# NAFTA Negotiations: Are U.S. Energy Companies Being Left to Their Fate?

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On the campaign trail, and throughout his term in office, President Trump has not been shy to express his discontent with the North American Free Trade Agreement (NAFTA), vowing he will either renegotiate it or "tear it up." As a result, in August 2017, the United States, Canada, and Mexico (the Parties) officially began renegotiation talks in Washington D.C.

The United States, whose main goal is to reduce its goods trade deficits of about $63 billion and $12 billion (2016) with Mexico and Canada, respectively, has lately been focusing on NAFTA's dispute resolution mechanisms. The Trump Administration now aims at eliminating Chapter Nineteen, which allows the private sector to challenge antidumping and countervailing duty rulings. It has also proposed to allow Parties to opt in-on a voluntary basis-to the dispute resolution system established in NAFTA Chapter Eleven, which allows foreign investors to challenge government actions in violation of international law.

Either terminating or renegotiating NAFTA has the potential to affect several sectors of the U.S. economy. Some of the most affected companies, for example, would be those exporting natural gas to Mexico, who because NAFTA requires national treatment for trade in natural gas, benefit from a provision in the Natural

Gas Act (NGA) exempting them from certain public interest and environmental reviews.

A review of all potential effects, however, would turn out to be too great an enterprise for this article. The following sections, consequently, will focus only on the implications to American energy companies doing business in Mexico.

**NAFTA and the Energy Industry**

Under NAFTA, the Parties are required to grant national treatment to goods of another Party, and are prohibited from imposing border taxes on such goods.

NAFTA Chapters Six and Eleven are particularly relevant to this article because they address the energy industry, and the protection of investments. Chapter Six mandates Parties to award national treatment to energy goods coming from other Parties, and generally restricts the imposition of export taxes or any measure restricting imports.

Chapter Eleven, on the other hand, contains several substantive provisions protecting a company's investment by, for example, requiring fair and equitable treatment, and ordering fair compensation for nationalized property. It also gives companies from one of the Parties the prerogative to initiate arbitration against the government of the other Parties, and establishes that awards issued by Chapter Eleven Arbitral Tribunals are final and directly enforceable, meaning that such awards must be enforced by local courts as if they were final judgments of a court of that Party.

It is worthwhile to notice, however, that Mexico excluded certain Oil and Gas (O&G) activities, such as exploration and exploitation, from the scope of NAFTA (Mexico's Reservation).

**The End of an Era: Mexico's Energy Reform**

The Reservation stemmed from Mexico's tradition of resource nationalism. This sentiment was expressed in Mexico's Constitution, which established that "in the case of petroleum[] and . . . hydrocarbons no concessions or contracts will be granted. . . ." and that "the Nation shall carry out the exploitation of [hydrocarbon] products. . . ."

In 2013, however, Mexico engaged several reforms directed at allowing the

participation of the private sector in the Energy industry ("Energy Reform"). The Energy Reform allows private investors to participate in O&G activities by bidding for certain contracts, i.e., service contracts, production-sharing, profit-sharing, and licenses.

The current legal framework has, unsurprisingly, boosted American investments in Mexico. The bidding rounds for O&G contracts in Mexico have been quite a success. By 2016, bidding rounds had already secured an investment of $7 billion, which is expected to increase to $40 billion, once the final round is concluded. So far, over twenty-six international oil companies have applied for the bidding rounds, including several U.S. companies, e.g., Chevron, ExxonMobil, and Anadarko.

**A Degeneration of French Law: Mexico's Rescisión Administrativa**

Although the Energy Reform has been undoubtedly beneficial for the industry, there is one piece of legislation that might make investors lose sleep. Under the Mexican Hydrocarbons Law of 2014, the Government is entitled to resort to what is known as rescisión administrativa, which grants it the power to rescind exploration and exploitation contracts with private investors without paying any compensation. Domestic law also removes any dispute arising from such a rescission from the scope of international arbitration, thereby providing Mexican Federal courts with exclusive jurisdiction.

The rescisión administrativa, which can be triggered by limited circumstances, e.g. an unauthorized transfer of interest, has rather severe consequences, for example, the reversion of the contractual area to the Mexican government, including all assets used for the development of the corresponding fields. In other words, the expropriation of investors' rights and assets, without any kind of compensation.

The risk of expropriation is particularly relevant for energy companies doing business in Latin America. The very Petróleos Mexicanos (PEMEX), for example, is the result of the expropriation of large foreign oil investments. Another good example is the case of Argentina, which, in 1992, privatized State-owned YPF only to renationalize it again ten years later.

Rescisión administrativa, however, is not a product of the relatively new Hydrocarbons Law. It was already established in pre-reform legislation, such as in the Public Works Law of 2009. It is based on the French law institution of the

contrat administratif, as used in Mexico and in various Latin American countries. One relevant difference among such jurisdictions, however, is that French law imposes indemnification obligations on the Government, whereas the Mexican law does not, hence producing fertile ground for investment arbitration. The COMMISA case is an example of the kind of disputes that may arise in this scenario.

COMMISA, a subsidiary of the American company KBR, contracted with PEMEX for the construction of two offshore platforms in the Gulf of Mexico. Disagreements surged between the parties leading to arbitration and to PEMEX applying rescisión administrativa to the contract. Although an ICC tribunal ruled in favor of COMMISA in Mexico, the claimant could not enforce the award because it was annulled by Mexican courts, claiming that the decision was contrary to Mexican law. The award was eventually recognized by a U.S. court, claiming, among other things, that rescisión administrativa was akin to expropriation without compensation and, hence, "repugnant to United States law." This recognition, however, turned out to be a rather pyrrhic victory because PEMEX does not have sufficient assets in the U.S. on which COMMISA can enforce the award. Eventually, KBR started NAFTA proceedings against Mexico but the case was dismissed for non-compliance with the treaty's requirement to waive other remedies.

**Fear Not, For NAFTA is Here**

NAFTA has the potential to shield American energy companies from the rescisión administrativa of their exploration and exploitation contracts because NAFTA Articles 1110 and 1120 prohibit expropriation without compensation, and grant such companies access to international arbitration tribunals, respectively. These provisions trump the Hydrocarbons law because, under both Mexican law and the Vienna Convention, Mexico cannot invoke its internal law as justification for its failure to perform a treaty.

A very similar situation was discussed in the case of Occidental Petroleum Corporation and Occidental Exploration and Production Company v. Republic of Ecuador, ICSID Case No. ARB/06/11, Award (October 5, 2012). As Mexican legislation, the Ecuadorian Hydrocarbons Law provided for caducidad in cases of unauthorized transfers of interest in petroleum contracts. Occidental, nevertheless, farmed-out a 40% economic interest in its contract without the required approval, which led to the termination of such contract. An ICSID tribunal ruled in favor of Occidental deciding that, although appropriate under Ecuadorian law, caducidad

was a measure tantamount to expropriation and contrary to Ecuador's obligation to provide fair and equitable treatment to foreign investors.

Granted, Mexico´s energy reform has given birth to a number of opposing opinions as to whether Mexico's Reservation is still in force or not, which, in turn, casts some doubts as to whether NAFTA protects American energy investments in the southern nation. It is worth to notice, nevertheless, that under NAFTA Article 1108, Parties are not allowed to include NAFTA Article 1110 in their reservations. Consequently, even if Mexico's Reservation were still in place, a strong argument can be made claiming that the treaty prevents the Mexican Government from expropriating U.S. investments without being required to pay any sort of compensation.

**Caveat Investors!**

The Parties are currently in a race against time, which they do not seem likely to win. Not much consensus has been reached so far, yet they intend to conclude negotiations prior to Mexico's 2018 presidential election. The rush is produced, among other things, by an eventual victory of current front-runner Lopez Obrador, who has been characterized as a populist socialist, making the survival of NAFTA even less likely.

In the face of Mexico's rescisión administrativa, as well as the legal and political uncertainty as to NAFTA's applicability and continuity, companies investing in Mexico are well advised to carefully structure their investments, taking into account other investment protection treaties that give them the assurances that, at this time, NAFTA cannot.