWH of electricity generated at a facility that **does** use fossil fuels, a Clean Generator will be entitled to receive one (1) CEL **multiplied by** the percentage of that facility’s generation which constitutes Clean Energy, as certified by the Energy Regulatory Commission (*Comisión Reguladora de Energía*, or the “CRE”). For purposes of this calculation, only Clean Energy generated in excess of certain minimum levels to be set by the CRE will be taken into account.

As a result of this formula, fewer CELs will be issued for generation from facilities that use fossil fuels than will be granted for generation from facilities that do not use fossil fuels, but the exact percentages that will be applicable to fossil fuel facilities have not been established and will depend on minimum performance standards set by the CFE. Above those minimum standards, the fossil fuel facilities will be deemed to be generating “clean energy.” How the CRE approaches the task of setting these performance standards will be a critical issue affecting the competitiveness of clean energy derived from solar, wind and geothermal, but the draft Guidelines do not specify any methodology for this determination.

The draft Guidelines also provide an additional incentive to install distributed generation from Clean Energy sources (“Clean Distributed Generation”). For Clean Distributed Generation, the number of CELs that otherwise would be issued to the Clean Generator based on the above formula will be **increased** based on a ratio that reflects the total power losses in the Mexican electrical power system. Accordingly, when the total power losses on the system are higher, the percentage increase in CELs issued for Clean Distributed Generation will also be higher. This is a method of encouraging more Clean Distributed Generation in order to reduce power losses in the system.

Clean Energy generated for a facility’s own use will not earn CELs. In addition, no CELs will be granted for electricity generated in violation of the dispatch instructions of the independent system operator of the Mexican national electrical system, which is known as the National Energy Control Center (*Centro Nacional de Control de Energía*, or “CENACE”).

SENER Will Determine the Optimum Requirements for Obtaining CELs

Under the Electricity Law, in the first quarter of every year, SENER must establish the requirements for acquisition of CELs that will be applicable in the following three years. The CEL requirements will be expressed as a percentage of the total load in a given period consumed by the industry participants who are obligated to obtain CELs.

The draft Guidelines set forth an elaborate procedure that SENER must follow in order to establish such CEL requirements. In setting CEL requirements each year, SENER will be required under the Guidelines to minimize the “social cost” of achieving Mexico’s policy objectives regarding clean energy in the following manner:

In coordination with planning for the installation and retirement of power plants, SENER must identify the “optimum” CEL requirements for each year, in a manner that minimizes the expected cost of achieving Mexico’s clean energy objectives over a horizon of 15 years. For purposes of making this determination, in January of every year SENER will prepare and publish estimates of the cost of clean energy in Mexico, which must take into account the expected evolution of power generation in Mexico in light of technological advances, as well as the economies of scale and efficiencies that result from a stable pattern of investment.

SENER will then set the CEL requirements each year based on what is necessary to achieve such “optimum” objectives over the following 15 years. For the third year of this 15-year horizon, SENER must establish CEL requirements equal to the “optimal” requirements, provided that the requirements cannot be less than the requirements previously established for that year. SENER can also establish CEL requirements for future years (beyond the following three years) if necessary to promote investment.

This procedure gives SENER the flexibility to adopt a gradual approach that favors low-cost generation in the short term but takes into account the forecasted change in Mexico’s generation mix (i.e., an increase in efficient gas-fired generation and retirements of less efficient generation) and the cost of renewable power generation over a 15-year horizon. It also puts a priority on low costs over low emissions—not surprisingly, given that one of the key objectives of the reform of the power sector is to reduce the cost of electricity.

Certain Industry Participants Will Be Required to Obtain CELs

Under the draft Guidelines and the Electricity Law, the following categories of industry participants (collectively, the “Obligated Participants”) will be required to obtain CELs:

- Suppliers (as defined in the Electricity Law). The term “Suppliers” refers to entities that have obtained a permit to sell electricity service to end users in Mexico.
- Qualified Users (as defined in the Electricity Law) that are authorized participants in the new wholesale electricity market that will be established under the Electricity Law (the “Wholesale Electricity Market”). The term “Qualified Users” refers to (i) entities whose electricity consumption and demand exceeds a threshold to be established by SENER, which has been set at 3 MW for the first year, declining at least to 2 MW after the first year and at least to 1 MW after the second year; and (ii) facilities and equipment that allow end users to receive electrical power (“Load Centers”) which as of the date the Electricity Law went into effect were included under interconnection agreements or small-producer power purchase agreements entered into before that date (“Legacy Interconnection Agreements”).
- End users that generate or import electricity for their own use without transmission of power over the Mexican national transmission grid or general distribution networks.
- Holders of Legacy Interconnection Agreements that include Load Centers whose energy does not come entirely from a power plant that uses Clean Energy.

Obligated Participants are granted some flexibility under the draft Guidelines in that they are allowed to defer compliance of up to 25 percent of the CEL obligations for up to two years, provided however that the obligation to obtain CELs will increase by 5 percent for each year deferred. If an Obligated Participant does not have sufficient CELs (and has not notified CRE of its election to defer), it shall be subject to administrative sanctions to be determined by the CRE.

CELs Will Be Tradable

The draft Guidelines state that the rules for trading CELs via the Wholesale Electricity Market will be included in the first set of market rules to be issued by SENER pursuant to the Electricity Law. Entities that have entered into market participant agreements with CENACE and posted the required security (“Market Participants”) will be permitted to offer to buy and sell CELs through the Wholesale Electricity Market. CENACE will set the price based on matching of offers, and settlement of CEL transactions will be made through the Wholesale Electricity Market. CENACE will report the CEL transactions to the CRE so that the CRE can validate the ownership of the CELs.

In addition to trades through the Wholesale Electricity Market by Market Participants, the draft Guidelines also permit anyone to contract bilaterally for CELs, including by entering into financial contracts that provide for the purchase or sale of CELs at a specified future date, as long as the trades meet the requirements of the CRE for monitoring, reporting, and verification of CELs. As contemplated under the Electricity Law, Suppliers will be obligated to enter into financial contracts for certain minimum amounts of CELs, in accordance with requirements and conditions to be established by the CRE. The draft Guidelines also state that the first market rules governing the operation of the Wholesale Electricity Market will provide for auctions through which Suppliers serving residential and small business users will enter financial contracts for CELs.

The Draft Guidelines Will Be the First of Several Steps to Implement the CEL Regime

On October 21, 2014, COFEMER issued a non-final opinion on the draft Guidelines with certain recommended changes. Also, on the same date, an industry association known as the Mexican Photovoltaic Solar Energy Association (*Asociación Mexicana de Energía Solar Fotovoltaica*, or “ASOLMEX”) submitted comments to COFEMER with certain additional proposed changes to the draft Guidelines that, in general terms, would favor solar generation. It is expected that a revised draft of the Guidelines will be submitted by SENER in the coming days, but it is not known to what extent the revised draft will take into account the comments from ASOLMEX. With the exception of the provision that would allow Obligated Participants to defer up to 25 percent of the CEL obligations for up to two years, which ASOLMEX proposes to eliminate, the other recommendations made by COFEMER and proposals made by ASOLMEX would not directly modify the provisions of the Guidelines summarized in this alert.

The Guidelines are only the first of many rules and regulations to be issued regarding CELs. Among other things, the CRE is required to issue general regulations related to CELs per Article 127 of the Electricity Law, as well as measurement and reporting requirements affecting CELs for generation of clean energy through “isolated supply,” i.e. self-supply without use of the national electrical system, as referenced in Article 126, Paragraph V of the Electricity Law. SENER will issue the initial market rules governing the operation of the Wholesale Electricity Market, which, as indicated above, will contain, among many other things, the rules and procedures regarding trading of CELs. SENER will also issue the CEL requirements and criteria mandated by the Electricity Law and in the Guidelines, including for the acquisition of CELs by Obligated Participants and the granting of CELs to generators of clean energy, as well as the estimated costs of clean energy technology in Mexico. Finally, the Ministry of the Environment and Natural Resources (*Secretaría de Medio Ambiente y Recursos Naturales*, or “SEMARNAT”) will issue the emissions reduction obligations for the electrical power industry, as stated in Article 129 of the Electricity Law.

If you have any questions about this alert, please contact the Pillsbury attorney with whom you regularly work or the authors below.

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