Kluwer Arbitration Blog

Construction Arbitration – A State-Owned Enterprise Perspective.

Almudena Otero de la Vega (Mexican Federal Electricity Commission) · Sunday, September 2nd, 2018

This is one of a series construction arbitration posts, providing the technical discussion from the SCAI, CAM, TILPA conference in Geneva and Mexico City.

Arbitration can be classified as follows:

a) Public arbitrations: when only states are involved.

b) Private arbitrations: when only private entities are involved.

c) Mixed arbitrations: when a state and a private entity are involved, for instance investor-state cases.

Taking into account this classification, the landscape of a public enterprise being involved in a private commercial arbitration raises several challenges. This post is aimed at analyzing such challenges and identifying certain problems that may eventually lead to potential disputes in major construction projects and that could be prevented at an earlier stage, taking into account the experience of the Mexican Federal Electricity Commission.

The Mexican Federal Electricity Commission and the Projects It Develops

The Mexican Federal Electricity Commission (CFE) is a productive state-owned company created in 1937 that generates, transmits, distributes and markets electricity in Mexico. It provides energy services to nearly 40.6 million clients in the domestic, agricultural, industrial and commercial sectors. Although the recent Mexican Energetic Reform (2013) has impacted the company to enhance its competitiveness in a free market arena, private investments in energy projects, as well as the introduction of arbitration clauses, are not new. In fact, the company has an overall experience of nearly twenty years participating in commercial arbitrations.

CFE invites private entities to participate in long-term investment infrastructure projects – such as combined-cycle power plants, transmission lines, dams or pipelines – through public tenders. Companies have the opportunity to learn about the project requirements and bid with attractive technical and economic offers. CFE selects the bidder with the best market conditions providing thus the first milestone of a long, frequently 25-year-long, contractual relationship.

Practical Aspects to Take Into Account in Construction Projects

When it comes to talking about the problems that arise in construction disputes, step one is generally to analyze the contract. In this way, for every obligation assigned to a party a potential breach of contract could be identified.

A model infrastructure contract, similar to the ones signed by CFE, would include public enterprise obligations concerning, for example, a) the legal condition and access to the site where the project is to be built, b) the issuance of certificates of acceptance, c) best efforts to cooperate with the other party during the project, d) timely payments according to a pre-defined schedule and e) the surveillance of the project.

On the other hand, the constructor's obligations may include, for instance, a) the construction of the project in accordance with contractual specifications, b) the supply, transport and testing of any materials, c) the payment of taxes and tariffs on the materials needed, d) the obtainment of required permits or studies, e) recording of all the activities and f) compliance with national content requisites.

Seen this way, a construction contract has mainly two parties: the public enterprise on one side and the constructor on the other. However, the public enterprise can hardly be seen as a single entity, and in order to comprehend the potential problems that can occur in a construction project, it is advisable to consider the complex relationships that take place within the public entity so as to fully understand the role it displays.

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In an enterprise, such as CFE, lawyers and engineers work back to back. When different backgrounds intervene in drafting or supervising a contract, mutual understanding and complementation is important. Thus, it is advisable to raise awareness among engineers about legal issues and to instruct lawyers about technicalities. Maps, pictures or diagrams often help lawyers understand how the different components of an infrastructure project work together.

Sometimes the gargantuan size of the enterprise forces the setting up of various legal teams that act at different stages. For example, some lawyers may be in charge of the drafting of the contract and the bidding process; others may be assigned to the day-to-day activities of the project while a third group can be specialized in handling the disputes. This division is not inadequate *per se*, but will only work effectively with appropriate communication and if the different groups learn from each other's experience.

If an enterprise of this sort was to ask me about the way in which this amalgamation process can be fulfilled at a practical level, I would recommend the following:

- Train the contracting drafting team and the legal team monitoring the project in dispute resolution. Even if they will not be personally handling the disputes, it is important that the lawyers that face day-to-day problems and the ones that formulate the clauses be aware of the procedures that will have to be enacted if a claim of breach of contract is somehow raised.
- Encourage the legal team in charge of monitoring the project to sustain criteria. If the legal response to any type of problem is the same for every constructor in any given case that will build up consistency that could easily be proven in an arbitration procedure.
- When a problem emerges, try negotiating first. Creating a negotiating mind frame for the legal team as a whole helps to avoid employing valuable resources in disputes that could be more easily settled with a win-win solution.

- Keep track of hypothetical questions posed by the lawyers that see the day-to-day issues. Most of those hypothetical questions might be, in fact, potential cases that could be prevented from turning into real disputes. By keeping a record of these types of questions the entity can be prepared to face problems and solve them within a reasonable time frame that would allow to widen the scope of possible solutions. If necessary, the consulted legal team can create guidelines for the other legal teams to follow and shed light towards the company's policy.
- Once the arbitration begins, it is advisable for the dispute resolution team to involve the legal team that monitored the project, since they are the ones that possess all relevant information and records about the pre-dispute environment and conduct of the parties.
- Once the arbitration is over, dispute resolution lawyers should instruct the contract drafting team in order to improve clauses that have been object of dispute so as to prevent a future dispute involving an already identified and problematic contractual term.
- Beware of the interconnection of the different dispute settlement mechanisms. Select a clause that clearly defines the boundaries between, for instance, negotiation, mediation, expert determination and arbitration, so that they do not overlap.

Afterthoughts for State-Owned Enterprises Involved In Commercial Arbitrations

State-owned enterprises are generally circumscribed to a pre-defined set of rules and public servants are urged to meticulously comply with such defined sets. For this reason, the coexistence of transparency procedures with document production procedures has created a scenario in which the public entity has a single opportunity to request information from the other party, but the private entity, by means of national transparency procedures that require the government to disclose information to any anonymous request, can have several opportunities to gather information to build its case. This can be seen as a clear disadvantage to which state-owned enterprises are condemned when involved in a commercial arbitration that contemplates document production. Further research will have to be made within the arbitration community in order to determine whether this phenomenon is really an inequality of opportunities of the parties to present their case, and, if so, the possible solutions that can be found inside the international arbitration arena to compensate such imbalance.

Finally, beyond the technical, economic and social factors involved in a major infrastructure project, one of the key features to keep in mind on behalf of the state enterprise is that dispute resolution mechanisms, such as arbitration, are mechanisms that apply to whichever parties need them. It is tempting to think that arbitration was primarily envisaged to protect investors that engaged in long-term contracts with the state, but the truth is that arbitration is a flexible mechanism that aids whoever invokes it. The last recommendation I would give to people working or advising such enterprises is to not fear using dispute settlement mechanisms. Waiting to be sued and then handling a dispute as respondent, when there is in fact a strong case against the other party, is quite difficult to attain. For example, (i) if the state-company believes the other party is in a breach of contract and charges liquidated damages and (ii) the other party sues in arbitration the recovery of the money; being as a respondent explaining the reason why money was charged in the first place without directly having activated the arbitration procedure leaves the company in a contradictory situation. Therefore, if you believe that the other party is in a contractual default but they do not agree with that interpretation, use arbitration to solve that issue and let your trained and experienced legal teams act in conjunction and win your case.

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