

KIRKLAND & ELLIS

Blog Post

The USMCA Offers Some Protections for U.S. Investments in Mexico's Energy Sector

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On July 1, the [United States-Mexico-Canada Agreement](#) ("USMCA") entered into force, replacing the generation-old North American Free Trade Agreement ("NAFTA") with a modernized trade agreement. Though the USMCA largely does away with the investor-state dispute settlement mechanism ("ISDS") that was a central feature of NAFTA, a similar ISDS system is preserved for certain U.S. investments in Mexico's energy sector.

USMCA

NAFTA conferred upon foreign investors the right to bring arbitration claims for mistreatment of their investments against the host country directly, without needing to go to domestic court or have their own government advance the claims. [Chapter 14](#) of the USMCA largely eliminates automatic ISDS as a general principle, but preserves a form of automatic ISDS as between the U.S. and Mexico with respect to investments involving government contracts in five "covered sectors": (i) oil and natural gas, (ii) power generation, (iii) telecommunications, (iv) transportation, and (v) infrastructure.

Investors with investments existing prior to the USMCA's entry into force can still bring claims under NAFTA until July 1, 2023. Canada will not be part of ISDS under the USMCA, but has an ISDS mechanism with Mexico via the [Comprehensive and Progressive Agreement for Trans-Pacific Partnership](#) ("CPTPP") that went into force in 2018.

ISDS

Four general grounds for ISDS claims are: (i) expropriation, either (a) direct (a taking) or (b) indirect (short of a taking, but with an equivalent effect); (ii) national treatment (discriminatory treatment as compared to domestic investors); (iii) most favored nation treatment (discriminatory treatment as compared to other foreign investors); and (iv) fair and equitable treatment (failure to provide a minimum standard of treatment or full protection and security).

Under the USMCA, U.S. investors may bring ISDS claims against Mexico both immediately and under all those grounds only if (i) they have investments in the covered sectors and (ii) they (or enterprises they own or control) are parties to certain contracts with parties exercising central governmental authority. If these two criteria are not satisfied, ISDS is still available, but in this case the investor (i) first must adjudicate the claims in Mexican courts for 30 months and (ii) even thereafter, may not bring claims for “indirect” expropriation, or for fair and equitable treatment.

Claims no longer covered by ISDS may still be advanced by the investor’s home country through the USMCA’s state-to-state dispute settlement mechanism.

Oil & Gas

In 2013, Mexico amended its Constitution, opening its oil and gas sector to foreign and private investment, including with respect to entering into joint venture agreements with PEMEX. Since taking office in December 2018, Mexico’s President, Andrés Manuel López Obrador (commonly known as “AMLO”), has not introduced any major changes at the constitutional or legislative levels concerning the energy sector, nor has AMLO threatened any nationalizations of energy assets or terminated any major energy contracts awarded by past administrations.

However, AMLO’s administration has implemented a series of actions, measures and policies designed to preserve and increase the market share of PEMEX (Mexico’s national oil company) and of CFE (the Mexican State-owned power utility). These developments have raised questions about the status of the energy reforms going forward and triggered concerns among foreign investors about the protections afforded to such investments.

Most Favored Nation Treatment

[Chapter 8](#) of the USMCA provides that “Mexico has the direct, inalienable, and imprescriptible ownership of all hydrocarbons in the subsoil of the national territory.” That statement could give investors pause as to the staying power of the 2013 energy reforms. However, [Article 32.11](#) of the USMCA provides that Mexico will not take measures with respect to Chapter 14 that are more restrictive than “parallel obligations in other trade and investment agreements that Mexico has ratified” prior to the USMCA.

This is instructive because Mexico’s [Annex 1](#) to the CPTPP incorporates the 2013 energy reforms, meaning that under the USMCA Mexico has taken on a most favored nation obligation to treat U.S. investors at least the same as investors from CPTPP countries. Thus, Mexico would not be able to repeal the 2013 energy reforms without risking breaching its treaty obligations under both the USMCA and the CPTPP.

As we reported, [here](#), since the 2013 energy reforms, Mexico’s oil regulator (“CNH”) has awarded 107 oil and gas exploration and extraction contracts to 73 companies from 20 countries and, as stated earlier this year by CNH’s Chair, it could soon begin auctioning interests in blocks currently held by PEMEX in order to attract partners for joint development. Under the USMCA, investments at the intersection of oil and gas and government should be eligible to benefit from ISDS under the USMCA without a requirement to first adjudicate the claims in Mexican court and without being limited by the types of claims that can be made.

Solar & Wind

As we reported [here](#) and [here](#), Mexico’s Ministry of Energy (“SENER”) and CENACE (the operator of Mexico’s power grid) have adopted several measures affecting sponsors of solar and wind power generation projects. Though at least some were undertaken expressly in the name of establishing grid security to try to mitigate the adverse effects on demand brought on by COVID-19, these measures could have a disproportionate effect on the operations of private renewable energy projects.

More recently, CFE announced [steep increases in transmission fees](#) it charges private energy producers.

Up until now, investors affected by SENER and CENACE’s measures have resorted to domestic law remedies. As [reported](#) in the Mexican press, as of June 26, parties have sought more than 150 injunctive relief (amparo) petitions from Mexico’s federal courts – a majority of which have resulted in suspension orders in favor of the petitioner. At

least one private power generator has obtained an injunction against CFE's increase in transmission fees.

The measures have also faced opposition from within the government. COFECE, Mexico's antitrust regulator, initiated a [constitutional review proceeding](#) requesting Mexico's Supreme Court to determine whether SENER's dispatch policy violates competition and market access principles protected by Mexico's Constitution. The Supreme Court [granted a temporary suspension](#) of SENER's dispatch policy pending its final ruling.

Expropriation and Fair and Equitable Treatment

SENER and CENACE's measures potentially could qualify as indirect expropriations, as they substantially diminish the value of investments in power generation projects in Mexico. The existence of a valid claim for fair and equitable treatment would depend on factors including whether the measures were imposed without due process and if private parties were adversely impacted disproportionately as compared with preferences provided to CFE.

However, it is not clear such claims could be advanced under the USMCA's ISDS. Under Annex 14-E, for power generation services to qualify as a covered sector it is specifically required that the services be provided "to the public" on behalf of a governmental authority of the host country.

Also, even if those claims were made, the USMCA may provide a defense. Chapter 14 of the USMCA provides that non-discriminatory government regulatory actions "designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment," generally will not constitute indirect expropriations. These objectives could be used to justify the actions indicated as having been undertaken in light of the COVID-19 pandemic and the stated rationale of providing grid security.

If such claims are not eligible for ISDS under the USMCA, they could be brought under NAFTA's ISDS before it is phased out.

Conclusion

The USMCA contains less protective ISDS provisions for U.S. energy investors in Mexico relative to NAFTA. U.S. investors in Mexico's oil and gas sector with contracts awarded

by CNH may find that fundamentally they can still rely on traditional ISDS to protect their investments. U.S. investors in the solar and wind sector instead may want to consider whether they can advance their claims under other investment treaties with Mexico, or under NAFTA while there is still time.

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