

CLIFFORD CHANCE



MEXICO'S SECOND AUCTION: PPA FEATURES AND BANKABILITY CONSIDERATIONS

Mexico has announced the winners of its second auction round for long-term power purchase agreements (PPAs) for clean energy production. The announcement by the federal electricity agency, Centro Nacional de Control de Energía (CENACE), which was made on September 28, 2016, much earlier than expected, reveals that 23 out of 57 bidders won tenders for the sale and purchase of electricity, capacity and clean energy certificates (CELS), with an emphasis on solar, wind and combined cycle gas turbine (CCGT) projects. Tenders for 15-year sales of electricity and 20-year sales of clean energy certificates were primarily awarded to photovoltaic solar projects (comprising 54% of electricity and 53% of clean energy certificates) and wind power projects (comprising 43% of electricity and 41% of CELS), whilst CCGT projects won the lion's share of 15-year capacity tenders (72%).

As with the [first power auction](#), the second auction round shows a strong continuing interest from international investors in Mexico's electricity sector. The average bid price of USD 33.47 per MWh, which is broadly comparable to pricing seen on international tenders elsewhere, was indicative of the high level of competition faced by prospective developers. Notwithstanding the generally bankable structure of the power purchase framework, raising international debt financing for such projects on a limited recourse basis will likely continue to face a number of challenges.

In contrast to the Independent Power Producer regime (*Los Proyectos de Inversión de Infraestructura Productiva con Registro Diferido en el Gasto Público*) (PIDIREGAS) (IPP Regime) in which the *Comisión Federal de Electricidad* (CFE) was the sole offtaker, the form of PPA attached to the first and second auctions has been designed to accommodate Mexico's push to create a wholesale electricity market. Under Mexico's power reforms, whilst CFE will remain the sole supplier of retail electricity, private generators are to sell into the wholesale

market or participate in medium-term or long-term auctions for energy and capacity, on an equal footing and in competition with CFE's subsidiary generation companies. One of the key objectives is to introduce competition into electricity generation, both to bring down production costs (which average around USD 66-88 per MWh) and to reduce regional imbalances in costs (which can vary from an average of USD 23 per MWh in the Tijuana and Ensenada zones to USD 66 per MWh in the Yucatan and 118 per MWh in the Baja peninsula). A major driver is to lower or eliminate the large difference between the costs of producing electricity and the rates retail customers pay, which is currently heavily subsidized by the Mexican government (by some estimates, the cost of supplying residential customers is more than double the price that CFE charges). Another key objective is to encourage new capacity of low-carbon generation, which under Mexican law includes renewables, nuclear power, efficient cogeneration, and carbon-capture technologies. Mexico's goal is for clean energy sources to provide 50% of the nation's electricity generation mix by 2050.

As such, whilst the new form of PPA contains several bankable features, it remains a non-negotiable document in which the state-owned offtaker CFE does not assume most of the political and market risk as under the IPP Regime. The PPA also contains an element of [merchant risk](#). The financing of the projects awarded during the first and second auction will thus depend on how investors, developers and financial institutions view the implementation of the electricity reforms and rules that will define its nascent wholesale market.

Below are some of the key features of the new form of PPA that are important from a bankability perspective:

1. PPA Term

- Electricity sales: 15 years from the commercial operations date.
- Capacity sales: 15 years from the commercial operations date.
- Clean Energy Certificates: 20 years from the commercial operations date.

2. Offtaker and Payment Support

- Offtaker is initially the CFE or a subsidiary of CFE as "Basic Energy Supplier" (*Suministrador de Servicios Básicos*). In the event that CFE's subsidiary is the offtaker, CFE must be a party to the PPA on a joint and several basis (*obligado solidario*). In future auctions other entities may participate as offtakers.
- Unlike Mexico's IPP regime in which CFE is required to include its payment obligations in Mexico's annual federal budget, the new PPA is silent as to such budgetary assurance. CFE's obligations under the PPA are not guaranteed by the federal government. However, if the offtaker ceases to be controlled by the Mexican federal government, the generator can terminate the PPA and receive a termination amount that guarantees receipt of the contracted price under the PPA over the remainder of its term (see below).
- Offtaker is required to post a standby letter of credit to guarantee its payments under the PPA following the commercial operations date and to secure the termination payment if not made in full (see below), but there is no requirement for such letter of credit to be issued by a creditworthy financial institution or to be renewed or replaced in the event the creditworthiness of the issuer thereof is adversely affected.

3. Generator Share Retention/Transfer Restrictions

- See Appendix 1 and 2 for a list of the companies awarded during the first and second auction.

- Original shareholders of the generator can sell their shares without the prior written consent of the offtaker but must retain control of the generator (i.e. 51% of the voting stock) until 1 year after the commercial operations date.
- Additional change of control restrictions apply depending on whether the shareholder's financial or technical competence was central in achieving the prequalification criteria. Shareholders whose financial capacity was essential to meet prequalification criteria must retain, directly or indirectly, at least 20% of its economic and corporate rights in the generator whilst shareholders whose technical expertise was necessary must retain, directly or indirectly, a minimum of 30% for up to 2 years after the commercial operations date and a minimum of 15% for up to 3 years after the commercial operations date.
- Generator cannot sell/transfer any of its rights over the power plant to a third party unless the transfer has no material impact on the generator's operating or financial capacity, the transferee assumes all of generator's obligations, and relevant authorizations are obtained.

4. Penalties and Performance Guarantees

- Generator is required to post one or more performance guarantees in the form of a letter of credit set forth in the PPA and which must be from a Mexican bank to cover a specified minimum investment unit per MW for contracted capacity, electricity and CELs per year.
- The performance guarantees are to be posted for construction and for operations and are designed to cover penalties that apply if milestones/performance targets are not met. Construction performance guarantees

are reduced by a set percentage upon achieving specific milestones.

- If commercial operations are not commenced by the scheduled commercial operations date the generator must pay a penalty equivalent to 5% of the monthly payments under the PPA and for delays in achieving milestones must pay 0.75% of the contract price of the PPA. In addition, the generator must increase the guaranteed amount for each month of delay by 10% where attributable to the generator, 2% where attributable to federal government delays and 5% where attributable to state/municipal government delays, subject to an overall cap of two times the original guarantee amount.

5. Dispatch Risk

- Offtaker is required to pay for whatever is delivered to it by the generator. Even if the offtaker does not take the electricity, capacity or CELs, it is still required to pay the price fixed in the contract for whatever is delivered by the generator, suggesting a take or pay structure.
- For electricity sales, if the generator delivers less than what is annually contracted for, the generator must then pay to the offtaker an amount equal to the average marginal spot market price multiplied by the quantity of the deficiency and the offtaker pays the contracted price for such quantity in deficiency. The generator thus continues to receive the contracted price for the delivered electricity, but will bear the gain or loss arising from the difference between the market price and the contracted price. If the generator decided not to deliver the contracted amount of electricity due to the local spot market price at the point

of delivery being negative¹ or as instructed by CENACE to manage grid reliability, the amount not so delivered is deferred until the future and is not treated as a deficiency. The generator is obligated to deliver the deferred amount at no additional cost to the offtaker, who is in turn obligated to pay for such deferred amount when delivered, and the deferred amount to be delivered by the generator is increased by 5% for each year it is deferred. Conversely if the generator delivers more electricity than the contracted amount per year the offtaker is required to pay for such excess electricity at the weighted average of the spot market price.

- If the capacity is less than the contracted capacity the generator is required to acquire replacement from a third party or to generate additional capacity at another power plant in each case from the same generation zone in which the plant is located and pay the fines that may be levied by the *Comisión Reguladora de Energía* (CRE) for deficient capacity. If the capacity exceeds the contracted capacity, the generator can freely sell such excess capacity on the market.
- For CELs, the generator is entitled to receive a CEL per each MW of electricity produced. If electricity production is deficient, Generator may defer up to 12% of the contracted CELs to be delivered to the offtaker for up to 2 years, but any CELs so deferred shall be increased by 5% for each deferred year. If after deferring for 2-years there is a deficiency in CELs, the generator must meet the contracted CEL amount by purchasing CELs in the market.

6. Adjustable Fixed Tariff

- Prices for the sale of electricity, capacity and CELs are fixed on an annual basis.
- Payments are made monthly upon invoicing by the generator on the basis of 12 equal instalments, with any adjustments made monthly by comparing the monthly instalment to the actual amount delivered in any month.
- Payments are made in Mexican Pesos and must be deposited into a Mexican account, but the generator can opt in its bid to index the amount to the Peso/U.S. Dollar exchange rate or to Mexican inflation.
- Adjustments to the tariff are made monthly to reflect Mexican inflation or Mexican Peso/U.S. Dollar fluctuations, as applicable, and an annual reconciliation of payments takes place to take into account the amount of monthly payments made, applicable penalties and transmission charges assumed by CFE.

7. Change in Law/Tax

- Change in law includes changes to or enactments of new laws or regulations, relating to electricity, environmental, customs, labor or tax laws and regulations, but excludes changes in the income tax rate.
- If a change in law results in the generator incurring higher or lower costs that cumulatively exceed 2% of the annual fixed price payable under the PPA in any year, either party may seek a price adjustment. The generator is required to propose an adjustment. Any dispute as to the proposed adjustment by the generator is to be resolved by expert determination.

8. Force Majeure and Extraordinary Events

- If a force majeure event (which covers typical force majeure type events such as wars, natural catastrophes, etc) or "extraordinary event" (which covers political force majeure events such as actions/omissions of a governmental authority, civil war or attacks against the power plant) affects either party's performance obligations for more than 180 consecutive days or 270 non-consecutive days within 18 months, the affected party may request the termination of the PPA.
- Generator may request a delay to the scheduled commercial operations date by up to 3 years due to force majeure/extraordinary events. However, even where such events are due to federal or municipal government delays, this would not entitle the generator to avoid having to increase the performance guarantee amount (see above).
- In contrast to the IPP Regime, no termination payment is to be made by the offtaker due to prolonged force majeure/extraordinary events.

9. Interconnection and Transmission

- Unlike the IPP regime, the award of the PPA does not guarantee interconnection between the generator's plant and the transmission network. A delay in interconnection attributable to a governmental authority qualifies as an extraordinary event and would entitle the generator to terminate if the delay is beyond 6 months, but the generator is not entitled to a termination payment.
- If a delay or unexpected adjustment to the interconnection process occurs,

¹ Wholesale electricity markets can sometimes result in prices below zero, i.e. where sellers pay buyers to take the power. This can arise where certain types of generators, such as wind plants or hydropower plants, cannot or prefer not to reduce output when demand is insufficient to absorb their output. Generators seeking to maintain output may offer to pay wholesale buyers to take their electricity.

the generator may extend the scheduled commercial operations date, but extensions are capped at up to 3 years.

- PPA does not directly address the consequences of a curtailment in transmission, suggesting that generators will have to rely on the applicable rules and conduct due diligence to assess the risk of curtailment in their particular circumstances.
- Delivery and sale of electricity, capacity and CELs occurs at the interconnection node between the generator's plant and the transmission network. CFE assumes the risk of price differences between the interconnection node and the transmission network.

10. Termination Regime

- Termination may occur due to (i) default by either the offtaker or generator (with some defaults not subject to a cure period and others subject to 10 or 90 day cure periods depending on the type of breach), (ii) a delay in achieving the commercial operations date by 12 months or more, (iii) delays in excess of 6 months caused by a governmental authority, the transmission or distribution entity or CENACE or (iv) a prolonged force majeure/extraordinary event (see above).
- Generator defaults that are not subject to cure and give rise to termination include failure to deliver the performance guarantees, failure to deliver the contracted products within 12 months of the scheduled commercial operations date and the loss of market participant status/generation licence. Offtaker defaults that give rise to an immediate right to termination include a failure to maintain its status as a "Basic Energy Supplier" or to renew its payment guarantee in favor of the generator, whilst payment defaults or failure to deliver the requisite payment guarantees are subject to a 10 day cure period.
- In case of a termination due to the generator's default, the offtaker shall be entitled to receive a contractual penalty equal to the value of the performance guarantee posted in favor of the offtaker at such time (see above). In addition, the offtaker has the option of continuing to receive electricity, capacity and CELs at the relevant prices set forth in the (terminated) PPA, in which case the generator is obligated to continue producing and delivering the products notwithstanding termination and the parties are to enter into the relevant agreement and legal instrument(s) to give effect to this arrangement.
- In the event of termination due to the offtaker's default, the generator must establish a payment trust in which the offtaker is to deposit upfront a lump sum amount equal to one year's worth of payments within 10 business days and then within 6 months either (i) deposit the pre-termination net present value of all remaining annual payments under the PPA for the remainder of the PPA term, or (ii) post a standby letter of credit in favor of the generator to guarantee the remaining annual payments due over the remainder term of the PPA.
- The termination amount is to be in Mexican Pesos if PPA payments were indexed to Mexican inflation or in U.S. Dollars if indexed to the U.S. Dollar/Mexican Peso exchange rate (and adjusted to reflect Mexican or U.S. inflation, as applicable).
- The termination trust will make payments to the generator if and to the extent that the amount that the generator receives from the sale of electricity, capacity or CELs in the spot

market is lower than the contracted PPA price, in which case the trust will pay the difference to the generator on a monthly basis to make the generator whole. The lenders may be direct beneficiaries of payments to be made by the trust.

11. Lender Rights

- Similar to the IPP Regime, the PPA does not prevent or require offtaker consent for the generator to create security over the power plant assets, to pledge the shares in the generator or to assign its collection or economic rights under the PPA in favor of the lenders.
- The PPA contemplates the entry into direct agreements with the lenders and to share information as to the generator's performance directly with the lenders, and requires the offtaker to notify the lenders of a default giving rise to an offtaker termination right and to give the lenders a reasonable period to cure the default, which is not to exceed 180 days.
- However, as with the IPP Regime, offtaker consent is required for enforcement of the share pledge and for the transfer of the generator's rights to a third party unless certain criteria are met (see above).

12. Governing Law and Dispute Resolution

- The PPA is subject to Mexican law.
- Technical and payments disputes are to be resolved by expert determination under the rules of the International Chamber of Commerce. All other disputes are to be subject to arbitration proceedings under the rules of the London Court of International Arbitration, with the seat in Mexico City and proceedings to be conducted in Spanish.

Appendix 1

Companies Awarded during the First Auction

	Name of company	Type of power	CELS	Electricity (MWh)
1.	SunPower Systems México, S. de R.L. de C.V.	Solar	263,815.00	269,155.00
2.	Enel Green Power México S. de R.L. de C.V.	Solar	972,915.00	972,915.00
3.	Enel Green Power México S. de R.L. de C.V.	Solar	737,998.00	737,998.00
4.	Enel Green Power México S. de R.L. de C.V.	Wind	539,034.00	539,034.00
5.	Energía Renovable de la Península, S.A.P.I. de C.V.	Wind	275,502.00	275,502.00
6.	Recurrent Energy México Development, S. de R.L. de C.V.	Solar	140,970.00	140,970.00
7.	Aldesa Energías Renovables, S.L.U.	Wind	113,199.00	113,199.00
8.	Aldesa Energías Renovables, S.L.U.	Wind	117,689.00	117,689.00
9.	Vega Solar 1, S.A.P.I. de C.V.	Solar	483,515.00	498,303.00
10.	Vega Solar 1, S.A.P.I. de C.V.	Solar	241,935.00	246,832.00
11.	Jinkosolar Investment Pte. Ltd.	Solar	277,490.00	277,490.00
12.	Jinkosolar Investment Pte. Ltd.	Solar	176,475.00	176,475.00
13.	Jinkosolar Investment Pte. Ltd.	Solar	48,748.00	48,748.00
14.	Photoemeris Sustentable S.A. de C.V.	Solar	53,477.00	54,974.50
15.	Energía Removable del Istmo II	Wind	–	585,731.00
16.	Energía Removable del Istmo II	Wind	585,731.00	–
17.	Sol de Insurgentes S.de R.L. de C.V.	Solar	60,518.00	60,965.00
18.	Consorcio Energía Limpia 2010	Wind	291,900.00	291,900.00

Appendix 2

Companies Awarded during the Second Auction

	Name of company	Type of power	CELs	Electricity (MWh)	Capacity (MWy)
1.	Alten Energías Renovables México Cuatro, S.A. de C.V.	Solar	812,417	722,044	75
2.	AT Solar	Solar	478,260	478,261	29
3.	Bluemex Power 1 S.A. de C.V.	Solar	249,982	249,982	–
4.	Comisión Federal de Electricidad (CFE)	Geothermal	198764	198764	25
5.	Comisión Federal de Electricidad (CFE)	CCGT	–	–	374
6.	Consorcio ENGIE Solar Trompezon	Solar	338,851	342,630	–
7.	Consorcio Fotowatio	Solar	779,161	779,162	–
8.	Consorcio Guanajuato	Solar	146,957	146,958	12
9.	Consorcio SMX	Solar	285,606	278,358	10
10.	Enel Green Power México S. de R.L. de C.V.	Wind	399,129	399,130	–
11.	Energía Renovable de la Península, S.A.P.I. de C.V.	Wind	–	–	30
12.	Energía Sierra Juárez Holding S. de R.L. de C.V.	Solar	117,064	114,116	–
13.	Eólica de Oaxaca S.A.P.I. de C.V.	Wind	818,264	818,265	–
14.	Frontera México Generación S. de R.L. de C.V.	CCGT	–	–	475
15.	Generadora Fénix S.A.P.I. de C.V.	Hydroelectric	314,631	–	–
16.	Green Hub, S. DE R.L. de C.V.	Solar	72,919	72,919	10
17.	HQ México Holdings, S. de R.L. de C.V.	Solar	252,444	252,445	18
18.	Kamet Energía México, S.A.P.I. de C.V.	Solar	353,466	353,466	–
19.	OPDE	Solar	289,508	289,509	–
20.	Parque Eólico El Mezquite S.A.P.I. de C.V.	Wind	774,938	820,636	77
21.	Parque Eólico Reynosa III, S.A.P.I. de C.V.	Wind	1,613,416	1,613,417	–
22.	Quetzal Energía México S.A.P.I. de C.V.	Solar	393,611	393,611	–
23.	Tractebel Energía de Altamira, S. de R.L. de C.V.	Wind	223,010	223,011	22
24.	X-Elio Energy, S.L.	Solar	363,136	363,137	30

AUTHORS



Charles Adams
Partner
T: +1 212 878 3415
E: charles.adams@
cliffordchance.com



Fabricio Longhin
Partner
T: +1 202 912 5015
E: fabricio.longhin@
cliffordchance.com



Catherine McCarthy
Partner
T: +1 202 912 5057
E: catherine.mccarthy@
cliffordchance.com



Alberto Haito
Associate
T: +1 202 912 5084
E: alberto.haito@
cliffordchance.com



Martin Menski
Associate
T: +1 202 912 5069
E: martin.menski@
cliffordchance.com



Alan Sakar
Associate
T: +1 202 912 5435
E: alan.sakar@
cliffordchance.com

CLIFFORD CHANCE

This publication does not necessarily deal with every important topic nor cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

www.cliffordchance.com

Clifford Chance US LLP, 31 West 52nd Street, New York, NY 10019.

© Clifford Chance 2018

Clifford Chance US LLP is a limited liability partnership organized and registered under the laws of the State of New York.

We use the word 'partner' to refer to a member of Clifford Chance LLP, or an employee or consultant with equivalent standing and qualifications.

If you do not wish to receive further information from Clifford Chance about events or legal developments which we believe may be of interest to you, please either send an email to nomorecontact@cliffordchance.com or contact our database administrator by post at Clifford Chance LLP, 10 Upper Bank Street, Canary Wharf, London E14 5JJ.

Abu Dhabi • Amsterdam • Bangkok
Barcelona • Beijing • Brussels
Bucharest • Casablanca • Dubai
Düsseldorf • Frankfurt • Hong Kong
Istanbul • London • Luxembourg
Madrid • Milan • Moscow • Munich
New York • Paris • Perth • Prague
Rome • São Paulo • Seoul • Shanghai
Singapore • Sydney • Tokyo • Warsaw
Washington, D.C.

Clifford Chance has a co-operation agreement with Abuhimed Alsheikh Alhagbani Law Firm in Riyadh.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.