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Mexico's New Energy Sovereignty Puts the USMCA Dispute Resolution Mechanisms to a Test

Guillermo Garcia Sanchez (Texas A&M University School of Law) · Friday, November 25th, 2022 · Institute for Transnational Arbitration (ITA)

A North American energy trade war may be on the horizon. President Andres Manuel Lopez Obrador (AMLO) is backstepping the opening of Mexican energy markets by halting the issuance of permits, providing competitive advantages to state-owned enterprises, and attacking independent regulators.

The re-centralization of the energy sector is being done in the name of Mexico's "energy sovereignty." Naturally, foreign companies that invested in Mexico after the passing of the 2013 comprehensive energy reform are alleging unfair and discriminatory treatment.

Mexico's North American partners have not remained quiet. In July 2022, the Canadian and U.S. governments officially began consultation procedures over AMLO's energy policies but after seventy-five days failed to settle the dispute with Mexico. The exhaustion of the consultation period triggers the first step in the state-to-state dispute resolution mechanism set up in Chapter 31 of the United States Mexico Canada Agreement (USMCA). The results of these procedures could lead to the establishment of a panel and, if Mexico loses the case, the suspension of trade benefits.

According to some estimates, the dispute could cost Mexico $30 billion in retaliatory tariffs on Mexican goods imposed by the U.S. and Canada. The active engagement of the governments marks the first time that foreign powers retaliate against Mexico's energy policies since 1938, when Mexico expropriated foreign oil and gas companies. It also marks the beginning of a regional trade conflict–in the midst of a global pandemic, the Russian-Ukraine conflict, unsettled energy markets, and global inflation that has reached its highest levels since the 1970s.

This post will discuss how the concept of energy sovereignty impacts the USMCA energy disputes and the way in which the state-to-state proceedings can affect investors' rights.

'Energy sovereignty'

As discussed in an extensive paper on the topic of the author of this post, the term *energy sovereignty* has different meanings depending on the international actor. Energy sovereignty represents not only the eagerness of the state to secure the flow of energy products and the resiliency of the electrical grid -energy security-, but also the right of the state to determine the

origin, quality, methods of control and efficiency of those resources. As such, the exercise of energy sovereignty has different strategies depending on the overall priorities of the state in question. Some might employ government-centered approaches where the use of state enterprises and the protection of key industries, such as oil and gas, is a priority to maintain the stability of the state. Others, might rely on market-oriented approaches where access to foreign resources and the global flow of clean energy products is the best way to exercise their energy sovereignty. Both of these visions collide in international trade and investment agreements and it is up to dispute resolution bodies to balance them out.

In the context of Mexico, it is noteworthy that the companies affected have not yet filed investment claims against the regulatory changes introduced by the AMLO administration. The Mexican judiciary, so far, issued injunctions against the implementation of the legislative changes, but the discriminatory treatment against the companies remains. Moreover, under the USMCA Chapter 14 Annex E companies in the energy sector do not need to exhaust domestic remedies or spend time in Mexican courts in order to file an arbitral claim. As of the writing of this post, the AMLO administration had three notices of dispute and three active cases in the energy sector. None of these cases involve actions taken by the government under the new energy policies but rather involve discriminatory or unlawful actions taken by the state-owned enterprises and Ministries against private companies under the 2013 energy legislation. For example, in terms of notices of dispute, Talos Energy filed a notice of intent under the USMCA agreement for actions taken by the Ministry of Energy after the company failed to reach a unitization agreement with Pemex; and Gulf Investments & Services Ltd. filed a notice involving an impounded vessel by Mexican authorities as part of a criminal investigation against Oceanografia for its contractual relationship with Pemex; Monterra Energy also notified the Mexican government of the emergence of a dispute involving the seizure of its Tuxpan terminal by the National Guard in 2021 after a controversial inspection by the Energy Regulatory Commission (CRE) and the Safety and Environmental Energy Agency (ASEA).

On the side of active cases, Finley, MWS and Prize initiated an ICSID arbitration under the USMCA against Mexico for a breach of contract by PEMEX on three oilfield service contracts; Terrance Highlands filed an investment claim under the UK-Mexico Bilateral Investment Treaty for the undue care of its impounded vessels in the criminal investigation against Pemex's contractor Oceanografia; Shanara Maritime International and Marifield Ltd, also filed an investment claim under the Mexico-Panama BIT for their impounded vessels in the Oceanografia criminal investigation; finally, Servicios Petroleros Oro Negro filed an investment case under NAFTA's legacy provisions for Pemex's alleged breach of contracts involving offshore drilling platforms.

Hence, it will be in the state-to-state panels where the new Mexican energy sovereignty approach will be tested.

Potential impact of consultation procedure on ISDS

The triggering of the state-to-state dispute resolution mechanisms raises an interesting question on how the precedent set by the panels could impact future investment claims. Ultimately, this is one of the first cases in which the home states spoused investors' claims as part of the state-to-state dispute resolution proceedings. In that sense, it is worth pointing out that the investment allegations

under Chapter 14 of the U.S. and Canada consultation request only included breaches of the national treatment standard. Hence, investors could still bring claims under the fair and equitable treatment or indirect expropriation, as long as their investments are considered covered government contracts under Annex E of Chapter 14.

Notwithstanding this fact, the state-to-state panels will be analyzing the same policies that the Mexican government enacted and that affect foreign investment in the energy sector. Therefore, it is hard to imagine future investment tribunals ignoring the state-to-state panels' interpretation. In the same vein, through their briefs, Canada, Mexico and the U.S. could agree on specific interpretations of the agreement that could potentially be considered as a subsequent practice by ISDS tribunals. It is worth remembering that in the context of NAFTA, the interpretation of the Free Trade Commission after the *Pope and Talbot* decision and the parallel litigation of cases in the WTO involving the sugar industry in Mexico, had an impact in the interpretations of subsequent arbitral tribunals. Finally, Mexico could also reach an agreement to compensate the U.S. and Canada for its actions. In contrast, the treaty is silent regarding the duty of the filing states to compensate their investors using the damages paid by Mexico.

Conclusion

Overall, the storm is still forming and the Mexican government does not seem to back away from its efforts to advance its "energy sovereignty" policies. Even in light of the consultations and the threats of ISDS claims, the Mexican President is benefiting from a hostile geopolitical atmosphere. The lingering effects of a global pandemic, the war in Ukraine, the energy crisis in Europe, and the fears that Mexico will stop cooperating with U.S. officials in security and immigration issues before the midterm elections gives policy space for Mexico to double down on its effort to change its domestic energy market. The costs of retaliation are too high, and the USCMA seems insufficient to tame the temptation of forcing investors to adapt to Mexico's new energy sovereignty.

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