Investment Arbitration Forum 2012

Dispute Resolution under Public Contracts

Conference Report

Wöss & Partners, S.C., IIJ/UNAM

On June 29, 2011, **Wöss & Partners, S.C.** and the **Instituto de Investigaciones Jurídicas (IIJ)** of the Universidad Nacional Autónoma de México (UNAM) organized the **Fifth Investment Arbitration Forum** on ***"Dispute Resolution under Public Contracts"*** in the prestigious Club Piso 51 in Mexico City's Torre Mayor. **Adriana San Román**, a partner of Wöss & Partners and financial analyst, reports:

Herfried Wöss, partner at Wöss & Partners, visiting scholar at Georgetown University Law and expert on privately financed infrastructure projects and dispute resolution, commenced with an overview about the dispute resolution procedures under the new Public Private Partnerships law referring to an recently published article in the Global Arbitration Review. He explained the overlapping issues between commercial and investment arbitration when state entities are involved, in particular in case of acts of state entities that may trigger state responsibility. This is particularly true for acts by Mexican state companies that are considered acts of authority and not arbitrable under the new PPP law and the public works and acquisition law as commented by the speaker in articles published in the Spain Arbitration Review.

Though the new PPP law rightly introduced the application of the Mexican commercial code, it still maintains elements deriving from the classical French law institution of the "contrat administratif", in particular when it comes to the termination and rescission of contracts and other acts of authority. He mentioned that this situation was one of the causes that led to the annulment of the US$300 million COMMISA award and generates uncertainty that will have to be remedied through legislative reform.

As a solution he proposed the "privatization" of public contracts not only in Mexico but throughout Latin America, referring to previous analyses of Héctor Mairal in Argentina and the contributions of Prof. Don Wallace of the International Law Institute in the forum of UNCITRAL. He suggested that the administrative procedure should end at the moment of the adjudication of a contract by a state entity with the contractual relationship being based on commercial law, referring to judicial precedents in that direction.

In the light of ever larger arbitration procedures related to failed infrastructure projects which are threatening the arbitration system, such as the Mexican Cadereytas arbitration, he proposed standing arbitration tribunals, which would provide benefits similar to dispute boards, avoiding the well known avalanche-effect of disputes in construction and infrastructure projects, but leading to final and binding arbitral awards for any upcoming dispute on a particular matter, which would provide an improved and new form of arbitration meeting the needs of large users. Such

standing arbitration tribunals would not only rule on the project agreement but also on any sub- or adjacent contracts in an infrastructure project.

In his presentation **Prof. Pablo T. Spiller**, Jeffrey A. Jacobs Distinguished Professor at the Haas School of Technology of the University of Berkeley, senior consultant with Compass Lexecon in New York, and financial expert in major commercial and investment arbitrations outlined an economic approach to damages compensation rooted in the famous Factory at Chorzów case (PCIJ 1928) notion that compensation ought to "wipe-out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed." Prof. Spiller's approach deconstructed the Chorzów standard in three parts: a) "wipe-out all the consequences…," which Prof. Spiller interpreted as requiring a "Causality test;" b) "re-establish the situation…," which he interpreted as requiring: 1) the avoidance of double counting (with reference to, in particular, recent award of RDC v Guatemala), 2) the use of ex-post information, as Chorzów's famous three questions grant any value windfalls to the investor, and 3) avoiding the inconsistency between discounting and compounding rates of interest when assessing damages as of the date of expropriation; c) "in all probability…..," which Prof. Spiller emphasized requires tribunals to make "unbiased" awards without excessive discounting for the uncertainty involved in valuations beyond what markets and investors would normally do through the implicit selection of a normal discount rate. In particular, care should be done of not double-counting risk, by incorporating risks either in the cash flows or on the discount rate, but not in both. Gave the examples of Siag v Egypt in which damages were awarded for highly profitable investments not made, and compared that to the Himpurna v PLN award in which damages were discounted for a profitable investment cut short as such claim would "tend to impoverish the host State."

Referring back to Chorzów, Prof. Spiller explained how the famous three questions provide a natural way to reconcile the two compensation criteria: damnum emergens and lucrum cessans, debunking the notion that damnum emergens ought to be linked to sunk investments – a notion, that according to him has led tribunals to double count by adding a component of sunk investments to the value of the expropriated assets (such as in Himpurna v PLN). Prof. Spiller explained that in Chorzów, Damnum emergens consist of the lost profits between date of expropriation and date of award (represented in question I.B); while Lucrum cessans is captured by the value as of the date of the Award (represented in question II) or as of the date of expropriation (represented in question IA). Chorzów, then provides for compensating for both only when damages are granted as of the date of the award, but if compensation is granted as of the date of the expropriation, there are no damnum emergens as all damages, by definition, are rooted in the expropriation act. Prof. Spiller provided an explanation of how the recent ADC & ADC Affiliate v. Hungary is a modern application of Chorzów's three questions, granting damages as of the date of the award, plus damnum emergens for lost profits since expropriation.

Prof. Spiller concluded by providing examples of recent tribunal awards showing contradictions between their stated compensation criteria, and what

the tribunals actually did. He also gave some practical recommendations as to how tribunals can avoid entering into contradictions between their stated compensation criteria and the awards as rendered. In particular, he emphasized that tribunals ought to engage with the economics of the case from the beginning by asking the hard economic questions at or even before the hearings either through prepared questions to counsel or their own cross examination of the experts, and that tribunals should pay attention to the economic implications of their legal theories, avoiding salomonic decisions as well as double counting or double discounting.

Ricardo Izeta Gutierrez, the head of the legal area of the thermoelectric projects Coordination of the Federal Electricity Commission (CFE) for over 20 years, presented an overview of the different types of dispute resolutions procedures used by CFE in its contracts. He expressly mentioned the independent expert procedures, which are characterised by the limited authority of the expert to solve issues of a technical character, but have allowed the solution of disputes in a short period of time and at a minimal cost to the parties. There are only a few of arbitral procedures that arose from independent expert opinions or determinations.

He celebrated the enactment of the new Public-Private Partnerships Law. Privately financed infrastructure projects of this nature were previously regulated by traditional public works and acquisition laws, which did not contemplate the collaborative character of PPPs and caused significant friction in the administration of such projects.

He agreed with the other speakers of the table that the improvement of public procurement in Mexico is showing positive results, though further progress is necessary to adapt procedures to the necessity of modern contracting of privately financed public infrastructure projects. He concluded that the arbitral procedure constitutes the most attractive method to solve disputes in contracts for infrastructure development.

According to **Pedro Javier Reséndiz Bocanegra**, of counsel of Greenberg Traurig's office in Mexico and expert in infrastructure projects, as a result of Mexico’s new public private partnership law, the atmosphere of domestic and international investments on infrastructure is certainly increasing to become one of the most interesting ways to invest and obtain benefits for the investor as well as for the country.

Before the public private partnership law was issued, the valid legislation regarding public biddings, leases, works and any other ways of partnership between the government and private investor was very limited. Unlike that legislation, the new private partnership law includes, among others, the possibility to propose new infrastructure projects by private investors, share the real risk of the investment with the government, as well as new ways of dispute resolutions that were not considered in other laws.

He considered that the evolution of the new dispute resolution mechanisms established on the public private partnership law will need to be monitored to start creating a good track record of cases in order to establish precedents and solidly based case law. For such purposes, it will be

essential to count with well skilled experts with proven knowledge in this type of projects to resolve such cases.

According to **Alejandro Faya**, the director general of foreign investments and consultant to the International Investment Agreements Program of UNCTAD, under international law, international responsibility is triggered by a conduct which is attributable to the State and is inconsistent with an international obligation. A conduct may be attributable to the State if it comes from a State organ, from an entity, which exercises elements of governmental authority or from persons acting under the control or direction of the State.

The violation of a contract or concession governed by municipal law, in and of itself, does not violates international law, unless the measure also breaches a specific obligation of international law, whether stemming from international custom or a treaty. Within the range of protection afforded by investment treaties, a State measure that breaches a contract may also breach specific standards, most likely indirect expropriation, fair and equitable treatment (FET) and the so-called “umbrella clause”. This however, would normally require that the breach of the contract or concession is extraordinary or of a great severity.

The first case would occur when the measure not only cause a total or near-to-total loss to the investment but also constitutes a deviation from the normal and ordinary functioning of the State. Recent tribunals have balanced two competing interests: the degree of the measure’s interference with the right of ownership and the power of the State to adopt its own policies. A breach of FET could also be found if the measure deviates from long-standing principles of customary international law, such as denial of justice, due process or manifest arbitrariness. It also may be caused by the breach of the investor’s reasonable and legitimate investment-backed expectations. Finally, an umbrella clause may be compromised by the very nature of such clause, namely the State ‘s obligation to abide by its commitments entered into with investors. In the last two cases, however, the outcome would depend on the scope of the specific clauses and/or the interpretative approach taken by the arbitral tribunal.

Fernando Estavillo, partner at Miranda & Estavillo in Mexico City and former member of the ICC's Court of International Arbitration, spoke about the situation of contractors’ claims arising from job suspensions and interruption, extensions of job schedules and term for completion, force majeure, not recoverable expenses, extra costs, loss of profits, damages and losses and the like, and what an arbitral tribunal would expect from the parties’ and particularly claimants’ submissions.

Since the applicable laws have specific provisions governing each of those cases where the inclusion of items or work not included in the original projects and the payment of the resulting costs and the granting of extensions or revisions are available, the inadmissibility of global claims for those subjects was pointed out and the importance of an appropriate contract and project management was stressed, emphasizing also the

relevance of the logbook, correspondence, supporting documents and related evidence.

The importance of the methodology for the presentation of the case before the arbitral tribunal was also discussed and emphasized, particularly concerning the submission of all appropriate memorials and related evidence in an orderly, concise and easy to handle manner, including suitable tables of contents and cross references, as to facilitate the location of the relevant data, arguments and supporting documents by the arbitral tribunal, and the understanding of their connections with the relevant facts, in such a fashion that claimants' allegations may be persuasive to the arbitral tribunal.

The programme was sponsored by the Chartered Institute of Arbitrators, Transnational Dispute Management, the Mexican Bar Association, the National Corporate Lawyers Association, the Centre for International Economic Law, the Escuela Libre de Derecho, the Universidad Iberoamercana and all Mexican arbitration centres and institutions such as ICC Mexico, the Mexican Arbitration Centre (CAM), the Mediation and Arbitration Centre of the National Chamber of the City of Mexico (CANACO) and the Arbitration Centre of the Construction Industry.

The Sixth Investment Arbitration Forum is scheduled to take place at Georgetown University Law in Washington DC at the end of June 2013.