CLIENT UPDATE

MEXICO REGULATORY CLIMATE FOR INFRASTRUCTURE PROJECTS

Background

This Client Update focuses on key legal and regulatory developments in Mexico related to works and services contracted by the Mexican Government from private contractors over the last year and their impact on infrastructure projects. It also briefly addresses key international developments.

Mexican statutes setting forth the requirements for infrastructure agreements executed between Mexican Government instrumentalities and Mexican and foreign companies, require to specify causes for termination such as failure to perform under the agreement, breach of Mexican laws and insolvency of the private contractor, in line with international market practices.

The policy embodied in such statutes was intended to create competitive pressures so as to improve efficiency, reduce costs, and lower the prices of infrastructure construction and services.

Change in Policy

The current Mexican president, Andrés Manuel López Obrador ("Amlo"), was sworn in on December 1st, 2018.

The Mexican Federal Administration characterized the infrastructure regulatory regime as one of the "neo-liberal measures" adopted by previous administrations. It started implementing a number of administrative measures aimed at reverting back the infrastructure market to a previous model of classic monopoly controlled by the Mexican Government.

Some of such administrative measures are being challenged in Mexican courts and international tribunals.

Mindful of the possible outcome of pending proceedings, the Mexican president introduced a bill of amendments to infrastructure legislation with a similar purpose to that sought by the

administrative measures being challenged: to undo fundamental pieces of Mexican infrastructure legislation.

Proposed Bill

On April 27, 2023 the Mexican President submitted a bill to the Mexican Congress to amend 23 statutes (the "Bill") to, among other: (i) provide that the Mexican Federal Administration can terminate any agreement for public works and services for infrastructure, at any point in time, for reasons of public interest or national security, without being liable in respect to damages, and (ii) delete the express priority afforded to international treaties to which Mexico is a party, over Mexican statutes relating to such public works and services.

The Bill does not define the concepts of public interest or national security.

Considering recent precedents of bills submitted to Congress -which is controlled by Amlo's party- there is a possibility that the Chamber of Deputies acts in haste to discuss and approve the Bill in its original form. There is a further possibility that the Bill is subsequently delivered to the Senate and approved after a perfunctory discussion of the same.

Let us assume that the Bill is enacted and a determination of a risk affecting the public interest or national security by an instrumentality of the Mexican Government is made in an unreasonable or unjustified manner, in respect to an agreement entered into after such enactment.

Potential Consequences

The Bill if passed by Congress, might lay the way open for a major unilaterally-induced change of circumstances in respect to the basis upon which Mexico traditionally invites Mexican and foreign investors to invest in Mexico's infrastructure market, and may lead in some instances to an arbitrary determination of public interest.

Evaluation of "Public Interest" by Mexican Courts

Mexican court precedents require that a determination of "public interest" as a basis to deny renewal of an administrative permit or carry out an expropriation, be clearly founded. Based upon such court precedents, a general or nebulous determination of a "public interest" as a basis to trigger termination of a contract between the public administration and a private contractor, should not suffice to enable such termination. A less than entirely founded reason of public interest determined by a governmental entity as a basis for termination, may be considered a unilateral and arbitrary determination and provide a basis to either require the

governmental entity to perform under the contract or enable the filing of a claim for damages against the same. [1]

Mexican courts have determined that an agreement creates an established relationship between the governmental entity and the private contractor, induces the latter to effect investments to perform under the agreement and creates a legitimate expectation to generate a profit from the same. Assuming the Bill is enacted, termination of an agreement under such circumstances, could only be triggered by a clear and present justification that a "public interest" reason exists.

Court precedents lead to conclude that a less than entirely founded determination that "public interest" is harmed, as a basis to trigger termination of an agreement, violates articles 14 and 16 of the Mexican Federal Constitution.

On a separate but related matter, the Federal Constitution provides that treaties executed by Mexico are valid and binding and prevail over Mexican statutory law. The proposed predominance of the provision for termination of infrastructure agreements over treaties, included in the Bill, would thus be unconstitutional.

Legitimate Expectations

Should the Bill be enacted, foreign investors affected by a less than entirely founded determination of harm to "public interest" might be able to seek redress through international arbitration proceedings under investment treaties between their home States and Mexico. Mexico is party to important multilateral treaties—such as the United States-Mexico-Canada Agreement ("USMCA") and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership ("CPTPP") —as well as to a wide range of bilateral treaties, including with Spain, the Netherlands, and the UK. Investment treaties contain standards that protect foreign investors from certain government measures, such as unfair and inequitable treatment, discrimination, and expropriation. Foreign investors that qualify for protection might recover damages from Mexico if they prove that an early termination of an agreement harmed their investment and violated the protection standards from the relevant treaty.

Foreign investors have brought dozens of investment arbitrations against other countries—particularly against Spain and Italy. These cases have generated important case law that

[1] Civil Code for the Federal District (*Código Civil para el Distrito Federal*), art. 1797. Primer Tribunal Colegiado en Materias Administrativa y del Trabajo del Décimo Primer Circuito. Décima Época, Registro 2016332, Tribunales Colegiados de Circuito, Jurisprudencia, Gaceta del Semanario Judicial de la Federación, Libro 52, Marzo de 2018, Tomo IV, Materia Administrativa, Tesis XI.1o.A.T. J/15 (10a.), pág. 3087.

provides valuable guidance on important issues, mainly on the fair and equitable treatment ("FET") standard.

The FET standard protects investors' legitimate expectations and shields them against arbitrary and discriminatory treatment, due process violations and denials of justice. In past investment disputes, tribunals have often centered their analysis on whether the host State's regulatory changes violated the investors' legitimate expectations.[2] As the tribunal in *Thunderbird* explained, "the concept of 'legitimate expectations' relates . . . to a situation where a [State's] conduct creates reasonable and justifiable expectation on the part of an investor (or investment) to act in reliance on said conduct, such that a failure by the [State] to honour those expectations could cause the investor (or investment) to suffer damage."

An invitation to foreign investors to participate in a bid for an infrastructure contract, subsequently subject to an early termination based upon a less than entirely founded "public interest" allegation, may violate legitimate expectations of the same and provide a basis for a claim under existing investment treaties.

A potential claim by a foreign investor, should be reviewed in light of key findings on legitimate expectations from the relevant arbitral jurisprudence: *First*, tribunals must balance the "[investor's] legitimate and reasonable expectations on the one hand and the [host State's] legitimate regulatory interests on the other."[3] *Second*, tribunals must measure an investor's legitimate expectation "against the information it should reasonably have known at the time of the investment."[4] *Third*, it is well established that representations and outright inducements that the host State made specifically to the investor give rise to legitimate expectations. *Fourth*, the host State must "implement[] its policies bona fide by conduct that is . . . reasonably justifiable by public policies and that [] does not manifestly violate the requirements of consistency, transparency, even-handedness and non-discrimination."[5] *Fifth*, absent specific commitments, a

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[2] *International Thunderbird Gaming Corporation v. The United Mexican States*, Arbitral Award, 26 January 2006, ¶ 147

[3] *Saluka Investments B.V. v. The Czech Republic,* UNCITRAL, Partial Award, ¶ 306.

[4] Among other, *Novenergia II - Energy & Environment (SCA) (Luxembourg), SICAR v. Spain*, SCC Case No. 2015/063, Award, 15 February 2018, ¶ 662 (holding that "an investor's legitimate expectations are based on the host State's legal framework and on any representations or undertakings by the host State at the time the investor makes the investment.")

[5] Among other, *Hydro Energy 1 S.à r.l. and Hydroxana Sweden AB v. Spain*, ICSID Case No. ARB/15/42, Award, 9 March 2020, ¶ 676.6 (concluding that the State's measures "must be suitable to achieve a legitimate policy objective, necessary for that objective, and not excessive considering the relative weight of each interest involved, and a balancing or weighing exercise

breach of the FET standard may only be established if "there has been some form of total or unreasonable change to, or subversion of, the legal regime."[6]

Tribunals deciding investment arbitrations against Mexico would likely take into account these five key findings on legitimate expectations, while considering the specific facts of each dispute.

Investors should carefully review the alternatives available to them with the assistance of legal counsel, in view of a change of circumstances and a potential arbitrary determination of public interest should the Bill be enacted. Such alternatives are likely to include arbitration under one of the array of trade and investment treaties entered into by Mexico, including USMCA, CPTPP as well as bilateral treaties. A possible action before Mexican courts based upon an arbitrary determination of "public interest" should also be factored into such analysis.

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Please do not hesitate to contact us with any questions.

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so as to ensure that the effects of the intended measure remain proportionate with regard to the affected rights and interests.").

[6] Among other, *Watkins Holdings S.à.r.l. and others v. Spain,* ICSID Case No. ARB/15/44, Award, 21 January 2020, ¶ 521 (finding that "after having entered into the [Energy Charter Treaty], there are limitation on its powers to alter the regulatory framework and it should not do so if such fundamental and radical changes would be unfair, unreasonable and inequitable, which would undermine an investor's legitimate expectation.").