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MEXICO: Dispute resolution under the new public-private partnerships law

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Herfried Wöss

Herfried Wöss, an arbitrator and partner at Wöss & Partners SC in Mexico City, says flaws in the disputes provisions of the new Mexican law on public-private partnerships may make investor-state arbitration a safer option for parties whose public contracts are unjustly terminated.

The new law on public-private partnerships (PPPs) entered into force on 16 January. As a result, all public works, acquisitions and PPP contracts in Mexico may be subject to arbitration and alternative dispute resolution – marking the summit of a development that began in 1993. Mexico has successfully performed a number of PPPs in the past and the new law adds a modern framework for PPPs.

Background to the new law

Modern arbitration in Mexico began with reforms to the Mexican Commercial Code in 1989 and with the incorporation into domestic law of the UNCITRAL Model Law on International Commercial Arbitration in 1993. The arbitration rules in the commercial code were last updated in January 2011, with revisions to the provisions governing the enforcement of arbitral awards and judicial assistance.

Arbitration of disputes relating to contracts with state entities first became possible in December 1993 with the simultaneous reform of article 14 of the Organic Law that governs state oil company Petróleos Mexicanos (Pemex) and its subsidiaries; and article 45 of the law on the public electricity service. The Pemex organic law states: “With respect to juridical acts of international character, […] Petróleos Mexicanos and its Subsidiaries may enter into arbitral agreements if this serves the better performance of their objective.”

In November 2008, this provision was superseded by article 6(2) of the Regulatory Law of Constitutional Article 27 in the Petroleum Sector; and article 72 of the new Pemex Law.

All other federal entities were barred from taking part in arbitration until the reform of the Public Works and Services Law and the Law for Public Sector Acquisitions, Leases and Services in May 2009. The reforms meant disputes arising from all federal works contracts and long-term acquisition contracts could be referred to arbitration. In January 2012, the long-term requirement to acquisition contracts was removed and now all federal acquisition contracts may be subject to arbitration.

Apart from that, amicable dispute resolution, introduced in May 2009, is allowed in all federal works and acquisition contracts without the need for general provisions by the

Ministry of Public Function, which have never been issued.

The right to arbitration and amicable dispute resolution mechanisms was established in article 17 of the Federal Constitution in 2008, which underlines the importance of arbitration in Mexico.

Such rapid and tremendously favourable development has naturally encountered glitches – such as the partial non-arbitrability of disputes arising from acts of state; and the recent annulment of a US$300 million ICC award in the Commisa v Pemex case on grounds including public order and res judicata.

In the past 10 years PPPs in the form of "service provision projects" have been successfully developed, including hospitals, motorways and sport and cultural centres.

The new PPP law

On 16 January 2012, the PPP law was published in Mexico's Official Gazette. It provides for the creation of "Asociaciones Público-Privadas" which are defined under article 2 as "any scheme to establish a long-term contractual relationship between the public and private sectors for the rendering of services to the public or a final user, with infrastructure partially or totally provided by the private sector with the objective to increase social welfare and the level of investments in the country". Article 3 of the PPP law includes any kind of association to develop productive investment projects, applied research programmes and innovation technology.

The new law is well structured and provides a modern framework for PPPs. Unfortunately, the dispute resolution chapter contains several flaws, which will be analysed in this article. The law contains a multi-tier dispute resolution mechanism in its chapter XII, including negotiations, expert committees, conciliation, arbitration and judicial dispute resolution.

Negotiations

Under article 134 of the PPP law, the parties should aim to resolve any "disputes of a technical or economic nature" through good-faith negotiations. This phrase "disputes of a technical or economic nature" derives from article 45 of the the public works law and was actually eliminated in the May 2009 reform. There is no reason why negotiations should be limited to technical or economic issues and not include legal matters.

Such negotiations have to take place within the term established by the parties. In case the parties do not come to an agreement within such negotiation period, the dispute has to be submitted to an expert committee of three members.

Expert committees

Expert committees in the form of dispute review boards have been used in some PPPs such as the Bajio hospital project. This project entailed the construction and operation (excluding medical services) of a specialised public hospital over 25 years. An expert committee of

construction experts was formed during the hospital's construction phase and another committee of hospital management experts during the operation phase. The committees issue non-binding recommendations that are admissible as evidence in any subsequent judicial proceeding before the federal courts. There is only one dispute review board throughout the whole contract period. No disputes were reported during the construction phase. Construction finished ahead of the scheduled date in the contract.

Under the PPP law, once the negotiations come to an end, each party appoints its expert and both experts appoint the third expert. In case of default, the third expert is appointed according to a procedure established in future regulations accompanying the PPP law. The scope of the expert committee determination is limited to issues of a technical and ecnomic nature and excludes legal questions. Such limitation is expressly established in article 134 of the PPP law. Because of the wording of article 134, the establishing of an expert committee seems to be obligatory.

The new expert committees are a step back from the progress already achieved under the above-mentioned PPPs. The expert committee is ad hoc and not a standing committee. It does not have full jurisdiction like ICC or FIDIC dispute boards have, but is limited to factual questions. As the "independent expert procedure" in model contracts of Mexican state companies shows, the distinction between factual and legal issues is causing problems in Mexico – particularly where the expert retains exclusivity over the determination of the factual issue and where the terms of reference are too wide (for example, allowing the expert to impose a penalty for late delivery instead of merely determining whether a weather event amounts to force majeure and can give rise to a time extension).

According to article 135 of the PPP law, each party has to present a "proposal to resolve the dispute", which seems to be a submission containing the parties' positions as the expert committee procedure does not contain elements of conciliation.

Article 135 also establishes that an expert committee determination is binding when approved unanimously by the members of the committee. Such binding force is evidently limited to the factual issues without including legal questions. A majority determination should be admitted as evidence in a subsequent arbitration. The admission of expert reports in federal judicial procedures is subject to a series of formal rules.

The solution found in the public acquisition and works laws – to leave it to the procuring authority to use any amicable dispute mechanism suitable for a particular project – seems a better solution than the expert committee established under the PPP law, which does not correspond to best practices for infrastructure projects.

Conciliation

Article 138 of the PPP law refers to the conciliation procedure before the Ministry of Public Function under the public acquisitions and works laws. Such conciliation procedure is fairly efficient and frequently used by parties to public contracts.

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Arbitration

Article 139(1) of the PPP law reads: “The parties of a public-private partnership contract may agree to an arbitral procedure, under rules of law, in order to solve the disputes deriving from the performance of such contract under the terms of title four of book five of the Commercial Code”.

Arbitration has to be performed in Spanish. The reference to the Commercial Code concerns the law of the arbitration procedure, which is actually welcome, as the public works and acquisition laws do not contain any reference to the applicable arbitration regime and the application of the Commercial Code instead of the Federal Code of Civil Procedure is a matter of legal practice only.

However, the rather positive access of Mexican PPPs to arbitration is blurred by restrictions of arbitrability.

Non-arbitrability of acts of state

Article 139(3) and (4) of the PPP law contains a variation of the partial non-arbitrability issue introduced with the May 2009 reform of the public works and acquisitions laws. Whereas in such laws only termination in the public interest and rescission for non-performance are considered non-arbitrable matters, the PPP law provides that:

> *Neither the revocation of concessions and authorisations in general, nor acts of authority may be subject to arbitration.*
>
> *The solution of disputes related to the legal validity of any administrative act may only be resolved before federal courts.*

In this respect it important to note that the exclusion of termination of concessions and authorisations from arbitration goes against the international tendency of making such public contracts subject to arbitration without restrictions, even though there is no obligation under international law to allow for arbitration. Restrictions to the arbitrability of concessions might be explained by Mexican legal tradition and its French and Spanish civil-law heritage. However, both the French and the Spanish laws nowadays allow for the arbitration of PPP disputes and there is no explanation in the travaux préparatoires of the PPP law why the termination or rescission of a contract should be considered non-arbitrable.

Another issue is the exception from arbitration of “acts of authority” (acts of state). According to the Mexican Supreme Court, certain unilateral acts of functionaries of state companies that modify or extinguish “juridical situations that affect the legal sphere of the governed person”are considered acts of authority subject to a constitutional injunction called amparo. Such amparo allows for the immediate suspension, and the annulment of the act of authority and aims to remedy the state of “defencelessness” of a contractor vis-à-vis a state company. The problem with this line of argument is that in combination with other ingredients such as the lack of proper distinction between public order and public

law, and the misconception of the legal principle of res judicata, any issue resolved by the arbitral tribunal that might be considered an act of authority (such as the execution of a bank guarantee by a state company) might trigger the annulment of the award. This is what happened in the Commisa v Pemex case: a court judgment that denied the contractor's amparo against the execution of a bank guarantee by the state company was held to have a res judicata effect over the corresponding arbitral award that ruled on the non-performance of the contract by the state company. The Supreme Court's act of authority doctrine leads to a conversion of private acts of state into public acts of state – with all the attendant consequences.

Under the public works and acquisition laws, it is unclear whether only the question of the validity of the act of authority is non-arbitrable or also the contractual effects of such an act, such as its conformity with the contract and damages claims arising from it. In contrast, article 139(4) of the PPP law clearly establishes that only disputes related to the "validity" of the administrative act are reserved for federal courts.

This is confirmed in article 122(2) of the PPP law, which states that any non-performance is subject to the contractual provisions and that any dispute deriving therefrom shall be resolved either by federal tribunals or through arbitration, which confirms that any question beyond the mere validity issue of the act of authority is arbitrable.

Another issue is the unforeseeability of the potential acts of authority that may arise under a public contract. At present, the rescission for cause and the termination for public interest by the state company are clearly acts of authority subject to the procedure established in the public works, acquisitions and PPP laws. However, it is not excluded that new acts of authority may arise, as the Eleventh Collegiate Court in Civil Matters of the First Circuit indicated in its 2011 judgment annulling the Commisa v Pemex award. The aforementioned "test" of acts of authority for the purposes of the amparo established by the Mexican Supreme Court does not give rise to a catalogue of clearly defined acts of authority. Such unforeseeability interferes with the principle of legality under Mexican law and the standard of transparency under international economic law.

However, as non-arbitrability is limited to the question of validity of the act of authority, this should not interfere in any arbitration under a PPP contract.

Contractual disputes without law?

Article 139(1) of the PPP law refers to the "performance" of the PPP contract and does not use formulas such as the "interpretation and execution" of such contracts, which are normally interpreted as a reference to full jurisdiction. The question therefore arises whether arbitration under a PPP contract is limited to the question of contractual non-performance. In other words, is the determination of the nullity of contractual provisions or other questions not necessarily related to the performance of the contract within the jurisdiction of the arbitral tribunal?

Nullity issues may arise in arbitrations under public contracts because the public works,

acquisitions and PPP laws contain mandatory provisions on public contracts. Such mandatory provisions are denominated as “public order” in article 1 of such laws, which causes considerable confusion, particularly as regards the question whether contractual provisions violating the applicable law are relatively or absolutely null and void. The reference to “public order” in such laws, has, without doubt, to be understood as public law, as the provisions of the public works, acquisitions and PPP laws do not comply with the legal definition of “public order” inferred by article 15 of the Federal Civil Code.

In a 2007 case, the Mexican Supreme Court held that the parties may not exclude, waive, modify or change contractual provisions contained in the public works law. In the underlying case, the financial cost had to be paid by the state company under article 69 of the public works law even if the corresponding provision had not been included in the contact. This shows how legal and contractual provisions are intermingled in public contracts with state entities in Mexico. In fact, claims made by contractors in public works and acquisition contracts are always made on the basis of the applicable legal and contractual provisions. Therefore, it does not seem possible to separate the contractual provisions from the mandatory legal provisions applicable to the public contract.

Article 139(1) of the PPP law has to be read in the context of article 140, which establishes that federal courts are competent to hear disputes deriving from the interpretation and application of the PPP law, as well as from any acts based on such law or on provisions derived from such law.

As any contractual dispute under public contracts in Mexico necessarily involves the interpretation and application of the applicable law, even in disputes related to the mere non-performance of the contract, this provision severely restricts the scope of the arbitration provision in article 139 of the PPP law. The legislative “initiative” omits any explanation for the separation between contractual performance and the application and interpretation of the law. In particular, the arbitral tribunal does not have any legal standing to submit questions of interpretation of the PPP law to the federal courts. The parties would waive their right to arbitration if they submitted a question of interpretation of the PPP law in parallel to a federal court.

Therefore, in spite of the good intentions of the legislature, the drafting of article 140 of the PPP law leads to a situation where arbitration becomes a major hazard. The problem could be solved through a systematic interpretation: article 140 of the PPP law cannot be interpreted to leave article 139(1) and (2) without effect. Moreover, the arbitration option for contractual non-performance issues is clearly confirmed in article 122(2) of the PPP law. Therefore, article 140 should be interpreted, “subject to article 122(2) and to article 139 of the PPP law”, that is, conferring full jurisdiction to the arbitral tribunal. The reference in article 140 of the PPP law to the exlusive jurisdiction of federal tribunals has to be understood in relation to the validity of acts of authority only.

However, it goes without saying that any uncertainty causes risks. As the annulment of the Commisa v Pemex award shows, even a carefully worded arbitral award does not provide a shield against such risks.

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Conclusion

The new PPP law and the reforms of the public works and acquisitions laws have opened arbitration and amicable dispute resolution to all public works, acquisitions and PPP contracts. Whereas the PPP law clarifies that the issue of partial non-arbitrability is limited to the question of validity of an act of authority, the scope of federal jurisidiction seems to interfere with the jurisdiction of the arbitral tribunal as regards the interpretation and application of the PPP law, which has to be solved through legal reform.

In case of unfounded termination or rescission of concessions, public works, acquisitions and PPP contracts, foreign investors may wish to contemplate investor-state arbitration in place of commercial arbitration.

Solutions and proposals for reform of the public works, acquisitions and PPP laws will be analysed at the Fifth Investment Arbitration Forum, which will take place at Club Piso 51, Torre Mayor, Mexico City on 29 June.

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