

Mexico faces potential 'tsunami' of arbitration cases over electricity reform

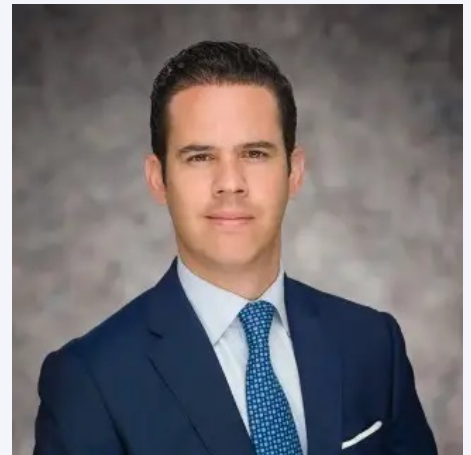


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The controversial reform of Mexico's electricity industry law could lead to a flood of arbitration cases that would weigh heavily on public finances, according to a lawyer.

The changes to the law, which give priority to dispatch from power plants owned by public utility CFE and have sparked criticism from investors, have been temporarily suspended by federal courts, with a series of appeals pending.

Opposition senators filed a measure to take the law to the supreme court to decide whether it complies with the constitution.



BNamericas spoke with Diego Durán de la Vega, partner at law firm Hughes, Hubbard & Reed in Washington, DC and an expert in international arbitration cases, about the risks involved in the process and the possibilities for foreign investors to defend themselves from the consequences of the law.

BNamericas: In view of the fact that the minority opposition in the senate decided to file a case questioning the constitutionality of the reform of the electricity industry law, how do you see this situation now the supreme court will have to rule on this reform?

Durán: There are three mechanisms in the constitution to challenge the law. The amparo [like an appeal], an unconstitutionality action and the constitutional controversy mechanism. A normal citizen like you and I can present an amparo, but not an unconstitutionality action, as that is restricted to other types of actors such as parliamentarians. At the same time, several amparo lawsuits have been filed, which are the ones that have achieved suspensions. The interesting thing is that federal judges, first a very brave one who, personally, I applaud him, because despite all the pressure he may have received before, during and continues to receive, he decided to follow his conviction and grant a suspension of the law. But it wasn't an ordinary suspension, the suspension had general effects. It applies to everyone. And we're going to see how this is resolved by the higher courts: there are interesting arguments why he did it, but there are also serious arguments against it. The federal administration decided to make moves against that judge [Juan Pablo

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Gómez Fierro], who is a federal judge, and asked the council of the judiciary and the president of the supreme court to initiate an investigation. This occurred in the context of the amparo cases. What's going to happen is that sooner or later the supreme court will rule on the validity of the reforms. I hope it will resolve this by determining that these reforms are unconstitutional, against international treaties and, therefore, cannot be valid. And with this the reform would be thrown out, and it would be a great victory for all those who don't agree with the changes to the law.

If this happens, the president has already said that he will try to enact constitutional reforms. The attacks on the private sector began many years ago and will probably survive this controversy. Before President [Andrés Manuel] López Obrador was elected, he had already made clear his position to empower the state-owned players, Pemex and CFE, and he has always been openly opposed to the energy reform of 2013-14. Before his administration began, many people had already indicated that he was going to do what he promised and difficult times were coming for the energy industry.

The administration began with administrative acts, agreements and regulations, the issuance of public policies, development plans, and as each one was being questioned by those who felt affected and suspended by the courts, it was increasing the level it used to seek its goals, and that's why we came to reforms to a law. And if they don't succeed in this way, they'll try to reform the constitution. The problem for them is that each step they go up and seek a higher norm to carry out their counter-reform, the process becomes more complex. It won't be easy to reform the constitution. There are more requirements to do so, we're in a [midterm] election year, so it's possible that they won't get the necessary votes in congress and local legislatures to pass such a reform, it depends on how well they do. That is if the court rules the reform is invalid.

BNamericas: And what happens if they decide otherwise, that the law is in accordance with the constitution?

Durán: The federal administration, since it began, has made several gestures that are relevant to investors, and not only in the electricity industry. There have also been events related to the oil and gas industry, mining, and we have also seen what happened with the international airport in Mexico City. And it has surprised all of us in the legal milieu that foreign investment interests have practically not presented investment arbitration cases in international tribunals.

This is due to the fact that the Mexican government has been very astute and has managed to reach agreements with the affected parties, so far. For now, we've not reached the point where international private interests, which are the ones that can file investment arbitration cases, feel that they have no choice but to file for arbitration. If things get to that point, then this tsunami of investment arbitration lawsuits is going to be seen. It's very likely that international tribunals will decide to condemn Mexico and a flood of convictions will come with a very important economic impact for the country.

BNamericas: If these judgments are likely to be favorable, why have investors not used arbitration cases?

Durán: Investment arbitration is usually seen as the last resort because it's expensive, takes several years, and only serves to make the state pay for the damage it caused. Through investment arbitration you won't be able to suspend a law or an administrative regulation that's affecting you. Many foreign companies with interests in Mexico are seeking advice, not only from Mexican lawyers, but also from international investment arbitration lawyers to look at their options. Most treaties say you can immediately go to investment arbitration if you suffered an impairment. They don't force you to exhaust domestic instances first. The T-MEC [free trade deal between Mexico, the US and Canada], for example, is criticized for having changed this. Before, Nafta didn't force you to exhaust domestic instances and now it does force you, although there are exceptional cases.

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In general, we have recommended to clients that, unless for some specific circumstance they have to go to investment arbitration immediately, that they exhaust their domestic resources first, because that can give them faster, less expensive solutions, and they don't involve only monetary compensation. With amparo cases, for example, you can get the reform ruled as unconstitutional and the changes suspended. This would allow them to continue operating as they did until now. But we have also told them that it's important that they do this with our advice to ensure that they don't do anything that could affect their right to eventually go to investment arbitration.

With arbitration, you assume the damage is done and ask for compensation. That's the reason why I have recommended that foreign investors keep this possibility in their back pocket. They save it for the moment when domestic actions and negotiations no longer work for them, because many of these foreign interests are looking to negotiate, nobody wants a fight with the current administration. They are well aware of the risks involved and prefer to reach an agreement.

There will come a time, either now with the electricity reforms, or with something similar that is taking place with the reform of the hydrocarbons law, or if the president wants to do something related to the mining industry, when this tsunami of investment arbitration will be seen. If the current administration doesn't change its position, sooner or later it will arrive. The private sector, and specifically foreign investment, are very close to losing patience and being cornered and having no other alternatives to defend themselves. This right that foreign investors have to sue Mexico before international courts is precisely derived from the fact that Mexico, with the objective of attracting investment to the country and promoting certain industries, signed treaties to protect foreign investment. They are long-term guarantees for investors.



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