LSU Journal of Energy Law and Resources

Volume 6
Issue 1 *Fall 2017*

3-23-2018

Mexico's Energy Regime Reforms: Rescission Risk, Mitigation, and Dispute Resolution

Becky L. Jacobs

Brad Finney

Mexico's Energy Regime Reforms: Rescission Risk, Mitigation, and Dispute Resolution

Becky L. Jacobs[*] *& Brad Finney*[**]

INTRODUCTION

In July 2017, an international consortium of energy companies from the United States, Mexico, and the United Kingdom announced a significant crude oil discovery in shallow waters off the east coast of Mexico.[1] This discovery is not only the fifth largest global oil discovery in the last five years and perhaps one of the top shallow-water fields discovered in the past twenty years, but, as "'the first offshore exploration well drilled by the private sector in Mexico's history[,]'" it has historical significance as well.[2]

This important find was made possible pursuant to recent landmark reforms to Mexico's energy legal regime that now allow foreign investors to participate in Mexico's energy sector.[3] Prior to these reforms, Mexico's energy industry was among the most tightly controlled in the world, closely associated with national sovereignty.[4] Indeed, many consider the

---

* Professor of Law, University of Tennessee College of Law. jacobs@utk.edu.

** Brad Finney, University of Tennessee College of Law, J.D. Candidate, Spring 2018.

1. Jude Webber & Nathalie Thomas, *Talos and Premier in 'Significant' Mexico Oil Discovery*, FIN. TIMES (July 13, 2017), https://www.ft.com/content/79969c16-66bb-11e7-8526-7b38dcaef614. The consortium partners are Talos Energy LLC (U.S. – 35%), Sierra Oil & Gas (Mexico – 40%), and Premier Oil PLC (U.K. – 25%).

2. *Id.*

3. *See generally* Tim R. Samples, *A New Era for Energy in Mexico? The 2013-14 Energy Reform*, 50 TEX. INT'L L.J. 603 (2016). This article will use the term "energy," but it will focus on oil and gas production. However, Mexico's constitutional reform included both the oil and gas *and* the electricity sectors and became law on December 21, 2013. Decreto por el que Se Reforman y Adicionan Diversas Disposiciones de la Constitucio n Politica de los Estados Unidos Mexicanos, en Materia de Energi a ([Decree to Amend the Mexican Constitution on Energy Matters)], Diario Oficial de la Federación [DO], 20 de Diciembre de 2013 (Mex.). A legislative package of nine new laws and a number of amendments to existing laws were drafted to implement the constitutional reforms and became law on August 12, 2014. Ley de Hidrocarburos [HL], Diario Oficial de la Federación [DO], 11 de Agosto de 2014 (Mex.).

4. *Id.* at 611.

Mexican petroleum expropriation of 1938 to be "the apogee of Mexican resource nationalism … [and] a patriotic triumph" that is celebrated as Oil Expropriation Day, a national holiday, each March 18th.[5]

Resource nationalism, sometimes expressed in its extreme form as expropriation, is a systemic risk for private international oil companies.[6] Given the historical precedent in Mexico for the use of expropriation within the energy sector, and with the recent upsurge in expropriations of foreign-owned oil assets in Bolivia, Ecuador, Russia, and Venezuela,[7] the Mexican government's approach to dispute resolution was a critical factor for foreign investors eager to take advantage of the Mexican energy reforms. While the reform package does authorize parties to exploration and production (E&P) contracts to agree upon alternative dispute resolution mechanisms, including arbitration,[8] it also contains a controversial unilateral rescission exception that could greatly impact foreign investors.[9]

This article will briefly review the history of oil production in Mexico and the governing legal regime in Part I, and in Part II, the recent reforms to that regime thereto. Part III will consider the reform's dispute resolution

---

5. Noel Maurer, *The Empire Struck Back: Sanctions and Compensation in the Mexican Oil Expropriation of 1938*, 71 J. ECON. HIST. 590, 590 (2011).

6. George Joffé, Paul Stevens, Tony George, Jonathan Lux & Carol Searle, *Expropriation of Oil and Gas Investments: Historical, Legal and Economic Perspectives in a New Age of Resource Nationalism,* 2 J. WORLD ENERGY LAW & BUS. 3 (2009). Expropriation is defined as "[a] governmental taking or modification of an individual's property rights, esp. by eminent domain[.]" *Expropriation*, BLACK'S LAW DICTIONARY (10th ed. 2014). A discussion of the nuances of the various forms of expropriation are beyond the scope of this article. This risk is present regardless of whether the foreign investor contracts directly with the host government. In fact, as one commentator noted, because international commercial law generally prohibits from recourse to host government assets, there are legal risks attendant to project contracts that implicate the host government's assets. Brandon Marsh, *Preventing the Inevitable: The Benefits of Contractual Risk Engineering in Light of Venezuela's Recent Oil Field Nationalization*, 13 STAN. J.L. BUS. & FIN. 453, 457-58 (2008).

7. Sergei Guriev, Anton Kolotilin & Konstantin Sonin, *Determinants of Nationalization in the Oil Sector: A Theory and Evidence from Panel Data*, 27 J. L. ECON. ORGAN. 301, 301-03 (2011).

8. Hidrocarburos [LH], Art. 21, Diario Oficial de la Federación [DOF], 11 de Agosto de 2014 (Mex.), *translated in* THOMPSON & KNIGHT, HYDROCARBONS LAW 12, https://www.tklaw.com/files/Publication/5f93e40d-fc4d-445c-b7f9-7dc1cc20b56e/Presentation/PublicationAttachment/9b630df7-5e9e-4e9c-a2f6-80af30e552ff/Mexico-Hydrocarbons-Law-English-Translation.pdf (last visited Oct. 24, 2017).

9. *Id.*

provisions and administrative rescission. Part IV will offer possible mechanisms by which foreign investors might mitigate the risk of administrative rescission to protect their investment in the Mexican energy sector. The final reflections of this article will focus upon the status and current success of Mexico's attempts to attract large international companies to invest significant amounts of capital and assets into Mexico's energy industry, despite concerns related to unilateral rescission.

I. HISTORY

A. Oil Production: Mexican Patrimony

Oil production is part of Mexico's cultural heritage.[10] Beginning with the Mayans and Aztecs,[11] and with the introduction of commercialized oil production in the mid-19th century,[12] hydrocarbons have become some of Mexico's most important natural resources and a source of enormous national pride.[13] Article 27 of the nation's Constitution enshrines the value of the industry, reserving to "the Mexican nation alone [the authority to] carry out all actions pertaining to the oil and gas industry without any work being performed by private companies," as well as granting to "the people of Mexico all water and land, including mineral rights."[14]

Prior to 1938, however, foreign investors had been permitted to produce oil in Mexico.[15] In fact, leading up to the mid-20th century, approximately ninety percent of the oil production in Mexico came from subsidiaries of two large foreign companies, both of which exist in some form today and are still key figures in the energy industry.[16]

---

10. Alejandro Lopez-Velarde & Philip D. Vasquez, *Historic Break with the Past: The New Foreign Investment Possibilities in the Mexican Oil and Gas Industry*, 55 NAT. RESOURCES J. 153, 154 (2014).

11. *Id.*

12. *Id.*

13. *See generally id.*

14. Constitución Política de los Estados Unidos Mexicanos, as amended, Art. 27 (pre-reform), Diario Oficial de la Federación [DO], 5 de Febrero de 1917 (Mex.). *See also id.* at 155-56.

15. *Mexican Expropriation of Foreign Oil, 1938*, OFFICE OF THE HISTORIAN, https://perma.cc/SG7L-UFTC (last visited Oct. 25, 2017). While there were fears that the 1917 Constitution might interfere with foreign oil investors operating in Mexico at the time of its enactment, the Calles-Morrow Agreement of 1928 reaffirmed the rights of oil companies to continue operations in the territories they had worked prior to 1917. *Id.*

16. *Id.* "Prior to expropriation in 1938, the oil industry in Mexico had been dominated by the Mexican Eagle Company (a subsidiary of the Royal Dutch/Shell

The oil and gas industry in Mexico grew at a substantial rate, and in the 1920s, Mexico became the second largest producer of oil in the world.[17] Yet, political unrest and animosity towards the large foreign oil companies mounted within Mexico; foreign producers exported the vast majority of the oil, retaining only a small fraction of the profits from their Mexican production within the country's borders.[18]

These issues reached a boiling point when Mexican labor unions sought higher wages from the foreign oil producers.[19] In 1938, Mexico's President, Lazaro Cårdenas, attempted to negotiate a settlement between striking oil workers and the oil companies. However, after the oil companies rejected settlement attempts and ignored both a government commission and an order from the Mexican Supreme Court, President Cårdenas expropriated the assets of these foreign oil companies through a decree dated March 18, 1938.[20] Mexico eventually agreed to compensate most of the companies with assets seized by the government, and conventional wisdom is that Mexico "did not pay the full value of the oil deposits . . . . In fact, [it compensated] only a third of total property values[.]"[21]

Following the expropriation of these assets, Mexico's State-owned oil company, Petróleos Mexicanos, more commonly referred to as Pemex,[22] was established.[23] After the creation of Pemex, and until the reforms in 2013, Mexico relied almost completely upon Pemex for the exploration, production, and distribution of oil and gas within Mexico and upon the revenue from its export.[24]

Company), which accounted for over 60% of Mexican oil production, and by American-owned oil firms including Jersey Standard and Standard Oil Company of California (SOCAL – now Chevron), which accounted for approximately 30% of total production." *Id.*

17. *Id.*

18. *Id.*

19. *See id.*

20. *See id.*

21. Lorenzo Meyer, *The Expropriation and Great Britain, in* THE MEXICAN PETROLEUM INDUSTRY IN THE TWENTIETH CENTURY 169 (Jonathan Brown & Alan Knight eds., 1992). For a very different economic analysis of the expropriation, *see* Maurer, *supra* note 5.

22. When referring to Pemex throughout this article, the author may be referring to one or more of its many subsidiaries in order to avoid wordiness and/or unnecessarily complicated explanations unrelated to the primary focus of this analysis.

23. *See* Dallas Parker et al., *Mexico: A New Frontier: Mexico's Energy Reform*, MONDAQ (June 5, 2014), https://perma.cc/78PT-USBH; Lopez-Velarde & Vasquez, *supra* note 10, at 155-56.

24. *See* Lopez-Velarde & Vasquez, *supra* note 10, at 155-56.

B. Toward Reform

Despite what one academic has called the nation's "Pemex Pride," or the symbiotic relationship between oil and Mexican national identity,[25] steep declines in oil production, weak gross domestic product (GDP) growth in the Mexican economy, and years of capital underinvestment coupled with a lack of available capital[26] put pressure on the government to reconsider its restrictive legal regime in order to attract foreign investment and capital to the energy industry. During the latter part of the 1990s, serious discussions began regarding private company participation in the energy industry.[27] These discussions started to gain traction.

The discussions led to actual change in 2008 when the Mexican government modified its regulations to permit Pemex to enter into "integrated service contracts" with private companies.[28] The incentives in these integrated service contracts were limited to bonus payments based upon predefined production targets: standard industry contracts, concessions, and production/profit sharing agreements were still prohibited.[29] Although these modifications were significant as they reflected a paradigm shift in the government's approach to its energy resources, they had limited impact, largely because they failed to address the need for more meaningful private company incentives and involvement in both upstream and downstream activities.[30]

It became clear that more significant reform might be required when, in 2004, the amount of oil and natural gas produced in Mexico began to fall, with oil production ultimately declining by approximately one million barrels per day.[31] This drop in production was not due solely to a lack of demand as there was, simultaneously, an increase of oil imports into Mexico.[32] By 2012, nearly half of the oil in Mexico was imported, nearly double that imported in the late 1990s.[33]

---

25. Megan McDermott, *Pemex Pride: The Symbiotic Relationship Between Oil and Identity in Mexico* (Oct. 2, 2014), https://perma.cc/D8W3-XDJB.

26. *See* Lopez-Velarde & Vasquez, *supra* note 10, at 155-56.

27. *See id.*

28. *Id.* at 156.

29. Tim R Samples & José Luis Vittor, *Energy Reform and the Future of Mexico's Oil Industry: The Pemex Bidding Rounds and Integrated Service Contracts*, 7 TEX. J. OIL GAS & ENERGY L. 215, 227, 229 (2012).

30. *See* Lopez-Velarde & Vasquez, *supra* note 10, at 156.

31. Richard H.K. Vietor & Haviland Sheldahl-Thomason, *Mexico's Energy Reform*, HARV. BUS. SCH. CASE 717-027, at 3 (Aug. 2017).

32. *See* Lopez-Velarde & Vasquez, *supra* note 10, at 156.

33. *Id.* at 156-57.

Decreasing Pemex revenues also drove the reform agenda. Capital constraints resulted in a lack of investment in maintenance and infrastructure in company assets. They also dramatically reduced the company's contribution to the national budget.[34] The Mexican economy was heavily dependent upon its energy industry, e.g., Pemex's revenue totaled approximately one third of the entire budget of the Mexican government throughout its history as a national monopoly.[35]

These conditions created the political space for the dramatic reform that resulted in the energy bill signed by President Enrique Peña Nieto in 2013 that completely reformed Mexico's energy industry by amending many articles of the Mexican Constitution.[36] This reform, among other important features, allows for private investment in the downstream, midstream, and upstream sectors and ends Pemex's monopoly of the oil and gas industry.[37]

II. THE REFORM

A. An Overview

The sweeping changes made to the legal regime governing Mexico's energy industry are an amalgam of, among others, the new Hydrocarbons Law, amendments to Articles 25, 27, and 28 of the venerable Mexican Constitution of 1917,[38] and to existing regulations.[39] These changes opened

---

34. *See Mexico - Competition from State-Owned Enterprises*, *Mexico Country Commercial Guide*, U.S. DEPARTMENT OF COMMERCE - INTERNATIONAL TRADE ADMINISTRATION, https://www.export.gov/article?id=Mexico-Competition-from-State-Owned-Enterprises (last updated Oct. 3, 2016).

35. *See id.*

36. *See id.*

37. *See id.*

38. Constitucion Politica de los Estados Unidos Mexicanos, 5 de Febrero de 1917, Arts. 25, 27, 28 (Mex.).

39. *See* Leopoldo Olavarría & Ryan Keays, *Mexico Approves Energy Reforms*, NORTON ROSE FULBRIGHT (Aug. 2014), https://perma.cc/5DRE-LBE6; Arturo de la Parra, Mauricio Llamas & José A. Estandía, *Mexico's New Regulatory Framework for Oil and Gas*, JONES DAY (Sept. 2014), http://www.jonesday.com/mexicos-new-regulatory-framework-for-oil-and-gas/. A detailed account of all new legislation and of the laws that required amendments in order to implement the energy reforms is beyond the scope of this article; the undertaking was truly monumental.

the Mexican energy industry to private foreign investment.[40] This dramatic transformation is one for which foreign investors had long hoped.

Reform of laws governing the exploration and production of hydrocarbons has generated the most interest from investors.[41] The new law mandates that E&P contracts be awarded through a competitive, transparent bidding process, in which Pemex must compete with participating private companies.[42] However, even if Pemex wins the auction, or if it is given a right to explore or produce through an asignacione, an entitlement to these oil fields that is a part of the holdover from the previous law, other entities may still have an opportunity to be involved in the activity.[43] Pursuant to the new law, regulatory agencies have discretion to select from several contractual arrangements with varying risk profiles, including license agreements, production sharing agreements, profit sharing agreements, and service contracts.[44]

The new law converts both Pemex and the Federal Electricity Commission to "State Productive Companies," the purpose for which is generating profits and creating value for their owner, the Mexican government.[45] Although State-owned, these entities are designed to operate as independent businesses, autonomous in terms of the management and budget decisions made by their respective boards of directors.[46]

The reform did not tamper with one fundamental aspect of Mexico's "Pemex Pride:" Article 27 of the Constitution preserves the sovereign's unequivocal ownership of all subsoil hydrocarbons.[47] While some have

---

40. *See* Diane Villiers Negroponte, *Mexico's Energy Reforms Become Law*, BROOKINGS (Aug. 14, 2014), https://perma.cc/9XSQ-LQ6S [hereinafter Negroponte, *Mexico's Energy Reforms*]; la Parra, Llamas & Estandía, *supra* note 39.

41. *See Mexico Energy Reform Resource Center and Americas Colloquium, Mexico Energy Reform*, HAYNES BOONE, https://perma.cc/9DCA-WXFX (last visited Oct. 25, 2017).

42. LH art. 5, DOF 11-08-2014 (Mex.). *See also* Olavarría & Keays, *supra* note 39; la Parra, Llamas & Estandía, *supra* note 39; Negroponte, *Mexico's Energy Reforms, supra* note 40. *See also* Diane Villiers Negroponte, *Mexico's Secondary Law Provides a Path Forward for New Investments in the Hydrocarbons Sector*, BROOKINGS (June 25, 2014), https://perma.cc/PV3Q-9PYA.

43. *See* John B. McNeece & Michael S. Hindus, *Mexico's Energy Reform Provides Significant Opportunities in Oil and Gas Exploration and Production*, PILLSBURY WINTHROP SHAW PITTMAN (Aug. 28, 2014), https://perma.cc/KY9A-7LDA.

44. *See generally* Samples, *supra* note 3.

45. *Id.*

46. *Id.*

47. Constitución Política de los Estados Unidos Mexicanos, CP, Article 27, Diario Oficial de la Federación [DOF] 05-02-1917, últimas reformas DOF 10-02-

argued that this might present accounting complications for foreign investors attempting to present accurate reserve figures,[48] Article 27's clear focus on "subsoil" hydrocarbons, a distinction that did not appear prior to the 2014 amendment, may provide the government with avenues for legal transfers or assignments after extraction.[49]

B. Further Changes on the Horizon for Mexico's Energy Industry

As mentioned above, Pemex's deteriorating financial condition was one of the primary causes of the sweeping reform in Mexico's energy industry.[50] Although it has improved since the reform took effect, the company is still confronting financial challenges.[51] From 2015 to 2016, Pemex had nearly an eight percent reduction in total assets and a total net income loss of over $9 billion in the fourth quarter of 2015 alone.[52] Pemex reduced its number of employees by approximately ten percent due to budget cuts of roughly $5.7 billion, and it is likely that Pemex will continue to lay off employees.[53] This poor financial situation could lead to further industry restructuring, including strategic changes regarding Pemex's use and investment of assets and an overhaul of its tax treatment.[54]

2014, http://www.oas.org/juridico/mla/en/mex/en_mex-inttext-const.pdf (retaining, then repeating, the existing constitutional assertion of State sovereignty over subsoil resources).

48. James L. Sweeney et al., *North American Energy*, *in* NAFTA AT 20: THE NORTH AMERICAN FREE TRADE AGREEMENT'S ACHIEVEMENTS AND CHALLENGES 99, 112-14 (Michael J. Boskin ed., 2014). These authors have drawn a comparison to Canada's E&P structure, under which private companies are authorized to explore and produce hydrocarbon reserves, but the Canadian provinces retain ownership of subsoil oil. *Id.*at 114.

49. Diana Villiers Negroponte, *Mexican Energy Reform: Opportunities for Historic Change*, BROOKINGS (Dec. 23, 2013), https://perma.cc/9P8F-TV8Q.

50. *See Mexico - Competition from State-Owned Enterprises*, *supra* note 34.

51. *See id.*

52. *See* Nacha Cattan, Adam Williams & Eric Martin, *Mexico Gives Pemex Tax Break Worth $1.5 Billion*, SALT LAKE TRIB., Apr. 14, 2016, at 13C1, 13C4, https://perma.cc/2ZLB-RYV3; *Mexico - Competition from State-Owned Enterprises*, *supra* note 34.

53. *See id.*

54. *See* David Alire Garcia, *Mexico to Keep Pumping Pemex for Tax Money Despite Promised Reforms*, REUTERS (Oct. 30, 2013), https://perma.cc/5ACA-DBB2; Turanzas, Bravo & Ambrosi, *Mexico: Energy Reform – Chapter III: PEMEX Tax Regime*, MONDAQ (June 30, 2015), https://perma.cc/J39M-G2AC; *Mexico - Competition from State-Owned Enterprises*, *supra* note 34.

The company's financial condition has impacted its operational strategy.[55] As its financial situation has weakened, Pemex appears to have abandoned plans to develop promising oil fields to which it had exclusive development rights.[56] Rather than moving forward with new development, Pemex's strategy appears to be identifying, focusing on, and improving its most profitable operating assets, eschewing high risk/longer time horizon fields with great potential.[57] While its focus on efficiency reduced Pemex's net losses by nearly sixty percent in 2016, this strategy may decrease the company's overall revenues, particularly longer term.[58]

Many industry experts have considered how the company might improve its financial outlook.[59] One idea addresses the negative impact of the Law of Hydrocarbon Revenues on Pemex's allowable tax deductions.[60] For example, in the first quarter of 2015, expenses reached over 200% of returns on operation because, under current law, Pemex is prohibited from fully deducting actual expenses.[61] That deduction is calculated based upon a percentage of the crude oil price, a factor that does not always fluctuate in the same manner as operation costs.[62] Thus, Pemex is unable to deduct expenses in the same way as can a private competing company.[63] One of the solutions currently proffered is for the Mexican government to amend the Law of Hydrocarbon Revenues to level the playing field by allowing for Pemex to deduct closer to the amount of its actual operating costs and expenses.[64] This seems to be a simple, yet effective, way to solve this problem and to improve Pemex's bottom line.[65]

This tax issue and the proposed solution present an interesting dilemma for private industry.[66] On one hand, Pemex's current financial difficulties are creating opportunities for its competitors.[67] The State company's withdrawal from several potentially lucrative development opportunities opens these prospects to private investors.[68] Conversely, a

---

55. *See Mexico - Competition from State-Owned Enterprises*, *supra* note 34.
56. *See id.*
57. *See id.*
58. *See id.*
59. *See id.*
60. *Id.*
61. *Id*. *But see* Negroponte, *Mexico's Energy Reforms, supra* note 40.
62. *Mexico - Competition from State-Owned Enterprises*, *supra* note 34.
63. *See id.*
64. *See id.*
65. *See id.*
66. *See id.*
67. *See id.*
68. *See id.*

financially unstable Pemex that consistently loses billions of dollars per year is not a particularly attractive business or joint venture partner.[69] Investors seek reliable partners, those willing and able to cover their share of costs and safely assume risk when investing in high risk/high reward E&P projects but with longer-term production horizons.[70] That same dilemma is likely present regarding any number of potential reform issues that may affect Pemex.[71]

III. DISPUTE RESOLUTION UNDER THE HYDROCARBONS ACT

A. Article 21

The specters of Mexico's 1938 expropriations and of the more recent nationalizations in the region are ever-present for foreign investors seeking entry to Mexico's energy sector. The 2013-2014 reforms attempt to alleviate concerns regarding similar "capricious government action."[72] Article 21 of the Hydrocarbons Act specifically authorizes parties to E&P contracts to agree to utilize arbitration and other alternative dispute resolution mechanisms as provided in the Mexican Commercial Code, which incorporates the UNCITRAL Model Law on International Commercial Arbitration, and the relevant international treaties to which Mexico is a party, such as the Inter-American Convention on International Commercial Arbitration.[73] Should E&P contracting parties choose arbitration, Article 21 imposes three explicit conditions upon arbitral proceedings and agreements: (1) Mexican federal laws must be the applicable law; (2) the arbitration must be conducted in Spanish; and (3) the award shall be based upon applicable law and shall be final and binding for both parties.[74]

---

69. *See* Olavarría & Keays, *supra* note 39; la Parra, Llamas & Estandía, *supra* note 39.

70. *See Mexico - Competition from State-Owned Enterprises*, *supra* note 34.

71. *See id.*

72. Kyle Doherty, Comment, *From "The Oil Is Ours!" to Liberalization: Resource Nationalism and the Mexican Energy Reform*, 53 HOUS. L. REV. 245, 260 (2015).

73. Hidrocarburos [LH], Art. 21, Diario Oficial de la Federación [DOF], 11 de Agosto de 2014 (Mex.); Inter-American Convention on International Commercial Arbitration, June 16, 1976, 1438 U.N.T.S. 245. *See* Alejandro Escobar, *The Mexican Oil & Gas Reforms: Arbitration and Dispute Resolution in the 2014 Mexican Hydrocarbons Act*, 2 ROCKY MTN MIN. L. FOUND. 13C-1, 13C-12 (2015) (referring to Código de Comercio, Arts. 1415-1480).

74. Hidrocarburos [LH], Art. 21, Diario Oficial de la Federación [DOF], 11 de Agosto de 2014 (Mex.).

Article 21's most significant limitation, however, is its exclusion of disputes regarding unilateral administrative rescission by Mexican regulators from any form of alternative dispute resolution, reserving to the federal courts exclusive jurisdiction over those disputes.[75] Pursuant to Article 20 of the Hydrocarbons Law, the Mexican Executive Branch, through its Comisión Nacional de Hidrocarburos, or National Hydrocarbons Commission (CNH), may unilaterally rescind an E&P contract under the following enumerated circumstances: (1) the contractor does not commence, or suspends, the planned E&P activities without due cause or approval from the CNH for a continuous period of more than 180 days; (2) the contractor fails to comply with the minimum work commitment; (3) the contractor assigns, totally or partially, the operation or the rights conferred in the E&P agreement without the prior approval of the CNH; (4) the contractor's willful misconduct or negligence causes a serious accident which damages infrastructure or causes a fatality or loss of production; (5) the contractor, willfully or without cause, provides false or incomplete information or fails to disclose to the relevant authorities information regarding production, costs, or any other relevant aspect of the contract; (6) the contractor fails to comply with a final resolution of any federal jurisdictional entity having res judicata effect; or (7) the contractor fails, without cause, to make any payment or delivery of hydrocarbons to the Mexican State in accordance with the time periods and terms established in the contract.[76]

Although arbitration and other forms of dispute resolution are explicitly allowed and encouraged by Article 21 of the Hydrocarbons Act, any and all disputes that relate to the government's unilateral administrative rescission are explicitly excepted from being submitted to these processes.[77] The Executive prerogative to unilaterally rescind the contract combined with the contractor's inability to submit such issues to arbitration is likely concerning for many potential investors, particularly those from jurisdictions with a

---

75. *Id.*

76. Hidrocarburos [LH], Art. 20, Diario Oficial de la Federación [DOF], 11 de Agosto de 2014 (Mex.), *translated in* THOMPSON & KNIGHT, HYDROCARBONS LAW 11-12, https://www.tklaw.com/files/Publication/5f93e40d-fc4d-445c-b7f9-7dc1cc20b56e/Presentation/PublicationAttachment/9b630df7-5e9e-4e9c-a2f6-80af30e552ff/Mexico-Hydrocarbons-Law-English-Translation.pdf (last visited Oct. 24, 2017). *See also* Escobar, *supra* note 73, at 13C-7-9; Olavarría & Keays, *supra* note 39.

77. Hidrocarburos [LH], Art. 21, Diario Oficial de la Federación [DOF], 11 de Agosto de 2014 (Mex.); Escobar, *supra* note 73, at 13C-7.

common law tradition.[78] Article 20 appears to seek to somewhat temper the discretion granted to the Executive Branch by limiting the scope of these rather broadly-worded rescission triggers to "las causas graves," or serious causes.[79] When one considers several of the "serious causes" specifically set forth in Article 20, such as failing to make a payment with no peso or dollar floor below which the rescission would not be appropriate, the limiting phrase itself is quite ambiguous, if not entirely meaningless.[80]

B. Dispute Resolution in the Model E&P Contracts

The language of Articles 20 and 21 left many questions unresolved for investors as to the Mexican government's vision regarding dispute resolution under the Hydrocarbons Law. Analysis of the Model Contracts published as part of Mexico's inaugural post-reform, deep-water tender open to private sector investors provides some insight.[81] This "Ronda," or round, of bidding involved exploration and production in ten deep water oil fields in the Gulf of Mexico with a total reserve potential of up to eleven billion barrels, including the tender to participate with Pemex in the deep water 'Trion' field.[82]

While, as discussed in Part II, the reform approved four contract structures for E&P agreements, i.e., license, production sharing, profit sharing or service, the form utilized in this bidding round was a license.[83] The relevant provisions of the Model Contracts appear in Articles 23 and 26.[84] Article 23 sets forth the conditions both for administrative rescission in Article 23.1 and for a separate right of termination for breach in Article

78. *See id.* Mexico's legal system, laws, and Constitution, however, were influenced by French and Spanish law, the traditions of which customarily granted the Executive Branch the power to change the conditions of, or completely rescind a contract.

79. Hidrocarburos [LH], Art. 20, Diario Oficial de la Federación [DOF], 11 de Agosto de 2014 (Mex.).

80. *Id.*

81. Alejandro Aurrecoechea, *Mexico's Deep-Water Oil Round: The Time Of Truth For Energy Reform?*, FORBES (Dec. 1, 2016), https://perma.cc/8K38-WF3N.

82. *Id.*

83. Contrato para la Exploración y Extracción de Hidrocarburos Bajo la Modalidad de Licencia (Aguas Profundas), COMISIÓN NACIONAL DE HIDROCARBUROS (Model Contracts) (Aug. 31, 2016), http://rondasmexico.gob.mx/l04-ap-contratos/. There were two Model Contracts: one for individual entities and another for consortia. *Id.* Because the provisions governing dispute resolution and administrative rescission are identical in both Models, this article will not distinguish between the two versions.

84. *Id.* at Arts. 23, 26.

23.4.[85] While the circumstances warranting rescission enumerated in Article 23.1 generally mirror those in the Hydrocarbons Law,[86] Article 23.1 contains several additional definitions that appear to be attempts to provide more clarity regarding "rescissive" circumstances, perhaps to reassure private international entities expressing hesitation about investing under such insecure legal conditions.[87]

While an exhaustive analysis of these provisions of the Model Contracts exceeds the scope of this article, a brief summary of several of Article 23.1's more interesting supplementary definitions is relevant. For example, Article 23.1(d)'s "Accidente Grave," or Serious Accident, is further defined as requiring three listed conditions in the conjunctive, i.e, damage to the facilities, loss of life, or loss of production,.[88] Other clarifications pertain to the legal terms of art "Sin Causa Justificada,"[89] or without just

85. *Id.* at Arts. 23.1, 23.4. The justifications for contractual termination are set forth in Article 23.4 of the Model Contracts. Although there was substantially similar language in several of the grounds warranting Article 23.1's administrative rescission and Article 23.4's contractual termination, such as Work Plan delays, the final published draft, dated August 31, 2016, appears to have resolved much of this duplication, eliminating at least a significant source of potential ambiguity and conflict. *See* Model Contracts, *supra* note 83.

86. *See supra* text accompanying note 8.

87. Fernando Cano-Lasa, *Mexico Energy Reform: Dispute Resolution for Operations Facing Administrative Rescission of Their Exploration and Production Agreements*, 39 HOUS. J. INT'L L. 5, 25-26 (2017).

88. Art. 23.1(i), Model Contracts, *supra* note 83. "Damage to the Facilities" also is further defined as a situation "that prevents the Contractor from carrying out the Petroleum Activities in the Contract Area during a period exceeding ninety (90) Days as of the accident occurs[,]" as is "loss of production," which "implies any uncontrolled destruction or leak of Hydrocarbons, equal or higher than ten thousand (10,000) barrels of equivalent crude oil; different from the vented, flared and discharged under standard operating conditions during the performance of the Petroleum Activities conducted under the Best Industry Practices and the Applicable Laws. If the accident occurs during the Exploration Period, any Oil or Condensates spill or Natural Gas leak shall be considered as Loss of Production." *Id.* at art. 23.1(i)(1), (3). "Información o Reportes Falsos o Incompletos," or False or Incomplete Information or Reports, also has an expanded definition in Article 23.1(v), requiring that they be "contrary to the truth or deliberatively insufficient in such a way that the minimum necessary elements . . . cannot be [ascertained] . . . according to their nature and purpose, and presented with the deliberate intent to deceive the CNH or any other Governmental Authority in order to obtain an undue benefit that would have come as a result of the submission of truthful and/or complete information." *Id.* at art. 23.1(v).

89. Translated, "[a]ny cause attributable without any doubt to the Contractor . . . ." *Id.* at art. 23.1(ii).

cause; "Culpa,"[90] or fault; and "Dolo o de Forma Dolosa,"[91] or willful misconduct, none of which provide the level of certainty that likely would assuage investor concerns about legal risks associated with administrative rescission.

In addition to these definitional clarifications, CNH created a procedural framework that may provide reassurance to investors that the Commission will not invoke the rescission clause imprudently. Article 23.2 provides for a mandatory investigation period of not less than thirty days and not more than two years.[92] During this time, the contractor shall guarantee the continuity of the E&P activities so long as they are safe and technically viable.[93]

Should CNH determine that just cause for rescission exists, Article 23.3 establishes the administrative process.[94] Briefly, CNH is required to provide written notice to the contractor of the cause or causes invoked, after which the contractor has thirty days to respond.[95] Within the next ninety days, CNH must evaluate the contractor's arguments and evidence and seek approval within its formal governance structure before rescission.[96] Most relevantly to this analysis, Article 23.3 mandates that all disputes regarding administrative rescission shall be resolved exclusively by the federal courts of Mexico, as provided in the Model Contracts' Article 26.4.[97]

With the exception of this federal court carve-out for administrative rescission, Article 26 is the primary "Applicable Law and Dispute Resolution" provision of the Model Contracts.[98] Article 26.1 selects the

---

90. To paraphrase the translation, any action or omission of the Contractor that causes a result that, even if not foreseen, was foreseeable, or, if foreseen, was the result of the Contractor's confidence that it would not materialize and that was derived in the violation of the Applicable Laws or a violation of a duty that was objectively required to be observed regarding industrial safety. *Id.* at art. 23.1(iii).

91. Translated, "[a]ny action or omission of the Contractor or the Participating Companies with the intention of pursuing a result directly." *Id.* at art. 23.1(iv).

92. *Id.* at art. 23.2.

93. *Id.*

94. *Id.* at art. 23.3.

95. *Id.*

96. *Id.*

97. *Id.* Article 26.4 does authorize contractors to initiate arbitral proceedings pursuant to Article 26.5 of the Model Contracts, but "only for the determination of the existence [and quantification] of damages that result" in a cause or causes of administrative rescission determined by a federal court to be unfounded. Art. 26.4, Model Contracts, *supra* note 83.

98. Art. 26, Model Contracts, *supra* note 83.

laws of Mexico as the governing law.[99] Articles 26.2 and 26.3 describe a mandatory conciliation procedure that must be undertaken in accordance with UNCITRAL's Conciliation Rules prior to the commencement of arbitration.[100]

Arbitration with a three-member panel is specified as the post-conciliation process for dispute resolution, again, with the exception of disputes pertaining to administrative rescission.[101] Article 26.5 selects the Secretary General of the Permanent Court of Arbitration at The Hague as the nominating arbitral authority, The Hague as the seat, and the Permanent Court of Arbitration of The Hague as the arbitral administrator.[102] The arbitration shall be conducted in Spanish, its substance governed by Mexican law, and its resolution in strict accord with the law.[103] Pursuant to Article 26.7, contractors may not suspend E&P activities during the pendency of a dispute, unless the parties agree otherwise or unless the CNH rescinds the relevant contract.[104] Further, the Model Contracts explicitly reference and confirm the applicability of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards and state that all awards shall be final and binding.[105]

C. The Consequences of Administrative Rescission

Administrative rescission results in serious legal and financial consequences for contractors.[106] While still liable for compliance with numerous onerous contractual obligations, the Model Contracts demand that the contractor pay contractually calculated liquidated damages; cease all non-essential E&P activities; and transfer of ownership to Mexico without compensation of all machinery, tools, equipment, goods, supplies, infrastructure, etc. acquired, provided, leased, or otherwise held for use for the E&P activities without compensation.[107] The Model Contracts do

99. *Id.* at art. 26.1.
100. *Id.* at art. 26.2, 26.3.
101. *Id.* at art. 26.5.
102. *Id.*
103. *Id.*
104. *Id.* at art. 26.7.
105. *Id.*
106. Art. 23.1, Model Contracts, *supra* note 83. Pursuant to Article 23.5 of the Models, these consequences also result in the event of a contractual termination pursuant to Article 23.4. *Id.* at art. 23.5. The seriousness of these impacts is somewhat mitigated by the fact that, unlike disputes concerning administrative rescission, contractual termination disputes are not excluded from the dispute resolution provisions of the Models' Article 26. *Id.* at art. 26.
107. Art. 23.5, Model Contracts, *supra* note 83.

provide for the possibility of a settlement, but the language is far from encouraging,[108] and the contractor likely will have little leverage at that point with which to question any government data or calculations.

As one observer noted, the Model Contracts' administrative rescission provisions demand that an investing party essentially agree to expropriation by contract.[109] Given the Mexican government's history of expropriation, investors would be unwise to ignore this threat, despite its obvious commitment to the reform and the economic realities driving the reform.

D. A Cautionary Tale of Two Clauses: Commisa v. Pemex and the Possibility of Parallel Proceeding

Mexico attempted to clearly differentiate the allocation of responsibility between the federal courts and arbitral tribunals in the new Hydrocarbons Law and the Model E&P Contracts published pursuant thereto. However, while the federal courts retain exclusive jurisdiction for disputes relating to or in connection with administrative rescissions[110] and arbitral tribunals are authorized to process any other claims,[111] one can envision several circumstances under which parallel proceedings might arise.

The *Corporación Mexicana De Mantenimiento Integral, S. De R.L. De C.V. v. Pemex Exploración Y Producción (Commisa v. Pemex)* case[112] demonstrates the hazards inherent in the dichotomous approach that the Mexican government has taken by carving out an exemption for administrative rescission from Article 21's dispute resolution structure in the Hydrocarbon Law. [113] Although this legal saga began in pre-reform era 2004 and dragged on for over thirteen years, the underlying facts in the saga are not particularly unusual.[114] Yet, this cautionary tale illustrates the legal complications that can arise when parties engage both the administrative rescission and arbitration provisions of a contract simultaneously, or in parallel, with regard to a single matter, or related matters.[115]

---

108. *Id.*

109. Brad Finney's quite astute statement in an initial draft of this article.

110. Art. 23.1, Model Contracts, *supra* note 83.

111. *Id.*

112. Corporación Mexicana De Mantenimiento Integral, S. De R.L. De C.V. v. Pemex Exploración Y Producción, 832 F.3d 92, 97 (2d Cir. 2016), *cert. dismissed*, 137 S. Ct. 1622 (2017) [hereinafter Commisa v. Pemex].

113. Hidrocarburos [LH], Art. 21, Diario Oficial de la Federación [DOF], 11 de Agosto de 2014 (Mex.).

114. *Commisa*, 832 F.3d at 97.

115. Hidrocarburos [LH], Art. 21, Diario Oficial de la Federación [DOF], 11 de Agosto de 2014 (Mex.).

Corporación Mexicana De Mantenimiento Integral, S. De R.L. De C.V., more commonly referred to as Commisa, a subsidiary of KBR, Inc., is a large engineering and construction company. In 1997, it contracted to build two offshore gas platforms for Pemex's E&P subsidiary, Pemex Exploración Y Producción, in the Gulf of Mexico.[116] The contract between these two parties contained a Mexican choice of law clause as well as dispute resolution provision specifying arbitration in Mexico.[117] Similar to the post-2013-2014 reform Model E&P Contracts, the *Commisa-Pemex* contract authorized Pemex to unilaterally rescind the contract administratively in the event of breach by Commisa or upon its failure to perform.[118]

When the working relationship between the parties began to deteriorate, Pemex invoked the rescission clause, alleging that Commisa had not met its contractual deadlines and that it had abandoned its work on the two offshore gas platforms.[119] Commisa sought arbitration while simultaneously disputing the constitutionality of Pemex's rescission in the Mexican courts.[120]

Commisa brought two proceedings, which resulted in different outcomes.[121] In 2009, the arbitral tribunal found in favor of Commisa on its breach of contract claim and entered an award for over $300 million in damages.[122] Its constitutional claims were not, however, successful in the Mexican courts. At the lower court level, the rescission was found to be both constitutional[123] and within the bounds of the contract.[124] In 2011, on appeal to the Mexican equivalent of the U.S. Court of Appeals, the court held that Commisa's $300 million arbitration award was against public policy, concluding that Mexican administrative law did not permit the arbitration of claims against a government agency and, accordingly, annulling the arbitral award.[125]

Commisa v. Pemex arrived in the U.S. courts in 2010 when Commisa attempted to enforce its arbitral award.[126] A U.S. federal district court determined that the arbitral award should be enforced as the Mexican court

116. *Commisa*, 832 F.3d at 98. While the court refers to the Pemex entity as PEP, these authors have retained the Pemex denomination. *See id.*
117. *Id.*
118. *Id.*
119. *Id.*
120. *Id.*
121. *Id.* at 97-99.
122. *Id.* at 99.
123. *Id.* at 98-100.
124. *Id.*
125. *Id.* at 99.
126. *Id.*

ruling that annulled the arbitration award offended core principals of justice.[127] The Court of Appeals for the Second Circuit affirmed the district court's decision in 2016,[128] and Pemex requested that the U.S. Supreme Court take this case.[129] Instead, the parties reached a settlement of the matter in 2017, prior to any substantive action on the part of the Supreme Court.[130]

The willingness of these U.S. courts to affirm an award that the host country had annulled caused alarm throughout the international investment community, and there was significant interest in the ultimate response of the U.S. Supreme Court to objections raised in *Commisa v. Pemex*.[131] Most consider the ability to execute an arbitral award in any country in which the losing party has assets to be the most attractive feature of international arbitration.[132] Both the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the New York Convention)[133] and the Inter-American Convention on International Commercial Arbitration of 1975 (the Panama Convention)[134] authorize courts in member States to enforce arbitral awards rendered in foreign States.[135] Each of these conventions provides limited circumstances under which a court may

127. Corporacion Mexicana de Mantenimiento Integral, S. de R.L. de C.V. v. Pemex-Exploracion y Produccion, 962 F. Supp. 2d 642, 657 (S.D.N.Y. 2013) (history omitted). A discussion of the entire history of the case, including its first appearance at the trial court and on appeal, is omitted to avoid a lengthy and unnecessary discussion. The opinion cited reflects the case on remand. *Id.* at 652.

128. *Commisa*, 832 F.3d at 119-20.

129. *See* Caroline Simson, *Battle Over KBR Unit's $300M Award Heads to Supreme Court*, LAW 360 (Feb. 21, 2017), https://perma.cc/94M4-NE6Y.

130. *See KBR Resolves Decade Long Dispute in Mexico*, OFFSHORE ENERGY TODAY (Apr. 10, 2017), https://perma.cc/CP5F-QFZ8.

131. *See, e.g.*, Letter Brief Amicus Curiae of the United States of America, Corporación Mexicana De Mantenimiento Integral, S. De R.L. De C.V. v. Pemex Exploración Y Producción, 832 F.3d 92 (2016) (No. 13-4022).

132. *See* Nathan M. Crystal, *The Duty of Competency in International Transactions: Part II*, S.C. LAW., Nov. 2012, at 9, https://perma.cc/7DXK-NMC2.

133. United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2518, 330 U.N.T.S. 3 [New York Convention].

134. Inter-American Convention on International Commercial Arbitration of 1975, Pub. L. No. 101-369, 104 Stat. 448 (1990) [hereinafter Panama Convention].

135. An arbitral award will only be recognized and enforced under the Panama Convention if the award was rendered in a State that has acceded to the Convention. *Id.* at § 304. *See also* R. Doak Bishop & Elaine Martin, Enforcement of Foreign Arbitral Awards, 3, 9-10.

refuse to enforce an otherwise eligible arbitral award,[136] one of which is a "set aside" pertaining to awards that have been annulled or otherwise set aside by a competent authority in the issuing country.[137]

At least one other court has taken this approach when considering whether to enforce a foreign arbitral award that had been annulled by a court in the primary jurisdiction. In *Chromalloy Aeroservices v. Arab Republic of Egypt*,[138] one of the first cases in the United States to raise this issue, the District Court for the District of Columbia enforced an arbitral award issued in Egypt, despite its annulment in Egyptian courts, stating that to do otherwise would "violate . . . clear U.S. public policy[.]"[139]

While the courts in these two cases did not do so, other U.S. courts *have* exercised their set aside discretion with regard to vacated foreign arbitral awards.[140] The Court of Appeals for the District of Columbia is one such court, ruling in the 2007 *TermoRio v. Electranta* case that an award set aside or annulled in the arbitral seat is no longer enforceable in the United States. In this case, the D.C. Circuit held that "secondary States (in determining whether to enforce an award) routinely second-guess the judgment of a court in a primary State, when the court in the primary State has lawfully acted pursuant to 'competent authority' to 'set aside'" a domestic arbitration award.[141] A power purchase contract was at issue in the *TermoRio* case. The agreement obligated Electranta, an entity owned primarily by the Colombian government, to purchase power from TermoRio, which was owned by a U.S. corporation.[142] Although the contract stipulated that all disputes should be settled in arbitration, a jurisdictionally-appropriate court in Colombia, the Consejo de Estado, vacated a $60.3 million arbitral award granted to TermoRio in the U.S., reasoning that the Colombian law in effect as of the date of the Agreement

136. *See Commisa*, 832 F.3d at 105-06; Bishop & Martin, *supra* note 135, at 10-11.

137. *See* 832 F.3d at 105-07; Bishop & Martin, *supra* note 135, at 10-11. For example, Article V of the Panama Convention limits, inter alia, the discretion of courts to refuse the recognition and execution of a foreign arbitral award to cases in which the requesting party is able to prove that the award "has been [annulled] or suspended by a competent authority of the country in which, or under the law of which, that award was made." Art. V(1), Panama Convention, *supra* note 134.

138. Chromalloy Aeroservices v. Arab Republic of Egypt, 939 F. Supp. 907 (D.D.C. 1996).

139. *Id.* at 913.

140. *See e.g.*, TermoRio S.A. E.S.P. v. Electranta S.P., 487 F.3d 928, 938, 941 (D.C. Cir. 2007); Baker Marine (Nig.) Ltd. v. Chevron (Nig.) Ltd., 191 F.3d 194 (2d Cir. 1999).

141. 487 F.3d 928.

142. *Id.* at 930-32.

did not expressly permit the use of the procedural rules that were applied in arbitration.[143] Here, the D.C. Circuit refused to interfere with a "peculiarly Colombian affair" concerning as it does "a dispute involving Colombian parties over a contract to perform services in Colombia which led to a Colombian arbitration decision and Colombian litigation."[144] The court noted that the discretion to refuse enforcement "is narrowly confined" to circumstances in which the foreign judgment is "repugnant to fundamental notions of what is decent and just in the State where enforcement is sought" or when it violates "basic notions of justice."[145] Accordingly, as the case facts were not "clear cut[,]" they did not meet that "high and infrequently met" standard for setting aside a foreign judgment.[146]

A similar result was reached in the *Thai-Lao Lignite (Thailand) Co. v. Government of Lao People's Democratic Republic*, a case decided in the same federal district as was the *Commisa* case.[147] The dispute in *Thai-Lao Lignite* pertained to a mining concession agreement between the Government of Laos and two private companies in which the parties agreed to submit disputes to arbitration in Kuala Lumpur, Malaysia.[148] A Malaysian arbitral tribunal originally issued a $57 million dollar arbitral award in favor of the companies for claims of improper termination.[149] The companies' petition to confirm the award was granted by the district court; the Second Circuit affirmed, and the U.S. Supreme Court denied certiorari.[150]

Shortly thereafter, however, the Malaysian courts vacated the arbitration award, concluding that the arbitrators had exceeded their jurisdiction.[151]

---

143. *Id.*

144. *Id.* at 939 (quoting TermoRio S.A. E.S.P. v. Electrificadora Del Atlantico S.A. E.S.P., 421 F. Supp. 2d 87, 101, 103 (D.D.C. 2006) (citations omitted).

145. *Id.* at 938-39 (citations omitted).

146. *Id.* at 938 (citations omitted).

147. *See* Thai-Lao Lignite Co., Ltd. v. Gov't of the Lao People's Democratic Republic, 997 F. Supp. 2d 214, 216 (S.D.N.Y. 2014), *appeal docketed*, No. 14-597 (2d Cir. Feb. 24, 2014).

148. *Id.*

149. *Id.* at 217.

150. Thai–Lao Lignite (Thailand) Co., Ltd. v. Gov't of the Lao People's Democratic Republic, No. 10 Civ. 5256, 2011 WL 3516154, (S.D.N.Y. Aug. 3, 2011), *aff'd*, 492 F. App'x 150 (2d. Cir. 2012), *cert. denied*, —— U.S. ——, 133 S. Ct. 1473 (Feb. 21, 2013). The award was also found to be enforceable in England by the English High Court of Justice, Thai-Lao Lignite (Thailand) Co. Ltd. & Hongsa Lignite (Lao Pdr) Co., Ltd. v Government of the Lao People's Democratic Republic, [2012] EWHC 3381 (Comm), on October 26, 2012, but its enforcement was denied by the Paris Court of Appeal. *See infra* Thai–Lao Lignite (Thailand) Co., Ltd. v. Gov't of the Lao People's Democratic Republic, at *2 n.9.

151. *Thai-Lao Lignite*, 997 F. Supp. 2d at 217-18.

Victorious at home, the Government of Laos returned to the U.S. to seek relief from the district court's earlier judgment granting enforcement.[152] This time, due to a lack of "extraordinary circumstances,"[153] the court determined that the judgments of the Malaysian courts "did not violate basic notions of justice" and reversed its earlier judgment enforcing the arbitral award.[154]

While the results in this case and in the *Commisa* case may appear contradictory, a focus on the "extraordinary circumstances"[155] present, or absent, in their facts may offer a unifying theme[156] to explain such seemingly divergent results. In *Commisa*, for example, the Mexican courts' judgments retroactively applied a prohibition on arbitrability in favor of a State-owned entity, leaving Commisa without other legal avenues in which to pursue relief.[157] Conversely, in *Thai-Lao Lignite*, the award had been set aside in the courts of a neutral, third country mutually selected by the parties on the universally-recognized ground, and it did not leave the unsuccessful parties without a remedy.[158]

This complicated and divisive issue is being disputed in courts internationally,[159] and observers were eagerly awaiting a definitive ruling

---

152. *Id.*

153. *Id.* at 227.

154. *Id.* at 230.

155. *Id.* at 227.

156. The U.S. Chamber of Commerce, in its amicus brief supporting Commisa in Pemex's petition for certiorari, proposed a multi-factor balancing test to guide courts considering whether to exercise their discretion to enforce awards annulled by the courts of the arbitral forum. *See* Brief Amicus Curiae of the Chamber of Commerce of the United States of America in Support of Petitioner-Appellee and Affirmance, Corporación Mexicana De Mantenimiento Integral, S. De R.L. De C.V. v. Pemex Exploración Y Producción, 832 F.3d 92, 97 (2d Cir. 2016) (No 1:10-cv-0206-AKH). This test presumes that all relevant treaty requirements have been satisfied: (1) the award must have been annulled; (2) by a competent authority; and (3) of a State in which, or under the law of which, the award was made, and it appears to explain the divergent results in the relevant cases. *Id.* The proposed multi-factor balancing test includes a consideration of the following factors, if present: (1) the pro-enforcement bias of the applicable convention; (2) level of scrutiny afforded to the award, or grounds required, for annulment; (3) the characteristics of the annulment proceedings; (4) the likelihood that the annulment order would be entitled to recognition in U.S. courts; and (5) any other circumstances that could tend to shift the balance in favor of or against enforcement. *Id.*

157. *Corporacion Mexicana de Mantenimiento Integral*, 962 F. Supp. 2d at 659.

158. *See Thai-Lao Lignite*, 997 F. Supp. 2d at 227-28.

159. This complicated and divisive issue is being disputed in tribunals and courts internationally. *See, e.g.*, Yukos Capital s.a.r.l. v. OAO Rosneft, 2009 (Amsterdam Court of Appeal), XXXIV Y. B. Comm. Arb. 703; PT Putrabali Adyamulia (Indonesia) v. Rena Holding et al, 2007 (Cour de Cassation), XXXII Y. B. Comm. Arb. 299;

from the U.S. Supreme Court in the *Commisa v. Pemex* case. While a Supreme Court ruling might have provided some clarity and perhaps a more certain standard for courts pondering foreign court annulments of arbitral awards,[160] the settlement of the case requires a longer wait for more clarity on the issue.[161]

Speculatively, however, it is conceivable that a Supreme Court ruling in favor of Commisa, confirming the arbitration award, might mitigate the rescission risk in Mexico's energy regime, at least for investors with jurisdictional ties to the United States. While Mexican energy industry regulations explicitly provide that governmental administrative rescissions are non-arbitrable,[162] some of the more ambiguous terms in the Hydrocarbons law and the Model E&P Contracts might offer investors the opportunity to begin parallel arbitration proceedings.[163] If successful in that forum, investors could then seek enforcement of the awards in their home jurisdictions, particularly if Mexican authorities intervened in the arbitral process in such a way as to qualify as "extraordinary circumstances,"[164] justifying the exercise of a court's discretion to enforce arbitral awards.[165]

Conversely, had the Supreme Court chosen not to enforce the arbitral award, administrative rescission likely would assume an even higher risk

---

Directorate General of Civil Aviation of the Emirate of Dubai v. International Bechtel Co. Limited Liability Company (Panama), 2005 (Paris Cour d'appel), XXXI Y. B. Comm. Arb. 629. *See generally* Julie Bédard, Lea Haber Kuck & Timothy G. Nelson, *PEMEX and US Enforcement of Foreign Arbitration Awards Nullified in their 'Home' Courts*, LEXOLOGY (Jan. 28, 2017), https://perma.cc/Q45M-CWWJ.

160. *See* Caroline Simson, *Eyes on High Court to Weigh in on Annulled Arbitral Awards*, LAW 360 (Feb. 21, 2017), https://perma.cc/6KMF-U4UT.

161. *See KBR Resolves Decade Long Dispute in Mexico*, *supra* note 130.

162. Hidrocarburos [LH], Art. 21, Diario Oficial de la Federación [DOF], 11 de Agosto de 2014 (Mex.).

163. *See id.*

164. *See Commisa*, 832 F.3d at 100, 111. It is likely, however, that the ruling in *Commisa* does not actually apply to investors in Mexico's energy industry given the current Model Contracts and stipulations. *See id.* at 111-112; Escobar, *supra* note 73, at 13C-3-10; Barry Fitzgerald, *BHP Billiton Breaks Mexican Oil Barrier in Pemex Deal*, AUS. NEWSP., Dec. 7, 2016, https://perma.cc/B6X6-WPWV. Under the current energy reform, the private party clearly is agreeing to not submit any issues regarding the rescission of the contract to arbitration; thus, this might not violate the notions of justice as the parties are explicitly agreeing to not arbitrate these issues. *See* Escobar, *supra* note 73, at 13C-7. And, it could be argued that the ruling in *Commisa* is inapplicable to current energy agreements because unlike current energy agreements, Pemex and Commisa did not agree to not submit any contract rescission issues to arbitration. *See* 832 F.3d at 102-110.

165. *Cf. Thai-Lao Lignite*, 997 F. Supp. 2d 214.

profile for foreign investors. It is unclear whether this risk would significantly impact the number of investors and the amount of money those investors would be willing to commit to Mexico's energy industry. However, a "non-enforcement" ruling from the Supreme Court would likely have caused some hesitation from investors.[166] It is possible that a holding from the Supreme Court in which the justices had elected not to enforce the arbitration award would ultimately have hurt the Mexican government in its quest to revitalize the energy industry.[167]

IV. ADMINISTRATIVE RESCISSION: RISK MITIGATION

Given the implicit tension between Articles 20 and 21 of the Hydrocarbon Law and the strong potential for disagreement regarding any contractual ambiguity, foreign investors must seek mechanisms to counter this particular risk. There are several options that may mitigate, if not entirely eliminate, this legal vulnerability, a few of which are considered briefly in the following text.

A. Extra-Contractual Options

1. NAFTA and Other International Investment Agreements

The North American Free Trade Agreement (NAFTA) and other international investment agreements (IIAs), including bilateral investment treaties (BITs) and multilateral investment agreements (MIAs), establish reciprocal substantive and procedural protections for foreign investors, including safeguards against expropriation of an investment by the host State and dispute settlement mechanisms outside a host State's legal system.[168] Clause 26.9 of the Model E&P Contracts, with the heading *International Treaties*, clearly establishes that, as translated, "[t]he Contractor is entitled to the rights recognized by the International Treaties subscribed by the State."[169] Some commentators believe that this explicit reference to, and

166. *See Commisa,* 832 F.3d at 111.

167. *See* Lopez-Velarde & Vasquez, *supra* note 10, at 155-57.

168. North American Free Trade Agreement, Can.-Mex.-U.S., Dec. 17, 1992, 32 I.L.M. 289 (1993) [hereinafter NAFTA]. *See generally North American Free Trade Agreement (NAFTA)*, OFFICE OF THE U.S. TRADE REP., https://perma.cc/FJZ3-87KC (last visited Oct. 25, 2017); *Bilateral Investment Treaties*, OFFICE OF THE U.S. TRADE REP., https://perma.cc/2A76-38EM (last visited Oct. 25, 2017).

169. Model Contracts, *supra* note 83.

the investor protections of, these instruments may offer investors options for mitigating the risk of administrative rescission.[170]

Now, to the caveats, one of which is the potential conflict between the 2013-2014 Mexican energy reform that relaxed the country's restrictions on foreign investment in its energy industry and Mexico's exclusion of that industry from NAFTA.[171] NAFTA's Chapter Six, titled *Energy and Basic Petrochemicals*, confirms "full respect" for the parties' Constitutions[172] and explicitly reserves for Mexico the entire spectrum of energy exploration, production, processing, transportation, storage, and supply chain, "including investment in such activities and the provision of services" therein.[173] This reservation includes all energy sectors, i.e., crude oil and natural gas; artificial gas' basic petrochemicals and their feedstocks; basic petrochemicals; electricity supply, with some exceptions; and various aspects of nuclear power.[174] This industry exclusion also appears in NAFTA's Annex III, which prohibits private investment in, inter alia, the hydrocarbon industry and provides that any such investment "shall not be construed to affect the State's reservation of those activities."[175]

The impact of the 2013-2014 energy industry reforms on NAFTA are subject to some debate. Some argue that the reform's constitutional changes would be sufficient to integrate the new energy regime without amendment, and others contend that its reservations must be modified.[176] There remains much uncertainty as to whether NAFTA's terms were drafted so as to integrate, without amendment, future legal developments within the party State. Unless these States have an appetite for a highly politicized NAFTA amendment process[177] and can negotiate mutually-

---

170. *See, e.g.*, Rob Nikolewski, *Energy Looks to be Spared in any NAFTA Reset*, SAN DIEGO UNION-TRIB., July 20, 2017, http://www.sandiegouniontribune.com /business/sd-fi-nafta-energy-20170526-story.html.

171. *Compare* Hidrocarburos [LH], Art. 21, Diario Oficial de la Federación [DOF], 11 de Agosto de 2014 (Mex.), *with* NAFTA, *supra* note 168, at art. 608 & Annex 602.3.

172. Art. 601(1), NAFTA, *supra* note 168.

173. *Id.* at art. 602.3(1).

174. *Id.*

175. Annex III, NAFTA, *supra* note 168.

176. *See* Rosío Vargas, *Energy Reform: 20 Years After NAFTA*, 48 PROBLEMAS DEL DESARROLLO: LATINOAMERICANA DE ECONOMÍA (Apr.-June 2017).

177. *See, e.g.*, Antonio Martinez, *What a Changing NAFTA Could Mean for Doing Business in Mexico*, HARV. BUS. J. (June 20, 2017), https://perma.cc/AL3X-B7L5. Consider, however, the notice of arbitration that KBR, the parent company of Commisa, filed against Mexico in 2013 alleging breaches of different provisions of Chapter XI of NAFTA as well as Article 1503(2). While this filing warrants its own analysis, which cannot be conducted in this article, it is interesting to note that

satisfactory terms, this uncertainty likely will remain until tested in the courts or an arbitral forum.[178]

Putting those reservations aside, non-NAFTA investors with jurisdictional claims to countries with which Mexico has executed an IIA[179] containing typical dispute resolution provisions may have cause for optimism. IIAs often specify that investor-State disputes shall be arbitrated under the umbrella of the International Center for the Settlement of Investment Disputes (ICSID),[180] and, while Mexico is not a member of ICSID,[181] it has established treaties pertaining to direct foreign investment with numerous countries, including, at last count, twenty-nine BITs.[182] Some of these treaties allow for arbitration pursuant to ICSID Additional Facility Rules[183] or UNCITRAL Arbitration Rules.[184] These arbitral administrators offer both neutral decision-makers and a neutral regime relatively unencumbered by party ties and, hopefully, influences. The majority of IIAs, including a number of Mexican IIAs, specify: the provisions of the

---

Mexico did not make any claim of arbitrability *ratione materiae* with regard to its Chapter 6 and Annex III reservation of all activities related to the hydrocarbons and electricity industries, including the exclusion of disputes arising therefrom from NAFTA's Chapter 11 dispute resolution procedures and notwithstanding private contracts. Gabriel Cavazos Villanueva, *Arbitration and Investment Protection within the Context of the Energy Reform in Mexico: A First Approach Based on* COMMISA v. PEMEX and KBR v. Mexico, *in* ESTADO DE DERECHO Y REFORMA ENERGETICA EN MÉXICO (Baker Inst. for Pub. Pol'y, 2017) (discussing KBR's NAFTA filing in connection with *Commisa v. Pemex*).

178. *But see* Villanueva, *supra* note 177.

179. Although it can prove to be a controversial strategy, multinationals often structure their transactional entities to take advantage of BIT protections. *See generally* Julien Chaisse, *The Treaty Shopping Practice: Corporate Structuring and Restructuring to Gain Access to Investment Treaties and Arbitration*, 11 HASTINGS BUS. L.J. 225 (2015).

180. *See* Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159 [hereinafter ICSID Convention].

181. *Database of ICSID Member States*, INTL. CTR. FOR SETTLEMENT OF INV. DISP., https://icsid.worldbank.org//about/Database-Member-States.aspx.

182. *See Investment Climate Statements for 2016 - Mexico*, U.S. DEP'T OF STATE, https://perma.cc/V89Y-U35Y (last visited Oct. 26, 2017); Additional Facility Rules, ICSID Convention (Apr. 2006), https://icsid.worldbank.org/en/Documents/icsiddocs/AFR_English-final.pdf.

183. *See, e.g.*, Commonwealth of Australia – Mexico Bilateral Investment Treaty, Austl.-Mex. art. 13(4), Aug. 23, 2005, 2483 U.N.T.S. 247 (entered into force July 21, 2007).

184. Commission on International Trade Law, G.A. Res. 31/98, art. 19.3 (Dec. 15, 1976) [hereinafter UNCITRAL Arbitration Rules].

agreement itself and general principles of international law as the applicable law;[185] they often are crafted in multiple languages, each text being equally authentic; and they generally do not appear to impose unbalanced, onerous arbitral language requirements upon investors.[186] Their scope of covered investments is generally broad,[187] but one might find potentially troublesome exclusions in Mexican IIAs, including language exempting resolutions that prohibit or restrict investment by its counterpart's investors from the dispute settlement provisions.[188]

Investor-State disputes resulting in investment arbitration generally are not contractual disputes, unless the contract's arbitration clause names the ICSID as the arbitral administrator. Several courts have held, however, that prejudicial State interference with arbitration may violate either investment or other treaties.[189] For example, the European Court of Human Rights decided a number of cases that involved the issue of execution of national and international arbitral awards, most of which alleged violations of the "fair trial" provisions in the European Convention on Human Rights and Fundamental Freedoms (ECHR).[190] In these cases, the Court

185. NAFTA signatories, however, are entitled to protections from the treaty regardless of the limitations of international law. *See generally* Pope & Talbot Inc. v. Gov't of Can., 41 I.L.M. 1347, 1357 (2002).

186. ICSID utilizes three official languages: French, Spanish, or English. Reg. 34(1), Regulations and Rules, ICSID Convention (Apr. 2006), https://icsid.worldbank.org/en/Documents/resources/2006%20CRR_English-final.pdf. *Cf.* Susan D. Franck, *Empiricism and International Law: Insights for Investment Treaty Dispute Resolution*, 48 VA. J. INT'L L. 767, 804-05 (2008) ("[P]reliminary empirical work on investment treaty dispute resolution demonstrates that the vast majority of awards are in English.").

187. *See e.g.*, Mahnaz Malik, Bull. #1, *Definition of Investment in International Investment Agreements*, INT'L INST. SUSTAINABILITY DEV. 1 (Aug. 2009), https://perma.cc/WW3A-8E89.

188. *See, e.g.,* Agreement between the United Mexican States and the Republic of Austria on the Promotion and Protection of Investments*,* June 29, 1998 (entered into force March 26, 2001). Article 19 of the Mexican-Austria BIT, titled *Exclusions*, states that "[t]he disputes settlement provisions … shall not apply to the resolutions adopted by a Contracting Party which, for national security reasons, prohibit or restrict the acquisition of an investment in its territory, owned or controlled by its nationals, by investors of the other Contracting Party, according to the legislation of each Contracting Party." *Id.* at art. 19.

189. Case of Regent Company v. Ukraine, App. No. 773/03, Eur. Ct. H.R. (2008), https://perma.cc/98RW-L34H; Case of Kin-Stib and Majkic v. Serbia, App. No. 12312/05, Eur. Ct. H.R. 85 (2010), https://perma.cc/T2L7-5HMH.

190. *See supra* note 189; European Convention for the Protection of Human Rights and Fundamental Freedoms art. 6(1), Nov. 4, 1950 (entered into force Sept. 3, 1953) (Article 6(1) states, in pertinent part: "In the determination of []civil

consistently has ruled that a commercial arbitration award is property under Protocol 1 of Article 1 of the ECHR and that, without valid reasons, a failure to enforce such an award violates that Convention's Article 6.[191]

Additionally, at least one arbitral tribunal, considering claims relating to the State interference with arbitration, has concluded that a party's arbitral award "crystallized" the investment at issue in the dispute.[192] The next logical argument is that the award itself may constitute jurisdictional investment. An award pursuant to an arbitral proceeding might endow the prevailing E&P investor with standing to pursue an independent claim against Mexico in an IIA, or perhaps even pursuant to NAFTA.

There is the caveat that any arbitration provisions in Mexican IIAs are subject to the same concerns attendant to the tension between the administrative rescission remedy and the dispute resolution structure prescribed in the Hydrocarbon Law and the corresponding provisions in the Model E&P Contract.[193] However, those IIAs with robust arbitration clauses and with no NAFTA-like industry or other investment exclusions might prove helpful for foreign investors participating in Mexico's energy sector.[194]

2. Political Risk Insurance

Given that E&P operations generally require significant fixed investments, firms in that sector are often subject to governmental actions and socio-environmental conditions that threaten their investments. Terrorism, widespread criminal activity, general lawlessness, or popular uprisings and insurrection are all, of course, political risks to investors; these risks often manifest in the form of responses by host, or, even their home,[195]

---

rights . . ., everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law.").

191. *See supra* notes 189-90.

192. Saipem v. Peoples' Republic of Bangladesh, Decision on Jurisdiction and Provisional Measures, ICSID Case No. ARB/05/07 (Mar. 21, 2007) & Award (June 30, 2009).

193. *See infra* Part IV.B.

194. *See* Isabel Fernández de la Cuesta, *Bilateral Investment Treaties Would Likely Have a Key Role in Mitigating Investment Risks If Mexico Undertakes Energy Reforms*, LEXOLOGY (Oct. 2, 2013), https://perma.cc/KJJ4-S75G.

195. Home countries, even those most developed, often create political risk for energy investors. For example, the British government, in 2005, retroactively increased its tax rate to 50% for oil and gas producing companies in the North Sea. *See Brown Doubles North Sea Oil Tax*, BBC NEWS (Dec. 5, 2005), https://perma.cc/7FPA-MUZR. U.S. investors, and in particular, oil companies, have been impacted by economic sanctions that the U.S. has imposed on a number

governments to increasing resource nationalism, national security concerns, or other post-contractual events.[196] Such responses by the foreign government may include the direct or indirect expropriation of assets;[197] the amendment, abrogation, or termination of contracts; currency manipulations, transfer restrictions, or availability; or the breach of, or improper interference with, contracts.[198]

To manage these particular risks, investors should consider purchasing political risk insurance (PRI) or some form of international or governmental export credit guarantee or funding that achieves the same purpose. The Overseas Private Investment Corporation (OPIC), Multilateral Investment Guarantee Agency (MIGA), export credit agencies, other governmental agencies, and private insurers such as Lloyds of London and Chubb all offer insurance products for specific political risks, including Expropriation, Nationalization, and Deprivation (CEND) risks; selective discrimination; political violence; and terrorism.[199]

OPIC is a frequent insurer in this market for U.S. investors.[200] It is part of the executive branch of the U.S. government and was one of the very first PRI providers.[201] Its products are available to U.S. companies doing business in and/or investing in particular emerging markets, including

---

of oil-producing States such as Iran. *See, e.g.*, Iran and Libya Sanctions Act of 1996, 50 U.S.C. § 1701 (1996), 35 I.L.M. 1273 (1996). Consider too the Trading with the Enemy Act, 50 U.S.C. § 16 (1994), and the International Emergency Economic Powers Act, 14 U.S.C. § 1422 (1994), which also may impose obligations on U.S. investors with foreign branches and, sometimes, with foreign entities owned or controlled by U.S. companies.

196. Joffé et al., *supra* note 6, at 3-4.

197. Expropriation does not only result from direct governmental seizure of assets; it may also be the product of State regulatory actions. Indirect, or creeping, expropriation, which sometimes is also referred to as a regulatory taking, can pose just as great a threat to investors as the more direct form of expropriation. *See generally id.*

198. *See id.*

199. A. F. M. Maniruzzaman, *The Issue of Resource Nationalism: Risk Engineering and Dispute Management in the Oil and Gas Industry*, 15 TEX. J. OIL GAS & ENERGY L. 79, 99-100 (2010).

200. OVERSEAS PRIV. INVEST. CORP., https://perma.cc/MT7A-J58S (last visited Oct. 27, 2017). This website offers much more detailed information regarding OPIC's eligibility requirements, coverage limits, etc. *See also* OVERSEAS PRIV. INVEST. CORP., OPIC HANDBOOK, https://perma.cc/3QET-A38F (last visited Oct. 27, 2017).

201. *Id.*

Mexico.[202] It provides extensive coverage from expropriation, impairment of contract, regulatory risk, tumult caused by political upheaval, and other improper foreign government interference actions.[203] Additionally, OPIC offers arbitral award default and denial of justice coverage[204] that protects U.S. companies as well as their debt and/or equity investors.[205] OPIC also provides enhanced coverage for petroleum E&P in developing countries, including protection against interference with operations and expropriation, defined as losses attributable to unilaterally-imposed material changes in project agreements by host governments and as asset confiscation of tangible assets and bank accounts.[206]

MIGA, another popular PRI insurer, was established by an international convention as a member of the World Bank Group.[207] This agency insures projects that promote foreign direct investment into developing countries in order to enhance confidence among cross-border investors.[208]

All PRI policies, however, have limitations. Eligibility requirements may exclude certain investors or countries,[209] and coverage limits may be inadequate,[210] a grave concern when making E&P investments. There also may be gaps in specific coverage areas. For example, some PRI will not compensate investors for some forms of expropriations, including those arising from actions provoked by the investor, from lawful host State regulation or taxation, or from host State actions taken in a commercial

---

202. *Political Risk Insurance*, OVERSEAS PRIV. INVEST. CORP., https://perma.cc/FR6S-CYPC (last visited Oct. 27, 2017); *Where We Work,* OVERSEAS PRIV. INVEST. CORP., https://perma.cc/4X9A-RGQT (last visited Oct. 27, 2017).

203. *Political Risk Insurance*, *supra* note 202.

204. *See Arbitral Award Default*, OVERSEAS PRIV. INVEST. CORP., https://perma.cc/7N4R-SELK (last visited Oct. 27, 2017).

205. *Id.*

206. OPIC HANDBOOK, *supra* note 200, at 22-23.

207. World Bank: Convention Establishing the Multilateral Investment Guarantee Agency art. 26, Oct.11, 1985, 24 I.L.M. 1598, 1617.

208. *History*, MULTILATERAL INV. GUARANTEE AGENCY, https://www.miga.org/who-we-are/history/ (last visited Oct. 27, 2017).

209. *See Insurance Eligibility Checklist*, OVERSEAS PRIV. INVEST. CORP., https://perma.cc/7S3S-C8A2 (last visited Oct. 27, 2017). *See also* OPIC HANDBOOK, *supra* note 200, at 5-6, 10, 12, 17.

210. For example, OPIC has no minimum investment requirement for PRI, but it does limit coverage to $250 million per project and up to $300 million for projects in the oil and gas sector that have offshore, hard currency revenues. Oil and gas projects with investment grade credit and with offshore, hard currency revenues may be approved for up to $400 million if the project receives a credit evaluation of investment grade or higher. OPIC has no minimum investment size requirements. *See* OPIC HANDBOOK, *supra* note 200, at 16.

capacity.[211] Relevant to hydrocarbon investors, "OPIC will not compensate for loss of reserves of any kind."[212] Currency inconvertibility coverage is another example where there may be PRI gaps; some policies may not protect against host State currency devaluations as they are characterized as a "commercial" risk.[213]

Limitations, however, are inherent in any risk management option. They should not deter foreign energy investors in Mexico from seriously considering PRI as one mechanism for minimizing the risk of expensive and prolonged legal proceedings caused in the event of an administrative rescission.

Investors have a number of other extra-contractual[214] risk management devices, many of which might be characterized as common sense. It seems obvious, but many potential disputes can be avoided by cultivating good working relationships with international and host country partners; with government officials, administrators, and administrative staff at all levels of government (and with their counterparts in opposition parties); with local community members; with non-governmental organizations and other civil society groups; with the press; and with lenders and insurers. So too can sharing technology and expertise generously, exceeding local content and labor requirements when possible; and investing in local communities.[215] Conversely, most foreign investors seek to minimize physical assets in the host State and to match or transfer as much risk as possible to third party contractors that are better able to manage particular risks, such as material supply.

While it is impossible to eliminate all risks, investors can and do implement well-planned strategies for its mitigation. In addition to these and other extra-contractual mechanisms, potential investors in the Mexican E&P sector can make effective use of contract terms as a hedge against uncertain legal risks like administrative rescission.

B. Contractual Options

For those investing in Mexico's E&P sector, the government's Model Contracts will govern their activities. Such pre-published models often leave scarce opportunity for revisions or for the negotiation of new

---

211. *See, e.g.*, OPIC HANDBOOK, *supra* note 200, at 18.

212. *Id.* at 23.

213. *See id.* at 18.

214. The authors refer here to the investment-specific contracts rather than to any other of the multiple contracts that document a large E&P investment.

215. *See, e.g.*, Margarita T.B. Coale, *Stabilization Clauses in International Petroleum Transactions*, 30 DENV. J. INT'L L. & POL'Y 217, 219 (2002).

terms.[216] In the event that such an opportunity arises or that conditions change, however, common contract clauses may provide some measure of protection against the legal risks inherent in the potentially conflicting Articles 20 and 21 of the Hydrocarbon Law and their counterparts in the Model Contracts.

A joint enterprise with local and international partners is one contract structure that provides both contractual and extra-contractual risk management. It does so by contractually spreading an investor's risk over a larger pool of stakeholders as well as by extra-contractually deterring interventionist host State action.[217] The inclusion of local entity partners may be an effective method of allocating to them project political risks, such as using dollar-denominated or indexed pricing, local exchange rate and inflation risks, and force majeure clauses related to local conditions. Because governments often provide guaranties to their local entities, these risks ultimately are passed along to them.[218] There are some who contend that local partners create more problems than they solve,[219] but strategic joint ventures that align a host government's financial interests with an investment are often seen as a valuable deal structure, risk-management wise.

Holdback clauses are among the many post-closing price adjustment terms included in all manner of transactional agreements that serve the purpose of performance bond to incentivize party compliance with contractual commitments. [220] The release of the funds, held either by the payor or in escrow, generally coincides with the guarantee period.[221] The contracting parties agree on the holdback process. While details vary in different contracts, one party withholds a certain percentage of the total value of the contract from each payment until certain conditions are satisfied or until project completion, contract expiration, or some other pre-determined time.[222] Upon completion, and subject to failure of any

---

216. *But see supra* Part III.B.

217. Waelde & Ndi, *infra* note 233, at 232-33.

218. *Id.*

219. Symposium, *Energy & International Law: Development, Litigation, and Regulations*, 36 TEX. INT'L L.J. 1, 55-56 (2001).

220. Mark A. Cassanego, *Holdback Escrows in M&A Transactions*, CARR MCCLELLAN (Feb. 20, 2013), https://perma.cc/6T8U-678Q.

221. *Id.*

222. *See Holdback Clause Examples in Asset Purchase Agreements*, LAW INSIDER, https://perma.cc/PU4F-S28A (last visited Oct. 27, 2017); *see also Holdback Law and Legal Definition,* U.S. LEGAL, https://perma.cc/N73P-K89G (last visited Oct. 27, 2017).

conditions, the withholding party releases any remaining funds.[223] The parties often agree that the withholding party will pay interest on the money being withheld.[224]

The conditions under which a party is authorized to release the funds, or conversely, pursue a claim against the holdback funds, warrant particular attention and should be carefully crafted to avoid ambiguity and future misunderstandings. Events that trigger the release of funds may include target production levels, the expiration of closing price adjustments or representations and warranties, or milestone dates.[225] Parties seeking holdback funds often make claims pertaining to alleged breaches of representations and warranties or covenants and to adverse litigation.[226]

Creative, flexible mechanisms for revenue sharing between host governments and private investors are other contractual options that may mitigate political risks such as administrative rescission. Limited only by the creativity of the negotiators and the mutual appeal of the mechanism, these contract clauses align the economics of projects between investors and the host government. They can take many forms, such as minimum, minimal royalties with possible longevity incentives and/or baseline escalators in the event of an in increase in market prices above pre-determined levels.[227] Escalating royalty structures based upon a combination of contract longevity and market prices are another variation, as are options that establish inverse tax rates-to-market price formulae.[228]

Structures such as these not only may insulate investors from the risk of rescission, they also provide a reliable and stable source of income for host governments.[229] Because royalties are most often calculated as a percentage of gross revenues, without reductions for depreciations or other tax deductions claimed by the investor, this maximizes income for both

---

223. *See* Erik Krusch, *M&A Terms: No Holding Back When It Comes to Escrows*, WESTLAW M&A DAILY BRIEFING, 2014 WL 44047 (Sept. 27, 2010).

224. *Holdback Clause Examples in Asset Purchase Agreements*, *supra* note 222.

225. *See* Krusch, *supra* note 223.

226. *Id.*

227. Marsh, *supra* note 6, at 463-67.

228. *Cf. id.* Carry forwards may also be a part of revenue sharing calculations. These contracts provisions allow exploration expenditures made in excess of contractual requirements to carry forward as a credit to offset prospective expenditures, encouraging investment and accelerating E&P operations. The Minimum Work Program provisions set forth in Annex 5 of the Model Contracts appears to envision carry forwards. Annex III, Model Contracts, *supra* note 83.

229. *Id.*

the host government and for the investor, with the added investor benefit of quicker recovery of sunk costs.[230]

The calculation of royalties and other contract payments for Mexican E&P activities is set forth in Annex III of the Model Contracts, styled *Procedures to Determine Considerations*. [231] Pursuant to Article 4.1 of Annex III, the amount of the royalties will be determined for each type of hydrocarbon through the application of the rate corresponding to contractually specified values, with a consideration of State participation in production and additional investments commitments and subject to annual adjustment.[232] The success of alternative means of revenue allocation in Mexican E&P projects is dependent on the government's willingness to consider extra-Model options. Properly structured, however, alternative options provide incentives for host countries to avoid administrative rescissions.

There are other tools by which investors can align project economics so that both benefits and risks are shared with a host State. For example, economic and/or legal stabilization clauses may alleviate concerns of foreign investors with the State's commitment to stabilize a contract's economic bargain[233] or the laws governing a project rules, either universally or for individual projects.[234]

A total government take (TGT)[235] term can be an effective economic stabilizer. This term can be used in an offset clause, above which the investor would get a credit. The TGT would include all exactions from every level of government, including all taxes, duties, and royalties over the life of the contract, and other total projected distributions.[236] Should the government enact new legislation or regulations or apply existing laws in such a way that it raises government TGT above the baseline, the increases would be offset against future payments to stabilize distributions.

Liquidated damage clauses provide another contractual mechanism for minimizing any economic uncertainty pertaining to a legal risk such as

---

230. *Id.*

231. *Id.*

232. Art. 4.1, Annex III, Model Contracts, *supra* note 83.

233. Thomas W. Waelde & George Ndi, *Stabilizing International Investment Commitments: International Law Versus Contract Interpretation*, 31 TEX. INT'L L.J. 215, 240 (1996).

234. Álvaro Pereira, *Legal Stability Contracts in Colombia: An Appropriate Incentive for Investments?*, 12 RICH. J. GLOBAL L. BUS. 237 (2013).

235. *See generally* Keith J. Brewer, Stephen E. Hamilton & Richard A. Westin, *Economic Approaches to Nonrenewable Resource Taxation*, 11 J. NAT. RESOURCES & ENVTL. L. 175 (1995-1996).

236. *Id.* at 196-97.

an administrative rescission. [237] These clauses pre-determine the damages due in certain events of breach. [238] The calculations attempt to project what damages would accrue should the clause be activated.[239] Estimates such as these are notoriously difficult to predict, and, in order to avoid having the clause declared enforceable by a reviewing court, drafters should take care that the sum is not grossly disproportionate to realistic projections of actual damages.[240]

The administrative rescission language of Article 23 in the Model E&P Contracts appears to exclude the possibility of liquidated damages in favor of the investor.[241] To the contrary, investors are liable for contractually calculated liquidated damages following a rescission.[242] While there is settlement language in the Models, its calculations are strictly conscribed.[243]

Foreign investors participating in the Mexican E&P sector could seek to utilize such a clause in their agreements, should they have an opportunity to negotiate terms.[244] Similar to holdbacks, liquidated damages clauses can be useful disincentives to contractual breaches. Ideally, if an investor were able to include a reciprocal liquidated damages clause, one that takes into account the damage suffered following an unlawful administrative rescission, i.e., the value of seized assets, lost revenue, etc., it certainly would partially mitigate the risks associated with that governmental act.[245]

All of the contractual options briefly considered above are useful risk management tools for foreign investors in uncertain markets. For those investing in Mexico's E&P sector, because their Mexican counterparts have little incentive to negotiation additions or amendments to government's Model Contracts, contractual options may have limited value in minimizing the legal risks inherent in the conflicting administrative rescission remedy and the dispute resolution structure set forth in the Hydrocarbon Law and

---

237. *See* J. Frank McKenna, *Liquidated Damages and Penalty Clauses: A Civil Law versus Common Law Comparison*, THE CRITICAL PATH (Reed Smith, New York, N.Y.), Spring 2008, at 1; Cameron S. Hill, *Is Your Liquidated Damages Clause Valid?*, BAKER DONELSON PC (Apr. 14, 2008), https://perma.cc/D6TW-NY3R.

238. *See* McKenna, *supra* note 237; Hill, *supra* note 237.

239. *See* McKenna, *supra* note 237; Hill, *supra* note 237.

240. *See* McKenna, *supra* note 237; Hill, *supra* note 237.

241. *See supra* note 106.

242. Art. 23.5, Model Contracts, *supra* note 83.

243. *Id.*

244. *See* McKenna, *supra* note 237; Hill, *supra* note 237.

245. *See* Escobar, *supra* note 73, at 13C-10-11. *See also* McKenna, *supra* note 237; Hill, *supra* note 237.

the corresponding Model E&P Contracts.[246] Mexico has a good deal of leverage as there has been intense interest, and, to date, gratifying participation in its E&P tenders.

CONCLUSION

Mexico's energy reform was designed to attract foreign investment to the industry, and it creates significant opportunities for investors to capitalize on the vast reserves of Mexican natural resources. However, inherent risks inure to E&P, risks related to the uncertain nature of the sector, but also to elements of the legislative and contractual architecture of the reform itself.

Mexico's long history of producing and selling oil is troubled by the country's expropriation of foreign energy company assets. The government-owned entity created in the wake of those expropriations, Pemex, which has controlled the oil segment of the country's energy industry, has been described as being of "quasi-religious significance to the Mexican people."[247] Indeed, labor unions and civic organizations have taken to the streets to protest Mexico's energy reforms.[248] Coupled with the recent wave of energy nationalizations in the region and elsewhere,[249] investors may have legitimate concerns about making the type of substantial investment that is required and typical for hydrocarbon E&P.

Mexico's recent energy reform considerably decreases the amount of control that Pemex has within this industry, yet expropriation and government interference remain concerns for foreign investors. Additionally, while the dispute resolution provisions of the reform legislation were designed to reassure foreign investors, the administrative rescission exemption therefrom certainly may undermine investor confidence in the government's commitments. The *Commisa v. Pemex* case illustrates this risk quite dramatically.

Investors should carefully evaluate the administrative rescission exception as they calculate their risk tolerance for Mexican energy projects. There are mechanisms, extra-contractual and contractual, available to foreign investors to minimize potential risks. However, several of the world's largest oil companies have decided that the potential rewards are worth the risk, with both individual firms and consortia placing bids in the

246. *See supra* Part III.B.

247. Diana Villiers Negroponte, *Mexico's Most Critical Challenge: Energy Reform*, BROOKINGS (Nov. 20, 2013), https://perma.cc/2GFA-8LN3.

248. *Protests Mark Anniversary of Mexico's Oil Expropriation*, GUADALAJARA REP. (Mar. 20, 2015), https://perma.cc/T7MJ-BMJS.

249. *See* Guriev et al., *supra* note 7.

fourth round of the first tender, Round 1.4, to conduct E&P in ten of Mexico's deep-water oil fields.[250] Among the companies participating either individually or as part of a consortium were ExxonMobil, BP, Chevron, Shell, Murphy, Statoil, Total, Lukoil, and China's CNOOC.[251] Pemex also offered a farm-out, or lease, of its E&P rights to the deep-water Trion block in Round 1.4, with Trion being one of the most promising of the Pemex assets.[252]

The majority of observers deemed Round 1.4 a great success, with the Mexican authorities drawing praise for their transparency and their willingness to improve the fiscal and contract terms for its oil and gas tenders in response to market demands.[253] The improved terms obviously satisfied many market players: the total investment that may derive from this Round is estimated at $40 billion.[254]

The Pemex-BHP venture illustrates investor confidence in Mexico's commitment to reform. In its agreement with Pemex, valued overall at U.S. $1.2 billion, BHP holds a sixty percent stake in the venture and agreed to drill one appraisal well and one exploration well, to acquire additional seismic data, and to commit approximately $320 million to the contractually-required three-year Minimum Work Program.[255] It also agreed to pay an additional royalty of 4% over the base royalty rate of 7.5%, and, should the venture partners agree to move beyond the Minimum Work Program, BHP must invest the remainder of the $570 million minimum contribution, inclusive of the expenditure on Minimum Work. What won the bid for BHP was its upfront cash payment of $624 million, a figure that exceeded competitor BP's $605.9 million equivalent.

Despite the improvements that Mexico made to its program terms, the administrative rescission and dispute resolution provisions of the executed

---

250. *Bidders for Mexico Deepwater Rounds Listed*, THE OIL & GAS YEAR (Nov. 29, 2016), https://perma.cc/7PEH-9C65.

251. *Id.*

252. Melissa Sustaita, *Mexico's Deepwater Round Ends in Success*, OFFSHORE ENGINEER (Dec. 5, 2016), https://perma.cc/B473-4ZJ3. This Round also represented another historic first for Pemex, which joined a consortium with Chevron and Inpex, to, for the first time, competitively bid on, and win, rights to another block. Press Release, Pemex, Pemex, Chevron e INPEX Undersign a Contract for the Exploration of block 3 North of the Perdido Area (Feb. 28, 2017), https://perma.cc/QCA4-DNRP.

253. Ryan Stevenson, *Mexico Learning Lessons Ahead of Deepwater Bid Round*, NEWSBASE (Nov. 10, 2015), https://perma.cc/B8FT-HVXF.

254. Energy and Electricity Forecast, *Key Player – Pemex*, ECONOMIST INTELLIGENCE UNIT, 2017 WLNR 7511053 (Mar. 9, 2017).

255. Fitzgerald, *supra* note 164.

contracts from Round 1.4 appear largely unchanged.[256] The Model Contracts' administrative rescission exemption from arbitration, however unlikely its exercise, might result in protracted parallel proceedings.[257]

Perhaps, given Mexico's gratifying responsiveness to investor concerns, potential bidders might convince Mexican authorities to address the risks associated with the rescission and dispute resolution provision of its contracting scheme. If not, investors must consider the many options available to mitigate that risk to ensure a more predictable legal environment for their new investments in Mexico's energy sector.

256. Contratos Firmados, COMISIÓN NACIONAL DE HIDROCARBUROS (Firm Contracts), https://perma.cc/FL9E-AMYM.

257. *See supra* Part III.B.