

KIRKLAND ALERT

January 22, 2018

Mexico Signs ICSID Convention: Briefing for Clients With Mexican Interests

Introduction

On January 11, 2018, Mexico's Secretary of Economy signed the International Centre for Settlement of Investment Disputes (ICSID) Convention on behalf of Mexico. The long-awaited signature was penned amidst growing concerns about the outcome of the upcoming presidential election in Mexico and the prospect of changes to the North American Free Trade Agreement (NAFTA), in order to blunt the effect of these developments. Once ratified by Mexico, parties with investment treaty disputes involving Mexico will then at last be able to arbitrate those disputes with the full protection of the ICSID Convention, including nearly automatic award enforceability. In light of the current climate, clients with relevant interests in Mexico should consider whether to take advantage of available protections for their investments there, which may soon include ICSID protection.

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A Changing Tide in Mexico

Despite its place as one of the 10 most active countries in investment arbitration,¹ Mexico has long been one of the few countries that are not members to the ICSID Convention, which currently has about 153 countries as its members. Mexico's decision to sign the ICSID Convention could enhance protection for companies with covered investments in that country.

The shift in policy was likely driven by two key political developments: the upcoming presidential election in July and the ongoing effort to upend the terms of NAFTA. The current frontrunner for Mexican president, Andrés Manuel López Obrador, is a left-wing candidate who has been likened to Castro, Chávez and Maduro.² Mr. López Obrador is considered a populist and nationalist, which could threaten foreign investments into Mexico, including with respect to privatization of its energy sector.³ Analysts from several news outlets have reported that the election of López Obrador would be a "disaster for Mexico" and would plunge the country into a "perfect storm."⁴ Against this backdrop, President Trump has made growing calls to terminate NAFTA, which would reduce legal protection for U.S. and Canadian companies operating and investing in Mexico.⁵

The decision to sign the ICSID Convention is an important step in preparing for such a "disaster" because it enhances protections to companies with covered Mexican investments. In its press release, the Mexican government emphasized that the signing of the Convention would bolster Mexico's reputation as a "safe, reliable and attractive country for investments" and would grant "greater legal certainty to domestic investors abroad and foreigners in our country."⁶ Analysts expect that Mexico

will take the final step to ratify the ICSID Convention before its presidential elections this July.

Why Mexico's Accession to the ICSID Convention Matters

Where available, investment arbitration protects companies investing and operating in markets that present heightened country risks such as the risk of nationalization, unfair taxes and discriminatory regulation. In many countries, traditional litigation may be an ineffective means to challenge government conduct, often because of sovereign immunity protections.

International investment treaties and free trade agreements provide protections to investors and allow them to bring arbitration claims directly against host governments that violate their commitments. Today, there are more than 3,000 international investment treaties worldwide, signed by over 150 countries. NAFTA is an example of a free trade agreement that contains provisions providing protection for cross-border investments involving Mexico, the U.S. and Canada. In order to benefit from such agreements, however, a company must be a national of one of the signatory countries. Mexico has also signed more than 30 other bilateral investment treaties, which extend similar protections to investors in its territory.

The substantive protections afforded to investors depend upon the specific treaty or free trade agreement. Most commonly, treaties and free trade agreements provide the following:

- **Protection against unlawful expropriation.** The expropriation clause provides that investors receive fair compensation in the event of a taking of property by the government.
- **Fair and equitable treatment (FET).** The FET clause provides broad protection to investors, guaranteeing that (a) the government will abide by the terms offered to investors to induce investments; (b) the investor will not be treated in a discriminatory or arbitrary fashion; (c) the government will provide a stable and predictable legal and regulatory environment for investments; and (d) domestic court processes will provide for basic protections such as due process.
- **Observation of obligations (“umbrella clause”).** The umbrella clause makes all contractual obligations of the State enforceable under the relevant treaty. The benefit of this clause is that investors can pursue an international arbitration if the State breaches a contract, which allows the investor to avoid lengthy, or even biased, domestic court proceedings.
- **Most-favored nation clause.** The most-favored nation clause provides that no investor from one country should be favored over similarly situated investors from other countries.

When the investment protections described above are breached, investment treaties enable foreign investors to seek relief through investor-state arbitration. This is a

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neutral dispute resolution mechanism that allows an investor from one country to bring an arbitration directly against the country in which they have invested. The arbitrations are administered by neutral organizations, such as the ICSID, an arm of the World Bank, or the United Nations Commission on International Trade Law (“UNCITRAL”), an arm of the United Nations.⁷

Today, ICSID is the leading dispute resolution mechanism for foreign investors seeking recourse against foreign states. Most investors opt for ICSID given its near-automatic global enforcement mechanism. In addition, ICSID is a self-contained system that prevents domestic courts from interfering with the dispute resolution process. The public nature of ICSID can lead to enhanced settlement and collection outcomes, with data suggesting that states voluntarily pay awards in about 75% of cases. For these reasons, foreign investors into Mexico could stand to benefit from Mexico’s signature, as it could enhance protection of their investments.

Mexico’s signing of the ICSID Convention is significant for all investors with cross-border investments involving Mexico. Companies with investments *into* Mexico and Mexican companies with investments *out of* Mexico could benefit tremendously from the ICSID arbitration option.

Venezuela provides an apt example of the potential benefits that investment arbitration offers to companies during an anti-foreign-investor political regime. Following the mass expropriations and discriminatory tax measures enacted by presidents Hugo Chávez and Nicolás Maduro against foreign investors, 42 companies brought investment arbitration claims directly against the government of Venezuela. Investment arbitration cases have already resulted in a reported \$5.67 billion in awards rendered in favor of foreign investors against the Venezuelan government. Given that more than one-third of cases brought against Venezuela remain pending, this number will grow in the future.

In light of the potential shift in political regime in Mexico and lingering uncertainties over the future construct of NAFTA, companies with investments or operations in that country should consider taking steps to protect their right to bring an investment arbitration should it become necessary in the future.

What Investors Can Do To Strengthen Protection of Their Investments in Mexico

Companies should start by evaluating the existing protection of their investments in Mexico. This should include consideration of available treaties and free trade agreements. U.S. and Canadian companies with investments in Mexico are likely covered by NAFTA, although threats of renegotiation and termination undermine the protection offered by that instrument. U.S. and Canadian companies should therefore be prepared to restructure their investments into Mexico in the event of a significant renegotiation or termination of NAFTA.

In light of the potential shift in political regime in Mexico, companies with investments or operations in that country should consider taking steps to protect their right to bring an investment arbitration should it become necessary in the future.

Companies with unprotected investments in Mexico are encouraged to restructure their holdings for better protection. This can potentially be achieved by creating a special purpose vehicle without modifying the remainder of the corporate structure.

The timing of such restructuring is crucial. Restructuring must take place *prior* to a dispute arising, as the growing consensus is that a restructuring cannot create jurisdiction once the specific dispute is *foreseeable* to the investor. Waiting to restructure until a dispute arises brings significant risks to an investor.

Conclusion

While Mexico's accession to the ICSID Convention enhances protection for foreign investments, it is important for companies to consider the driving forces behind it. To protect against these political forces, companies with investments or operations in Mexico should evaluate the existing protection for their investments, and consider steps to enhance such protections in light of a shifting political regime in Mexico and the possible renegotiation or termination of NAFTA.

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- 1 See Alison Ross & Tom Jones, "Mexico signs ICSID Convention," *Global Arbitration Review* (Jan. 12, 2018), available at <https://globalarbitrationreview.com/article/1152707/mexico-signs-icsid-convention>.
 - 2 See "A Risky President for Mexico," *The Washington Times* (Dec. 14, 2017), available at <https://www.washingtontimes.com/news/2017/dec/14/editorial-andres-manuel-lopez-obrador-would-be-a-d/>.
 - 3 See *id.*; see also Jorge G. Castañeda, "A Perfect Storm is Coming to Mexico," *The New York Times* (Jan. 10, 2018), available at <https://www.nytimes.com/2018/01/10/opinion/mexico-tax-nafta-lopez-obrador.html>.
 - 4 See *id.*
 - 5 See Jeff Mason and David Lawder, "Trump Says Terminating NAFTA Would Yield the 'best deal' in Renegotiations," Reuters (Jan. 17, 2018), available at <https://www.reuters.com/article/us-usa-trump-nafta-exclusive/exclusive-trump-says-terminating-nafta-would-yield-the-best-deal-in-renegotiations-idUSKBN1F703Y?il=0>.
 - 6 See Agencia de Noticias del Estado de Mexico, "Mexico Signs Agreement to Settle Differences Between Investors and States," (Jan. 12, 2018), available at <http://www.notimex.gob.mx/ntxnotaLibre/474384>.
 - 7 Before investors can avail themselves of the ICSID system, Mexico must take the final step of ratification. To do so, the Mexican government must complete internal steps to facilitate the ascension, such as approval by its Senate, and then deposit an instrument of ratification, acceptance or approval with ICSID. The ICSID Convention would then enter into force for Mexico 30 days after the date of deposit pursuant to Article 68(2) of the Convention. The process of ratification is a procedural one and 95% of governments that have signed the ICSID Convention go on to ratify the instrument.
 - 8 Each party (the government and the investor) is entitled to select one arbitrator, and the third arbitrator is selected by a neutral mechanism.

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