

Mexico Supreme Court shows deference towards arbitral tribunal's absolute powers to admit and weigh evidence

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In a recent decision, the Mexican Supreme Court set a groundbreaking precedent, clarifying the extent of the concept of Mexican public policy in actions for setting aside arbitral awards. The court ruled that the power of an arbitral tribunal to determine the admissibility, relevance, materiality and weight of all evidence is absolute and, therefore, cannot be held to breach Mexican public policy rules.

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Background

Under Article 36(1)(a)(iv) of the **UNCITRAL Model Law** (www.practicallaw.com/7-205-6044), a court may resist the recognition and enforcement of an arbitral award where the composition of the arbitral tribunal 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.

Article 19(2) of the UNCITRAL Model Law provides that, in the absence of agreement between the parties, the tribunal may conduct proceedings in such manner as considered appropriate, provided that the parties are treated with equality and that each party is given full opportunity to present his case.

Facts

The dispute arose out of an agreement for the distribution and sale of monitoring and alarm systems in exchange for a sales commission (Agreement). The Agreement contained an arbitration clause referring all disputes to the Mediation and Arbitration Center of the Mexican Chamber of Commerce (CANACO).

Party A terminated the agreement and commenced arbitration proceedings with CANACO, seeking (among other things) a declaration from the arbitral tribunal that it had legally terminated the agreement. In March 2007, the arbitral tribunal rendered an award ruling that Party A had not legally terminated the agreement.

Party B then initiated a second arbitration before CANACO, seeking damages from Party A for the illegal termination of the Agreement and for the payment of unpaid commissions. After the time limit granted for the filing of evidence elapsed, Party B attempted to introduce new evidence on the record. The arbitral tribunal rendered an award in October 2009 (Final Award). It decided that, while Party B had failed to prove its actions for damages and lost profits, Party A was liable towards Party B for the

payment of unpaid commissions. In the Final Award, the arbitral tribunal reasoned that the new evidence introduced by Party B was inadmissible and, therefore, gave it no weight.

Party B moved to set aside the Final Award and filed annulment proceedings before a Mexico City court (a state court). Party B alleged (among other things) that, in deciding not to admit the evidence filed after the closing of the proceedings, the arbitral tribunal had breached Mexican public policy.

Mexico City court decision

The Mexico City court agreed with Party B's position and annulled the award on the grounds that the proceedings were not in accordance with the agreement of the parties (*Article 36(1)(a)(iv), UNCITRAL Model Law*) and that they breached Mexican public policy rules because the arbitral tribunal had failed to:

Admit the evidence filed by Party B (violation to due process).

Examine the *exceptio inadimpleti contractus* (defence of non-performance of the contract) invoked by Party B.

Appoint an expert to provide an independent opinion in view of the contradictory reports submitted by the experts appointed by the parties.

Observe the principle of *res judicata* with respect to certain decisions in the March 2007 arbitral award.

Appropriately decide the claim for damages and lost profits.

The lower court set aside the award and remanded the arbitration back to the arbitral tribunal for further proceedings, ordering it to admit the evidence and to issue a further award taking into account such evidence.

Party A filed *amparo* proceedings before a Federal District Court, seeking to reverse the lower court's decision to set aside the award.

Federal District Court decision

With respect to the first ground for annulment invoked by the lower court (failure to admit new evidence), the District Court agreed with the arbitral tribunal's decision not to admit the new evidence filed by Party B. The District Court held that, while the arbitral tribunal had indicated that it would only allow new evidence to be filed when such evidence had been unknown to the relevant party before the end of the evidence phase, there was sufficient proof that Party B had known about the evidence in question since June 2008. However, Party B had unduly waited until September 2008 (once the time to file evidence had elapsed) to file it before the tribunal. Therefore, the District Court overturned the lower court's decision on this ground for annulment.

With respect to the second ground for annulment raised by the Mexico City court (failure to examine the *exceptio inadimpleti contractus*), the District Court held that, since Party B had failed to prove that it had continued to perform its obligations under the contract after receiving the notice of termination from Party A, the state court did not need to analyse that ground for annulment any further. The District Court further stated that, since Party B had failed to comply with certain conditions imposed by the Agreement, the failure to examine that defence was not a ground for annulment. Therefore, the case could not be remanded back to the arbitral tribunal for further proceedings on this issue.

Regarding the question of the arbitral tribunal's decision not to award damages and lost profits to Party B, the District Court held that the arbitral tribunal had reached an incorrect decision as it had failed to analyse the issue of whether the notice of termination of the agreement was properly made. Therefore, the District Court upheld the Mexico City court's decision to annul the award on this issue.

The Federal District Court further decided to overturn the decision to remand for further proceedings and instead ordered that the arbitral award be partially vacated on the grounds of failure to observe the principle of *res judicata* with respect to certain decisions contained in the first arbitral award. The District Court found that, by dealing with issues related to the method of calculation for the sales commissions, the arbitral tribunal had breached Mexican public policy rules with respect to the principle of *res judicata* because those issues had been previously dealt with by the arbitral tribunal in the first arbitral award.

Both parties appealed the District Court's decision before the First Circuit Collegiate Courts:

Party B alleged that the District Court had erred in its decision to overturn the lower court's decision to annul the award on the basis of failure to observe due process with respect to the issue of evidence.

Party A claimed that the District Court's decision should be overturned on the issue of *res judicata*, given that the arbitral tribunal did not even hear the issues of calculation of sales commissions. While such issue had been raised in Party A's counterclaim, those claims were considered withdrawn by the arbitral tribunal after Party B failed to pay its share of the advance on costs.

The case was removed to the Supreme Court.

Decision

The First Chamber of the Mexican Supreme Court overturned the District Court's decision to revoke in part and to uphold in part the Mexico City court's annulment. Furthermore, it ordered the District Court to issue a new resolution revoking the entirety of the Mexico City court's decision to annul the arbitral award.

The First Chamber overturned the District Court's decision to uphold the lower court's ruling to annul the award on grounds that the arbitral tribunal had failed to properly resolve the claims for damages and lost profits. The First Chamber reasoned that the annulment procedure under Article 34 of the Model Law did not grant any court the power to review the merits of the arbitral award, but it did grant the power to annul an award that goes against Mexican public policy. The First Chamber held that the

correctness or appropriateness of the arbitral tribunal's findings with respect to the issue of damages and lost profits is an issue related to the merits and is therefore outside the court's review powers under Article 34 of the Model Law. It further indicated that the issue of whether the arbitral tribunal had erred in its decision with respect to damages and lost profits cannot, of itself, be held to breach public policy.

Similarly, on the issue of whether the arbitral had violated public policy norms for failing to admit the new evidence filed in the arbitration and to appoint a third expert in light of the contradictory opinions of the parties expert witnesses, the First Chamber held, in *dicta*, that in accordance with Article 19(2) of the Model Law, the powers of the arbitral tribunal to determine the admissibility, relevance, materiality and weight of any evidence is absolute and, therefore, cannot be questioned by the court system in annulment proceedings nor held to breach Mexican public policy rules.

In *dicta*, the First Chamber indicated that the mere dismissal or failure to entertain an allegation of *res judicata* was not, of itself, a violation of public policy or a sufficient ground for annulment of an award under Article 34(2)(b)(ii) of the Model Law. In that regard, the court further held that the concept of public policy should be not only be understood as the principles that are destined to protect a nation's fundamental institutions, but also as a principle that protects against serious violations to fundamental principles of justice and due process.

The First Chamber further indicated that, while it was unable to deal with the merits of the dispute before the arbitral tribunal, it was evident from the record that the issue of sales commissions had not been dealt with by the arbitral tribunal in the first award.

Comment

Through this decision, the Supreme Court took an important step forward in the deference it has traditionally shown towards arbitration. Specifically, it confirms arbitral tribunal powers to admit and weigh evidence as they deem appropriate. This criterion also confirms that grounds for the annulment of awards are narrowly tailored in Mexico's arbitration law.

Lastly, we believe this decision clearly shows potential plaintiffs that arguing lack of tribunal powers in weighing the evidence presented to them by the parties will not grant them annulment of the award. This illustrates the respect Mexico's legal system holds towards arbitration.

Case

Facultad de Atracción 78/2011 (www.practicallaw.com/4-523-2347).

Resource information

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