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The USMCA and recognition of the Mexican State's ownership of hydrocarbons

El T-MEC y el reconocimiento de la propiedad del Estado Mexicano sobre los hidrocarburos

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Abstract

Chapter 8 of the US-Mexico-Canada Trade Agreement (USMCA) recognizes the direct domain and the inalienable and imprescriptible ownership of Mexican hydrocarbons. This article aims to understand that chapter (1) from the perspective of the metamorphosis of investment agreements, (2) its relationship with other chapters of the USMCA, and (3) its effectiveness for the Mexican government. The report concludes that (A) Chapter 8 is the response to the current uncertainty of the international foreign investment regime and the need to adjust investment treaties; (B) the recognition that the Mexican States owns hydrocarbons through government contracts that are entitled to the treaty protection for investments provided for in the USMCA; and (C) Chapter 8 does not appear to be an effective tool for the Mexican government because certain limitations present in other parts of the agreement continue to be applied to the hydrocarbons sector, such as the obligation to grant the same treatment to U.S. and Canadian investors as to Mexican ones. Finally, it becomes evident that Chapter 8 of the USMCA does not seem to be a good model to follow for the Bolivian case.

Keywords: Agreement between the United States of America, the

United Mexican States, and Canada (USMCA); hydrocarbons; investment treaties; Bolivian Constitution.

Resumen

El Capítulo 8 del Tratado Comercial México-Estados Unidos-Canadá (T-MEC) reconoce el dominio directo y la propiedad inalienable e imprescriptible de los hidrocarburos mexicanos. El trabajo pretende comprender este capítulo (1) desde la perspectiva de la metamorfosis de los acuerdos de inversión, (2) su relación con otros capítulos del T-MEC y (3) su vigencia para el gobierno mexicano. El informe concluye que (A) el Capítulo 8 es la respuesta a la incertidumbre actual del régimen internacional de la inversión extranjera y de la necesidad de ajustar los tratados de inversión; (B) el reconocimiento de la propiedad mexicana de los hidrocarburos se realiza a través de contratos gubernamentales que no interfieren con las protecciones generales para las inversiones previstas en el T-MEC; y (C) el Capítulo 8 no parece una herramienta efectiva para el gobierno mexicano porque ciertas limitaciones presentes en otras partes del acuerdo continúan aplicándose al sector de hidrocarburos, como la

obligación de otorgar el mismo trato a los inversionistas estadounidenses y canadienses que a los mexicanos. Finalmente, se pone en evidencia que el Capítulo 8 del T-MEC no parece ser un buen modelo a seguir para el caso boliviano.

Palabras clave: Tratado entre los Estados Unidos Mexicanos; los Estados Unidos de América y Canadá (T-MEC); hidrocarburos; tratados de inversión; Constitución de Bolivia.

1. Introduction

On February 7, 2009, Bolivia approved its Political Constitution, providing in its Article 359.I that

Hydrocarbons, whatever their state or form, are the inalienable and imprescriptible property of the Bolivian people. The State, (...) exercises ownership of all of the country's hydrocarbon production and is the only one empowered to sell it. (...).

The ownership of hydrocarbons was one of the triggering issues so that, at that time, a Constituent Assembly was raised to guarantee state ownership over the exploitation and marketing of this resource and, later, to establish that no agreement or convention could totally or partially violate such ownership. Finally, the Bolivian Constitution would provide in its ninth transitory provision the denunciation or renegotiation of international treaties that are contrary to it.

Such constitutional mandates implied the reduction of foreign investment in the hydrocarbon sector, the appearance of disputes with investors and the denunciation of several international agreements. However, now, more than ten years later and after a global metamorphosis of international

trade and investment agreements, it is pertinent to review the possibility of including the recognition of state ownership of strategic natural resources within the new international investment agreements.

In this sense, the recognition in Chapter 8 of the USMCA of the Mexican State's direct, inalienable and imprescriptible ownership of hydrocarbons is an experience that deserves to be reviewed. So, the objective of this article is to better understand Article 8.1 of the USMCA (1) from the perspective of the metamorphosis of investment agreements, (2) in its relationship with other chapters of the USMCA, and (3) considering its effectiveness for the Mexican government.

2. Background: USMCA Chapter 8

The North American Free Trade Agreement (NAFTA) included a chapter on energy and basic petrochemicals (Chapter VI), with various provisions on the energy sector. During the NAFTA renegotiations, Chapter 8 on Energy had been specifically foreseen, which provided for the integration of the North American energy market through an open market and without interference in contractual relationships. However, with the new administration of Mexican President Andrés Manuel López Obrador, the chapter would be renegotiated with a single article (Article 8.1) that recognizes the direct domain and the inalienable and imprescriptible ownership of hydrocarbons (Martinez, 2022).

In fact, the text of Article 8.1 provides that

(...) the Parties confirm their full respect for sovereignty and their sovereign right to regulate with respect to matters addressed in this Chapter in accordance with their respective Constitutions and domestic law, in the full exercise of their democratic processes.

Furthermore, pursuant to Article 8.1.2 the United States and Canada recognize, without prejudice to their available rights and remedies, that

- (a) Mexico reserves its sovereign right to reform its Constitution and its domestic legislation; and
- (b) Mexico has the direct, inalienable, and imprescriptible ownership of all hydrocarbons in the subsoil of the national territory, including the continental shelf and the exclusive economic zone located outside the territorial sea and adjacent thereto, in strata or deposits, regardless of their physical conditions, pursuant to Mexico's Constitution (...).

As Martínez (2022) points out, due to the claims of the United States regarding some measures adopted by Mexico in the Energy Sector, Mexico, through its Federal Electricity Commission, has recently argued that Article 8.1 constitutes a reservation whose effect is to exclude the application of the Agreement to the entire sector (including the electricity sector). However, foreign investors have argued a grammatical interpretation, pointing out that Article 8.1 is simply a statement that refers to hydrocarbon issues, not electricity. In addition, it must be considered that the recognition by the United States and Canada of Mexico's sovereign right to reform its legal framework on its hydrocarbons is without prejudice to the rights of the United States and Canada and the remedies available in the USMCA itself.

3. The metamorphosis of investment agreements

The way investment treaties have evolved and the current state of the investment regime explain in part the meaning and purpose of Article 8.1 and the current investment protection standards in the USMCA. Lim, Ho

and Paparinskis (2021, pp. 83-84) have pointed out that the metamorphosis of investment treaties is understood from their periods of creation (1959-1990), proliferation (1990-2007), and adjustment (2007 and beyond). Investment agreements have evolved into complex instruments that detail formal and substantive protection of foreign investment. In that order, during 1959-1990, the wide approval of arbitration stands out, with the entry into force of the Convention of the International Center for Settlement of Investment Disputes (ICSID). Between 1990-2007, investment treaties increased and were also tested with the claims of foreign investors, which resulted in significant payments in favor of investors and alarm for States. Finally, from 2007 onwards, in the face of an evident crisis in the international investment regime, UNCITRAL transparency rules were adopted and Investor-State arbitration began to be replaced by the Investor-State judicial settlement. So, we live in an era of uncertainty regarding the international investment regime, with adjustments and denunciations of investment treaties.

Under the USMCA, arbitration has been restricted to relations between Mexico and the United States and, in addition, is available for violations of the treaty's substantive rules where investors have entered into government contracts. According to Sacerdoti, Chapter 14 of the USMCA (Investments) offers more limited protection than NAFTA and does not take into account the criticisms of some countries, civil society, and some think-tanks of the Investor-State dispute settlement mechanism. In the case of Mexico, the benefits of investment protection (as in NAFTA) only remained for large companies with greater political contact. Thus, the most protected investments are the most capital-intensive and the least environmentally friendly (hydrocarbons); and the least protected are those related to manufacturing, which is the most labor-intensive and therefore the most important against poverty and unemployment (Sacerdoti, 2020, pp. 1-2). It is evident that Chapter 8 is the answer to the uncertainty of the foreign investment regime and is an adjustment that States want in

investment treaties. However, given the economic importance and political influence of business in the hydrocarbon sector, it is unlikely that arbitration will be reserved for this sector.

4. USMCA investment protection

Hydrocarbon investments by the United States or Canada in Mexico will continue to be entitled to the full protection of the USMCA as long as they are made through government contracts, according to Article 8.1 USMCA. Chapter 8 does not interfere with protections provided in other chapters of the USMCA. Other chapters should be taken into account, such as

- Chapter 14: Investment;
- Chapter 15: Cross-Border Trade in Services; and
- Chapter 22: State-Owned Enterprises and Designated Monopolies.

In Chapter 14, the Investor-State dispute settlement procedure applies to investments in oil and gas and other listed sectors in which companies have a contract with Mexico's federal government (Annex 14-E-6 (b) "covered sectors"). Chapter 15 establishes three basic protections for foreign investments in general: namely, most-favored-nation treatment, national treatment, and other minimum standard of treatment provisions. Finally, Chapter 22 is a new chapter that places restrictions on state-owned enterprises, stipulating that USMCA Parties are prohibited from discriminating against foreign enterprises. It is important to know Chapters 14, 15, and 22 in order to read Chapter 8 in context and understand its scope (Cacheaux Cavazos & Newton, 2022, pp. 14-15).

According to Herdegen, despite that the most-favored-nation treatment is not a principle of customary international law, this basic protection constitutes a relative standard requiring that an investor from a contracting State be treated at least as favorably as an investor from a non-contracting third State. On the other hand, the principle of national treatment requires equal treatment between foreign and national investors in a similar situation in a host state. Other minimum standards of treatment provisions are fair and equitable treatment and umbrella clauses that refer to compliance of contracting States with obligations they have assumed towards a foreign investor (Herdegen, 2013, p. 411).

Thus, having indicated that government contracts in the hydrocarbon sector are entitled to the full protections of the treaty, it is important to consider whether any exceptions exist within the treaty (Chapter 32, "Exceptions and General Provisions") or in the existing annexes to the agreement. First, regarding Chapter 32, it has no article that provides an express exception for the energy sector; and, second, a review of the annexes shows that Mexico has not adopted specific hydrocarbons measures. In consequence, Chapter 14 would apply without reservation (Vejar & Moyano, 2019). Therefore, even with the recognition of Mexican ownership of hydrocarbons within Chapter 8, the hydrocarbon investment in Mexico must take place through government contracts that fall within the USMCA's category of government contracts that are entitled to the treaty protection. Chapter 8 seems almost irrelevant as it does not interfere with the general investment protections provided in the USMCA.

5. Effectiveness of USMCA Chapter 8

For Olson (2020, p. 546), Chapter 8:

(...) does not state anything new about Mexico's hydrocar-

bon law or state anything inconsistent with international law. Although chapter 8 uses more forceful language, it essentially restates what the United States and Mexico acknowledged in the 2012 treaty.

Because [Andrés Manuel López Obrador's] administration unlikely has the capacity to roll back Mexico's energy reforms as promised, chapter 8 of the USMCA seems mostly symbolic. AMLO's administration can halt the bidding process and renegotiate a few contracts, or if he finds it politically expedient, he can allow all private contracts already negotiated to remain. Keeping, the existing contracts and not allowing any more would have the benefit of allowing PEMEX to gain expertise, an expanding market (...).

In the same way, Gantz (2020, p. 120) adds that "(...) energy exports are a major source of foreign exchange for Mexico and maintaining and increasing energy export earnings are critical to generating the revenues the president will require to carry out many of his domestic reforms (...)". On 26 December, 2020, Mexico published an Import and Export Resolution regarding hydrocarbons and petroleum products; the resolution shortens the maximum effective term of the permits contemplated in the previous regulation, from twenty to five years (Solano, Moreno, & Flores, 2020, p. 141). The White House accused the Energy Regulatory Commission (CRE), a supposedly autonomous Mexican agency, of not exercising its powers in an "impartial" manner, as established by the treaty, and of favoring Pemex. On the Mexican side, the main defense seems to be Chapter 8 and the Secretary of Energy recently proposed a policy that seeks to force the purchase of natural gas exclusively from PEMEX. According to the United States, Mexico's policies violate Chapter 2, on National Treatment; 14, on Investments; and 22, on Parastatal Companies (Cullell, 2022). Therefore, Chapter 8 does not seem effective for the Mexican government to pro-

pose hydrocarbon policies in line with Andrés Manuel López Obrador's promises. Apparently, there is no way to argue that Chapter 8 excludes Mexico from its other obligations related to most-favored-nation treatment, national treatment, and other minimum standards.

6. Conclusions

Chapter 8 of the USMCA includes provisions (Article 8.1) that recognize Mexican ownership of hydrocarbons and the parties confirm their full respect for sovereignty and their sovereign right to regulate in accordance with their respective Constitutions and domestic laws. Specifically, the United States and Canada recognize, without prejudice to their rights and available remedies in USMCA, that Mexico reserves its sovereign right to reform its Constitution and its domestic legislation, and has the direct, inalienable, and imprescriptible ownership of all hydrocarbons.

After reviewing the metamorphosis of investment agreements, it is evident that Chapter 8 is the answer to the current uncertainty of the foreign investment regime and is also a necessary adjustment to investment treaties. Arbitration will continue regarding disputes in the hydrocarbon sector, given its economic importance and political influence. Considering the relationship of Chapter 8 with other chapters of the USMCA, the recognition of Mexican ownership of hydrocarbons takes place through government contracts that are entitled to the treaty protection (most-favored-nation treatment, national treatment, and other minimum standards). Therefore, Chapter 8 does not interfere with the general investment protections provided for in the USMCA. Finally, Chapter 8 does not seem to be an effective tool for Andrés Manuel López Obrador's government; in fact, despite its introduction, certain limitations present in other parts of the agreement continue to apply to the hydrocarbons sector, such as the obligation to grant the same treatment to U.S. and Canadian investors as to Mexican

ones.

Therefore, the provisions of Chapter 8 of the USMCA do not seem to be a good model to follow for the Bolivian case, taking into account that the Bolivian Constitution provides for the ownership of hydrocarbons not only within the strata of the earth, but also during its commercialization. Likewise, the possibility of international arbitration with foreign investors over natural resources such as hydrocarbons is out of place in Bolivian legislation unlike what happens in Mexico, where, in addition, the investment protection standards recognized in the USMCA serve as additional defense mechanisms for the investor.

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