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Will Mexico Lead The Next Wave of Investment Arbitration Claims?

Damián Vallejo (Cooley LLP) · Monday, August 6th, 2018 · Young ICCA

Mexico held its general elections (including presidential election) on July 1st. The Government of the country has shifted from a center-right president, Enrique Peña Nieto from the *Partido Revolucionario Institucional* (Institutional Revolutionary Party), to the favorite candidate for the recent elections, the left-wing politician Andrés Manuel López Obrador ("AMLO").

AMLO, a member of the *Movimiento de Regeneración Nacional* (National Regeneration Movement), achieved the presidency in his third run for the job. Although he started as a member of the PRI, he is now seen as a populist and a nationalist. There has been an increasingly growing fear in Mexico's business community for the past few months fueled by AMLO's lead in the polls that recently materialized with 53% of the votes. AMLO's continuous public statements and electoral promises have intensified these fears.

Among other proposals, AMLO has suggested conducting a widespread audit of the oil sector, which includes revisiting the privatization of Mexico's state owned oil company, Petróleos Mexicanos. He has also mentioned the cancellation or suspension of the latest wave of private contracts to develop the oil industry. Other electoral promises include suspending the construction of the new international airport of Mexico City, valued in over $11 billion. He has stated that contractors should not expect cancellation fees if the project is abandoned.

In light of the current political climate, foreign investors should review the foreign direct investment protections in place and determine whether it is time to restructure existing investments. Mexico is party to thirty plus bilateral investment treaties ("BITs") and a handful of other international agreements granting investment protections. A large number of these international agreements are with European Union ("EU") Member States.

Although many of the foreign investors currently operating in Mexico will probably have some degree of investment protections in place under existing BITs and free trade agreements ("FTAs"), attention should be brought to the modernization of a particular international agreement: the EU-Mexico Global Agreement. The new agreement, currently in the works, will replace the existing agreement between the EU and Mexico.

Negotiations of the EU-Mexico Global Agreement (the "Global Agreement") kicked off in May 2016. After almost two years, on 21 April 2018, Mexico and the EU reached an agreement in principle. The latest public official draft of the agreement, still under negotiation, includes some

interesting provisions in its "Investment Chapter" that foreign investors from both regions should be aware of.

The definition of "Enterprise of the EU / Enterprise of Mexico" in article 3, for example, includes a footnote whereby both parties agree that the concept of "effective and continuous link" with the economy of a European Union Member State enshrined in Article 54 of the Treaty on the Functioning of the European Union ("TFEU") is equivalent to the notion of "substantive business operations". Thus, under the current version of the agreement, a foreign investor would not be able to claim access to the substantive protections of the agreement simply by incorporating a shell corporation or holding company in the home state. Many BITs currently in place with EU Member States do not have this jurisdictional requirement.

Perhaps more importantly, Article 22 of the Investment Chapter on "Relationship with Other Agreements" provides that the new agreement shall replace and supersede all the existing investment treaties in force between Mexico and the European Union Member States listed in "Annex YY". To date, no agreements have been added to "Annex YY" and the question of which specific agreements will be effectively derogated by this new treaty remains uncertain. Nevertheless, it is safe to assume that a number of BITs and FTAs in place between Mexico and EU states will fall in this category, even though many of them include sunset clauses. This likely outcome is confirmed by paragraph 3 of Article 22, which stipulates that investors may only bring investment claims under the previous treaties when two cumulative conditions are met. First, the acts triggering the claims must have been conducted before the entry into force or provisional application of the new agreement. Second, no more than three years should have elapsed since the entry into force or provisional application of the new agreement.

The foregoing should inform foreign investors' strategies when conducting nationality planning or investment restructuring. If the current BITs/FTAs are used for investment planning, the underlying protections may not be available for the foreseeable future. This is a complex and somewhat uncertain situation as there are many variables at play that could affect the entry into force of the new agreement and its impact on foreign investment. Will Mexico sign the deal after the elections? Will the EU modify certain provisions considering the newly elected Mexican president? Both fair questions that have no clear answer at this stage.

Faced with this uncertain landscape, foreign investors may find some solace in the timeline pursuant to which other free trade agreements recently concluded by the EU have been implemented. A good example is the Comprehensive Economic and Trade Agreement between the EU and Canada ("CETA"). CETA's negotiation began in June 2007 at the EU-Canada Summit in Berlin. A final text was adopted in August 2014. Nevertheless, CETA's provisional application did not begin until the 21 September of 2017. There is thus a three-year gap between the adoption of CETA's final text and its provisional application.

Taking CETA as an example, three or more years could elapse before the new Global Agreement is rolled out. Mexico and the EU are aiming to have a final text by the end of 2018, so a provisional application of the new agreement could be expected for the beginning of 2022, at the earliest. Considering this, the aforementioned provisions of the new EU-Mexico agreement would leave the ISDS provisions form all the BITs/FTAs included in "Annex YY" without effect. Claims under such treaties or agreements could only be brought against the States if the acts triggering those claims occurred before the provisional application or entry into force of the new agreement (beginning in 2022, hypothetically), provided that no more than three years have elapsed since

such entry into force.

With this in mind, foreign investors in Mexico are left with three choices: (i) structuring/restructuring investments in the country through the international agreements currently in place, considering that the protections granted by these agreements will not be enforceable after the beginning of 2025 (provided the agreements are included in "Annex YY" of the new agreement and this is finalized); (ii) do nothing and therefore remain unprotected; or (iii) structure/restructure investments through international agreements entered into by parties which will not be affected by the new Global Agreement.

The later should leave the US and Canada outside of the equation, for the time being. Although these two countries will not be affected by the new EU-Mexico agreement, the current status of the NAFTA negotiations might also leave US and Canadian investors with no other choice but to structure/restructure investment through other jurisdictions.

It is also important to consider that the Mexican Constitution provides for a six-year presidential mandate, starting on the 1st of December of the electoral year. This implies that AMLO's mandate will extend through late 2024. Bearing this in mind, structuring/restructuring investments through international agreements currently in place might seem like a good choice after all.

Mexico is not a unique example. Foreign investors should embark in the worthwhile endeavor of analyzing which are the optimal protection alternatives for their investments in jurisdictions that have recently witnessed nationalist and populist ideas.

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