

VAN BAEEL & BELLIS



**Mexico and Foreign Investment in the
Energy Sector:
Update on Recent Developments
(November 2022)**

| 8 Nov 2022

BACKGROUND

This Client Alert provides an update on our earlier Client Alert dealing with the effect of recent regulatory developments in the energy sector on foreign investments in Mexico. On 20 and 21 July, the United States (“US”) and Canada respectively commenced an amicable dispute resolution process with Mexico by requesting consultations (the “Consultations”) under [Chapter 31 of the United States–Mexico–Canada Agreement](#) (“USMCA”). The Consultations relate to Mexican President Andrés Manuel López Obrador’s (“AMLO”) recent regulatory changes to Mexico’s electric and energy sectors, which, in particular, seek to favour Mexico’s state-owned electrical utility, the Comisión Federal de Electricidad, and state-owned oil and gas company, Petróleos Mexicanos (read more about this development in our recent client alert [here](#)). The US and Canada consider that these regulatory changes are incompatible with Mexico’s commitments under the USMCA. At present, there is no outcome in relation to these Consultations, but it is reported that the consultation period which was due to expire in October 2022 has been extended.

The consultation process under the USMCA

Chapter 31 of the USMCA sets out the State-to-State dispute settlement mechanism governing disputes arising between Mexico, the US and Canada (the “Parties”) on the interpretation and application of the USMCA. This Chapter provides that consultations shall comprise the first formal dispute resolution step to reach a mutually satisfactory resolution for all Parties involved.

If these consultations fail, the next step in the dispute resolution mechanism set out under the USMCA is the establishment of a dispute settlement panel (“Panel”) to determine within six to seven months whether a Party has failed to comply with its obligations under the USMCA.¹

Since the USMCA entered into force on 1 July 2020, the Parties have initiated three other consultation processes regarding different measures.² None of the disputes in question was settled at the initial consultation stage.³

The Consultations requested by the US and Canada in July 2022

In accordance with Chapter 31 of the USMCA, the Parties agreed to hold Consultations on 23 August 2022, and were expected to resolve the dispute in question by the beginning of October 2022 (i.e. within 75 days of the requests for Consultations).⁴ However, according to various public reports, the Parties have now agreed to extend the timeline provided under Chapter 31 and to continue with the Consultations.

¹ The findings of a Panel are reflected first in an initial report, on which the Parties can comment, and then in a final Panel report that indicates whether or not a Party’s measure is inconsistent with its obligations under the USMCA or whether a benefit of the investor is nullified or impaired (i.e. as a result of the application of a measure that is not found to be inconsistent with the USMCA). However, the Parties may agree on a particular manner of resolving the dispute, which may entail the award of compensation or another remedy. If the Parties are unable to agree on how to resolve the dispute within 45 days from the receipt of the final Panel report, the complaining Party may suspend the application of benefits under the USMCA until the disputing Parties resolve the dispute.

² The Consultations mark the fourth time that the Parties requested consultations under Chapter 31 of the USMCA.

³ Two of these disputes resulted in a final Panel report, and, in the third dispute, a final Panel report is pending. For more information on these other dispute proceedings see: USMCA Secretariat, Chapter 31 Disputes, available [here](#).

⁴ Unless a different timeline for the Consultations is agreed between the Parties.

Should no resolution be achieved at the Consultations stage, the US and Canada may request the establishment of a Panel. This appears to be a likely outcome, as (i) all other consultation requests under the USMCA led to the establishment of Panels, (ii) AMLO insists that the regulatory measures giving rise to the Consultations are consistent with the USMCA, and sent a letter to President Biden addressing the differences in the Parties' interpretation of energy sovereignty following the initiation of the Consultations, (iii) AMLO publicly [stated](#) a few days after the Consultations took place that the request for Consultations was "foolish", casting doubt over the efficiency and successful outcome of the Consultations, and (iv) the extension of the Consultations occurred almost at the same time that Tatiana Clouthier, who led the talks on the Mexican side, resigned as Minister of Economy - together with the team in charge of the Consultations.

If a Panel holds that the measures introduced by the Mexican Government are inconsistent with the USMCA, Mexico will be required to align its energy policy with its obligations under the USMCA. This could be achieved, for example, by eliminating the discriminatory elements in its recently amended Electric Industry Law and Hydrocarbons Law.

Non-compliance with a decision by a Panel could lead to the US and Canada suspending Mexico's benefits under the USMCA.

The impact of the Consultations on foreign investors

Although a Panel decision will not have any direct effect on foreign investors, a Panel decision finding "inconsistency" could indirectly benefit foreign investors affected by AMLO's recent regulatory changes since it is likely that, as a result of such a finding of inconsistency, AMLO would be forced to reverse these regulatory changes.

Moreover, whilst not necessarily binding, a determination of "inconsistency" by a Panel may be highly persuasive before an investor-State arbitral tribunal where the facts underpinning the relevant investment arbitration are similar to those forming the background of the Consultations. In such a case, it is certainly possible that an investor-State tribunal would come to the same conclusion as the Panel.

Past cases under the North America Free Trade Agreement ("NAFTA") indeed suggest that an investment arbitration tribunal may well follow the same approach taken in any inter-State process. In *Cargill v. Mexico*, *Archer Daniels Midland v. Mexico*, and *Corn Products International v. Mexico*, three cases concerning tax measures imposed by Mexico on soft drinks, the investment arbitration tribunals considered, followed and agreed with the reasoning of the WTO Panel and Appellate Body, which had previously ruled that those tax measures were discriminatory, and concluded that Mexico had breached NAFTA Chapter 11 (Investment).

Separately, whilst these Consultations and the potential establishment of a Panel involve only the US, Canada and Mexico, they may still be of significant interest to foreign investors in Mexico from outside the US and Canada. Other trade agreements concluded recently between Mexico and third countries, such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership and the agreement in principle between the European Union and Mexico (which is not yet in force), as well as the thirty-one bilateral investment treaties between Mexico and third countries, contain similar obligations to those of Mexico under the USMCA.

It is therefore conceivable that a finding that Mexico's recent regulatory changes in the energy sector are in breach of Mexico's obligations under the USMCA could have a domino effect and could lead to further claims by foreign investors under treaties other than the USMCA seeking to challenge AMLO's measures. The outcome of the present Consultations should therefore not only be of interest to US and Canadian investors. Third States and their foreign investors should now be following the outcome of the present Consultations very closely.

Lawyers to contact



Nicholas A. Lawn
Partner
nlawn@vbb.com



Adriana Pérez-Gil
Associate
aperezgil@vbb.com



Helin Laufer
Associate
hlaufer@vbb.com

VAN BAEL & BELLIS

BRUSSELS

Glaverbel Building
Chaussée de La Hulpe 166
B-1170 Brussels, Belgium

Phone: +32 (0)2 647 73 50
Fax: +32 (0)2 640 64 99

GENEVA

26, Bd des Philosophes
CH-1205 Geneva
Switzerland

Phone: +41 (0)22 320 90 20
Fax: +41 (0)22 320 94 20

LONDON

5, Chancery Lane
EC4A 1BL London
United Kingdom

Phone: +44 (0)20 7406 1471