

# Mexico's Wind Market Is Moving Forward With Reforms

Recent legal and regulatory developments should result in increased opportunities for investment.

By Allan T. Marks & Miguel Duran

Global developers have long been attracted by Mexico's ample wind resources. Regulatory uncertainty and difficulties in obtaining grid access and long-term power contracts have been challenges for projects until recently. Now that the government is putting in place the regulatory changes needed to implement the country's sweeping energy reform legislation that was adopted in the last few years, Mexico's renewable energy market remains poised to grow to unprecedented levels. Project developers and investors that might have been hesitant to enter the wind energy sector in Mexico until there was a well-defined framework now enjoy a comprehensive set of laws and regulations providing assurance and guidance.

Early players in the market that successfully navigated uncertain waters are now blessed with coveted knowledge and experience. Although there are still practical issues to be resolved and challenges to overcome, Mexico is demonstrating that it is committed to renewable energy. Opportunities for investment in wind power projects in Mexico look more promising than ever.

As an oil-rich country with the second-largest unexplored crude oil reserves in the world, Mexico has historically satisfied its energy needs by



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relying mostly on oil and gas. The energy reform mainly introduced a restructuring of the oil and gas industry, a vital component of Mexico's economy, to attract international companies and modernize the sector. The com-

prehensive reform also impacts the power sector and contains measures to encourage renewable energy generation. The initial auction of oil and gas exploration and exploitation blocks, held in mid-2015, did not meet the original expectations (less than 15% of the blocks were awarded), and further drops in world oil prices may impede forthcoming auctions. Even if increases in oil and gas production could help satisfy the growth in energy demand (the government estimates that approximately 55 GW of new generation capacity will be needed over the next





**Engineers slowly guide a substation for the 130 MW La Bufa Wind Farm up a steep incline.**

Photo courtesy of Mexico Power Group

15 years), complete energy independence in an economically and environmentally conscious manner requires shifts in the energy mix. With those goals in mind, Mexico established the ambitious goal to obtain no less than 35% of the country's power from renewable energy sources by 2024, and approximately half of the renewable capacity is expected to be provided by plants powered by Mexico's plentiful wind resources.

### **Regulatory developments**

One of the hallmarks of the energy reform law was the development of the new wholesale power market managed by the Centro Nacional de Control de Energia (CENACE), or the National Center of Energy Control. CENACE is charged under the energy reform law with maintaining the fairness, efficiency and transparency of the wholesale power market and protecting non-discriminatory access to the national transmission grid. The final regulations setting forth the market's rules were published by the Comision Reguladora de Energia (CRE), or the Energy Regulatory Commission, in September 2015.

Previously, generators were basically limited to selling power to the Comision Federal de Electricidad

(CFE), or the Federal Electricity Commission, the national utility, or under certain circumstances to local industrial or commercial users under long-term power purchase agreements (PPAs).

Now, generators may sell power through CENACE directly into the wholesale market. Qualified users will be able to purchase power on the spot market (day-ahead, hour-ahead or real-time) and will have the option to enter into bilateral contracts with private electricity generators. Furthermore, CENACE will hold annual auctions to award contracts (both long- and mid-term) for the sale of energy and capacity. The initial auction, for 15-year power sale agreements, was published last November, and awards are expected to be announced in late March. Auctions for three-year contracts are expected to begin later this year, and 20-year contracts for the sale of clean energy certificates (CELs) will be tendered in 2018. Additionally, each wholesale market participant is required to obtain at least a portion (currently 5%) of its electricity from clean sources.

Though a solid wholesale market and the availability of long-term PPAs already provide a strong foundation to entice wind energy developers and

investors, the enactment of the Ley de Transicion Energetica (LTE), or the Energy Transition Act, on Dec. 24, 2015, constituted a further enhancement to support the development of renewable energy in Mexico. This new law was introduced to regulate the sustainable production of energy, to encourage clean energy sources and to reduce emissions from power generation. The LTE establishes intermediate targets for renewable energy production equal to 25% in 2018 and 30% in 2021 to support the achievement of the energy reform's 35% goal for three years in the future. The passage of the LTE encountered strong opposition by several trade groups, including the Camara Nacional de la Industria del Hierro y del Acero, or the National Chamber of the Iron and Steel Industry, which argued that the LTE would require Mexico to consume renewable energy that it still does not have and that strong demand and weak supply could increase electricity prices dramatically and could even threaten the survival of some small businesses. In response to these demands, the LTE introduced, as a compromise, a flexibility mechanism that would relax the requirements during the initial years in the event there is an insufficient number of CELs or if prices exceed certain thresholds. The new law should create additional demand for clean energy, thus enhancing the investment climate for wind power and other renewables.

### **Grandfathered projects**

Understandably, the pace of development of the wind energy projects governed by the new regulatory regime has been constrained by the growing pains of the transition period, ranging from the coordination between new and old entities (e.g., the CFE, CRE and CENACE) splitting responsibilities that were previously centralized with the CFE. That regulatory uncertainty caused some investors to be more cautious, and they are now investigating the market with more clarity as to the rules of the game. The transition period,



**New regulations should help Mexico wind farm development in states without significant build.**

while the new regulations were being formulated and the regulators were building institutional capacity to take on their new roles, also delayed solutions to other practical issues that may have hindered renewable power investments until now: availability and terms of interconnection agreements; load balancing requirements; dispatch priority; and impact of congestion in parts of the transmission system. Against that backdrop, several projects that were approved under the old governing system, particularly under the self-supply framework, were, nonetheless, able to make progress and, now under construction, are expected to reach commercial operations in the near future.

Notably, although most of the wind project development in Mexico has historically been concentrated in the state of Oaxaca, the past year has seen an increase in activity in Mexican states without a significant prior presence in the wind energy sector. The Tres Mesas Wind Project, for example, is currently under construction in the state of Tamaulipas, a state that currently holds only 54 MW of installed wind energy capacity.

The two phases of the project will have an aggregate capacity of 148.5 MW and will provide electricity to a

subsidiary of Grupo Alfa, one of the largest conglomerates in Latin America, and to Wal-Mart de Mexico. The project is being financed by the U.S. Overseas Private Investment Corp. and the North American Development Bank through an innovative U.S. dollar/Mexican peso dual-currency loan facility.

The state of Zacatecas, so far unrepresented in the wind energy generation sector, has also seen increased interest. Its governor recently announced that over 10 billion pesos are expected to be invested in wind energy projects currently under development or construction. Significantly, in late 2015, developer Mexico Power Group (MPG) announced the successful financing of the 130 MW La Bufa Wind Farm, with debt financing provided by Sumitomo Mitsui Banking Corp., The Korea Development Bank, Nacional Financiera and Bancomext. In partnership with private equity investor First Reserve, which has acquired an ownership stake in La Bufa, MPG will develop and construct a wind project that will supply a majority of the power required by Volkswagen de Mexico's manufacturing plant in Puebla. The creditworthiness of Mexican corporate off-takers was sufficient to attract

both debt and equity from outside of Mexico based on the long-term power sales agreement.

### **Working with indigenous communities**

Mexico has one of the largest indigenous populations in the Americas. Prior to the government taking any legislative or administrative measure that may materially impact an indigenous community, the community should be involved in a consultation process to discover and mitigate potential harmful effects.

Though this is not a new challenge and expert developers are adept at creating fruitful relationships with neighboring indigenous groups, the potential consequences of neglecting these responsibilities have recently come into the spotlight and emphasize the importance of understanding the community and open collaboration.

In December 2015, a court in Oaxaca suspended permanently the construction of a proposed 396 MW wind farm located in the Isthmus of Tehuantepec, Oaxaca. Despite the project having been approved by some indigenous communities a few months earlier, other groups continued to challenge it. Their contentions focused on a lack of prior and, more significantly, free consultation.

They claimed that several members of the communities that opposed the project suffered harassment, that only indigenous project supporters were provided transportation to the hearings, and that less than 1% of the population had an opportunity to vote.

Developers in the area asserted that the consultation process, which lasted eight months, merely provided an opportunity for professional blackmailers to exert pressure on them while pursuing their own private interests, rather than the interests of the wider community.

Such a contentious process, though not commonplace, is perhaps the result of a confluence of factors in the area, including the economic difficulties of a large percentage of the state's population, the large presence

of indigenous communities and the existence, currently, of 21 wind farms in the area (out of 31 wind projects in the whole country) due to the outstanding wind resource in the region.

The lesson is not that local opposition is a particularly high risk in Mexico compared with other jurisdictions. Rather, this is an issue that smart developers should address seriously and early in the development and siting of a project to prevent problems from arising later.

### **Cross-border concerns**

As more wind projects are developed in the northern part of Mexico, participants should also be aware of potential compliance issues created by the confluence of two sets of laws, particularly with respect to environmental and social aspects. For instance, the 155 MW Energia Sierra Juarez wind farm, located in Baja California, just south of the U.S.-Mexico border, has recently been the subject of legal chal-

lenges. (For more on the wind project, see “Meet The Wind Farm That Knows No Borders” on page 24.)

The project, which is expected to expand its capacity by up to 700%, currently sells all of its output across the border to California utility San Diego Gas & Electric. Although the project was approved by Mexico’s environmental agency, San Diego county residents have opposed it because of potential violations of U.S. environmental laws, such as the National Environmental Policy Act (NEPA), the Endangered Species Act and the Migratory Bird Treaty Act.

Opponents claimed environmental impacts would occur in Mexico, which ordinarily would be outside the reach of U.S. authority. Nevertheless, opponents claim that by obtaining a border-crossing permit to connect to the grid, which was granted by the U.S. Department of Energy in 2012, the project would be subject to NEPA rules and regulations.

Of course, cross-border legal issues are unlikely to be a concern for most Mexican wind energy projects, but they should be considered for some border area projects where multi-jurisdictional issues could arise.

The new regulatory framework – still in its infancy – has opened up more opportunities, and both developers and financiers are already taking advantage of them. Given slowing demand growth in other markets and a challenging environment for foreign investors in some other Latin American countries, international players should focus attention on Mexico’s wind market for potential new development opportunities over the next several years. 

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