THE INTERNATIONAL ARBITRATION REVIEW

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Editor
James H Carter

THE LAWREVIEWS

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EIGHTH EDITION

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MEXICO

Adrián Magallanes Pérez and Rodrigo Barradas Muñiz[1]

I INTRODUCTION

Recently, there have been a couple of significant developments in Mexican arbitration law resulting from bills passed by Congress and from decisions made by the Mexican Supreme Court of Justice.

Congress approved an initiative proposed by the President in 2016 regarding a constitutional reform aiming to allow Congress to enact a general law on alternative methods of dispute resolution (see Section II.i, *infra*). In addition, according to a new provision added to the General Law of Business Corporations, the shareholders of simplified stock companies must submit their disputes, and the disputes that arise between them and third parties, to the alternative methods of dispute resolution provided for in the Commerce Code, unless there is an agreement to the contrary.

The Mexican Supreme Court ruled on *amparo directo* proceeding 71/2014 regarding a dispute between the Federal Electricity Commission (CFE) and an independent power producer arising from the interpretation of the power purchase agreement executed between them. The Supreme Court's decision led to different judicial criteria that were published in March 2017 regarding arbitration agreements concluded between government authorities and private individuals.

In the area of oil and gas, which represents an area of great interest for both national and foreign investors since changes in Mexican law now allow private participation in the sector, there was a recent and interesting variation in the government's selection of rules to govern the arbitration proceedings.

The National Hydrocarbons Commission established a model contract for exploration and extraction activities containing an arbitration clause governed by the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules and designating The Hague as the place for arbitration.

Another interesting recent development concerning oil and gas was the entry into force of the Hydrocarbons Law, which establishes that any dispute relating to the administrative rescission of contracts – which can only be based on a limited catalogue of serious causes provided in statutory law – cannot be referred to arbitration and is of the exclusive jurisdiction of the Mexican courts.

1 Adrián Magallanes Pérez is a partner and Rodrigo Barradas Muñiz is an associate at Von Wobeser y Sierra, SC.

i Law governing arbitration

Applicable law

In Mexico, commercial arbitration is governed by the Commerce Code, which applies to all commercial disputes submitted to arbitration in Mexico. Unlike other matters reserved to the local congresses, the Mexican Constitution grants the faculty to issue commercial law to the Federal Congress. This circumstance implies that there is a unique set of rules regarding commercial arbitration applicable in all the country, preventing the problems often seen in other federal states in which each district has a different applicable law.

The Commerce Code was amended in 1993 to incorporate, with only a small number of minor modifications, the UNCITRAL Model Law of 1985 as Mexico's arbitration law. In 2011, the Commerce Code was amended again to incorporate some of the provisions of the Model Law, as amended in 2006.

There are two significant differences between the provisions of the Commerce Code and the Model Law. The first refers to interim relief requested to a court: under the Commerce Code, it is necessary to process a complete trial to obtain interim relief from a court. The second refers to the number of arbitrators in cases where there is no agreement between the parties, because the Model Law establishes three arbitrators must be appointed while the Commerce Code requires only one arbitrator.

The corresponding book of the Commerce Code applies to both domestic and international arbitrations with a seat in Mexico.

Matters that cannot be referred to arbitration

There are several subject matters that, according to different statutes of the Mexican legal system, may not be referred to arbitration, such as the following:

a Article 568 of the Federal Code of Civil Procedure establishes that national courts have exclusive jurisdiction over disputes arising from:
- internal regimes of Mexican embassies and consulates and their official proceedings;
- acts of authority or acts related to the internal regime of the state and of the federal entities;
- land and water resources located within national territory; and
- resources within the exclusive economic zone or resources related to any of the sovereign rights regarding such zone;

b Article 1 of the Bankruptcy Law establishes that national courts have exclusive jurisdiction over personal and commercial bankruptcy proceedings;

c Article 1 of the National Code of Criminal Procedure provides that criminal liability is not arbitrable;

d Article 52 of the Superior Court of the Federal District Organisational Act provides that all issues related to family law and civil status must be ruled by national courts;

e Article 14 of the Tax and Administrative Federal Court Organisational Law establishes that matters related to taxes are not arbitrable;

f Article 123, Section XXXI of the Constitution provides that labour disputes must be ruled by special boards and tribunals;

g according to Article 27, Section XIX of the Constitution, agrarian disputes are not arbitrable;

h under the Law of Acquisitions, Leases, Services of the Public Sector, as well as the Law of Public Works and Related Services, arbitration is excluded in any dispute regarding the lawfulness of administrative rescissions or the early termination of contracts executed between public entities and private parties under the framework of those laws; and

i under Article 227 of the Industrial Property Law, parties may only submit a dispute to arbitration when the controversy affects private rights exclusively. If the dispute concerns a public interest, then it is not arbitrable.

Mexican courts' attitude to arbitration

In the vast majority of cases, Mexican courts rule in favour of the enforcement of national or foreign awards. A Mexican court can only refuse to recognise and enforce an award under Mexican law for the reasons established in the Commerce Code, which mirror those provided for in the New York Convention (e.g., if the arbitration agreement is null and void or if the award deals with an issue not contemplated within the scope of the arbitration agreement).

Courts have been very careful not to attend arguments that result in the revisiting of the merits of a controversy. For that reason, several Mexican courts have issued rulings denying the annulment of awards based on allegations of breach of public policy with the aim of enabling the court to revisit the merits of the case.

Treaties related to commercial arbitration

Mexico is a party to the following international treaties related to commercial arbitration: the New York Convention of 1958, which was ratified in 1971; the Inter-American Convention on International Commercial Arbitration (Panama Convention), which was ratified on October 1977; and the Inter-American Convention on Extraterritorial Validity of Foreign Judgments and Arbitral Awards (Montevideo Convention), which was ratified in 1987.

ii International and domestic arbitration

Under Mexican law, there is no relevant distinction between domestic and international arbitration. As long as the seat of the arbitration is Mexico, both domestic and international arbitrations are governed by the Commerce Code, and the same rules apply to both.

Most arbitration in Mexico is institutional. The most frequently used institutions for international arbitration in Mexico are the International Chamber of Commerce (ICC), the International Centre for Dispute Resolution and the London Court of International Arbitration. As regards domestic arbitrations, the most commonly used institutions are the Mexico City National Chamber of Commerce (CANACO) and the Mexican Arbitration Centre (CAM).

iii Structure of the Mexican courts

Mexico is a federal state. Therefore, there is a federal judiciary branch and a local judiciary branch in each one of the country's 32 states.[2] Jurisdiction depends on the distribution of the subject matter under the Constitution.

2 Mexico City was, until 2016, a federal district with a legal regime different from the 31 sovereign states that integrate the federation. However, in 2016 an amendment to the Constitution modified the status of the Mexican capital, which is now virtually the 32nd state.

The federal judiciary is composed of:

a the Supreme Court of Justice, consisting of 11 justices nominated by the President and elected by the Senate;
b collegiate circuit courts, integrated by three judges;
c single-judge circuit courts;
d district courts; and
e the Federal Judicial Board, which is in charge of management tasks.

Currently, the district judges, collegiate judges, and single-judge circuit court judges are all selected by competitive examination.

In the past two decades, the judicial branch has experienced a positive and straightforward development, and has exercised constructive influence on the control of the executive and legislative branches.

The situation in the local judiciary systems is not the same. Although significant efforts have been made throughout the years to improve these systems, they are still commonly characterised by their slow resolution of cases and inefficiency.

Regarding commercial disputes, and specifically proceedings related to commercial arbitration, both local and federal courts have jurisdiction.

The judiciary in Mexico is familiar with the law and practice of domestic and international arbitration. Nonetheless, the most experienced courts in arbitration matters in Mexico are still the federal courts in Mexico City.

iv Local institutions

CANACO has two sets of rules for arbitration proceedings: the Rules of Arbitration, applicable to any commercial dispute with an amount over 124,860 investment units (UDIS);[3] and the Rules for Low-Amount Arbitration, applicable to any commercial dispute with an amount under 124,860 investment units (UDIS).

The main differences between the two sets of rules refer to the duration of the proceeding and the composition of the arbitral tribunal.

CAM was created in 1997 and has two versions of its Rules of Arbitration. The first was in force from 1997 to 2009, and the second has been in force since 1 July 2009. Both versions were inspired by the rules of the ICC.

v Trends related to arbitration

In recent years, there has been a clear increase in the use of arbitration in Mexico, and its practice has gradually spread among many sectors of the economy. Without doubt, arbitration is now a common alternative means for private parties and the government to resolve disputes, although the number of cases is still low if compared to other countries with similar or even smaller economies.

3 Investment units (UDIS) are units based on price increases that are used to settle obligations or commercial acts. They were created in 1995 to protect banks and focused mainly on mortgage loans. Banco de México publishes the value in pesos of the Mexico investment unit for each day of the month in the Official Federal Gazette.

This steady increase in the number of arbitration cases is directly related to the fact that Mexican law is favourable to arbitration, and the courts have held pro-arbitration criteria in the vast majority of cases.

Administrative rescission of contracts

Since the entry into force of the new Hydrocarbons Law in 2014, there has been ongoing discussion on the legal and economic consequences of Articles 20 and 21 of that statute. These Articles grant Pemex the right to determine the administrative rescission of contracts entered into with private entities, and they state that all disputes related to the administrative rescission cannot be referred to arbitration and are of the exclusive jurisdiction of the Mexican courts. However, the consequences of administrative rescission (such as the determination of damages and lost profits) can be referred to arbitration.

The administrative rescission of a contract is an act of governmental authority by which a contract is unilaterally terminated by the state in a mandatory and enforceable manner, and in the cases expressly recognised by statutory law (e.g., a serious breach of contract as defined in the statute). It is an 'exorbitant' contractual remedy under Mexican administrative law, and can only be exercised by the governmental party to the contract being rescinded.

Mexican courts have held that administrative rescissions are constitutional because of two main reasons: they can be challenged before judicial courts; and the individual or entity subject to an administrative rescission proceeding may submit evidence demonstrating that the government's intention to rescind the contract lacks legal grounds (e.g., to prove there was no breach of contract).

The administrative rescission has severe consequences that go beyond the termination of the contract, such as the following:

a immediate return of the contract area;
b payment of damages and lost profits;
c the possibility of being disqualified form executing future contracts with the state for up to five years; and
d economic sanctions.

II THE YEAR IN REVIEW

i Developments affecting international arbitration

There have been no significant changes to the Commerce Code or any other law applicable to international arbitration during recent months.

Regarding domestic arbitration, as previously mentioned, the President proposed changes to the Constitution to allow Congress to enact a general law focused on determining the general principles and foundations for alternative means of conflict resolution. This initiative was approved by Congress, and the constitutional amendment was published in Mexico's Official Journal of the Federation (DOF) on 5 February 2017. Congress must now issue the general law on alternative means of conflict resolution. The bill corresponding to that law has not yet been voted on; however, it is worth mentioning that the current proposal does not include provisions related to commercial arbitration.

Additionally, on 14 March 2016, a decree was published containing an addition to the General Law of Business Corporations. The new provision states that, unless there is an agreement on the contrary, all disputes arising between the shareholders of simplified stock

companies, as well as disputes between them and third parties, should preferably be solved using alternative methods of dispute resolution provided in the Commerce Code, including arbitration.

Among other things, last year the President sought to transform all commercial proceedings into oral trials with the objective of speeding up the resolution of cases. However, only regular commercial trials have seen relevant changes, while proceedings related to arbitration remained untouched. On 25 January 2017, a reform of the Commerce Code was enacted stating that starting from January 2018, all commercial disputes that have an estimated value of less than 1 million Mexican pesos shall be conducted in an oral manner. Additionally, as of January 2019, this same provision will apply to disputes that do not exceed 1.5 million Mexican pesos. After January 2020, all commercial disputes shall be conducted orally.

Finally, a recent judicial criterion addressed the issue of interpreting Article 17 of the Constitution. Since 2008, Article 17 has stated that Mexico's general federal laws shall provide a variety of alternative mechanisms for dispute resolution. The Supreme Court has stated that this provision recognises the right to choose arbitration as the mechanism to solve a dispute as a constitutional right and not simply as a consequence of contractual freedom. It is held that the decision to submit a dispute to arbitration must not be understood merely as a renunciation of the constitutional right of demanding justice before the courts, but also as an affirmative exercise of the right to go to arbitration as a right that deserves the same type of constitutional protection.

ii Arbitration developments in local courts

Supreme Court of Justice decision in the CFE case

In a recent case, the First Chamber of the Mexican Supreme Court of Justice ruled on the constitutional action (*amparo*) registered under Docket Number 71/2014, a case arising from a power purchase agreement executed between CFE, a state-owned electricity company, and an independent power producer. After a dispute arose regarding a malfunctioning in the electrical energy generating plant of the independent producer, an arbitral tribunal rendered a final award in favour of said party. CFE tried to set aside the award before the Mexican courts under the argument that there were public policy violations and that the arbitral tribunal ruled on issues that, according to the power purchase agreement, corresponded to technical expertise.

Three relevant judicial criteria stemmed from this case regarding the standard of judicial review of awards and the cases in which a public policy violation occurs. These judicial criteria were published in March 2017.

Regarding one criteria, the Supreme Court of Justice found that a judge cannot examine the merits of the award and must limit its analysis to the specific issues established in the Commerce Code for the setting aside of arbitral awards. Additionally, it was determined that, even when the matters submitted to arbitration – and therefore the decision reached by an arbitral tribunal – seem to violate matters of public policy, the state is allowed to make exceptions to the general rule that precludes these matters from being submitted to arbitration. This is by virtue of the special nature that the state has under public law regarding the conclusion of contracts with private individuals. In this sense, public entities that have agreed in the first place to submit to arbitration all disputes that arise from public contracts cannot afterwards argue the limitation of public policy. The Supreme Court also found that

the decision of agreeing to the arbitration clause is in itself a decision of public policy, and that the key issue is to verify that arbitrators ruled on the controversy within their scope of competition.

It was also determined regarding another criteria that, when interpreting the scope and limitations of an arbitration agreement, the arbitral tribunal must take into consideration the grounds for the annulment of an arbitral award found in Article 1457 of the Commerce Code. In this sense, judicial authorities are empowered to review the interpretation made by arbitral tribunals. Nonetheless, it was also found that judges should limit to two steps of analysis when making said review. First, they must analyse the text of the arbitral agreement itself, determining if the terms used by the parties are clear or not, and abide by the agreement if they are. In cases where the terms are not clear, the second step consists of taking into account the interpretation that the arbitral tribunal gave to the clause without being able to determine the invalidity of the clause based on an interpretation that, on their own, they deemed better.

Corporación Mexicana de Mantenimiento Integral, S de RL de CV (Commisa) v. Pemex

Another relevant case regarding the annulment of awards in Mexico, which saw developments in the past year, is *Commisa*.

It is a very complex case that resulted in the annulment of an ICC award by Mexican courts based on the administrative rescission figure. This award was issued against Pemex, and its enforcement is being sought in New York, despite the annulment.

The dispute arose from a contract executed between Commisa and Pemex in 1997 to build and install two offshore natural gas platforms in the southern part of the Gulf of Mexico. In 2004, seven years after the contract was executed and just before the works were about to be finished, each party charged the other with breaching the contract. Commisa filed for arbitration against Pemex, and Pemex responded by initiating an administrative rescission proceeding and by ultimately terminating the contract.

Pemex challenged the jurisdiction of the arbitral tribunal, stating that administrative rescission was an act of governmental authority that could not be arbitrated. The tribunal affirmed its jurisdiction over all the disputes involved in the case, and eventually ruled in favour of Commisa.

While the arbitration unfolded, a law giving jurisdiction to the Federal Administrative Court to resolve all matters relating to administrative rescission disputes entered in force in 2007. In addition, an amendment to the Public Works Law entered into force in 2009 providing that administrative rescission disputes are not arbitrable.

In 2010, Pemex filed an award annulment request before the Mexican courts arguing that the dispute was not arbitrable because it involved an act of authority and that the award breached public policy. The Mexican courts annulled the award in 2011 under the argument that issues involving the administrative rescission by Pemex were intertwined and inseparable from the contractual issues resolved in the arbitration, and that the proper forum to hear the dispute was the Federal Administrative Court.

Commisa filed a petition before the New York Southern District Court to enforce the award, and it was granted. Pemex appealed the ruling, and the Appeal Court ordered the District Court to address the issue of whether the enforcement of the award should be denied because it was set aside in Mexico.

The New York District Court stated that it had discretion to confirm an annulled award, but that this discretion was narrow based on *Termo Rio*. The applicable standard was whether the annulment decision breached 'fundamental notions of justice'.

Applying that standard, the District Court concluded that the retroactive application of the law was at the centre of the dispute, and that the Public Works Law was applied retroactively, which constituted a breach of the basic notions of justice. Therefore, it determined to confirm the award despite its annulment by the Mexican courts. Pemex then appealed the judgment.

In April 2017, it was announced that both parties reached a settlement under which Commisa's parent company, KBR, received an estimated payment of US$435 million in order for both parties to dismiss all pending litigation regarding this matter.

iii Investor–state disputes

Mexico is not a party to the Convention on the Settlement of Investment Disputes between States and Nationals of other States (ICSID Convention). However, it has included ICSID-related provisions in almost all of its investment treaties.[4]

Given that ICSID arbitration is not a possibility against the state, an investor only has the option to start a proceeding under the Additional Facility Rules or to base its claim on the arbitration rules established in the corresponding bilateral investment treaty. The UNCITRAL Arbitral Rules are very often found in treaties executed by Mexico.

To our knowledge, there are currently only three relevant pending cases under the ICSID Additional Facility Rules against Mexico: *Deana Anthone, Neil Ayervais, Douglas Black and others v. United Mexican States*,[5] *Lion Mexico Consolidated LP v. United Mexican States*[6] and *Telefónica, SA v. United Mexican States*.[7] *Anthone* deals with claims under the North American Free Trade Agreement (NAFTA) arising out of the government's alleged unlawful interference with the claimants' casino business in Mexico, including raids on facilities, seizure of equipment and bank account funds, closure of facilities and invalidation of a gaming permit. *Lion Mexico* concerns an investment in a real state project protected under NAFTA. *Telefónica* concerns an investment in telecommunications services protected under the bilateral investment treaty entered into by Spain and Mexico in 2006.

Again to our knowledge, there are two investment arbitration cases against Mexico pending under the UNCITRAL Rules. The first was initiated by Shanara Maritime International, SA (Panama) and Marfield Ltd Inc (Panamá), and arose from precautionary injunction measures imposed by Mexico's Attorney General on two vessels. The second was initiated by private investors from the United States under NAFTA regarding acts of the government that allegedly rendered their company in Mexico, Tele Fácil México S.A de CV, commercially unviable by denying it access to the Mexican telecommunications market.

Regarding treaties with provisions related to investment, Mexico's Secretary of Economy signed the Trans-Pacific Partnership Agreement (TPP) on 4 February 2016. However, the treaty has not yet been ratified by the Mexican Senate. It will enter into force after ratification by all signatories if this occurs within two years. In the event that the TPP is not ratified by 4 February 2018, it will enter into force once it has been ratified by at least six states that, in combination, account for at least 85 per cent of the combined gross domestic product of the original signatories.

4 Mexico has signed over 30 bilateral investment treaties and has entered into 10 free trade agreements, all of which include ICSID arbitration clauses.

5 ICSID Case No. ARB(AF)/16/3.

6 ICSID Case No. ARB(AF)/15/2.

7 ICSID Case No. ARB(AF)/12/4.

III OUTLOOK AND CONCLUSIONS

The number of arbitration proceedings in Mexico, as well as the size of the disputes, has experienced significant and continuous increases for quite some time. In addition, the arbitration practice has spread among many sectors of the economy.

The steady growth in the Mexican arbitration practice is in part based on the fact that Mexican courts usually favour the enforcement of national or foreign awards. The ongoing development of case law confirms the pro-arbitration attitude of the Mexican judiciary, particularly at a federal level.

There are still some matters that require a definitive interpretation from the Mexican courts regarding the regulation of arbitration under the Commerce Code, but overall the Mexican case law on the subject is extensive.

In the near future we expect a significant increase in the number of arbitration disputes in the oil and gas industry based on the new Hydrocarbons Law and due to the opening up of Mexico's energy industry to private investment.

Appendix 1

ABOUT THE AUTHORS

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Adrián Magallanes Pérez obtained his law degree (JD), *summa cum laude*, from the Escuela Libre de Derecho, Mexico City. He holds a master of laws degree (LLM) from New York University School of Law, New York, where he received the Arthur T Vanderbilt Scholar Award for academic merit. Admitted to practise in Mexico and New York, he is a professor of international litigation at the Escuela Libre de Derecho.

His areas of practice are civil, commercial and administrative litigation, commercial arbitration, constitutional *amparo* and administrative proceedings, energy and natural resources, foreign investment, government procurement and public works, investor–state arbitration, oil and gas and public-works arbitration, and class actions.

He speaks Spanish and English.

He is chair of the arbitration committee of the Mexican Bar Association and a member by invitation of the Argentine Centre for International Studies. He was a global advisory board member of the International Centre for Dispute Resolution – Young & International (Y&I) (2007–2010) and an executive board member of the International Centre for Dispute Resolution – Y&I (2010–2013).

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Rodrigo Barradas Muñiz obtained his law degree (JD), *magna cum laude*, from the Escuela Libre de Derecho, Mexico City. He is a professor of international commercial arbitration at Universidad La Salle and an associate professor of international litigation at the Escuela Libre de Derecho.

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