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International Energy Arbitration: Is A New Wave Of 'Resource Nationalism' On Its Way?

Lee Rovinescu (Freshfields Bruckhaus Deringer LLP) · Sunday, March 4th, 2018 · Institute for Transnational Arbitration (ITA), Academic Council

The 5th Annual ITA-IEL-ICC Joint Conference on International Energy Arbitration was held in Houston last month, and the focus was on the year past and the year ahead in the arbitration of international disputes in the energy industry. From the topics discussed, predictions rendered and questions raised at the conference, attendees departed considering whether the next wave of resource nationalism – the meaning of the term itself engendering debate among conference panelists (discussed below) – would come from a North American state.

Key developments in North America: Naturally, the re-negotiation of NAFTA was an issue that received lots of attention over the course of the two-day conference, not least because the keynote address was delivered by US Department of State Senior Advisor, Richard Westerdale. The status of the negotiations and the form that investor-state dispute settlement (ISDS) will take has been the subject of much analysis by the arbitration community over the past 12 months.

While the future of NAFTA received the requisite air time at the conference, a different North American development on which (depending on your preferred source of arbitration news) the community has focused less was one of the headline points from the conference's first panel – "Mexican Energy Disputes: A New Era", chaired by Silvia Marchili with panelists Prof. Julián de Cárdenas Garcia, Cecilia Ibarra-van Oostenrijk, Raymundo Piñones de la Cabada and Gabriel Salinas. The issue is the potential impact that Mexico's July 2018 Presidential election will have on the country's energy sector. The leading candidate, Andrés Manuel López Obrador of the National Regeneration Movement (abbreviated as MORENA in Spanish) was a staunch opponent to the opening of Mexico's energy sector in 2013, and has alluded to unwinding those reforms if elected.

A look back – opening of Mexico's energy industry (2013): In December 2013, Mexico introduced constitutional amendments ending the state's monopoly over the oil and gas sector, which had persisted since the industry's nationalization in 1938. Congress voted in favor of opening the sector to private and foreign investment (the *Apertura*). The state's proven oil reserves rank in the top 15 to 20 worldwide, and so the *Apertura* created significant opportunity for foreign investors. In particular, the state sought private investment for its deep-water oil resources, as well as its shale oil and gas fields. Since then, Mexico has held at least ten tenders for private participation in the industry. According to a government website, the state has since signed 74 contracts for the exploration and extraction of hydrocarbons, with 70 different companies from 18 different countries (including Mexican companies).

The standard form contracts issued for the various bidding rounds – discussed by the panel at the conference – are publicly available. The contracts used in the more recent bidding rounds contain what Professor Cárdenas considers to be a rather unique provision acknowledging the existence of protections under investment treaties. For example, the September 2017 contract used in the third bidding round for shallow water blocks provides: "The Contractor shall enjoy the rights provided for in the international treaties to which the State is a party" (Article 27.9). During the panel discussion, Ms. Marchili asked whether such provisions confer on tribunals constituted under the contracts jurisdiction to consider treaty breaches, but the answer from the panel was that there are different possible interpretations.

As noted by Professor Cárdenas, the standard form contracts used across all of the bidding rounds have arbitration clauses that are favorable to foreign investors: arbitration under the UNCITRAL Rules, seated in The Hague (see, e.g., Article 26.5 in the standard form contract for the first bidding round for deep water blocks). However, he also noted that the contracts contain a carve-out for disputes arising from the "administrative rescission" of a contract, which are instead referred to the Federal Courts of Mexico (see, e.g., Article 26.4).

Under the standard form contracts, the National Hydrocarbons Commission (the state entity signing the contracts) may rescind a contract based on, among other grounds, a failure by the contractor to: (i) comply with a minimum work program, or (ii) make payment or deliver hydrocarbons in accordance with the contract (see, e.g., Article 23.1). Naturally, there is scope for differing interpretations on the manner in which the grounds for rescission may be applied. And, depending on the outcome of the July election, the provisions concerning administrative rescission may be brought to the fore – especially if a new Administration attempts to renegotiate or unwind the contracts and wishes to creatively avoid resolving disputes arising therefrom in an international forum (for further discussion on administrative rescission under Mexican law, see recent Kluwer blog post by Jaramillo).

A look ahead – Mexico's general election (July 2018): Predicting election results has proven to be a fruitless endeavor. Notwithstanding, the current reports are that Mr. López Obrador is the leading candidate in Mexico's July 2018 Presidential election, and that should be of interest to the international arbitration community.

Mr. López Obrador's policies were considered at the conference during a discussion on "Resource Nationalism in Emerging Markets." The panel was moderated by Sylvia Noury, and included panelists R. Doak Bishop, E. Ned Mojuetan, Kate Brown de Vejar, and Juan Carlos Boué. As mentioned above, Mr. López Obrador was an opponent of the 2013 *Apertura*, and, for the upcoming election, he has campaigned on a nationalist / protectionist agenda. He has expressed a desire to revisit the regulatory changes introduced through the *Apertura*. Ms. Brown de Vejar – who is based in Mexico City – explained that Mr. López Obrador's camp has promised respect for the rule of law, but indicated that he would still consider pursuing the renegotiation of contracts that do not align with his view of the energy sector.

Since the conference, Mr. López Obrador's intentions have become clearer. On 5 February 2018, speaking about the many contracts signed with foreign oil companies since December 2013, he was reported as saying in no uncertain terms: "We will revise all these contracts, we will not allow the oil, which is owned by the people and the nation, to go back into the hands of foreigners" (see local and international press reports).

Is a new wave of resource nationalism afoot? In Ms. Brown de Vejar's view, there is a risk that the deals that have been struck since the *Apertura* may be so vulnerable to abuse by the foreign contracting parties that there may be a call for their renegotiation irrespective of the outcome of Mexico's election. A discussion on this issue would not be complete without acknowledging the lively debate on her panel concerning the definition of *resource nationalism*. Half the panel rejected the term as being unfairly pejorative; the term, those panelists said, is used to imply that there is something improper with a state taking action to ensure that sufficient returns from its natural resources enure to the benefit of the state and its people. The other half of the panel accepted the term, explaining that it is used to refer to circumstances when a state reneges on undertakings made in contract or to induce foreign investment in order to increase government take.

In any event, whatever label is assigned to Mr. López Obrador's threat to revisit *Apertura* contracts, if he is elected, and if he does ultimately act on such threats, foreign investors certainly will consider what actions can be brought under the arbitration agreements in their contracts and/or pursuant to investment treaties in force.

This leads to an important issue of timing, and full circle to the NAFTA re-negotiation: whether the treaty will be renegotiated and agreed before Mexico's general election. Given the constitutional constraints preventing foreign investment in Mexico's energy industry when NAFTA was agreed in 1992, Mexico made a general reservation in Annex 602.3 reserving to itself the exploration and exploitation of crude oil and natural gas. NAFTA was not amended after the 2013 *Apertura* to reflect the changes in Mexico's energy policy referenced above. Meanwhile, American and Canadian companies already have signed contracts to participate in the sector. If NAFTA's renegotiation is completed prior to the election, then those companies may receive significantly better investment protection than will be available if NAFTA's renegotiations are completed under an Administration run by Mr. López Obrador.

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