

**Risk to Foreign Investments in the Energy sector in Mexico**

This Client Alert provides an overview of current reforms in the Energy sector in Mexico and the potential effects of such reforms on foreign investments in Mexico.

Since entering office, President López Obrador has introduced a series of measures to reform the Energy sector. Notably, in 2021, López Obrador introduced two bills intended to amend Mexico's Electric Industry Law and Hydrocarbons Law.

Continuing uncertainty as to whether these reforms will enter into force means that foreign investors should closely follow any future developments and consider now the applicable instruments that may provide protection to them under international law. Mexico's international treaties protect investments not only of US and Canadian investors (under for example, the NAFTA) but also of other foreign investors including European investors in Mexico.

**BACKGROUND**

Since President López Obrador took office in 2018, reforming the Energy sector has been one of his legislative priorities. Above all, he has pledged to review the previous energy reform package enacted by the former administration ("**Energy Reform 2013**"), as well as contracts granted to foreign investors under those earlier reforms.

Since 2019, López Obrador has taken a series of actions granting preferences to Mexico's SOEs, *Petróleos Mexicanos* (PEMEX) and *Comisión Federal de Electricidad* (CFE) and undermining the authority of independent bodies<sup>1</sup> in charge of implementing the Energy Reform 2013 and regulating the sector. In the renewable energy sector, the government cancelled long-term energy auctions, suspended pre-operation testing of wind and solar power plants, amended the rules granting Clean Energy Certificates, and issued a new reliability policy aimed at changing both the "economic dispatch" principle and open and non-discriminatory access to the grid.<sup>2</sup>

Moreover, in 2021, López Obrador issued two bills to amend the Electric Industry Law<sup>3</sup>

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<sup>1</sup> For example, the *Comisión Reguladora de Energía* (CRE), *Comisión Nacional de Hidrocarburos* (CNH) and *Centro Nacional de Control de Energía* (CENACE) are all affected by the proposed reforms.

<sup>2</sup> See Agreement issued by the Ministry of Energy establishing the National Electrical System's Reliability, Safety, Continuity and Quality Policy (the Policy), issued on 15 May 2020, available [here](#).

<sup>3</sup> The Executive branch submitted the Electricity Industry Law on 1 February 2021.

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and the Hydrocarbons Law<sup>4</sup>. The bills were approved without due consideration in the Mexican Congress and entered into force on 10 March 2021 and 22 April 2021, respectively.

The proposed reforms to the Electric Industry Law i) provide new rules for generators to access the grid, prioritizing the energy produced by CFE-owned power plants over privately-owned facilities and technologies; ii) eliminate the obligation to purchase power through auctions; iii) oblige CRE to revoke privately held supply permits; and iv) amend the rules granting Clean Energy Certificates.

The hydrocarbons reform bill provides i) minimum storage capacity requirements for permit holders; ii) the suspension and revocation of permits for non-compliance with certain requirements or “imminent danger to national security, energy security or to the national economy”; and iii) the occupation of private facilities by Pemex.

Both bills raise constitutional concerns due to the costs of compliance, legal uncertainty, threats to free competition and the granting of preferential treatment to PEMEX and CFE. As a result of such concerns, a number of operators have requested injunctions (*amparos*) to suspend their effects. Due to their unconstitutionality, the above-mentioned amendments, and some of the other actions implemented by the government, have therefore already been suspended by Mexico’s federal courts.<sup>5</sup> However, there remains substantial risk that the injunctions currently in place will be discharged, and the amendments will again become operative. President López Obrador has severely criticised these injunctions and attacked the Federal Judicial Branch. He has also recently stated that, if necessary, he will submit a bill to reform the Mexican Constitution.<sup>6</sup>

### IMPLICATIONS FOR EUROPEAN INVESTORS IN MEXICO

Mexico's amendments to the Electric Industry Law and Hydrocarbons Law are likely to impact foreign investors' investments in the energy sector and to violate Mexico's foreign investment commitments under the Free Trade Agreements (**FTAs**) and International Investment Agreements (**IAs**) which Mexico has signed.

In recent years, there has been substantial Foreign Direct Investment into Mexico’s Energy sector including by foreign investors based in Europe. These foreign investments could potentially be affected by both sets of reforms.

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<sup>4</sup> The Executive branch submitted the Hydrocarbons Law on 26 March 2021.

<sup>5</sup> The reforms to the Electric Industry Law and the Hydrocarbons Law will remain suspended indefinitely until the Mexican Courts resolve definitely all the suspensions granted.

<sup>6</sup> On 12 July 2021, President López Obrador announced he was already preparing a bill for a Constitutional reform in the Electricity sector.

If their investments are protected by an applicable FTA or IIA, foreign investors should consider Investment Arbitration as a potential remedy to mitigate any damage which may be suffered as a result of these legislative amendments. Investment Arbitration offers foreign investors an international forum to seek relief in cases where a government (such as the Mexican Government) imposes regulatory measures which damage an investor's investment in breach of international treaty obligations.

In addition to the NAFTA and the new USMCA, Mexico has signed and entered into 10 FTAs with an Investment Chapter and 30 IIAs<sup>7</sup> including 17 treaties with European States<sup>8</sup>. For example, Mexico signed and entered into a BIT with Spain in 2008<sup>9</sup> and with Italy in 2002<sup>10</sup>. These treaties could provide valuable protection in respect of European energy investments in Mexico.

Both reforms have a discriminatory and arbitrary nature, as well as a potential to deprive investors of their investments. The treaties referred to above generally include guarantees against expropriation, unfair treatment and discrimination. Foreign investors may, therefore, be able to bring claims against Mexico for breach of these guarantees.

Foreign investors who suffer damage caused by regulatory change, in breach of Mexico's international investment obligations, may be able to claim significant monetary compensation from the government as well as other remedies as part of the Investment Arbitration process.

### CONCLUSIONS

López Obrador's reforms in the Electricity and Hydrocarbons sectors threaten foreign investments in both sectors. Although these reforms are currently suspended because of injunctions imposed by the Mexican Courts, there is a real risk that these reforms will become operative again if the Mexican Government is successful in its attempts to challenge the current injunctions which are in place.

Foreign investors affected by López Obrador's reforms may have grounds to bring an investment claim against Mexico pursuant to the FTAs and IIAs signed by Mexico. Foreign

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<sup>7</sup> See Ministry of Economy, Countries with Treaties and Agreements signed with Mexico, available [here](#). Also see UNCTAD, Investment Policy Hub, International Investment Agreements Navigator (Mexico), available [here](#).

<sup>8</sup> Germany, Austria, Belgium and Luxembourg, Denmark, Slovakia, Spain, Finland, France, Greece, Iceland, Italy, Netherlands, Portugal, United Kingdom, Czech Republic, Sweden, Switzerland.

<sup>9</sup> Agreement on the Promotion and Reciprocal Protection of Investments Between the United Mexican States and the Kingdom of Spain, signed on 10 October 2006, entered into force on 03 April 2008.

<sup>10</sup> Agreement between the Government of the Italian Republic and the Government of the United Mexican States for the Promotion and Mutual Protection of Investments, signed on 24 November 1999, entered into force on 05 December 2002.

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investors should therefore now be considering the structure of their investments and whether such investments are currently covered by any applicable FTAs or IIAs.

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