

Author:

[E-mail](mailto:)  [Lars Markert](mailto:)[E-mail](mailto:)  [Carlotta Bruessel](mailto:)[E-mail](mailto:)  [Masaki Kawasaki](mailto:)[E-mail](mailto:)  [Benedikt Yuji Kaneko](mailto:)

*This newsletter was drafted based on information available as of 12 May 2022.

1. Introduction

This newsletter considers recent developments in the Mexican energy sector and how they might impact Japanese investors. In the last two years, the administration of Mexican President López Obrador has made repeated attempts to tighten legislative controls on international investment. These amendments stand in stark contrast to Mexico's December 2013 reform of the regulatory framework which opened the energy market to international investment and ended the then-existing state monopoly ("**2013 Energy Reform**").¹

In early 2021, the Mexican Congress passed an amendment to the Electricity Industry Law; however, the Mexican Supreme Court initially blocked its implementation.² Then, on 30 September 2021, President Obrador put a Constitutional Reform Bill before the Chamber of Deputies ("**Bill**").³ The Bill aimed at centralizing part of Mexico's energy sector by creating a state monopoly operated by the *Comisión Federal de Electricidad* (Federal Electricity Commission, "**CFE**"). These developments threatened to effectively oust private foreign electricity providers from the Mexican electricity market. The proposed amendments also considered, *inter alia*, the elimination of the independent system operator and energy regulatory agencies, and a cancellation of all self-supply and existing private power purchase agreements. Finally, the Bill proposed that CFE's electricity be dispatched first.⁴

While the Bill was ultimately defeated by the Mexican Congress on 17 April 2022,⁵ the continued efforts of the Obrador administration indicate that other attempts to reform Mexico's energy market could be imminent. It is therefore useful to examine, in Section 2, what the Bill originally proposed, as future regulation attempts

¹ Diario Oficial de la Federación, Mexico, 20 December 2013, at http://dof.gob.mx/nota_detalle.php?codigo=5327463&fecha=20/12/2013.

² A vote from the Supreme Court on the constitutional legitimacy of these amendments is expected by 7 April 2022. See S&P Global, Mexican Supreme Court decision on 2021 power sector changes expected by end of day, 7 April 2022, at <https://www.spglobal.com/commodity-insights/en/market-insights/topics/cop26-un-climate-change-conference>.

³ Constitutional Reform Bill before the Chamber of Deputies, Mexico, 1 October 2021, at <http://gaceta.diputados.gob.mx/PDF/65/2021/oct/20211001-I.pdf>.

⁴ Bloomberg, AMLO Seeks More Market for Mexico's Utility with New Reform, 2 October 2021, at <https://www.bloomberg.com/news/articles/2021-10-01/mexico-s-amlo-seeks-constitutional-change-to-electricity-laws>.

⁵ Drazen Jorgic and Dave Graham, Mexican president's contentious electricity overhaul defeated in Congress, 18 April 2022, at <https://www.reuters.com/world/americas/mexican-lawmakers-vote-presidents-contentious-electricity-overhaul-2022-04-17/>.

will likely follow the same lines. Sections 3 and 4 set out the potential impacts of any future amendments on existing contracts and potential remedies for Japanese investors to protect their investments under the international investment protection mechanisms in place between Japan and Mexico.

2. Proposed amendments

President Obrador has expressed his aim to strengthen Mexico's public companies' control of energy prices, arguing this would benefit the Mexican people and protect them from foreign corruption.⁶ In line with this, the Mexican Congress amended the Electricity Industry Law in 2021. The amendments relate to (1) the order used by the grid operator to dispatch energy from generators to benefit CFE; (2) the elimination of restrictions on CFE hydroelectric power plants from participating in the market of renewable energy certificates; and (3) the elimination of parts of the legal framework that allows companies to generate their own electricity.⁷ On 7 April 2022, the Mexican Supreme Court held by a majority vote that some parts of the Law are unconstitutional, but missed the required super majority of eight votes to invalidate the Law entirely.⁸ Most notably, CFE's planned priority access to the grid over private renewable energy projects was rejected by a seven to four majority.⁹ Two more complaints against the law are still pending and the Court will reportedly reconvene to consider these.¹⁰ In the now likely case that the 2021 Electricity Industry Law will not be invalidated altogether, those that might become affected by it will have to individually challenge its constitutionality. Such a challenge only requires a simple majority and is therefore more likely to succeed. In its decision of 7 April 2022 the Supreme did not weigh in on the question whether the reform was in accordance with Mexico's international investment protection treaties.¹¹

The second attempt at reform came in the form of proposed amendments to the Mexican Constitution, in particular Articles 25, 27 and 28, introduced through the Bill on 30 September 2021:

- All existing and pending power generation permits and power purchase agreements would be cancelled. Self-supply permits would not be recognized or would be acquired by the CFE. In the same vein, private sector energy producers' surplus supplies would not be recognized.
- Private sector participation in the energy generation process would be limited to 46% percent (with CFE proposed to generate 54%).

⁶ Economist, Andrés Manuel López Obrador's energy policy will hurt Mexico, 8 January 2022, at <https://www.economist.com/leaders/2022/01/08/andres-manuel-lopez-obradores-energy-policy-will-hurt-mexico>.

⁷ S&P Global Commodity Insights, Mexican Supreme Court decision on 2021 power sector changes expected by end of day, 7 April 2022 at <https://www.spglobal.com/commodityinsights/en/market-insights/latest-news/natural-gas/040722-mexican-supreme-court-decision-on-2021-power-sector-changes-expected-by-end-of-day>.

⁸ law360, Mexico's High Court Greenlights Reforms To Electricity Sector, 8 April 2022, at <https://www.law360.com/articles/1482419/mexico-s-high-court-greenlights-reforms-to-electricity-sector>.

⁹ Bloomberg, Mexico Supreme Court Rejects Only Parts of AMLO's Electricity Law, 8 April 2022, at <https://www.bloomberg.com/news/articles/2022-04-07/mexico-supreme-court-delivers-partial-ruling-on-amlo-s-power-law>.

¹⁰ Reuters, Mexico's top court upholds changes to power law in win for president, 8 April 2022, at <https://www.reuters.com/world/americas/mexico-supreme-court-upholds-key-element-change-power-law-2022-04-07/>.

¹¹ IA Reporter, Mexico Round-Up, 12. April 2022, at <https://www.iareporter.com/articles/mexico-round-up-supreme-court-of-justice-upholds-contested-electricity-reform-provisional-measures-requests-and-decisions-virtual-and-in-person-hearings-and-an-application-for-an-additional-award/>.

- The generation, conduction, transformation, distribution, and supply of electricity would become a strategic area of the state for which the CFE would be solely responsible. As a result, the CFE would be the only entity allowed to commercialize electricity in Mexico and would be responsible for ensuring the supply of that energy throughout the country. CFE's power would be dispatched first, followed by power generated by the private sector energy producer.
- CFE would incorporate the functions of the National Center of Energy Control, National Electric System. The functions of the Energy Regulatory Commission and the National Hydrocarbons Commission would be incorporated by the Ministry of Energy. This effectively transfers regulatory function controls over the industry to the state.
- Clean Energy Certificates, concerning emissions targets and restrictions, would be cancelled.

Pursuant to Article 135 of the Mexican Constitution, Congress has to approve any constitutional amendment by a two-thirds qualified majority. Thereafter, proposed amendments of this nature have to be approved by a majority of the State legislator and by law makers in Mexico City.¹² After much debate, the Bill was ultimately defeated by the Mexican Congress on 17 April 2022.¹³ It achieved only 275 votes (out of 500), and thus fell significantly short of the required two-thirds majority.¹⁴

3. Impact on existing contracts and steps for investors

Reforms to Mexico's energy sector as envisaged by the Electricity Industry Law and the Bill could have serious consequences for Japanese investors and their investments in the Mexican electricity market. These developments therefore require Japanese companies to assess their investments in Mexico, including contractual rights and obligations. The effects on individual investors will vary depending on the nature of their investment. In a worst-case scenario, private sector participants in the electricity generation business may be barred from supplying their generated electricity to the grid or supplying it to other private companies. This scenario could leave investors in a position where investments lose all value and a continuation of business in the Mexican energy sector would no longer be a profitable option. In addition, the impact of the reform could extend to joint-venture partners, contractors or suppliers as a result of the cancellation of supply contracts or revocation of permits.

It is therefore recommended that (Japanese) investors in the Mexican energy sector review their contractual engagements and ensure that they safeguard and stabilize existing rights and retain the possibility to operate in Mexico even in the event of a potential reform. It might become necessary for investors to re-negotiate certain arrangements with their contracting partners for these purposes. In case such negotiations are not successful, it will be important to have robust dispute resolution mechanisms in place, including arbitration agreements allowing for a neutral (and usually confidential) resolution of disputes. A review of existing

¹² Mauro Arturo Rivera León, Understanding Constitutional Amendments in Mexico: Perpetuum mobile Constitution, Mexican Law Review, Vol. 9. Issue 2., ages 3-27 (January – June 2017), at <https://www.elsevier.es/en-revista-mexican-law-review-123-articulo-understanding-constitutional-amendments-in-mexico-S187005781730001X>.

¹³ President Obrador indicated that if the Bill was to be rejected by Congress, he would file further proposed amendments to the Mexican Constitution which would focus on nationalizing Mexico's lithium resources, Financial Times, Mexican president's radical energy reform defeated in congress, 19 April 2022, at <https://www.ft.com/content/728da54c-d2c5-43ee-9943-c3e22bb43bb0>.

¹⁴ Reuters, Mexican president's contentious electricity overhaul defeated in Congress, 18 April 2022, at <https://www.reuters.com/world/americas/mexican-lawmakers-vote-presidents-contentious-electricity-overhaul-2022-04-17/>.

business structures and potential changes to them should therefore also include the analysis of existing dispute resolution mechanisms to assess all possible options.

4. Investment protection and its enforcement

In addition to contractual protections, Japanese investors are entitled to protections through international agreements in force between Japan and Mexico, namely the bilateral Agreement between Japan and Mexico for the Strengthening of Economic Partnership (“**Japan-Mexico EPA**”) and the multilateral Comprehensive and Progressive Agreement for Trans-Pacific Partnership (“**CPTPP**”). These international agreements are not mutually exclusive, and investors will have to assess which of them constitutes the ideal basis for potential claims. The investment protection provisions do not concern the contractual relationship between a Japanese investor and another private contracting partner. Rather, they protect Japanese investments against Mexican Government actions which violate the protection provisions included in the Japan-Mexico EPA or the CPTPP. In case of a violation, Japanese investors in principle will be able to claim damages directly against Mexico.

(1) Investment Protection

The Japan-Mexico EPA and the CPTPP protect investments from expropriation without compensation.¹⁵ Such protections are not only limited to direct expropriation or nationalization but can also take the form of indirect expropriation and measures that are ultimately equivalent to expropriation (for example through the revocation of permits or prohibitions on the operation of foreign private companies). The envisaged cancellation of power generation permits and power purchase agreements and the planned monopoly of the CFE might lead to situations in which Japanese investments lose all their value, without proper compensation.

Japanese investors in Mexico will also be protected through the fair and equitable treatment (“**FET**”) standard set out in the Japan-Mexico EPA and the CPTPP.¹⁶ The FET standard protects Japanese investments in Mexico against unfair and unequal treatment by the Government of Mexico. Both the Japan-Mexico EPA and CPTPP tie the FET standard to the minimum standard of treatment under customary international law. It is debated whether this is a stricter standard than the “regular” FET standard found in many other investment agreements, which usually covers (a) unreasonable, arbitrary and discriminatory treatment; (b) failure to offer a stable and predictable legal framework; (c) lack of transparency and denial of due process and justice; and (d) frustration of an investor’s legitimate expectations. The proposed Bill or any similar measures would have to be measured against those or similar standards to assess whether Mexico, by implementing its reforms, has breached the FET standard to be accorded to Japanese investors.

Japanese investors need to keep in mind that it is generally accepted that States retain a so-called “right to regulate”, i.e. the right to enact new regulations. Not every regulation changing the *status quo* will therefore violate an investment protection provision.¹⁷ However, it is highly questionable whether Mexico’s planned energy reforms will fall under the ambit of such “right to regulate”. At first glance, their main purpose seems to be turning back the clock on the 2013 Energy Reform by largely closing Mexico’s energy market to private companies and reintroducing a state monopoly. This constitutes such a drastic overhaul of the energy market that it is doubtful whether Mexico’s reforms could be considered a non-compensable regulation.

¹⁵ See Article 61 of the Japan-Mexico EPA and Article 9.8(1) of the CPTPP.

¹⁶ See Article 60 of the Japan-Mexico EPA and Article 9.6(1) of the CPTPP.

¹⁷ See the note to Article 57 of the Japan-Mexico EPA and Article 9.16 of the CPTPP.

(2) Enforcement Mechanism

The Japan-Mexico EPA as well as the CPTPP include options for Japanese investors to initiate arbitral proceedings against Mexico if it infringes investment protection provisions.¹⁸ Before an investor can initiate an investment proceeding, the investor and Mexico must attempt to settle their dispute amicably by way of negotiations (a so-called “cooling-off period”). The cooling-off period under the Japan-Mexico EPA is 180 days and six months pursuant to the CPTPP.¹⁹ The time limit after which a claim becomes time-barred is three years under the Japan-Mexico EPA and three years and six months under the CPTPP from the date the investor has or should have known that the investment protection provision has been breached.²⁰

Notably, both the Japan-Mexico EPA and the CPTPP include rules on transparency and require the publication of certain documents submitted in the arbitral proceedings.²¹ The CPTPP even expressly states that hearings should be conducted publicly. This could potentially increase pressure on Mexico to settle a dispute amicably. In the past we have observed that the prospect of an investment arbitration alone can lead to a favorably negotiated outcome for the investor. However, considering the strong rhetoric employed by Mexico’s President Obrador, this might be less likely in the case of Mexico’s energy reform. The State is also no stranger to investment-arbitrations and has been the Respondent in at least 35 known investor-state arbitrations.

Mexico and Japan have ratified the ICSID Convention and, as a result, Japanese investors contemplating bringing an investment arbitration under either the Japan-Mexico EPA or CPTPP are able to choose between arbitration under the ICSID Convention or under the UNCITRAL Arbitration Rules.²² While both arbitration rules have their distinguishing features, one of the most significant differences between the two options lies in the different enforcement procedures for arbitral awards rendered as a result of the arbitral proceedings. For ICSID arbitrations, all 157 contracting states to the ICSID Convention are obliged to enforce pecuniary obligations arising out of awards as if it constituted a court judgment of their national courts, while an award rendered as the result of an UNCITRAL arbitration may be enforced in all 169 signatory states to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the so-called “New York Convention”).

Notably, pursuant to the CPTPP it is possible to commence court proceedings in parallel to any arbitral proceeding.²³ However, this is prohibited pursuant to the Japan-Mexico EPA.²⁴

5. Conclusion

While Mexico’s 2013 Energy Reform opened its energy markets to foreign investment, the Mexican government’s current push to reverse the clock and close the market leaves foreign investors in Mexico at risk of significant losses. Investors are therefore well advised to consider how to protect their investments.

¹⁸ See Article 76(1) of the Japan-Mexico EPA and Article 9.19 of the CPTPP.

¹⁹ See Articles 77 and 78 of the Japan-Mexico EPA and Articles 9.18 and 9.19 of the CPTPP.

²⁰ See Article 81 of the Japan-Mexico EPA and Article 9.21 of the CPTPP.

²¹ See Article 94(4) of the Japan-Mexico EPA and Article 9.24 of the CPTPP.

²² See Article 79(1) of the Japan-Mexico EPA and Article 9.19(4) of the CPTPP.

²³ See Article 9.21(3).

²⁴ See Article 81.

Existing investment protection provisions between Japan and Mexico provide safeguards for Japanese investors. Potential claims for damages against the Mexican government under international treaties could be brought by way of investment arbitration. For further assistance and an introduction to the practice of investment arbitration, please feel free to contact us or to watch an exclusive [N&A webinar on investment-arbitration \(in Japanese\)](#).²⁵

In order to respond to the business needs of our clients, we publish newsletters on a variety of timely topics. Back numbers can be found [here](#). If you would like to subscribe to the N&A Newsletter, please fill out [the N&A Newsletter subscription form](#).

This newsletter is the product of its authors and does not reflect the views or opinion of Nishimura & Asahi. In addition, this newsletter is not intended to create an attorney-client relationship or to be legal advice and should not be considered to be a substitute for legal advice. Individual legal and factual circumstances should be taken into consideration in consultation with professional counsel prior to taking any action related to the subject matter of this newsletter.

Public Relations Section, Nishimura & Asahi [E-mail](#) 

²⁵ N&A Legal Forum Online, Investment Arbitration Webinar Series, at <https://www.nishimura.com/ja/seminars/LFO20210421.html>.