

PEMEX, PRIVATIZATION and the NAFTA TRAP

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In mid-June, 2008, the Canadian Union of Public Employees (CUPE) and the Communications, Energy and Paperworkers Union of Canada (CEP) asked international trade lawyer Steven Shrybman¹ to meet with independent trade unions representing workers in Mexico's energy sector. These meetings arose from a commitment by CUPE and CEP to work in solidarity with Mexican and U.S energy sector unions to confront plans for the next round of continental integration promoted by the Bush, Harper and Calderone governments under the banner of the Security and Prosperity Partnership (the SPP).

The following offers a brief summary of the presentations made on behalf of the Canadian unions by Mr. Shrybman at meetings convened in Mexico City and Villahermosa on June 16, 17 and 18, 2008.

Calderone's Sweeping 'Reforms' to Mexico's Energy Laws

Mexican President Calderone has tabled amendments to Mexican law that would greatly increase foreign investment in the oil and gas sector, and ensure US companies access to deep water reserves in the Gulf of Mexico. His agenda, pushed by the US and its energy corporations, would enhance US energy security at the expense of the Mexican economy and the environment.

If Calderone succeeds, he will be leading the Mexican people into a trap that was set years ago and hidden in the investment rules of the North American Free Trade Agreement (NAFTA).

As this note explains, under NAFTA rules, if foreign investment in the energy sector is allowed, Mexico will be exposed to NAFTA investor claims that can negate constitutional safeguards and NAFTA reservations that now protect Mexican sovereignty over energy resources. A growing number of investor claims against Canada and against Mexico's southern neighbours show what Mexicans can expect if Calderone succeeds with his 'reform agenda'.

It is also important for the people of Mexico to understand the serious price that Canadians have paid for acceding to US and corporate demands that it embrace free trade, privatization and de-regulation for its energy sector. The result, as a recent headline in a leading Canadian newspaper proclaimed, has reduced Canada to a virtual "energy colony of the United States".

NAFTA Energy Rules

The first thing to understand about NAFTA and Mexican law relating to the energy sector is that unlike Canada, Mexico negotiated important exemptions from NAFTA energy and investment

¹ Mr. Shryman is a partner in the law firm Sack Goldblatt Mitchell, and he was accompanied by another lawyer from the firm, Mr. Hugo Leal-Neri, who has practiced law in both Mexico and Canada.

rules. These exemptions are crucial if Mexico is to maintain sovereign control of its energy resources in the face NAFTA Energy (Chapter 6) and Investment (Chapter 11) rules.

Under Chapter 6, NAFTA imposes two broad constraints on energy policy and law. The first prohibits export taxes on all energy goods (Article 604). This means that Mexico may not adopt a two price energy policy to shield its own people and businesses from the impacts of volatile and sharply rising world oil prices.

NAFTA also imposes a blanket prohibition on all export controls (Article 603) with only a limited exception for emergencies. Even then, Article 605 guarantees the US a proportional share of another NAFTA party's energy resources. In the case of Canada, this means that even in times of domestic supply shortages, US markets are still entitled to 65% of all Canadian oil production, and with the growth of exports from the tar sands, that proportion is destined to grow.

Chapter 11 Investment Rules

Equally problematic are NAFTA investment rules which prohibit a diverse array of government policies and laws that affect foreign investors, including those that: favour Mexican companies (*National Treatment*: Article 1102); require private investors to hire workers or source services in Mexico (*Performance Requirements*: Article 1106); or attempt to discontinue or reverse privatization (Expropriation, Article 1110).

The most important right accorded foreign investors under NAFTA is to sue the government of Mexico for damages if it fails to adhere strictly to NAFTA rules.² When such damage claims are made they are decided, not by Mexican courts or judges, but by secretive international arbitration panels (Article 1120). **The most important point is that because such claims are decided under international law, Mexico's constitution, including its protection for energy sovereignty, simply does not matter.**³

Investor-State Claims

In fact foreign investors have successfully invoked NAFTA rules to sue Mexico. In the first of these cases, a US-based hazardous waste company was awarded \$18 million US when a poor Mexican community refused to give the company a permit to operate a hazardous waste facility that threatened local groundwater.⁴ These same rules have been invoked on numerous occasions against all three NAFTA Parties, and recently by US energy giants to claim damages against

² Under Articles 1121 and 1122 foreign investors of a NAFTA party have a virtually unqualified right to claim damages for violations of the broadly-worded constraints established by the chapter.

³ Under the Vienna Convention of the Law of Treaties [Articles 27 and 46], "Party may not invoke the provisions of its internal law as justification for its failure to perform a treaty."

⁴ *Metalclad v. Mexico*; http://www.naftaclaims.com/disputes_mexico_metalclad.htm

Canada.⁵ In this case, Mobile Oil and another US-based oil company have claimed more than \$35 million US in damages because of research and development spending requirements imposed by the Canada-Newfoundland Offshore Petroleum Board. The companies say these performance requirements are prohibited by NAFTA investment rules. Yet Calderone continues to tout foreign investment as a way to revitalize research and development of the Country's oil sector.

Other transnational energy corporations have made or threatened claims against several of Mexico's southern neighbours under bi-lateral investment treaties for which NAFTA served as a prototype. In one of the first of these cases a tribunal ordered Ecuador to pay Occidental Corporation \$71million because it had raised taxes on the company's oil revenues. In a case against Bolivia, big oil companies are challenging the right of the newly elected government to renegotiate the terms of development and services contracts.⁶ In other cases, rate regulation or environmental laws are the targets. In yet others, the claims are made simply to recover losses from projects the company itself has bungled.

Mexico's NAFTA Reservations

While the Salinas government gave away far too much for so-called 'free-trade' with the US, Mexico refused to abandon state control of the oil and gas sector by negotiating key exceptions to NAFTA Energy and Investment rules. But the reservation from the punishing investment rules only applies so long as Mexico restricts foreign investment the energy sector. Thus, as soon as Mexico allows foreign investment in the sector, for example in the form of a service contractor, such investors gain full rights under NAFTA.

To put this another way: while the US failed in 1994 to pressure Mexico into accepting free trade for energy,⁷ it set a trap for a future Mexican government to lead its people into – as Calderone now plans.

Canada's Experience Under Free Trade In Energy

Any doubt about the folly of present 'reforms' must be dispelled by understanding the consequences for Canada of having 1) submitted to free trade energy rules, and 2) sold its only state-owned oil and gas company, PetroCanada.

The result has left Canada, one of the best endowed energy nations in the world, with no strategic oil reserve nor the ability to supply its own largest markets.⁸ While Canada produces more than

⁵ See "U.S. oil companies challenge Canada's demands for R&D spending under NAFTA, by Damon Vis-Dunbar", Investment Treaty News; and "US Oil Companies signal intention to sue Canada over local content requirements", Luke Eric Peterson, Investment Treaty News, November 15, 2007

⁶ http://www.iisd.org/pdf/2006/itn_jan31_2006.pdf

⁷ We understand that a certain amount of foreign investment has already occurred in the oil and gas sector, but exposure to NAFTA investor claims is proportionate to the extent and character of such investment, and present 'reforms' would greatly increase foreign investment in the sector.

enough oil and gas to meet its own needs, the largest share of its resources are shipped south, and most Canadians are entirely dependent on off-shore oil supplies to meet their heating, transportation and industrial needs.

Moreover, Canada is the only nation in the world that is committed to serving US energy needs in priority to its own. This is because under NAFTA, US consumers are now entitled to at least 60% of Canadian natural gas, and approx 65 % of its oil and gas – and this US share continues to grow. Moreover, even if supply shortages arise, Canada is precluded from meeting its own needs before those of the US (Article 605).

In addition, to an ever increasing extent, raw - rather than processed - tar sands heavy oil is exported to the US, and with it, the enormous potential for economic development and job creation that would otherwise come to Canada from upgrading and refining. For example, the export of oil through just one pipeline (435,000 barrels per day) means a lost opportunity to create 18,000 permanent jobs.

Finally, because unlike most countries Canada has no state-owned oil company, the enormous windfall profits arising from dramatic oil price increases are accruing to foreign investors, not the Canadian people.

A Path Not to be Travelled

While Mexico's oil and gas industry is facing serious challenges, foreign investment and free trade are not the answer unless the country wants to follow in Canada's footsteps and see much of the oil wealth flow into the coffers of transnational energy corporations, while the Mexican people suffer price increases and supply shortages, both at the same time.

NAFTA rules exist to entrench free trade policies that prohibit public policies and laws that Mexico will need to renew its oil and gas sector, ensure that benefits accrue to the people of Mexico, and that development take place in a sustainable manner. Mexico will need all the tools it now has to deal with the pressing challenges ahead - NAFTA rules seek to take those tools away permanently.

Mexico has the great advantage of having largely insulated itself from the application of free trade rules for energy. It would be a terrible mistake for it to negate these safeguards by allowing greater foreign investment in its oil and gas sector.

⁸ Several new pipeline projects will boost oil exports from Canada to well over 3 million barrels per day, but not one Canadian pipeline exists to serve major population and industrial centres in Eastern Canada which remain entirely dependent on off-shore supplies.