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Protecting RES Investments in Mexico Update on Legislative Measures

March 2021

Mexico’s electricity reform threatens foreign investments

On 10 March 2021, a controversial Electricity Reform Act (the “**Reform Bill**”) to amend Mexico’s Electric Industry Law came into force. The Reform Bill, which was submitted by Mexico’s President, Andrés Manuel López Obrador in February 2021, introduced a number of measures that favour the State company, Comisión Federal de Electricidad (“**CFE**”), to the detriment of private investors.

The Reform Bill, among other things: (i) changes the operational rules of the national grid and the priority dispatch of energy to benefit CFE’s power plants; (ii) no longer requires CFE and the grid operator to hold long-term power auctions for basic electricity supply, a policy that sought to encourage private investment; (iii) provides that clean energy certificates can be granted to all clean power generation facilities, regardless of their ownership and commercial operation date, thus diluting their value and favouring CFE’s older power plants; and (iv) revokes and changes the rules relating to privately held self-supply permits which previously benefited the country’s smaller energy companies.

The changes to the Electric Industry Law represent a reversal of the country’s energy policy. In particular, they strike a heavy blow to producers of renewable energy in Mexico, many of which had invested in the country on the basis that they would enjoy preferential access to the national grid and benefit from the clean energy certificates system.

Against this background, it is no coincidence that these changes have already generated widespread criticism among domestic and international industry players and stakeholders who are expected to seek redress from the Mexican courts. In fact, in a decision dated 10 March 2021, a district court suspended, on an interim basis, the effect of the Reform Bill. In all likelihood, the Mexican Government will seek the revocation of this suspension.

As discussed below, qualifying investors may be able to seek redress against the effects of the Reform Bill by resorting to the robust protections afforded by investment treaties concluded between Mexico and the investors’ relevant home states.

Investment treaties and protections

Mexico has concluded over 40 treaties protecting investments in the country, which include bilateral investment treaties ("**BITs**"), multilateral investment treaties ("**MITs**") and other legal instruments (in particular, free trade treaties). Many of these treaties provide a significant level of protection to the property, assets and rights (referred to in these treaties as "investments") of companies (referred to in these treaties as "investors") against sovereign risks in Mexico. These treaties include NAFTA, USMCA, the Mexico-Netherlands BIT, the France-Mexico BIT, the Germany-Mexico BIT and the Mexico-Spain BIT.

Many of these treaties grant substantive rights to investors:

- These treaties usually protect all types of assets, including shares, which have been acquired or are controlled by a company or an individual who holds the required nationality.
- In many cases, the protections include a guarantee against illegal expropriation and a prohibition from imposing disproportionate, discriminatory or arbitrary measures (the "fair and equitable treatment" standard, "**FET**"). The FET standard also protects the legitimate expectations of investors regarding the conduct of Mexico and the stability of its regulatory framework. These protections may also include a duty on Mexico to protect relevant investments from harmful acts by State bodies or third parties.
- The non-fulfilment of these obligations under these treaties gives the wronged investor the right to compensation for both wasted investments and loss of expected future profits.

The Reform Bill, in particular, may violate the FET standard**,** as it could be inconsistent with the legitimate expectations of investors in Mexico's renewable energy sector on the stability of the preferential access to Mexico's electricity grid and the system of clean energy certificates.

Procedurally, a large number of investment treaties concluded by Mexico offer significant advantages to investors:

- An investor can directly file an action against Mexico before an international arbitral tribunal.
- The parties can choose the arbitrators.
- The parties can nominate arbitrators of neutral nationalities.
- If an award is made in favour of the investor and requires enforcement, this is facilitated by the New York Convention (Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958), which is applicable to the majority of countries and, in some cases, the ICSID Convention of 1965 (to which Mexico is a party). The ICSID Convention also requires contracting States to enforce awards as if they were final judgments of that State's judiciary.

Funding disputes

The costs of pursuing an investment treaty arbitration against a State can be high due to the complex nature and duration of these proceedings. Due to the attendant costs, often times, claimants fund their dispute not themselves but by resorting to Third Party Funding ("**TPF**").

In a funded dispute, the funded party pays nothing towards legal fees as the case progresses – these are paid by a third-party funder that has no direct interest in the arbitration. When the case is successful, the funder receives its investment back, plus a pre-agreed margin that reflects the risk incurred. The funded party receives all the rest. If the case is unsuccessful, the lender receives nothing. Besides reducing the financial risks, funding preserves the company's cash flows, removes the dispute costs from the P&L and balance sheet "drag" is eliminated. Funding can also be used to protect against unpredictable adverse costs if coupled with after-the-event insurance.

Our lawyers have experience with all major funders in complex litigation and arbitration cases, including investment treaty arbitration. We advise clients on the suitability of funding, the selection of the funder and in the negotiation of the funding terms.

Clyde & Co's experience of investment treaty arbitration including against Mexico

Clyde & Co is home to one of the foremost and largest investment treaty arbitration teams in the world. We have extensive experience pursuing investment treaty claims against Mexico. At present, our lawyers based in Mexico City and London are representing the claimants in two large investment treaty arbitrations against Mexico.

In addition, our lawyers have a broad experience representing parties in treaty claims involving the renewable energy sector, arising from fact-patterns comparable to the current situation in Mexico.

Our experience includes:

- Representing a European claimant in a Euro 200+ million investment treaty claim before ICSID against Italy under the Energy Charter Treaty ("**ECT**"). This dispute relates to an investment in the solar PV sector.
- Acting in a multi-billion Euro ECT arbitration under the UNCITRAL Rules pursued by multiple European claimants in relation to an alleged investment in Spain's solar PV sector.
- Acting in an ECT arbitration under the SCC Rules for several million Euros arising from an investment in Spain's solar PV sector.
- Third-party involvement in an ECT investment treaty arbitration at ICSID. The dispute related to an investment in the solar PV sector in Italy.
- Representing German investors in ad hoc arbitration against the Czech Republic relating to retrospective changes to the renewable energy support scheme.
- Counsel for a German utility in ICSID proceedings against Spain relating to retrospective changes to the renewable energy support scheme.

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