Panel Discussion: Energy Regulation in Mexico

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Recommended Citation
Available at: https://digitalrepository.unm.edu/usmexlj/vol3/iss1/11
Ewell Murphy: We have heard descriptions of three very important Mexican industries. In at least one of them, the hard minerals industry, there have been remarkable openings in the new legislation. In the electric power industry, we have seen some clarification of investment rights, i.e., affirmative clarifications. While this legislative change has been going on in Mexico, the North American Free Trade Agreement (NAFTA)\(^1\) has been created and suddenly, in theory, given rights to Canadian and United States investors. With the new laws and with NAFTA, do you think that Canadian and United States investors have any greater access to the industries you have talked about than other foreign investors may have, e.g., investors from Japan or Europe.

Abdon Hernández: Since the new law was enacted, numerous companies from Canada and the United States are coming to Mexico due to the proper legal framework. This is also because the environmentalists in Canada and the United States are shutting down their domestic companies, and because of high corporate expenses for reclaiming lands that are being environmentally damaged. In addition, the United States and Canada are going to Mexico because, with NAFTA, there will be more value to mineral products exported from Mexico. NAFTA was just the "icing on the cake." The main reasons why Canadian and United States producers are going to Mexico are the environmental restrictions in Canada and United States and the opening of the Mexican mining industry to foreign investors.

Murphy: In terms of actual legal access to Mexican mining concessions, would a Japanese mining company now have as much access as a Canadian or United States company?

Hernández: Yes, it would. As a matter of fact, the Japanese government is actively involved in exploration for the Mexican government as a contractor. At the company I work with, we have a joint venture with the Japanese, which has been rather difficult. The Japanese have assigned Mexico to Sumitomo, which is the vehicle for mining activities in Mexico, whereas Mitsui is the Japanese vehicle for mining activities in Peru.

Murphy: Does this create any antitrust problems?

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**Hernández**: I do not know. It is a government action. I assume the Japanese have sovereign immunity protection.

**Murphy**: What about the electric power industry? Would you say that Canadian and United States investors have any special access that foreign investors generally do not have?

**William DeGrandis**: There are Japanese, French and other companies already involved in some of these consortiums. I do not think United States companies have any legal edge, but the United States Independent Power Producers (IPPs) and power companies have been doing this longer than other entities, certainly of any Canadian company that I can think of, except for North Canadian Power. The Japanese and the French companies, except for Electricité de France, have mainly been equipment suppliers. They are only recently taking a developer role to sell their equipment. Thus, United States companies may have a practical edge because they are used to being involved in these partnerships. I believe that, strategically, to spread risk, there will be more consortiums like Samayuka, involving United States, Japanese and Canadian companies, all taking their respective roles and risks. But I do not believe a United States company has any special legal advantage.

**Murphy**: What about the oil industry, specifically the oil service industry: contractors, suppliers and manufacturers of secondary petrochemicals. Does NAFTA give Canadian or United States investors any access to that area that is not generally available to foreign investors?

**Miguel Jauregui**: I think you have to differentiate. The only area where United States and Canadian investors have an advantage is in government procurement. Everything else is on a level playing field.

**Murphy**: To the extent that procurement would involve electric power, then the same thing would apply for electric power.

**DeGrandis**: I would agree.

**Murphy**: Mr. Hernández, you were also talking about the new mining law. You said that, consistent with the Constitution, the new mining law requires foreign concessions to be taken through Mexican companies.

**Hernández**: Yes.

**Murphy**: Regarding Mexican companies, were you thinking only of Sociedades Anónimas and S.A. de C.V. as the main corporate structures for mining or could other forms of legal organization be used?

**Hernández**: In fact, in the field of mining, Sociedad de Responsabilidad Limitadas (S.R.L.s) are very popular.

**Murphy**: For tax reasons, I could see that would really work for mining.

**Hernández**: Right. In addition, I have seen at least one set of bylaws of a S.R.L. which has different allocations of voting rights so that, in effect, a voting trust exists. There may be social parts split into new 100 peso parts. There may be various categories of social parts, with some limited voting rights and with other kinds of special rights.

**Murphy**: This becomes very sophisticated.

**Hernández**: There is more flexibility because one does not have to register the articles of incorporation (institutos de incorporación). This
is one of the major distinctions from United States companies. In the United States there are articles of incorporation; in Mexico, institutos de incorporación. But in Mexico there is no judicial review. Formerly, it was necessary to register the institutos in the Public Registry of Property. One would also have to go to court, where the Attorney General’s Office, more as a formality, would ensure compliance with the law, although it is a private law. Today, there is no judicial review; thus one has much more flexibility.

Ignacio Gómez-Palacio: Cultural background must be taken into account when you think about Mexico. Mexican corporate law must be viewed through the eyes of Mexican culture, with the eyes of a Mexican counsel. One cannot just go in and “Japanize,” “Americanize” or “Canadianize” Mexico. The mentality of Mexico is comprised of seventeen million Indians and other mixed cultures. Our concept of progress is like that of the United States; however, the United States mentality is closer, than Mexico, to that of Europe.

Murphy: You said it very well—every country has to be true to its own cultural identity.

Jauregui: About eighteen years ago, Mr. Hernández and I drafted the charter and bylaws, for tax purposes, of the first Mexican S.R.L. It was a joint venture between Peñoles and AMEX to extract copper. One of the features incorporated was the “bucket of oil” clause, whereby corporate investors could profit-share as partners in the S.R.L., either in kind with copper extracted or in cash if the copper was sold. This created the necessity to prove to United States tax authorities that this was a mining partnership.

Murphy: This is really interesting. It is my understanding that, at least until now, one must get clearance from the Ministry of Foreign Relations to form a Mexican company that is going to have foreign participation. There has to be something like a Calvo clause stating that foreigners will not appeal to their government for support in the event of claims against the Mexican government. Is this still required by the language from Article 27 of the Mexican Constitution?

Hernández: A permit from the Foreign Affairs Ministry is still required, but your application need only include: (1) the preferred names of the corporate entity and (2) whether to include an exclusion clause for foreigners or a Calvo clause. It is really a formality.

Murphy: But is it correct that you still have either an exclusion of foreign investors or a Calvo clause reference?

Hernández: Yes.

Murphy: By agreement of the three countries under NAFTA, Mexican, United States and Canadian investors have been given the right to appeal to their sovereign government for help in the event of an expropriation

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2. Named for the Argentine diplomat and jurist, Carlos Calvo (1824-1906), this term refers generally to the waivers he advocated of a foreigner’s access to foreign tribunals and diplomatic espousal of the foreigner’s claim against the local sovereign.

or in an arbitration, through the arbitration provisions of NAFTA. This seems to be inconsistent with the Calvo clause. In spite of that, I understand that the Calvo clause will still be required of United States and Canadian investors.

Hernández: Rafael Estrada can cast some light on this.

Rafael Estrada: Under NAFTA, a commission representing the three governments is going to be established. That would be the proper forum for a United States or Canadian investor to go to for protection. Whether that is a violation of the Calvo clause or not is uncertain.

Murphy: No, it is an argument. I can see the issue here.

Estrada: The treaty commission is a multi-national entity.

Jauregui: I would like to add a couple of comments. The Calvo clause has perhaps been tampered with. The decree that was drawn up in 1993, prior to the signing of NAFTA, states that the Calvo clause is specifically not applicable where there is an international treaty. As you know, Mexico treats NAFTA as a treaty, not as an agreement.

Murphy: Was this a presidential decree?

Jauregui: It was a presidential decree that was drafted by the Ministry of Foreign Relations dealing with the applicability of the Calvo clause as it relates to international treaties. The decree states that the Calvo clause is not applicable in a scenario involving an international treaty.

Murphy: Essentially, if we argue that NAFTA gives Canadian and United States investors the right to be exempt from application of the Calvo clause, this decree in effect says that an international treaty such as NAFTA can do just that.

Jauregui: This exemption would not involve the normal dealings of the company. In my opinion, the applicability of the Calvo clause is ultimately dependent on the chapters of NAFTA. If the subject is covered by NAFTA, the Calvo clause would not apply; if the subject is not covered by NAFTA, the Calvo clause would apply.

Murphy: Suppose that a United States investor wanted to claim against the Mexican government, but did not want to go through the NAFTA mechanism. Would the Calvo clause prevent such an investor from obtaining the support of the government as a mechanism for that?

Jauregui: Sure.

Murphy: That is a very sophisticated way to rationalize the whole thing. Let us have comments and questions from the audience.

Estrada: I have a preoccupation triggered by an assertion made by Abdon Hernández, who said, more or less, that the legislative and regulatory activity of the federal government under the Salinas Administration has demonstrated consistency between political speeches and action. I tend to agree with that statement, but I would like to remind everyone that Article 28 of the Mexican Constitution has a paragraph which empowers the federal Congress to declare any economic activity in Mexico as reserved to the government. For instance, if Congress were to state that the production and commercialization of neckties is a strategic economic activity, then this declaration, by the simple act of Congress, reserves this particular economic activity to the government. This has
been overlooked by the Mexican business community and the time has come to ask for a complete reform of Article 28. Salinas has carried out very important economic reforms which have opened many opportunities for business in Mexico, both from local and foreign investment. With Zedillo in the presidency, economic reform may be reversed through acts of Congress without the need to fight for the approval of constitutional reform.

Herndández: I believe that in key issues for private enterprise and for the business community, there has been consistency. There are other things that as lawyers, perhaps, we ought to be aware of. For example, your reference to Article 28 of the Constitution. If Mexico did have an independent legislative branch that really voted in accordance with the mandate of their constituency, they would probably not approve the changes of law mentioned. Of course, the phrase “act of Congress” is used. If Congress said “pursuant to regulatory powers of Article 89 of the Constitution,” that would be more problematic. At least Article 28 says Congress, although the representatives of the Partido de Acción Nacional (PAN) and the Cárdenistas did not get as many reforms as they would have desired. At least progress is being made in the right direction. If Mexico ever reaches a moment when a separation of powers truly exists, then all will be safe.

Jauregui: I am concerned about Article 28, an act of Congress and the rules of law. The Salinas Administration liberalized the mining industry, foreign investment and banking, and obtained a “stamp of approval” by adoption of NAFTA. It is not that it is a “cure-all”; it is just a stamp of approval. However, it is going to be very difficult to go back on this liberalization because it is supported by a long series of commitments. The laws in Mexico are in place, but there is some difficulty in enforcing them without a proper judiciary. Therefore, I would say that this factor is not only up to the Zedillo Administration, but also to the Mexican people. In my opinion, the Mexican government is now ineffective. It is up to private people and entrepreneurs to take care of this problem. We must make sure that the Mexican treasury does not get in the way of the ergo omnes and application of our decrees. Also, nothing must stand in the way of the prevalence of the law. This is really the challenge of the future.

Ken Hoffman: I have three questions. First, does anyone have any estimate as to when the new regulations might come out under the 1993 Foreign Investment Law? The second question speaks strictly to energy. I understand that there was previously a provision for a twenty year trust to allow for 100% foreign participation in secondary petrochemicals. This is no longer necessary because all secondary petrochemicals are open. Is there any chance that a trust arrangement could be used in the basic

petrochemicals? The third question also relates to basic petrochemicals. There is a conflict that needs to be resolved between the list of eight basic petrochemicals under the Mexican law and the definition of basic petrochemicals under NAFTA. I assume there is now a mechanism that will resolve this, but how and when?

Jauregui: Yes, there is. The purpose of a trust is to avoid conveying to the private investor the right to manufacture, exploit or sell basic petrochemicals. But trusts enable a private investor to participate in some form in the production of basic petrochemicals or in the establishment of plants to manufacture basic petrochemicals.

Murphy: The third question was, “Is there an inconsistency between the definition of the eight basic petrochemicals in the Mexican Foreign Investment Law and the NAFTA provisions?”

Jauregui: Yes, there is an inconsistency and I believe that in the hierarchy of laws, NAFTA would prevail.

Murphy: With most favored nation treatment, would NAFTA nationals have the access of all foreign nationals under the Foreign Investment Law?

Jauregui: Exactly. If you have a limitation as a Canadian or a United States land investor in a restricted zone, you could likely do away with that limitation by most favored treatment or most favorable of all treatments.

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5. NAFTA honors the extraction, production, sale and investment in nine basic petrochemicals in Mexico as reserved under Article 27 of the Mexican Constitution: methane, ethane, butane, propane, pentane, hexane, heptane, naphtha and carbon black feed stocks. NAFTA, supra note 1, art. 601.