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Arbitration under the Mexican Energy Reform: The Lessons of COMMISA v. PEMEX

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1. Background

Modern arbitration in Mexico commenced with the reforms to the Mexican Commercial Code in 1989 and with the incorporation in such code of the UNCITRAL Model Law on International Commercial Arbitration in 1993. Project agreements with state entities such as Petróleos Mexicanos (PEMEX) and the Federal Electricity Commission (CFE) may be submitted to arbitration since 1993. In 2009, arbitration was made available for all federal government procurment contracts under the Federal Law for Public Works and Services (Public Works Law) and the Federal Law for Acquisitions, Leases and Services of the Public Sector (Public Acquisition Law), with the exception of the administrative rescissión and termination of contracts and project agreements which is actually not found in the laws governing PEMEX and CFE. The Public-Private Partnerships Law (PPP-Law) as of January 16, 2012 extends non-arbitrability to any act of authority by a State entity.

The limitations of arbitrability in the Public Works and Acquisition and the PPP laws seem to have been provoked by the COMMISA v. PEMEX case. In such case, claimant pursued constitutional litigation (amparo) parallel to the arbitration in order to have the aministrative rescission of the project agreement by PEMEX declared as an act of authority, which is a requirement of admissibility in any amparo action, and to have such act annulled because of purported violations of the Mexican Federal Constitution. Whereas the courts finally recognized that the administrative rescission, that had hitherto been considered as of a commercial nature *de iure gestionis*, was an act of authority *de iure imperii*, claimant lost the amparo. The arbitral award was annulled in Mexico due to the binding force of the act of authority and the *res iudicata* effect of the amparo judgment which denied the annulment of such act of authority on the arbitration.

Under French law, on which Mexican law is based, State contracts, by definition, are not arbitrable save when the contrary is expressly established by law, as has been the case with PEMEX and CFE since 1993. French and Mexican law provides for exorbitant powers of the State, allowing for the unilateral modification and termination of a contract. Unilateral administrative acts are considered to be valid unless annulled in an ordinary administrative procedure or an annulment action in an administrative or amparo court procedure, as confirmed by the Second Chamber of the Mexican Supreme Court in 2006, as part of the COMMISA amparo procedure, which makes arbitration redundant in case of the administrative rescission or termination of a contract with a State contract.

The COMMISA case is also an example of the problematic use of the French law institution of the *'contrat administratif'*, as used in Mexico and in various Latin American countries, as already observed by Hector Mairal in 2002. Whereas in France contract termination or events distorting the contractual balance trigger indemification obligations of the State or State entity, in Mexico and many Latin American countries such indemnification obligations are very rudimentary or non-existent. Combined with the inherent inarbitrability of acts of State, this creates a considerable political risk which is likely to provoke investment arbitrations.

The Mexican energy reform, through its secondary laws as of August 11, 2014, makes a radical change abandoning the institution of the administrative contract in favour of project agreements based on commercial law, with the partial exception of the administrative termination or rescission of contracts for the exploration and extraction of oil and gas.

2. The arbitration regime of PEMEX and the CFE after the energy reform

Under new Ley de Petroleos Mexicanos (new PEMEX law) as of August 11, 2014, project agreements are governed by such law and commercial law as expressly stated in articles 3 and 7, second paragraph. In particular the new PEMEX law does not contain any reference to administrative rescission or termination and expressly allows for commercial terms in project agreements.

Of utmost importance is the new article 80 of the new PEMEX law, which establishes that all acts during the public tender proceeding until the award of a project are considered administrative acts. Once the contract has been signed, any contract related acts are considered of a private law nature or, in case of PEMEX, *de iure gestionis*, and are governed by mercantile law or civil law. This evidences the mercantile character of project agreements under the 2014 PEMEX law. By expressly stating that future project agreements are commercial agreements and omitting any reference to the administrative rescission and termination of the project agreement, the COMMISA contingency seems to have been eliminated.

Article 115 of the new PEMEX law expressly provides for arbitration and any other means of amigable dispute resolution to be agreed by PEMEX and its subsidiaries, based on commercial law and international treaties, without any exception as regards arbitrability *ratione materiae*.

The same legislative approach has been taken with the Federal Electricity Commission under the new CFE law as of August 11, 2014. Articles 3 and 7 of the new CFE law expressly refers to commercial legislation applicable to its project agreements. Any acts of the entity in public tender procedures are considered administrative acts, however, and as article 82 of the new CFE law clearly establishes, commercial law is applicable to projects agreements. Article 118 of the new CFE repeats the authority to compromise in arbitration with the same wording as under the new PEMEX law.

With the new PEMEX and CFE laws, the Mexican Congress has taken an important step to eliminate the political risk caused by the ruling of the Second Chamber of the Supreme Court on the non-arbitrability of the administrative rescission and termination as a consequence of the COMMISA amparo, by expressly providing for a mercantile regime and confirming the lack of any non arbitrability issues with respect to project agreements.

The new Electricity Industry Law provides for commerial contracts between the State and private entities in its articles 5 and 66 based on the Mexican Commercial Code including permits or

concessions, save where the law expressly provides for the State acting as authority. The law does not contain any provisions with respect to the administrative rescission or termination of a contract. Due to the mercantile character of energy contracts, arbitration seems to be permitted, though there is no express provision to that respect in the law. The Energy Regulatory Commission resolves disputes with respect to interconections and disputes of companies of the energy sector with the National Energy Control Center. Contracts with land owners relating to rights of way and other encumbrances necessary for the transmission and distribution of energy are subject to dispute resolution before federal tribunals. Similar provisions are found in the new Geothermal Energy law.

The energy reform left untouched the inarbitrability issues under the public works and acquisition laws, with respect to the administrative rescission and termination, as well as with any act of authority under the PPP law. Moreover, the notion of act of authority is not clearly defined in Mexican jurisprudence.

3. Oil and Gas Exploration and Production Contracts under the new Hydrocarbon Law

Oil and gas exploration and production contracts with the National Hidrocarbons Commisions are governed by commercial law, subject to the imperative provisions contained in the Hidrocarbon Law, as expressly established in article 22 of the new Hidrocarbon Law as of August 11, 2014 and its future regulations. This is confirmed in article 97 of the new Hidrocarbons law which expressly refers that the acts of the hydrocarbon industry are considered mercantile providing for the application of the Mexican commercial and civil codes.

Such contracts with the new National Hidrocarbons Commission under the Hydrocarbon Law as of August 11, 2014 relate to natural resources such as oil and gas that are the property of the Nation. In spite of their mercantile character, article 19, section VIII, of the Hidrocarbons Law clearly establishes that provisions for the administrative rescission and termination have to be included in these contracts. The causes for administrative rescission are expressly regulated in article 20 of the new Hidrocarbons Law and refer to gross non-performance of the contractor.

Article 21 of the new Hidrocarbon law provides for arbitration of oil and gas exploration and production contracts subject to the the Mexican Commercial Code as *lex arbitri*. The administrative rescission and termination is expressly excluded from arbitration as a matter of inarbitrability ratione materiae. This means that according to the judgment of the Second Chamber of the Mexican Supreme Court as of 2006, the administrative rescission and termination would have to be litigated before Mexican federal courts in administrative matters, which are quite competent in tax matters, water and perhaps also competition and intellectual property law, but fairly ill-equiped to hear cases on complex infrastructure projects.

Article 20, paragraph 6, of the new Hidrocarbon law expressly states that in case of an administrative rescission, the contractor has to transfer the contractually assigned area including any ‘connected and accessory goods and equipments’ to the State without indemnification. However, compensation provisions may be established in the oil and gas exploration contract according to paragraph 7 of article 20 of the new Hidrocarbon law, which seems to indicate that the contractor will not be able to refuse the return the exploration and production area including its sunk investment, but may obtain a compensation established in the contract and executed through an ordinary administrative procedure before Mexican federal courts. Therefore, it will be important that the future oil and gas exploration and production contracts contain straightforward lump sum

compensation provisions with respect of any sunk investment made by the contractor.

4. Conclusions

The secondary laws of the Mexican energy reform are an important step to guarantee full arbitrability with respect to PEMEX and CFE contracts and to recoup the status ex ante COMMISA, albeit under a modern commercial law regime. However, the effects of the judgment of the Second Chamber of the Mexican Supreme Court rendered as a consequence of the COMMISA amparo are still felt in the general federal contract regime and the PPP law. A particular situation exists under the new Hidrocarbons Law where considerations relating to the public domain of oil and gas seem to have motivated the administrative rescission regime, albeit in the context of a commercial project agreement, which will pose considerable challenges to contract drafters. This leads to three categories of federal project agreeements or concessions: (a) administrative contracts, (b) hybrid contracts based on commercial law but subject to administrative rescission or termination which can only be litigated in ordinary administrative litigation or amparo, and (c) commercial project agreements which are fully arbitrable such as under the new PEMEX and CFE laws.

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