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Case Note

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The administrative contract, non-arbitrability, and the recognition and execution of awards annulled in the country of origin: the case of *Commisa v Pemex*

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ABSTRACT

This article analyses the recognition of foreign arbitration awards annulled in their country of origin using *Commisa v Pemex* as a case study. It considers the origins and causes of the award's annulment by Mexican courts, its subsequent enforcement by a New York federal court and considers whether the particular circumstances of annulment play or should play a role in enforcement procedures.

1. INTRODUCTION[1]

On 16 December 2009, an arbitration panel seated in Mexico issued an award for approximately US$300 million in favour of the claimant in *Commisa v PEP*, ICC Case No 13613/JRF (the 'Case'). While Commisa—the Mexican-based subsidiary of US firm KBR—sought to enforce the 2009 ICC award (the 'ICC Award') in Mexico and the USA, PEP—a wholly-owned subsidiary of Mexico's state-owned oil company, Pemex—applied to Mexican courts for an annulment of the award. On 25 August 2011,

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1 An older version of this article was published in Spanish in Lima Arbitration in 2014. Wöss, Figueroa and Cabrera, *El Contrato Administrativo, Inarbitrabilidad y el Reconocimiento de Laudos Anulados en el País de Origen – el Caso COMMISA*, Revista Lima Arbitration No 6 (2014), <http://www.limaarbitration.net/LAR6/Revista.pdf> accessed 14 September 2015.

a Mexican appeals court annulled the ICC Award, finding that the dispute was inarbitrable and barred by *res judicata* based in part on a 2006 ruling by the Mexican Supreme Court. In its 2006 decision, the Supreme Court explained that the state is empowered to unilaterally rescind an administrative contract pursuant to its exorbitant powers, and that such rescission can only be challenged in an ordinary administrative court proceeding. Therefore, under Mexican law as it was in 2011, neither the legality of the state's rescission nor a contractor's related claims for damages could be resolved by arbitration.

Notwithstanding the award's annulment, Commisa continued to seek enforcement of the ICC Award in the USA. In August 2013, almost exactly two years after the award's annulment in Mexico, a district court in New York confirmed the ICC Award, paving the way for Commisa to begin executing on Pemex's assets in the USA. Confirmation proceedings were also brought in Luxembourg.

The enforcement saga that has followed the *Commisa v PEP* arbitration has brought to the fore the substantially different approaches to arbitration that exist within Latin American legal systems, most of which are rooted in the French tradition. This article uses the *Commisa* case to understand these differences, in particular, the uneasy coexistence of the institution of the 'administrative contract'—a form of contract available only to the state and which imbues the state with extraordinary powers of rescission that cannot be adjudicated in arbitration—and the commercial project agreements—contracts that are generally governed by private law which may be adjudicated in arbitration—that many states now use in large infrastructure projects.

This tension exists in French law as well, where administrative contracts with the state or state entities are inarbitrable[2] with limited exceptions, such as in certain public–private partnerships. Likewise, French administrative law provides the state with exorbitant powers to unilaterally modify or terminate an administrative contract. Yet whereas in France contractual losses caused by the state are subject to liberal indemnification obligations,[3] such indemnification is rather rudimentary in Mexico and other Latin American countries. Unfortunately, French law can provide little guidance on arbitration-related issues arising from state contracts to countries like Mexico, since the highly sophisticated French courts are capable of solving issues arising from administrative contracts under the so-called *marchés publics* (tender markets for awarding public contracts), and these disputes are hardly ever arbitrated.

This article also seeks to clarify the contrasting approaches taken by the two legal traditions involved in *Commisa*, and to find a long-term solution that will confer stability to international commercial arbitration in similar cases. The New York district

2 Code Civil [C civ] art 2060 (Fr); Jean-Marc Sauvé, *L'arbitrage et les personnes morales de droit public*, Colloque du 30 septembre 2009 organisé par la Chambre Nationale pour Arbitrage Privé et Public, Le Conseil d'État et la Juridiction Administrative, <http://www.conseil-etat.fr/Actualites/Discours-Interventions/L-arbitrage-et-les-personnes-morales-de-droit-public (13 October 2009) accessed 14 September 2015.

3 Bernardo M Cremades Sanz-Pastor, *State Participation in International Arbitration*, Cremades y Asociados, 23 September 2011, at 10, <http://www.cremades.com/pics/contenido/STATE_PARTI CIPATION_IN_INTERNATIONAL_ARBITRATION.pdf> accessed 14 September 2015; Jean-Christophe Honlet, and others, 'France' in James H Carter (ed), *The International Arbitration Review* (Law Business Research, London 2010) 98, 104; Jean-Christophe Honlet and Gauthier Vannieuwenhuyse, 'International Arbitration and French Public Entities: The INSERM Decision of the Tribunal des Conflicts' *IBA Arb Newsl* (IBA, London), March 2011, at 77 n.8 (referring to Ordinance No 2004-559 of June 2004).

court that enforced the ICC award against PEP had no point of reference in the US law that could help it understand the peculiar issues with arbitrating claims under an administrative contract. The institution of the administrative contract does not exist in the Anglo-American tradition. While the use of arbitration can be restricted in government procurement contracts, these restrictions are explicitly noted in the contract and are not derived from a common law concept that certain government contracts are inarbitrable, if such a principle even exists.[4] It is thus unsurprising that an American-owned company like Commisa was unaware of the risks posed by the administrative contract when it concluded an arbitration agreement with a subsidiary of Pemex—a state-owned entity whose governing law at the time expressly permitted arbitration.

Section 2 of this article presents a case study of *Commisa v Pemex*, providing a legal and factual history of this multi-jurisdictional case, which has included an ICC arbitration and court actions in Mexico and the USA. Section 3 takes a closer look at the Mexican proceedings, highlighting the French civil law concepts of the administrative contract, *res judicata*, and the public policy that undergirded the legal theory used by the Mexican courts to deny enforcement to the ICC Award. Finally, Section 4 explains the New York court's reasoning in confirming the ICC Award despite its annulment in Mexico and places that decision in the context of other US court decisions addressing the confirmation of a foreign award annulled in the country of origin, as well as the New York and Panama Conventions.[5] The article ends with a suggestion for how the *Commisa* contingency can be avoided in the future.

2. BACKGROUND TO THE *COMMISA V PEP* DISPUTE

2.1 Commisa and PEP spar in arbitration and in Mexican courts, while Mexican arbitration law continues to adapt

The Case originated in a 1997 contract signed by Corporación Mexicana de Mantenimiento Integral, S de RL de CV ('Commisa') and Pemex-Exploración y Producción ('PEP') providing for Commisa's construction and installation of two deep-water oil platforms in the Gulf of Mexico (the 'Contract').[6] PEP was and remains a wholly-owned subsidiary of *Petróleos Mexicanos* ('Pemex'), which is Mexico's state-owned and operated oil company tasked with managing the exploitation and production of petroleum and natural gas. The Contract was governed by Mexican law and provided for disputes to be arbitrated under the rules of the International Court of Arbitration of the International Chamber of Commerce (the 'ICC').

4 While some agency guidelines may direct the agency to eschew arbitration, those guidelines must be incorporated by referenced into a given contract. See, eg 48 CFR s 33.214(g) ('[b]inding arbitration, as an ADR procedure, may be agreed to only as specified in agency guidelines').

5 See *Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 10 June 1958, 21 UST 2517, 330 UNTS 3, <http://www.uncitral.org/pdf/english/texts/arbitration/NY-conv/XXII_1_e.pdf> accessed 14 September 2015, (the 'New York Convention'), *and* the *Inter-American Convention on International Commercial Arbitration*, 30 January 1975, OASTS No 42, 1438 UNTS 245, <http://www.oas.org/juridico/english/treaties/b-35.html> (the 'Panama Convention').

6 A discussion of this case can be found in Herfried Wöss, and others, *Damages in International Arbitration under Complex Long-term Contracts § 3.185-200* (OUP, Oxford 2014).

The Contract also granted PEP the right to administratively rescind the agreement. In 2003, PEP and Commisa signed a further agreement extending the Contract ('Convenio C'), also governed by Mexican law.

The relationship between PEP and Commisa reached an impasse in March 2004 when the parties exchanged mutual accusations of violating contractual obligations. A subsequent mediation was unsuccessful. On 1 December 2004, Commisa filed an arbitration against PEP before the ICC (the 'ICC Arbitration'). On 16 December 2004, PEP notified Commisa that it was administratively rescinding the Contract, claiming that Commisa had abandoned the project and failed to meet certain contractual targets. PEP applied contractual penalties equal to 10 per cent of the total amount of work completed prior to 23 May 2003, as well as other sanctions for the alleged failure to meet contractual targets for gas delivery.[7] On 23 December 2004, while the ICC Arbitration was pending, Commisa challenged PEP's administrative rescission by filing an *amparo*—essentially a constitutional appeal—with Mexico's Fourteenth District Court in Administrative Matters (the 'Administrative District Court') seeking the annulment of the administrative rescission and its immediate suspension as a preliminary measure. Commisa obtained the preliminary measure during the pendency of proceeding, but ultimately lost the *amparo*.

The Administrative District Court rejected Commisa's challenge, ruling that the administrative rescission was a commercial act (an act *de jure gestionis*), and not an act of state (an act *de jure imperii*), and thus did not properly fall within the jurisdiction of that court.[8] Unsatisfied by this result, Commisa filed a request for revision with the Sixth Collegiate Court in Administrative Matters of the First Circuit (the 'Sixth Collegiate Court'), which referred the matter to the Mexican Supreme Court, which in turn agreed to issue an advisory opinion. In its 23 June 2006 judgment, the Supreme Court of Mexico concluded that (i) the Mexican Constitution allowed the state to unilaterally rescind an administrative contract under its exorbitant powers, and (ii) the only legal remedy against the administrative rescission and its consequences was the ordinary administrative court procedure.[9] It also recognized the administrative rescission as an act of state or *de jure imperii*.[10]

Neither the Sixth Collegiate Court nor the Supreme Court reviewed the full merits of whether PEP's administrative rescission was justified under its Contract with Commisa. Instead, their decisions were limited to affirming the constitutionality of an administrative rescission undertaken without prior judicial review, as well as establishing the exclusive jurisdiction of the Administrative District Court[11] to resolve

7 ICC 13613/JRF, Preliminary Award (20 November 2006) at ¶¶ 1–8; *Amparo en Revisión* 358/2010, *Décimo Primer Tribunal Colegiado en Materia Civil del Primer Circuito* (25 August 2011) at 10, 12.

8 *Amparo en revisión* 1081/2006, Segunda Sala de la Suprema Corte de Justicia de la Nación (23 June 2006) at 18.

9 ibid at 58. The case was then returned to the Sixth Collegiate Court, which in a decision of 23 February 2007 confirmed that the administrative rescission had not violated applicable legislation. *Amparo en Revisión* 358/2010, (n 7) at 15.

10 ibid at 24, 25, 28.

11 Jurisdiction over administration rescissions has since been transferred to the Federal Tax and Administrative Court. See below n 15.

disputes over the legality of individual administrative rescissions. Commisa, however, did not heed the Supreme Court's guidance (by re-filing the case before the Administrative District Court); it discontinued its search for judicial review of PEP's rescission in Mexican courts while it focused on the arbitration.

Meanwhile, in the ICC Arbitration, PEP challenged the tribunal's jurisdiction over their dispute with Commisa, arguing that the Mexican Supreme Court's decision rendered its entire dispute with Commisa *res judicata*. The arbitral tribunal rejected PEP's jurisdictional objections in a preliminary award in November 2006.[12] In October 2007, PEP, apparently for the first time, argued before the arbitrators that its administrative rescission was not susceptible to adjudication by arbitration because it was an act of state.[13] When the panel rejected this argument, PEP noted its objection but it did not appeal this award and continued to participate in the arbitration. This is noteworthy because, under the substantive law of the contract and the procedural law of the arbitration (Mexican law), PEP was entitled to appeal this preliminary award to local courts.[14]

During the pendency of the ICC Arbitration, there were several important developments in the Mexican law relevant to the Case. On 7 December 2007, the Mexican legislature amended the Organic Law of the Federal Tax and Administrative Court, granting it original jurisdiction over lawsuits involving administrative rescissions and other administrative acts.[15] This reduced to 45 days the 10-year statute of limitations applicable to district courts concerning administrative rescissions. Later, in May 2009, the legislature's enactment of Article 98 of the Federal Law on Public Works and Services established that, unlike contractual disputes, disputes relating to Pemex's administrative rescissions could not be submitted to arbitration.[16] These reforms were undoubtedly influenced by the Mexican Supreme Court's 2006 decision in response to Commisa's *amparo*.

2.2 The 2009 ICC Arbitration Award

In December 2009, the majority of the arbitral tribunal issued an award ordering PEP to pay Commisa approximately US$300 million, plus interest. The ICC Award did not mark the end of the dispute. Over the next six years, this dispute would ping pong around courts in New York and Mexico in a still on-going battle

12 See ICC Award at 7–8 (referring to the Preliminary Award of 20 November 2006). The tribunal re-affirmed its competence to hear the merits of the dispute in Procedural Order No 7 of 18 May 2007. See ibid at 17.

13 See *Corporación Mexicana de Mantenimiento Integral v Pemex-Exploración y Producción*, 962 F.Supp.2d 642, 647 (SDNY 2013) (hereinafter *Commisa*). Up to this point, PEP appears to have limited its jurisdictional defence in the ICC Arbitration to arguing that the tribunal lacked jurisdiction over this specific case. See ibid.

14 The New York court found this fact compelling. See ibid (citing to art 1432 of Mexico's Commercial Code).

15 See *Ley Orgánica del Tribunal Federal de Justicia Fiscal y Administrativa* [Organic Law of the Federal Tax and Administrative Court], art 14(VII).

16 See *Ley de Obras Públicas y Servicios Relacionados con las Mismas* [Law on Public Works and Related Services], art 98.

over the ICC Award's enforcement. In November 2010, a district court judge for the Southern District of New York (the 'S.D.N.Y.') issued an order confirming the ICC Award.[17] In August 2011, Mexico's Eleventh Collegiate Court for the First Circuit (the 'Eleventh Collegiate Court') ordered the annulment of the ICC Award.[18] The S.D.N.Y. reconsidered the ICC Award in an August 2013 order and decided once more to confirm the ICC Award, declaring that the Mexican annulment decision violated, among other concepts, 'basic notions of justice'.[19] In 2014, Commisa's parent company KBR filed a notice of arbitration against Mexico under UNCITRAL rules, claiming that the 2011 annulment violated the investment protections guaranteed under NAFTA. In April 2015, KBR's claim was dismissed for lack of jurisdiction.[20]

3. COMMISA IN MEXICAN COURTS: THE SYSTEMATIC RISK POSED BY THE ADMINISTRATIVE CONTRACT

As the preceding section shows, the *Commisa v PEP* dispute followed parallel tracks in Mexican courts and at the ICC. The Mexican court's ultimate decision to annul the ICC Award must be understood in that context: it came at the end of a long legal battle with Mexico over the proper scope of judicial review of administrative actions. Consequently, this section analyses the dispute from the perspective of the underlying transformation under Mexican law of PEP's administrative rescission from an act *de jure gestionis* into an act *de jure imperii*, and its effects on the arbitrability of administrative contracts in Mexico. The jurisprudence generated by this dispute implicates important questions of public policy, which highlight not only the tension between a state's roles as a commercial and public actor, but also the importance of understanding the history of the Mexican legal system, which, like many Latin American jurisdictions, is derived from French law.

3.1 The development of Mexican arbitration legislation prior to *Commisa*

State-owned entities in Mexico have had the authority to include arbitration agreements in their commercial contracts since at least the early 1990s. In 1993, the Mexican legislature adopted the UNCITRAL Model Law and issued special legislation for both Pemex and the *Comisión Federal de Electricidad* (CFE), allowing these

17 In November 2010, District Judge Hellerstein of the SDNY granted Commisa's motion to confirm the ICC Award. PEP promptly appealed this decision to the Second Circuit Court of Appeals, which stayed enforcement of the ICC Award in New York pending the resolution of PEP's efforts in Mexican courts. See *Commisa* (n 13) at 649.

18 The Eleventh Collegiate Court in Civil Matters for the First Circuit (*Décimo Primer Tribunal Colegiado en Materia Civil del Primer Circuito en el Distrito Federal de México*) heard this matter on appeal from the Tenth District Court on Civil Matters in the Federal District ('Tenth District Court'), which had dismissed PEP's action and found that the arbitration tribunal was empowered to review this case. An earlier court—the Fifth District Court on Civil Matters for the Federal District (the 'Fifth District Court')—had also dismissed PEP's action on substantive grounds. See ibid at 649–50.

19 ibid at 644.

20 See Luke Eric Peterson, 'Mexico Secures Dismissal of NAFTA Claim brought by Kellogg, Brown and Root (KBR) in dispute arising out of unpaid ICC arbitration award' Investment Arbitration Report (23 June 2015).

entities to arbitrate their commercial disputes.[21] The Pemex Organic Law that was in force until 2008 read:

> Regarding legal acts with an international character, *Petróleos Mexicanos* or its Subsidiary Organizations may sign arbitration agreements when it furthers the accomplishment of their object.[22]

The organic laws of Pemex and CFE did not contain limits on the arbitrability of administrative rescissions or any other contractual act by these state-owned entities. In practice, these acts were always considered *de jure gestionis*, although the risk of their treatment as acts of state or *de jure imperii* was latent.[23] (Only acts *de jure gestionis* are arbitrable under Mexican law.)

A series of legal reforms beginning in 2008 made arbitration more widely available in disputes involving public entities while also reinforcing the inarbitrability of acts of state. An amendment to the Federal Constitution of 18 June 2008[24] enshrined the right to pursue alternative dispute resolution mechanisms. In May 2009, all federal public entities (in addition to Pemex and CFE, which already enjoyed this right) were finally permitted to include arbitration clauses in their contracts,[25] thereby allowing the arbitration of all federal contracts involving public works or long-term acquisitions. In January 2012, the limitation to long-term contracts was removed for acquisition contracts.[26] Following the new legislation, all federal works and public acquisitions contracts could be submitted to arbitration, subject to certain limitations, which included the inarbitrability of administrative rescissions. The 2012 Public–Private Partnerships Law (the 'PPP Law'), which permitted arbitration of contracts disputes for public–private partnerships, further extended the scope of inarbitrable actions to include all acts of authority.[27]

21 See *Ley Orgánica of PEMEX* [Organic Law of PEMEX], art 14; *Ley del Servicio Público de Energía Eléctrica para la Comisión Federal de Electricidad (CFE)* [Law for the Public Service of Electrical Energy for the Federal Electricity Commission], art 45. An organic law, or *ley organica*, is akin to the governing or organizational legislation for an entity.

22 This language was modified with minimal changes by art 6, para 2 of the *Ley Reglamentaria del Artículo 27 Constitutional en el Ramo del Petróleo* [Implementing Law of Article 27 Constitution in the Matter of Oil] and art 73 of the *Ley de Petróleos Mexicanos* [PEMEX Law] on 28 November 2008.

23 Herfried Wöss, 'Arbitration, Alternative Dispute Resolution and Public Procurement in Mexico, the 2009 Reforms, Analysis and their Impact' (2010) 7 Spain Arb Rev 19–31; TDM 4 (2009), Special Edition Latin America.

24 See the third (now fourth) para of art 17 of the Federal Constitution of 28 June 2008.

25 See the Law on Public Works and Related Services (n 15) and the *Ley de Adquisiciones, Arrendamientos y Servicios del Sector Público* [Law on Public Sector Acquisitions, Leases and Services] of 28 May 2009.

26 Herfried Wöss, 'Solución de Controversias al Amparo de la Nueva Ley Mexicana de Asociaciones Público-Privadas' (2012) 5 Lima Arb 2, 185–94.

27 The *Ley de Asociaciones Público Privadas* (the 'PPP Law'), which came into force on 16 January 2012, extended the scope of inarbitrable actions to include not only administrative termination and rescission, but any act of state. See PPP Law, art 139, ¶¶ 3–4. The issue of the inarbitrability of acts of authority in contracts with public entities appears to have been influential in the *Commisa* case.

3.2 The problem of the French *contrat administratif* in Latin America, and in Mexico in particular

The renowned Argentine jurist Héctor Mairal has argued that the institution of the administrative contract derived from French law and its use in contracts in Latin America is very problematic.[28] In his view, under French law the state has extraordinary powers concerning public contracts, including the right to modify, rescind or terminate a contract unilaterally and without judicial approval. This principle has been incorporated into Mexican law, where state-owned entities can rescind or terminate administrative contracts without first obtaining a judicial order. The private contractor to an administrative contract,[29] meanwhile, must pursue a judicial action to achieve a lawful contract termination. Since the 2006 judgment of the Mexican Supreme Court, the administrative act of rescission or termination is considered an act of state, and enjoys the presumption of validity until it is revoked in a constitutional appeal or *amparo*, the latter of which is essentially an annulment hearing.[30]

Prior to the *Commisa* case, there was a latent risk that a Mexican court might treat an administrative rescission as inarbitrable, but in practice such acts were treated as acts *de jure gestionis* and, therefore, arbitrable. As noted by the Mexican jurist Diego Andrade Max: '[A] legal act, relating to a contract, that can be imputed to an organ of a state that is acting as a party to that contract unquestionably constitutes an act *de jure gestionis*.'[31]

However, since the 2006 judgment of the Mexican Supreme Court, it has been clear that an administrative rescission is an act of state and therefore may only be litigated before administrative tribunals and not in arbitration. The inarbitrability of an act of state is a fundamental principle of Mexican law, which directly derives from its French legal heritage. As we will discuss further in the next section, it is Commisa's legal strategy in Mexican courts in 2004–06 that resulted in the conversion of the administrative rescission into an act of state, with rather negative consequences for the whole Mexican arbitration system as regards state contracts.

3.3 The *Commisa* case: the conversion of an act *De Jure Gestionis* into an act *De Jure Imperii*, and its consequent inarbitrability

When the relationship between Commisa and PEP turned sour in mid-2004, the parties first attempted mediation. In December 2004, Commisa filed an ICC arbitration claiming damages under its Contract with PEP. PEP did not announce its intention to administratively rescind the Contract until 15 days after the arbitration had been filed. At this point, Commisa had a choice of whether to allow the ICC tribunal to

28 Héctor A Mairal, 'Government Contracts under Argentine Law: A Comparative Law Overview' (2002) 26 Fordham Int'l LJ 1716, 1716–53; Héctor A Mairal, De la Peligrosidad o Inutilidad de una Teoría General del Contrato Administrativo, El derecho, 179, at 655–700 (Argentina).

29 Where not otherwise defined, references to 'contractors' in this article refer to private parties who have entered into administrative contracts with a state or state-owned entity.

30 This is analogous to a *cassation* proceeding under French law.

31 Diego Andrade Max, 'Mexican Governmental Agencies as Parties to International Commercial Arbitration— Historical, Theoretical and Practical Aspects' doctorate dissertation, University of Vienna, May 1994, at 153.

act as the sole adjudicator of its legal dispute with PEP, or to open a new front by challenging the rescission in Mexican courts. As we have seen, Commisa chose the latter option. On 23 December 2004, Commisa filed an *amparo* in Mexican courts seeking the annulment and immediate suspension of Pemex's administrative rescission.

A prerequisite of the admissibility of an administrative appeal is an act of state or an act *de jure imperii*. In other words, in order to claim an *amparo*, Commisa had to argue that the administrative rescission was an act *de jure imperii* and not *de jure gestionis*. The first court to review Comissa's *amparo*—the District Court in Administrative Matters—recognized this inconsistency, denied the existence of an act of state and dismissed the appeal on 23 August 2005. Thus the judge in the first instance was correct in denying the admissibility of Commisa's appeal because the administrative rescission was an act *de jure gestionis* and not *de jure imperii*.[32] But Commisa did not appreciate that this ruling was strategically helpful to its case, establishing, as it did, that PEP's termination was commercial and thus subject to arbitration. Instead, Commisa filed an appeal with the Sixth Collegiate Court, which referred the matter to the Mexican Supreme Court for an advisory opinion on a case of legal importance.[33] The Supreme Court heard the dispute and, in its 23 June 2006 judgment, found that the state was constitutionally allowed to unilaterally rescind an administrative contract, describing a rescission as a:

> special privilege of the State, which places it in a distinct and more favorable situation than that which governs for those individuals that contract with it.[34]

In the same decision, the Court stated that:

> When an administrative entity exercises its right of rescission, private parties contracting with that public entity retain the right of access to the administration of justice by the courts. The procedural rights provided for by law allow the affected private party to efficiently challenge the administrative act of contractual rescission.[35]

Accordingly, Commisa managed to convert what the court of first instance considered to be an act *de jure gestionis* into an act *de jure imperii*, germinating the legal justification for the Award's later annulment. By treating the administrative rescission as an act of state, the Mexican Supreme Court vested PEP's actions with the presumption of legality that could only be challenged in an ordinary administrative litigation before the competent district court.[36] Yet, upon losing the *amparo*, for

32 See *Amparo en Revisión 1081/2006* (n 8) at 18.

33 ibid at 24, 25, 28.

34 ibid at 58.

35 Cited in *Amparo en Revisión 358/2010*, Eleventh Collegiate Court in Civil Matters for the First Circuit (25 August 2011) at 14.

36 Herfried Wöss, 'Orden Público, Derecho Público, Cosa Juzgada e Inarbitrabilidad en Contratos Públicos en México - la anulación del laudo del Caso ICC 13613/CCO/JRF' (2012) 14 Spain Arb Rev 111–31, Transnational Dispute Management, Vol 9, Issue 3 (April 2012).

reasons known best to Commisa and its lawyers, it did not return to the Administrative District Court to have PEP's rescission reviewed. Instead Commisa halted its pursuit of judicial review in Mexican courts. By failing to challenge the rescission in a new administrative proceeding in 2006, Commisa allowed PEP's rescission to retain its presumption of validity as an act of state, a state of affairs that would later have disastrous consequences for the arbitral award.

This unfortunate litigation strategy revealed real problems in the Mexican arbitration system and exacerbated them. The inarbitrability of administrative rescissions extends to the determination of matters such as whether performance has taken place under a contract and the availability of remedies like damages for contractual breach, issues that cannot be separated from the question of the legality of the administrative rescission. Consequently, an arbitration clause will have no practical effect in cases of administrative rescission, thus allowing a state or a state-owned company to opt-out of arbitration by using administrative rescission. This risk has recently been partially overcome by new CFE and Pemex laws enacted pursuant to the Mexican energy reform.[37]

3.4 The annulment of the *Commisa* award for violation of public order and *Res Judicata* as a consequence of the parallel court proceeding

As discussed in Section 2, the ICC Award was annulled in 2011 by Mexico's Eleventh Collegiate Court for violations of public order and *res judicata*. In the annulment proceeding, the Eleventh Collegiate Court invoked the Mexican Supreme Court's 2006 opinion when it confirmed administrative rescissions cannot be reviewed in arbitration:

> Although it is true that there was an arbitral agreement to submit to arbitration all the controversies that arise from the contract, it is also true that the appellant as a state entity has the right to administratively rescind this contract unilaterally and imperatively, a right that was not renounced nor is capable of renunciation. Accordingly, once an administrative rescission has been issued, an arbitral tribunal is precluded from ruling on this act of state, even indirectly or in a parallel proceeding.[38]

The Court went on to discuss the effect that the earlier court decisions had on its decision to annul the ICC Award. First, it cited the Mexican Supreme Court's finding that PEP's administrative rescission was an administrative act of state subject to the jurisdiction of the Federal Courts, specifically District Courts.[39] The Mexican Supreme Court's decision, it wrote, 'has the effect of *res judicata* both in the present dispute, where there is an identity of the parties, and even in the dispute at issue'.[40] Unless the institution of administrative rescission is declared unconstitutional, it wrote, 'this rescission must continue in force until the resolution of the present

37 Mexico's recent energy reforms are briefly discussed in the conclusion to this article.
38 *Amparo en Revisión 358/2010* (n 35) at 410-1.
39 ibid at 422.
40 ibid at 457–58.

appeal, as there is no proof to the contrary'.[41] *Res judicata* also applied, the Court explained, to the decision of the Sixth Collegiate Court in 2007 confirming PEP's administrative rescission and denying Commisa's *amparo*.[42]

Having established that PEP's administrative rescission was inarbitrable and citing two earlier court decisions confirming that this particular rescission had never been properly challenged in an administrative litigation in the district courts, the Eleventh Collegiate Court concluded that the tribunal in the ICC Arbitration lacked the jurisdictional authority to issue an award in this matter. The arbitration tribunal, the Court wrote:

> had the ability to determine that the competence and jurisdiction that had been granted to it was only to resolve questions involving private interests, . . . and that it lacked the ability to judge an act of state because of its public nature. By not confining itself to its remit, [the tribunal] transgressed into the public order and, as a consequence, this award is void, pursuant to Article 1457 of the Commercial Code.[43]

Because the administrative rescission and the related acts had to be treated as acts of authority pursuant to the 2006 Supreme Court judgment, the Eleventh Collegiate Court had little choice in concluding that PEP's 2004 rescission of the Contract was binding and that the legality of this act of state remained intact because Commisa had not filed a timely challenge to the rescission before an administrative law judge. Furthermore, because the rescission's status as an act of state remained unchallenged, the arbitral tribunal could not rule on the legality or validity of PEP's rescission nor review Commisa's claim for damages.

When the Mexican Supreme Court decided that an ordinary administrative hearing is the exclusive venue to litigate the rescission of an administrative contract, it deprived private contractors of their right to resort to alternative dispute resolution mechanisms (including their right to arbitration) as established in the Constitution and in the Pemex legislation. Moreover, it left contractors bearing the risk that their contractual counter-parties—state or state-owned companies—might opt-out of arbitration through administrative rescission. Although the Federal Tax and Administrative Court—now the competent court for reviewing administrative rescissions[44]—is one of the most capable judicial institutions in Mexico for any kind of tax and administrative matter, it can hardly be considered equipped to hear cases involving complex infrastructure projects.

Unfortunately, this result was foreseeable following Commisa's decision to press forward with its *amparo* and to insist that the administrative rescission should be considered an act of state. The situation would have been quite different if the subject of the arbitrability of an administrative rescission had been first raised by PEP at the execution phase of the arbitral award. Without these earlier judgments issued in

41 ibid at 458.
42 ibid at 458–59.
43 ibid at 459.
44 See above n 15.

the parallel proceedings, the argument of *res judicata* would not have been available to justify annulment. It goes without saying that Commisa doubtless did not intend this result when it commenced the *amparo* seeking the immediate suspension of the act of state, but it also apparently did not consider the possible impact of the *amparo*.

4. *COMMISA* IN US COURTS: THE RECOGNITION OF ANNULLED AWARDS

In January 2010, over a year before the Award was annulled in Mexico, Commisa filed a petition to confirm the ICC Award in New York courts. PEP opposed Commisa's application for enforcement, citing its on-going annulment efforts in Mexico. On 2 November 2010, District Judge Hellerstein of the SDNY confirmed the ICC Award, and Commisa began execution proceedings.

PEP appealed the decision to the US Court of Appeals for the Second Circuit, seeking an emergency stay of execution pending its Mexican appeal.[45] Following the August 2011 annulment decision, the Second Circuit remanded the case to the SDNY to 'address in the first instance whether enforcement of the award should be denied because it "*has been set aside or suspended by a competent authority of the country in which, or under the law of which, the award was made.*"'[46]

This question reignited a lively debate among courts and commentators about whether awards that are annulled in their place of origin may be enforced in another jurisdiction. To respond to this inquiry, this section will first identify the relevant criteria for annulling awards under the New York Convention (the 'Convention'). Next, this section will analyse the standards under which vacated awards may be enforced in foreign jurisdictions.

4.1 The power to annul arbitral awards under the New York convention

The US courts have repeatedly recognized the inherent tension between an award's primary and secondary jurisdictions. That is, the jurisdictions under which an award is rendered and where an award is subsequently enforced, respectively.[47] The Second Circuit clarified this dichotomy in the 1997 *Yusuf*[48] case:

> The [New York] Convention specifically contemplates that the state in which, or under the law of which, the award is made, will be free to set aside or modify an award in accordance with its domestic arbitral law and its full panoply of express and implied grounds for relief. See [New York] Convention art. V(1)(e). However, the Convention is equally clear that when

45 Although the Second Circuit denied PEP's application for a stay, the parties reached a deal to stay execution upon PEP's depositing $395,009,641.34 into a Court maintained bank account. See *Commisa*, 962 F.Supp.2d at 649.

46 Mandate of the US Court of Appeals for the Second Circuit at 2, *Corporación Mexicana de Mantenimiento Integral, S de RL de CV v Pemex-Exploración y Producción, USCA*, Case No 10-4656-cv (2d Cir 8 March 2012).

47 See *TermoRio SA ESP v Electranta SP*, 487 F.3d 928 (DC Cir 2007) (hereinafter *TernoRio*).

48 See *Yusuf Ahmed Alghanim & Sons, WLL v Toys "R" Us, Inc*, 126 F.3d 15, 23 (2d Cir 1997) (hereinafter Yusuf).

> an action for enforcement is brought in a foreign state, the state may refuse to enforce the award only on the grounds explicitly set forth in Article V of the Convention.

In other words, primary jurisdiction refers to the domestic law where, or under which, an award is rendered. An award's secondary jurisdiction, on the other hand, refers to the jurisdiction where enforcement is sought. The *Yusuf* decision unambiguously carves out the primary jurisdiction's power to annul an award based on domestic law. Such a power is referenced in Article V(1)(e) of the Convention. It reads:

> 1. Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that:
> . . . .
> (e) The award has not yet become binding, on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.[49]

By way of example, the 1999 *Baker Marine*[50] case acknowledged the primary jurisdiction's power of annulment. In refusing to enforce an award that had been set aside by the Nigerian courts (and decided under Nigerian law), the Second Circuit stated: 'it would not be proper to enforce a foreign arbitral award under the Convention when such an award has been set aside by the Nigerian courts'.[51]

The domestic arbitral law of the USA is born out of the Federal Arbitration Act (the 'FAA').[52] Accordingly, when an award is rendered within the territory of the USA, a party can look to any of the FAA's explicit or implied grounds for seeking annulment. This is precisely what the *Yusuf* court held:

> We read Article V(1)(e) of the [New York] Convention to allow a court in the country under whose law the arbitration was conducted to apply domestic arbitral law, in this case the FAA, to a motion to set aside or vacate that arbitral award.[53]

4.2 Power to enforce a foreign arbitral award annulled at the primary jurisdiction

Like any court of secondary jurisdiction, a US District Court may only refuse to enforce a foreign arbitral award upon one of the seven grounds listed in Article V of

49 The text of art 5(1)(e) of the Panama Convention, which governs enforcement of the ICC Award in *Commisa*, is virtually identical. See Inter-American Convention on International Commercial Arbitration, art 5, para 1(e), 13 January 1975, 1438 UNTS 245; OASTS No 42; 14 ILM 336.

50 See *Baker Marine (Nig) Ltd v Chevron (Nig) Ltd*, 191 F.3d 194 (2d Cir 1999) (hereinafter *Baker Marine*).

51 ibid at 196.

52 See 9 USC 1, et seq.

53 See *Yusuf* (n 48) at 29.

the Convention. On the other hand, the US courts may enforce foreign awards that have been annulled in their place of origin in only one rather broadly-defined circumstance, that is, when the decision to vacate that award contravenes US public policy.[54]

The first US case to confirm a foreign award annulled at its primary jurisdiction (or seat) focused much of its analysis on the semantic differences between Articles V and VII of the Convention. While Article V uses the word 'may', Article VII utilizes the word 'shall'. As a result, Article V has often been interpreted to embody a permissive standard.

To better understand this dichotomy, this subsection will first identify the relevant provisions in Articles V and VII and will then discuss pertinent case law.

Article V(1) states (emphasis added):

> 1. Recognition and enforcement of the award *may* be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof that:
>
> a. The parties to the agreement referred to in article II were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made; or
> b. The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case; or
> c. The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced; or
> d. The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place; or
> e. The award has not yet become binding, on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.[55]

54 For a discussion of international practice under the New York Convention relating to the enforcement of awards annulled at the place of arbitration, see Nadia Darwazeh, art V(1)(1), in Herbert Kronke, and others (eds), *Recognition and Enforcement of Foreign Arbitral Awards, A Global Commentary on The New York Convention* (Kluwer Law International, Netherlands 2010) 301–44. See also Dana Freyer, 'The Enforcement of Awards Affected by Judicial Orders of Annulment at the Place of Arbitration' in Emmanuel Gaillard and Domenico Di Pietro (eds), *Enforcement of Arbitration Agreements and International Arbitral Awards, The New York Convention in Practice* (Cameron May, London 2009) 757–86.

55 See *New York Convention* (n 5) at art V(1).

> Article V(2) adds:
> 2. Recognition and enforcement of an arbitral award *may* also be refused if the competent authority in the country where recognition and enforcement is sought finds that:
>
> a. The subject matter of the difference is not capable of settlement by arbitration under the law of that country; or
> b. The recognition or enforcement of the award would be contrary to the public policy of that country.[56]

By contrast, Article VII(1) of the Convention alludes to the international character of arbitral proceedings. It states (emphasis added):

> 1. The provisions of the present Convention *shall* not affect the validity of multilateral or bilateral agreements concerning the recognition and enforcement of arbitral awards entered into by the Contracting States *nor deprive any interested party of any right he may have to avail himself of an arbitral award in the manner and to the extent allowed by the law or the treaties of the country where such award is sought to be relied upon.*[57]

This conflict, between Article V's 'may' and Article VII's 'shall', first reached the US District Courts in 1996 via the *Chromalloy* case.[58] An arbitration tribunal in Cairo, Egypt had awarded Chromalloy Aeroservices Inc, a US company, over $18 million in a dispute against the Republic of Egypt. Chromalloy sought enforcement of this award in the USA but, before a decision was rendered, the Cairo Court of Appeals annulled the award on the grounds that the arbitrators had improperly applied Egyptian private law.[59] The US District Court nevertheless enforced the award. Demarcating the tension between Article V(2) and Article VII, the Court explained:

> While Art. V provides a discretionary standard, Art. VII of the [New York] Convention requires that, "the provisions of the present Convention *shall not* . . . deprive any interested party of any right he may have to avail himself of an arbitral award in the manner and to the extent allowed by the law . . . of the count[r]y where such award is sought to be relied upon." 9 U.S.C. Sect. 201 note (emphasis added). In other words, under the Convention, Chromalloy maintains all rights to the enforcement of this Arbitral Award that it would have in the absence of the Convention. Accordingly, the Court finds that, if the Convention did not exist, the Federal Arbitration Act would provide Chromalloy with a legitimate claim to enforcement of this arbitral award.[60]

56 See ibid at art V(2).
57 See ibid at art VII(1).
58 See Matter of Arbitration Between Chromalloy Aeroservices, a Div of Chromalloy Gas Turbine Corp & Arab Republic of Egypt, 939 F Supp 907 (DDC 1996) (hereinafter *Chromalloy*).
59 Cairo Court of Appeal (5 December 1995), 25 YB Com Arb 265-68 (1999).
60 *Chromalloy* (n 58) at 909–10.

Following this interpretation of Article VII, the *Chromalloy* court evaluated the award under Chapter 1 of the FAA, which deals with domestic arbitration awards, in addition to Chapter 2 of the FAA, which governs foreign awards.[61] The Egyptian court had annulled the award based on the tribunal's purported misapplication of Egyptian law.[62] Accordingly, because mistake or misapplication of the law are insufficient bases to deny enforcement to a domestic award under Chapter 1 of the FAA, the *Chromalloy* court found that the Egyptian award was valid, and the foreign court's annulment award was not entitled to *res judicata* effect in US courts.[63]

The *Chromalloy* court also pointed to the parties' arbitration agreement, which read: '[t]he decision of the said court shall be final and binding and cannot be made subject to any appeal or other recourse'. As a result, the *Chromalloy* court found that the Cairo Court of Appeals' decision contradicted US public policy, which favours final and binding arbitrations. As the *Chromalloy* court explained: '[N]o nation is under an unremitting obligation to enforce foreign interests which are fundamentally prejudicial to those of the domestic forum.'

In sum, the *Chromalloy* decision stands for the idea that a party may seek enforcement of a foreign award using the standards for enforcing and annulling domestic awards under the FAA. This position, however, has been largely abandoned and the *Chromalloy* decision has been the subject of stern criticism by some commentators for its application of Article VII to enforcement. In fact, it is generally accepted across most legal systems presently that only a competent court at the primary jurisdiction can annul an arbitration award and that only the substantive law of the arbitral seat should be applied to determine whether an award might be annulled.[64] Without acknowledging it, the *Chromalloy* court disregarded this principle.

The case law that followed the *Chromalloy* decision has chipped away at the theory sustained in that decision, consistently holding that Article V of the Convention (and, where it applies, Article 5 of the Panama Convention, which contains virtually identical language) exclusively governs questions of enforceability. Nonetheless, the confusion latent in Article V's discretionary standard remains. While Article V of the Convention recognizes that a court *may* deny enforcement to an arbitral award that has been duly annulled at the primary jurisdiction, nowhere in its text does the Convention specify whether or under what circumstances a court may choose to confirm such an award. Thus, while the importance of US public policy has diminished in the post-*Chromalloy* case law, it has remained an essential factor for later courts considering the fate of an award annulled at its seat.

The Second Circuit began to claw back the *Chromalloy* theory in 1999, when it issued the *Baker Marine* decision.[65] *Baker Marine* obtained two awards following an arbitration in Nigeria: one for $2.23 million and one for $750,000, against Danos and Chevron, respectively. *Baker Marine* sought enforcement in Nigeria, but the Nigerian

61 ibid at 910–12.

62 The Egyptian Court of Appeals found it improper that the tribunal applied civil instead of administrative law.

63 *Chromalloy*, (n 58) 911.

64 *Commisa*, 939 F. Supp at 643.

65 See *Baker Marine* (n 50) at 194.

presiding court set aside both awards on the grounds that the evidentiary record did not support the tribunal's findings and that the tribunal had incorrectly awarded punitive damages. *Baker Marine* then sought enforcement in the District Court of the Northern District of New York. This court refused to enforce the award because 'it would not be proper to enforce a foreign arbitral award under the Convention when such an award has been set aside by the Nigerian courts'. On appeal, *Baker Marine* invoked Article VII of the Convention, as was done in the *Chromalloy* case. Reviewing the District Court's decision on appeal, the Second Circuit rejected Baker Marine's arguments and buried any vestigial ambiguities in regards to Article VII and the FAA. The Court explained:

> Nothing suggests that the parties intended United States domestic arbitral law to govern their disputes. The primary purpose of the FAA is ensuring that private agreements to arbitrate are enforced according to their terms.

The Second Circuit in *Baker Marine* did not follow *Chromalloy*, but it also refrained from discrediting the DC court's reasoning.[66] It explained: '[T]he district court [in *Chromalloy*] concluded that Egypt was seeking to "repudiate its solemn promise to abide by the results of the arbitration," and that recognizing the Egyptian judgment [to annul] would be contrary to the United States policy favoring arbitration.'[67] On the other hand, in *Baker Marine,* the Second Circuit determined that the Nigerian judgment did not conflict with the US public policy because the plaintiff was not a US citizen and had not initially sought to confirm the award in the USA, and because the defendants had not breached any promise by appealing the award in Nigerian courts.[68] Thus, the court decided that domestic arbitral law had no role in determining whether the award should be enforced.

Once again, in 1999, the SDNY was asked to interpret the relationship between the FAA and the New York Convention.[69] Mr Spier, a US citizen, had received a $1 billion lire award in Italy, which had been subsequently annulled by the Italian Supreme Court of Cassation. Mr Spier nonetheless sought enforcement in the USA. The SDNY affirmed the annulment on the grounds that the FAA was wholly inapplicable. After all, this was a decision rendered by an Italian tribunal in Italy. The enforcement of this foreign award was *solely* governed by Article V(1)(e) of the Convention for two reasons: (i) there were no US public policy considerations at issue, as was the case in *Chromalloy*, and (ii) because Article V(1)(e) of the New York Convention governs the enforcement of awards that are annulled at their place of origin.

The *Spier* court also distinguished the *Chromalloy* decision on the same grounds as the *Baker Marine* court. It read Egypt's repudiation of its contractual promise not

66 In *Baker Marine*, Judge Leval of the SDNY focused on distinguishing the facts of *Chromalloy*, noting that the petitioner did not argue that the Nigerian court acted contrary to Nigerian law in vacating the award, and the contract did not establish that awards were non-appealable.

67 *Baker Marine* (n 50) at 197.

68 ibid at 197, fn 3.

69 In *Spier v Calzaturificio Tecnica*, SpA, 71 F Supp 2d 279 (SDNY 1999) (hereinafter *Spier*).

to appeal an arbitral award 'as the decisive circumstance' in *Chromalloy*: 'Only that circumstance is singled out as violating American public policy articulated in the FAA, thereby justifying the district court's enforcement of the Egyptian award.'[70]

The *Spier* decision turned over a new leaf for the enforceability of annulled arbitral awards in the USA. This decision implied a clear progression away from the *Chromalloy* position, under which foreign annulled awards could be set aside simply when the decision to annul contravened the US public policy. *Spier* did not, however, clearly define the standard under which foreign annulled awards could be set aside in the USA. In this context, and with the rising tide of enforcement requests for foreign and international arbitral awards, the 2007 *TermoRio*[71] decision, issued by the DC Circuit Court of Appeals, paved the way for US Courts faced with the enforceability dilemma by providing a clear foundation for future cases.

In *TermoRio*, the court refused to enforce an award that had been set aside in Colombia. A Colombian contractor secured an arbitration award in Colombia against a public utility company owned by the Colombian government. Throughout the arbitration proceedings, the Colombian government fruitlessly objected to the tribunal's jurisdiction. A Colombian court vacated the award, finding that it violated local law because, as of the date of the arbitration agreement, Colombian law did not expressly permit the use of the ICC rules of procedure in arbitration.[72] The court upheld a decision not to enforce the annulled arbitral award under the Panama Convention because there was nothing in the record 'to suggest that the parties' [annulment] proceedings before Colombia's *Consejo de Estado* [Council of State] or the judgment of that court violated any basic notions of justice to which we [U.S. courts] subscribe'.[73] As the court explained, 'an arbitration award does not exist to be enforced in other Contracting States if it has been lawfully "set aside" by a competent authority in the State in which the award was made'.[74] The court also noted that both parties were Colombian, the contract involved work conducted in Colombia, and based on the facts, there was no indication that the parties desired to have US law applied to their disputes.

In effect, the DC Circuit in *TermoRio* finally raised, and defined, the bar in regards to public policy arguments. The court found that '[i]t takes much more than a mere assertion that the judgment of the primary state 'offends the public policy of' the

70 ibid at 287–88 (citing *Baker Marine*, 191 F.3d at 197 n.3) (noting the absence of similar language in the *Spier* contract, the court concluded that there was 'no adequate reason for refusing to recognize the judgments of the Italian courts').

71 *TermoRio* (n 47) at 936.

72 ibid at 931.

73 ibid at 939. The court here was referencing the conclusion of the Fifth Circuit Court of Appeals in *Karaha Bodas*, which interpreted the 'public policy exception' of the New York Convention thus:

> Under Article V(2)(b) of the New York Convention, a court may refuse to recognize or enforce an arbitral award if it would be contrary to the public policy of that country. The public policy defense is to be construed narrowly to be applied only where enforcement would violate the forum state's *most basic notions of morality and justice*.

Karaha Bodas Co. v. Perusahaan Pertambangan Minyak Dan Gas Bumi Negara, 364 F.3d 274, 305-06 (5th Cir. 2004).

74 ibid at 936.

secondary state to overcome a defense raised under Article V(1)(e)'.[75] The DC Circuit explained that a US District Court might be allowed to ignore a foreign annulment only where the party demonstrates that the decision to vacate was 'repugnant to fundamental notions of what is decent and just in the State where enforcement is sought'.[76] This would be the case, for example, where the decision 'tends clearly to undermine the public interest, the public confidence in the administration of the law, or security for individual rights of personal liberty or of private property'.[77]

This brief excursus on the enforceability of arbitral awards annulled at their primary jurisdiction shows how the attitude of US courts has changed over the course of a decade. Having clearly abandoned the *Chromalloy* position and adopted the *TermoRio* standard, U.S. district courts are now more likely than ever to refuse enforcement to a foreign award that has been annulled by its primary jurisdiction. This is consistent with academic commentary, much of which is in agreement that foreign courts should not confirm arbitration awards that have been annulled by a competent authority.[78] But this trend is tempered by the district courts' right to invoke US public policy.[79] An annulled arbitral award may still be enforced in a US court where a judge finds that the decision to set aside that award was made in grave contravention of US public policy. In this manner, then, the *Commisa* decision joins this ever-growing body of law that will likely continue to distance itself from the *Chromalloy* position and further cultivate the *TermoRio* standard.

4.3 New York, August 2013: the ICC award is upheld

On 27 August 2013, Judge Hellerstein of the SDNY granted Commisa's petition to enforce the ICC Award, refusing to defer to the Mexican Court's annulment decision. When Commisa filed the ICC arbitration in 2004, the court wrote, it had 'every reason

75 ibid at 937–38. Judge Edwards also implicitly criticized *Chromalloy* as he commented that the New York Convention does not allow courts to 'routinely second-guess the judgment of a court in a primary State, when the court in the primary State has lawfully acted pursuant to "competent authority" to "set aside" an arbitration award made in its country'. ibid at 937.

76 ibid at 938.

77 ibid.

78 Albert Jan van den Berg, 'When Is an Arbitral Award Nondomestic Under the New York Convention of 1958?' 6 Pace L Rev 25, 41–42 (1985); W Michael Reisman, *Systems of Control in International Adjudication and Arbitration: Breakdown and Repair* (Duke University Press, Durham, NC 1992) 115–16; see also Gary Born, *International Arbitration: Cases and Materials* (Kluwer Law International, Netherlands 2011) 1118–23 (collecting authorities).

79 The concept of the US public policy as it is used in the *Chromalloy*, *Baker Marine*, and *TermoRio* decisions is different from the public policy described in art V(2)(b) of the New York and Panama Conventions. In practice, US public policy, as it is used in these cases, is a judicial concept that is rarely, if ever, defined but which assesses whether the foreign court has annulled an arbitral award in a way that disregards party autonomy and the language of the underlying arbitration clause, particularly when an American party has been affected. See, eg Pedro Martinez Fraga, *The American Influences on International Commercial Arbitration: Doctrinal Developments and Discovery Methods* (CUP, Cambridge 2009) 179 ('Thus, "U.S. public policy", nowhere defined in either opinion [*Chromalloy* or *Baker Marine*], is transformed into a conceptual "catch-all" clause that is a phrase substituting the reasoned activity of judging whether the competent tribunal in the primary state disregarded party-autonomy or the plain language of the arbitration clause at issue, in applying its substantive law leading to the nullification of the arbitration award.')

to believe that its dispute with PEP could be arbitrated[80] Unable to identify any legal authority alerting Commisa to the contract's inarbitrability, and in the absence of alternative fora where Commisa could raise its claims, the S.D.N.Y. found that the decision violated "basic notions of justice."[81] Citing *TermoRio*, the S.D.N.Y. read Article 5 of the Panama Convention to allow it the discretion to confirm an arbitration award that had been duly annulled by a foreign court if that annullment decision is 'repugnant to fundamental notions of what is decent and just in the United States'.[82]

In order to determine whether the Mexican Court's annulment decision conformed to 'basic' or 'fundamental' notions of justice, the SDNY reviewed the legal process that resulted in the Award's annulment, focusing primarily on two issues: (i) whether the Eleventh Collegiate Court retroactively applied laws to arrive at its decision, and (ii) the effect of the annulment decision on Commisa. Both PEP and Commisa provided the SDNY with summaries of the Mexican legal proceedings supported by documentary evidence, and presented experts on Mexican law.[83] In his decision, the district judge insisted that he was 'neither deciding, nor reviewing, Mexican law'.[84] Rather, he based his decision 'not on the substantive merit of a particular Mexican law, but on its application to events that occurred before that law's adoption'.[85]

4.3.1 The Mexican annulment decision relied on the retroactive application of Article 98

The law that received the court's greatest scrutiny, and whose perceived application proved the most galling to the district judge, is Article 98 of the 2009 Law of Public Works and Related Services,[86] which was not in force at the time the parties entered into their contract.[87] The Eleventh Collegiate Court made extensive reference to this law in its annulment decision, although it claimed that it was merely using Section 98 as a 'guiding principle'.[88] The SDNY was not satisfied by this explanation and concluded that the 2009 law was critical to the annulment decision.

In addition to Article 98, the Eleventh Collegiate Court claimed to derive support from a 1994 decision of the Mexican Supreme Court, which established that administrative rescissions qualified as acts of authority.[89] However, because the 1994 decision did not mention arbitration, the SDNY found that it was insufficient to put Commisa on notice of issues affecting the enforceability of its arbitration agreement.[90]

80 *Commisa* (n 13) at 657.
81 ibid at 661; see also above n 73.
82 ibid at 657 (citing *TermoRio* (n 47) at 939).
83 The judge held a three-day hearing at which he heard expert testimony offered by Dr Claus von Wobeser on behalf of Commisa and Mr Roberto Hernández–Garcia on behalf of PEP.
84 *Commisa* (n 13) at 661.
85 ibid.
86 This law provides that disputes related to administrative rescissions are not arbitrable. See the Law on Public Works and Related Services (n 16) at art 98, Diario Oficial de la Federación [DO], 28 May 2009 (Mex), <http://www.oas.org/juridico/spanish/mesicic3_mex_anexo29.pdf> accessed 14 September 2015.
87 The parties contracted in 1997 and 2003. See *Commisa* (n 13) at 644–45.
88 ibid at 650.
89 ibid at 650, 658–59.
90 ibid at 659, 661.

Without any legal authority to place Commisa on notice that its claims were not arbitrable, the SDNY concluded that Commisa was unfairly prejudiced when it first learned, several years into the arbitration, that administrative litigation in Mexico was the only medium available to pursue its claims.[91] When Commisa commenced the arbitration in 2004, the court wrote, it reasonably expected that its disputes with PEP would be arbitrable.[92] Commisa's contracts with PEP, as well as Pemex's Organic Law, which regulates PEP's operations as a state instrumentality, and the investment provisions of NAFTA all contemplate the possibility of arbitration. The SDNY decided that it was a flagrant violation of US public policy as well as inherently offensive to universal principles of justice that the Mexican Court relied on a retroactively applied law to set aside an award in favour of a private entity to the benefit of a state-owned entity.[93]

4.3.2 Deferring to the Mexican annulment decision would leave no recourse for commisa

The second issue the SDNY explored in its opinion was the meaning and effect of the ICC Award's annulment on Commisa. In the interval between the commencement of arbitration proceedings and the Eleventh Collegiate Court's annulment of the Award, there were significant and radical developments in Mexican law concerning the regulation of administrative rescissions. As discussed above,[94] in 2007 the Mexican legislature expanded the jurisdiction of the Federal Tax and Administrative Court to include original jurisdiction over disputes arising out of administrative rescissions and other administrative acts involving Mexican state entities.[95] In essence, these reforms, when applied retroactively, limited Commisa to a single court to litigate claims arising out of PEP's administrative rescission, and its shortened statute of limitations had already run.

In fact, following the annulment of the ICC Award, Commisa filed an action with the Mexican Federal Tax and Administrative Court, which dismissed all of Commisa's claims in 2012. The court held that its 45-day statute of limitations applied, instead of the 10-year statute of limitations applicable to breach of contract claims in Mexican district courts.[96] Further, the court argued that Commisa's claims were barred due to *res judicata*, citing the 2004 and 2006 decisions confirming the state's right to issue administrative rescissions and finding that PEP had properly issued its rescission. As the SDNY wrote in its 2014 decision, '[t]his lack of remedy is

91 The court also noted that PEP had improperly waited until October 2007 to allege that the arbitration agreement was invalid for public policy reasons, and in fact, did not have legal authority to support this argument until 2009, when art 98 was enacted. See ibid at 647, 658.

92 ibid at 661.

93 ibid at 659.

94 See Section 3.1.

95 See the Organic Law of the Federal Tax and Administrative Court, at art 14(VII), *Diario Oficial de la Federación* [DO], 3 June 2011 (Mex), <www.sep.gob.mx/work/models/sep1/Resource/f74e29b1-4965-4454-b31a-9575a302e5dd/ley_organica_trib_fed_just_fis_admva.htm> accessed 14 September 2015. See also *Commisa* (n 13) at 647–48.

96 See Section 2.1. According to the Federal Tax and Administrative Court, the 45-day statute of limitations had long expired, as it began to accrue when PEP issued its administrative rescission on 14 December 2006.

particularly unjust because COMMISA has been deemed to owe damages to PEP, even though there has been no full hearing on the merits outside arbitration, simply because PEP issued an administrative rescission'.[97]

From these facts, the SDNY concluded that failure to enforce the ICC Award would effectively leave Commisa without a remedy.[98] One of PEP's experts argued that Commisa had a remedy in Mexican courts because it could challenge the Administrative Court's dismissal of its claims.[99] The SDNY was not convinced by this testimony, explaining that any solution requiring 're-litigation in the Mexican courts' would add 'undue and unreasonable delay to a case that has lasted over 10 years'.[100]

4.4 PEP appeals to the second circuit

On 15 October 2013, PEP filed a Notice of Appeal to the Second Circuit against Judge Hellerstein's decision. PEP argued, among other things, that the SDNY's discussion of the merits of the Mexican Court's annulment decision contravenes precedent indicating that it could not review a Mexican court's analysis of Mexican law, even if it could do so accurately.[101] In its reply, Commisa argued that Judge Hellerstein's judicial review was 'limited to determining the meaning and effect of the [Mexican annulment] decision',[102] and finds support in judicial precedent recognizing that a court 'should hesitate to defer to a judgment of annulment that conflicts with fundamental notions of fairness'.[103]

An appeal has also been filed from the decision of another district judge of the SDNY in *Thai-Lao Lignite Co, Ltd v Government of Lao People's Democratic Republic*,[104] which refused to enforce an arbitration award that had been annulled at the seat of arbitration. In that case, a Thai claimant sought to enforce an arbitration award issued in Malaysia. After the SDNY confirmed the award and once enforcement proceedings were underway, a competent court in Malaysia annulled the award. On reconsideration, Judge Wood of the SDNY vacated her earlier decision and refused to enforce the award. The Second Circuit will be deciding both appeals in 2015. The Second Circuit's decisions in both *Commisa* and *Thai-Lao* will be of great interest to companies (and their lawyers) that arbitrate abroad against businesses and individuals with assets in New York.

97 *Commisa* (n 13) at 660.

98 ibid at 644, 659.

99 The expert stated that the Administrative Court's reliance on art 14(VII) of 2007 was erroneous because such statute was future-oriented and the Mexican Constitution prohibits retroactive application of laws. ibid at 660 n.24.

100 ibid.

101 See Brief for Respondent-Appelant, at 18, *Corporación Mexicana de Mantenimiento Integral, S de RL de CV v Pemex-Exploración y Producción*, No 13-4022 (2d Cir 28 January 2014). PEP has also argued that Judge Hellerstein should not have relied on *Chromalloy*, which is not controlling precedent in the Second Circuit and has been rejected by courts in other circuits.

102 ibid at 54–55.

103 Brief for Appellee at 41, *Corporación Mexicana de Mantenimiento Integral, S de RL de CV v Pemex-Exploración y Producción*, No 13-4022 (2d Cir 11 April 2014) (citing *Commisa* (n 13) at 656, 657).

104 10-CV-5256 KMW DCF, 2014 WL 476239 (SDNY 6 February 2014).

5. CONCLUSION

As the *Commisa* case demonstrates, the pursuit of a commercial arbitration and a constitutional action against the state as parallel proceedings can have unintended consequences, particularly when arbitrating across the civil law–common law divide. As we have seen, by challenging PEP's contract termination in administrative courts, Commisa implicitly accepted PEP's classification of its action as an act of state, and not as a commercial act. In its review of the case, the Mexican Supreme Court took for granted that PEP's action had been an administrative rescission—a fact that was not in dispute between the parties at the time. Since the administrative rescission under French-derived legal systems carries with it extraordinary protection from judicial review, this proved to be a fatal concession for Commisa to make.

The potential for disaster was known. As discussed in Section 3, many Latin American scholars have recognized the systematic risk posed by the *contrato administrativo* as their countries have sought to eliminate barriers to the enforcement of arbitration agreements. At least in Mexico, the latent risk that an administrative rescission would be ruled inarbitrable was foreseeable, even before *Commisa*. In an ideal world, a foreign company's mistake in pursuing an ill-advised domestic court strategy would not spell the end of its arbitration rights. But while Mexico's legal system is imperfect, part of the blame must also rest on Commisa and its lawyers. At the outset of this case, Commisa's local counsel was a Mexico City banking firm that was not sophisticated in arbitration, while dispute resolution strategy was directed by a large US firm. By failing to engage local counsel that understood the relevance of Mexico's French legal tradition and the resulting restrictions on the arbitrability of administrative contracts, Commisa was at a disadvantage.

Unfortunately, the Mexican Supreme Court's 2006 decision has caused considerable damage to the Mexican arbitration system, leaving only one possible solution: a legislative abandonment of the concept of the *contrato administrativo* in infrastructure projects. The Mexican legislature has taken steps in this direction with its recent reforms of the energy sector,[105] in particular by authorizing both Pemex and the CFE to incorporate arbitration agreements in their project agreements.[106] The newly amended laws governing these state-owned entities omit any reference to administrative rescission or termination, and instead expressly allow for the application of commercial law.[107] But the reforms did not resolve the arbitrability issues affecting the rest of Mexico's energy sector, as the administrative contract remains the default in the rest of the hydrocarbons industry.[108]

105 For a fuller discussion of Mexico's energy reforms, see Herfried Wöss, 'Wöss & Partners SC, *Mexican Energy Reform and Arbitration: the lessons of Commisa v Pemex*' *Kluwer Arbitration Blog* (7 November 2014) <http://kluwerarbitrationblog.com/blog/2014/11/07/arbitration-under-the-mexican-energy-reform-the-lessons-of-commisa-v-pemex/> accessed 8 May 2015.

106 See art 115 of the New PEMEX Law of 11 August 2014, art 118 of the New CFE Law of 11 August 2014.

107 See arts 3, 7 of the New Pemex Law; arts 3, 7 of the New CFE Law.

108 See, eg the New Hydrocarbons Law of 11 August 2014, art 19 (requiring contracts with the National Hydrocarbons Commission to allow administrative rescission or termination); art 20 (requiring the contractor, in case of an administrative rescission, to transfer the contractually assigned area –including any 'connected and accessory goods and equipment'– to the State without indemnification).

Meanwhile, in New York, Commisa and PEP are awaiting the Second Circuit's decision on PEP's appeal. Unless the Second Circuit reverses Judge Hellerstein's holding, *Commisa* will remain a landmark case delineating some of the extraordinary circumstances that justify the enforcement of annulled arbitral awards. From Judge Hellerstein's holding in *Commisa*, we may infer that, even after being annulled by a competent authority in the primary state, a foreign award might still be enforced by the SDNY where some combination of these conditions exist:

i. the annulment is largely based on laws that were not in force at the time the parties entered the contract, or on case law not specifically addressing arbitration;
ii. the requesting party does not receive fair notice that its disputes are not arbitrable; and
iii. refusing recognition and enforcement of the award would leave a private party without the ability to litigate its claims.

The presence of all these circumstances in the Mexican annulment decision has been deemed contrary to fundamental notions of justice in the USA. Perhaps the Second Circuit will clarify whether some of these factors matter more than others.

If the SDNY's decision is confirmed, the ICC Award could have a long life in the USA as PEP tries to protect its assets from execution by Commisa. While we wait for the US appeals court, we can reflect on this lesson: Commercial arbitration is not based on an underlying transnational law, but rather on many different national legal systems. The right to arbitrate is not absolute, but is something to be preserved. Therefore, for legal teams operating across borders, knowledge of local arbitration law is critical, as is the ability to communicate with lawyers from a different tradition.