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Procompetitive Industrial Policy – Note by Mexico

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More documents related to this discussion can be found at www.oecd.org/competition/pro-competitive-industrial-policy.htm

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Mexico

1. Introduction

1. Since the 1980s, the modernization of the Mexican economy saw the State retreating from key economic activities through privatization and market-oriented reforms. However, recently there has been a tendency to rethink the role of the State in the economy, trying to increase the participation of State-Owned Enterprises (SOEs) in the economy. The former, has had an impact on competition conditions and the participation of economic agents, mainly in energy markets.

2. This contribution presents a case regarding industrial policy in Mexico. Specifically, it provides an example regarding a recent merger review case in which the electricity SOE filed the proposed acquisition of several power plants, and how Cofece and the Mexican State collaborated to modify the terms of the transaction to strike a balance between the Mexican state industrial policy and competition policy Cofece and the Mexican state industrial and competition policy and the Mexican state industrial policy.

2. Legal provisions for the interplay between industrial policy and competition policy in Mexico

3. In recent years, the Mexican State, as part of its industrial policy, has striven for economic growth and welfare for people in Mexico through increasing its participation in priority sectors of the economy.

4. According to article 25 of the Mexican Constitution[1], the State shall have exclusive control over strategic areas, always maintaining ownership and control over the State organisms and SOE's that are established for this purpose. Article 28 of the Mexican Constitution lists the strategic areas where the State has exclusive functions and that are not considered monopolies[2]. Furthermore, it also recognises that the State may own companies to effectively manage those strategic areas under its responsibility. And as article 27 sets forth, the State may participate alone, or with partners from the private and social sectors, in these areas.

5. Particularly in the electricity sector, in which our example case takes place, the State is the only economic agent, through the state-owned enterprise, the Federal Electricity Commission (CFE, for its initials in Spanish), that is allowed to participate in the transmission and distribution of electricity activities considered a strategic area of the economy (with the possibility of entering into contracts with private agents for the improvement and expansion of the grid). In the segments for electricity generation and

[1] The Mexican Constitution is available in Spanish at: https://www.diputados.gob.mx/LeyesBiblio/ref/cpeum.htm.

[2] Post, telegraphs and radiotelegraphy, radioactive minerals and nuclear energy generation, planning and control of the national electric system, as well as the public services of transmission and distribution of electric energy, the exploration and extraction of oil and the other hydrocarbons, minting of currency and issuing banknotes.

provision or supply of electricity[3], since the 2013 reform of the electricity sector[4], these markets are open to the participation of the private sector. To the extent that this legal framework is in force, competition policy for the energy sector is in line with the current industrial policy.

6. However, the Mexican government has promoted legislative initiatives to modify the 2013 reforms with the aim of securing CFE's market share, shifting the industrial policy objectives to favour a policy of providing energy through the SOE. Accordingly, the case explained below referring to the acquisition of Iberdrola's plants by the Mexican government, responds to these efforts for the CFE to increase its electricity generation capacity.

3. Industrial policy and national champions: the case of a merger in the electricity generation market

7. In September 2023, Mexico Infrastructure Partners FF (MIP FF) notified the acquisition of 13 power generation plants owned by Iberdrola and its subsidiaries[5]. The transaction was to be executed through a trust fund that would operate as the acquisition vehicle managed (SPV) by MIP FF. The State's National Infrastructure Fund (FONADIN, per its acronym in Spanish) would be the main source of financing for the purchase of the plants, which is a national fund whose purpose is to invest in the development of infrastructure projects, including those in the Mexican electricity sector. Legally, FONADIN is part of the federal public administration and, therefore, its decision-making is subject to the Federal Executive.

8. Another aspect to bear in mind regarding this merger is that Iberdrola is one of the main competitors of the CFE in the electricity generation market, so it was an horizontal merger.

9. During its analysis, Cofece identified that the relevant market, in the product dimension, corresponded to the electricity generation market. Likewise, it detected that the National Interconnected System (SIN) comprises several relevant markets whose geographic reach is determined by the demand and congestion of the SIN's transmission grid.

10. After reviewing the transaction, Cofece considered the short, medium, and long-term situation in the electricity generation market.

11. 10 out the 13 power plants operate under the Independent Power Producer (IPP) scheme, meaning that they had long-term contracts to sell their electricity exclusively to the Federal Electricity Commission (CFE) until 2027 and up to 2042. For this reason, the transaction would not affect the market structure, as the capacity of these plants was already committed to CFE. The remaining 3 plants represented 1.8% of the available capacity in the national market, so it is unlikely that the market could be affected.

[3] Article 4, Electricity Industry Law (LIE for its initials in Spanish).

[4] See the *Decree amending and adding various provisions of the Political Constitution of the United Mexican States, in the area of Energy*, available in Spanish at: https://www.dof.gob.mx/nota_detalle.php?codigo=5327463&fecha=20/12/2013#gsc.tab=0.

[5] File number CNT-101-2023. The public version of the resolution is available in Spanish at: https://www.cofece.mx/CFCResoluciones/docs/Concentraciones/V6082/3/6065999.pdf.

12. However, as FONADIN is a public trust managed by the Mexican government, who also owns CFE, Cofece determined that the transaction required greater corporate governance controls to ensure that FONADIN's participation would not compromise the plants' independence in the market.

13. In that regard, Cofece concluded that, under the terms that it was notified, it could generate risks in the electricity generation market, unless the notifying parties could guarantee independent decision-making in the operation of the acquired generation plants, at the administrator, technical committee, and shareholders meetings levels.

14. If not, the transaction could potentially hinder, decrease, harm, or prevent competition and market access. To reach this conclusion, the Commission considered that:

- The identified relevant markets are characterized by high concentration;
- CFE is the main participant in said markets:
- There are considerable barriers to entry; and
- The notified transaction could generate links between Fideicomiso CKD (the trust that issued the transaction's Certificates of Capital Development securities, in which CFE has a controlling stake) and CFE.

15. On the other hand, Cofece considered that, as a result of the transaction, a structural link that would allow frequent communication between competitors, generating risks to the process of competition and free market access for the identified relevant markets. This channel could also facilitate anticompetitive practices.

16. Consequently, the notifying parties proposed remedies to prevent the anticompetitive effects of the transaction. After assessing these proposals, Cofece considered that, in general terms, they directly contributed to correcting the identified risks.

17. To further enhance these remedies, the Commission put forward modifications and precisions to bind the buyers to: i) operate the generation plants independently, and ii) avoid exchanges of sensitive or strategic information between competitors.

18. With regards to the first set of remedies, among others:

- FONADIN or its related parties must reduce and maintain their investment in the SPV up to a maximum of 51%. This participation must be reached within a 24-months period.
- An independent professional administrator must be appointed to be in charge of decision-making related to the operation of the electricity generation plants in the market.
- Controls and mechanisms must be established so that decisions related to the management of the electricity generation plants can only be adopted through qualified voting or with mandatory intervention of institutional investors or independent members.
- Controls and mechanisms must be established that oblige the persons in charge of the operation of the electricity generation plants to act independently and without conflict of interest.

19. Also, to compel the buyers to avoid exchanges of sensitive or strategic information between competitors:

- They must appoint a compliance officer totally independent of the parties to verify and guarantee this situation; and

- Executives and persons in charge of the operation of the electricity generation plants must refrain from holding positions in any other competitor; in addition, those who have been public officials in the last 4 years cannot be appointed.

20. Ultimately, the acquisition of the power plants was conditionally authorized by the Board of Commissioners on February 13, 2024.

21. In summary, these remedies allow the transaction to take place in a context where there the power plants are managed without intervention of the SOE, fostering competition in the sector and ensuring choice, competitive.