Arbitration and Investment Protection within the Context of the Energy Reform in Mexico: A First Approach based on COMMISA v. PEMEX and KBR v. Mexico

Gabriel Cavazos Villanueva, Ph.D., Instituto Tecnológico de Estudios Superiores de Monterrey
Prepared for the study, “The Rule of Law and Mexico’s Energy Reform/Estado de Derecho y Reforma Energética en México,” directed by the Baker Institute Mexico Center at Rice University and the Center for U.S. and Mexican Law at the University of Houston Law Center, in association with the School of Government and Public Transformation at the Instituto Tecnológico y de Estudios Superiores de Monterrey, the Centro de Investigación para el Desarrollo A.C. (CIDAC), and the Faculty of Law and Criminology at the Universidad Autónoma de Nuevo León.

© 2017 by the James A. Baker III Institute for Public Policy of Rice University

This material may be quoted or reproduced without prior permission, provided appropriate credit is given to the author and the James A. Baker III Institute for Public Policy.

Wherever feasible, papers are reviewed by outside experts before they are released. However, the research and views expressed in this paper are those of the individual researcher(s) and do not necessarily represent the views of the James A. Baker III Institute for Public Policy.

Gabriel Cavazos Villanueva, Ph.D.
“Arbitration and Investment Protection within the Context of the Energy Reform in Mexico: A First Approach based on COMMISA v. PEMEX and KBR v. Mexico”
Study Acknowledgements

A project of this magnitude and complexity is by necessity the product of many people, some visible and others invisible. We would like to thank Stephen P. Zamora of the University of Houston Law Center and Erika de la Garza of the Baker Institute Latin America Initiative in helping to conceive this project from the start. We would also like to acknowledge the support received from Luis Rubio and Verónica Baz of the Centro de Investigación para el Desarrollo A.C. (CIDAC); Pablo de la Peña and Alejandro Poiré of the Instituto Tecnológico y de Estudios Superiores de Monterrey; and Oscar Lugo Serrato and Manuel Acuña of the Law School at Universidad Autónoma de Nuevo León. The collaboration between our institutions and the material and moral support were key to this project’s success.

We would also like to acknowledge the logistical support and project coordination provided by Lisa Guáqueta at the Mexico Center, as well as the efforts of all of the authors that participated in this study and the many silent hands that helped put together workshops, events, and meetings related to this project. We also thank the peer reviewers, editors, style correctors, and translators, and Tirant lo Blanch.

This study is dedicated to Stephen P. Zamora, our friend and colleague and one of the driving forces behind this project, who passed away before the completion of this study.
About the Study: The Rule of Law and Mexico’s Energy Reform/Estado de Derecho y Reforma Energética en México

The 2013 changes to the constitutional framework and the summer 2014 enabling legislation in Mexico’s energy industry represent a thorough break with the prevailing national narrative as well as the political and legal traditions of twentieth century Mexico. Mexico is about to embark on an unprecedented opening of its energy sector in the midst of important unknown factors, as well as a fiercely competitive and expanding international energy market. Mexico is one of the last developing countries to open its energy sector to foreign investment, and although there are important lessons that can be learned from other countries’ experiences, this does not imply that the opening will be necessarily as successful as the government promises or that the implementation of the new laws will go smoothly. Almost certainly, after the enabling legislation goes into effect, important questions of law will emerge during the implementation, and unavoidably, refinements to the legislation will have to take place.

The book “Estado de Derecho y Reforma Energética en México,” published in México by Tirant lo Blanch and written in Spanish, is the culmination of a major research effort to examine rule of law issues arising under the energy reform in Mexico by drawing on scholars and experts from American and Mexican institutions in order to bring attention to the different component parts of the new Mexican energy sector from a legal standpoint.

Study Authors

Regina M. Buono
Gabriel Cavazos
Guadalupe Correa Cabrera
Josefina Cortés
José Ramón Cossío Barragán
José Ramón Cossío Díaz
José del Tronco
Ana Elena Fierro Ferraez
Hector Fix Fierro
Miriam Grunstein
Mara Hernández

Francisco J. Monaldi
Isidro Morales Moreno
Ana Lilia Moreno
Tony Payan
Alejandro Posadas
Eduardo Pérez Motta
Pilar Rodríguez
Luis Rubio
Luis Serra
Alberto Abad Suarez Ávila
Introduction

On December 20, 2013, the reforms to the Mexican Constitution permitting the investment of private capital in the hydrocarbons and electrical industries for the first time in 75 years were published. The secondary laws that were approved by Congress established the possibility of an arbitration clause being included in contracts related to energy projects. Arbitration of conflicts arising from energy contracts would open up many possibilities for private investors, although it would also present public policy concerns.

The purpose of this paper is to analyze both the scope and limits of arbitration as a means for resolving disputes related to energy contracts in Mexico, as well as the protection that foreign investors may receive when entering into this type of contract. Considering that the Mexican state has in the past violated the investment protection standards contained in treaties to which it is a party, whether or not foreign investors will be able to resort to investment arbitration—despite existing legal limitations—will be of particular importance.

With this in view, the first section describes and analyzes the constitutional and legal rules that allow for arbitration within the context of the new legal framework governing hydrocarbons and electricity in Mexico. The second section examines recent energy arbitration proceedings that, although occurring outside the context of the reform, have large implications for the same. It focuses on the case of COMMISA v. PEMEX, which involved both the Mexican Supreme Court of Justice and United States district courts. Finally, the third section will address the question of whether—given the limitations of the reform—investment arbitration would still be possible in the case of breaches of investment protection standards contained in treaties signed by Mexico. This last analysis is based on an investment arbitration case that has not yet been finalized as of the date of writing this paper: KBR v. Mexico, which arose directly out of the COMMISA case.

Arbitration Within the Scope of the Energy Reform

Provisions in the 2013 constitutional reform transform the laws governing energy in Mexico that have essentially been in effect since the expropriation of the petroleum industry in 1938 during the administration of Lázaro Cárdenas. Petróleos Mexicanos (PEMEX) and the Federal Electricity Commission (CFE) cease to be state-owned industries, as Article 25 of the constitutional text establishes them under a new category: “productive state companies.” Neither the constitutional text nor the regulatory laws provide a definition of a productive state company. However, Article 4 of the PEMEX Law sheds some light, determining that such a company:

- performs corporate, economic, industrial, and commercial activities; generates economic value and profitability for its owner, the Mexican state; acts in a transparent, honest, and efficient manner based on fairness and social and environmental responsibility; and strives to improve productivity to maximize the state’s petroleum revenue and thereby contribute to national development.
Likewise, Articles 2 and 3 of the same law establish that PEMEX is the exclusive property of the federal government; however, it will be subject to the terms of its own law, and commercial and civil regulations will be applied on a suppletory basis. As we will see below, these regulatory definitions are important for determining when an activity of PEMEX (or of the CFE) is to be considered an administrative act, or an act subject to private law. The foregoing is relevant to determining whether a dispute can be subject to arbitration.

Article 27 of the Constitution maintains the nation’s ownership of the hydrocarbons in the subsoil and expressly prohibits granting concessions for the exploration and extraction of hydrocarbons. It allows for these activities to be carried out through assignments to state organizations—or through contracts with state organizations or individuals in order to share risk, technology, and experience—and establishes that the nation’s ownership of the hydrocarbons must be affirmed in all assignments or contracts. In the case of the electrical sector, Article 27 states:

The planning and control of the national electric system, as well as the public services of transmitting and distributing electric energy, are the exclusive domain of the nation; in these activities, no concessions will be granted, without prejudice to the state being able to enter into contracts with individuals pursuant to the terms established by the laws, which will determine the manner in which individuals will be able to participate in other activities of the electrical industry.\(^5\)

Again, the possibility of the state entering into contracts with individuals is stated in the actual constitutional text. Finally, Article 28 of the Constitution establishes that the exploration and extraction of oil and gas, as well as the public services of transmitting and distributing electric energy, are “strategic activities”—i.e., activities that are exclusively carried out by the state, although this does not constitute a monopoly. Within this context, reference is made to activities in which the state is clearly executing “governmental actions” and which would therefore not be arbitrable, on principle.

However, the new laws governing both PEMEX and the CFE establish more specific criteria regarding the possibility of arbitrating potential disputes arising from contracts, as referred to in the constitutional articles.\(^6\) It is important to mention that prior to the energy reform—specifically since 2009—arbitration has been available for all government procurement contracts at a federal level, pursuant to the terms of the Public Works and Related Services Act as well as the Public Sector Procurement, Lease, and Services Act.\(^7\) According to this legal framework, arbitration is not permitted in cases of rescission or early termination.\(^8\) Likewise, Article 139 of the Public-Private Partnerships Act\(^9\) establishes that arbitration does not apply to the cancellation of concessions and authorizations in general, or to any acts of authority. Likewise, exclusive jurisdiction is granted to the federal courts for the resolution of disputes related to the legal validity of any government act.

As indicated earlier, the PEMEX Law establishes that the relevant contracts are governed by said law, and by the provisions of civil and commercial legislation in a suppletory manner. In turn, Article 80 of this law states that all acts that are carried out within the contracting procedure, up to and including the award, will be considered a government act. However,
as soon as the contract has been signed, it and all subsequent contracts are private in nature and governed by the applicable commercial or private legislation.

Thus far, this point remains clear: the legislation is explicit in terms of the commercial nature of contracts with PEMEX, and therefore leaves the door open to arbitration for resolving disputes by not referring to exceptions in cases of administrative rescission or early termination. As a matter of fact, Article 81 of the current PEMEX Law establishes that as soon as a contract has been awarded and signed, all subsequent disputes will be within the jurisdiction of the federal courts, except when an alternative dispute resolution mechanism has been agreed upon.

Subsequently, Article 115 states that PEMEX and its subsidiaries are authorized to agree to alternative dispute resolution mechanisms, arbitral clauses, or commitments pursuant to the terms stipulated in applicable commercial legislation and relevant international treaties signed by Mexico. It goes further by providing that in the case of legal acts or contracts that either have effects or are carried out outside of the nation, PEMEX and its subsidiaries are authorized to agree to the application of foreign law, to be subject to the jurisdiction of foreign courts regarding commercial issues, and to sign arbitral agreements whenever suitable to best achieve their purpose. Within this last context, it remains very clear that in the case of a dispute that has arisen out of a contract regulated by the PEMEX law, PEMEX may be subject to the jurisdiction of a foreign tribunal without recourse to sovereign immunity as a defense, which it had previously used in cases litigated in the United States.\textsuperscript{10} Of course, it can also enter into contracts governed by foreign law and be subject—in principle—to arbitration in any agreed-upon location. These provisions do not contain any exception for arbitrability \textit{ratione materiae}.

In a similar manner, the CFE Law establishes that bidding procedures prior to the awarding of a contract are administrative in nature, although Article 82 makes it clear that as soon as the contract has been signed, all resulting acts are of a commercial nature. The distinction that both the PEMEX and CFE laws make between \textit{acta jure gestionis} (acts of a commercial nature), rather than \textit{acta jure imperii} (acts of public authority) with respect to contracts based on these frameworks constitutes a very significant change related to the circumstances that gave rise to the COMMISA dispute, which will be discussed below.

In spite of the foregoing, the new Hydrocarbons Act\textsuperscript{11} does maintain the government contracting process, insofar as early termination and rescission related to oil and gas exploration and extraction is concerned. In fact, Articles 22 and 97 emphasize the commercial nature of the actions of the hydrocarbons industry. Article 97 establishes that “in any matters not set forth by this law, the acts of the hydrocarbons industry are considered to be commercial acts, and they will therefore be governed by the Commercial Code and, in a suppletory manner, by the provisions of the Federal Civil Code.”

Obviously, the nature of the law is one of public utility, considering that it regulates a sector that is deemed strategic by the Constitution. Within this context, whenever a government contract is rescinded by the government (generally known as “administrative
Arbitration and Investment Protection

rescission”), this action can only be challenged through arbitration before a Mexican administrative tribunal. In this context, Article 20 of the Hydrocarbons Act establishes that the federal executive branch, by means of the National Hydrocarbons Commission (CNH), may proceed with administrative rescission of contracts for exploration and extraction and recover the contractual area only in the event of any of the serious causes that the provision lists. Regardless of these causes, within the contract itself it is possible to agree on causes for rescission and early termination respectively. Under these circumstances, the contractor is entitled to challenge the administrative rescission before the CNH itself, claiming what it is entitled to by law. The same article establishes that as a consequence of administrative rescission, the contractor will transfer the contractual area to the state without any charge, payment, or indemnity whatsoever. According to Article 4, Section III, of the same law, “contractual area” refers to:

> The surface and depth determined by the Ministry of Energy as well as the geological formations contained in the vertical projection on said surface for said depth, where the exploration and extraction of hydrocarbons is carried out based on the signing of contracts for exploration and extraction.

According to the foregoing section, Article 21 of the Hydrocarbons Act establishes that within exploration and extraction contracts, it is possible to establish alternative dispute resolution mechanisms to solve controversies arising from the contracts themselves, including arbitration agreements pursuant to the terms set forth in the Commercial Code and in international treaties dealing with matters of arbitration and dispute resolution to which Mexico is a party—except in cases of administrative rescission, which has already been discussed. Unlike PEMEX and the CFE, neither the CNH nor any contractors are entitled to subject themselves to foreign laws. Therefore, within the scope of arbitration proceedings, the applicable law must be Mexican federal laws.

The contract model for the so-called “Round One” of PEMEX’s bidding rounds establishes a substantial difference in its dispute resolution clauses by emphasizing that all disputes that arise from or are related to the legal grounds for administrative rescission or any act of authority must be resolved exclusively in Mexico’s federal courts. The foregoing notwithstanding, any other dispute that cannot be resolved through a conciliation procedure after three months must be submitted to arbitration, in accordance with the Regulations of the United Nations Commission on International Trade Law. The authority in charge of designating the arbitral procedure shall be the secretary general of the Permanent Court of Arbitration at The Hague, where the arbitration will be held.12

As shown by these rules, the August 2014 laws have introduced a fundamental change by abandoning the administrative contract—which had been governed by administrative law13—with the exception of the stipulations contained in the Hydrocarbons Act related to oil and gas exploration and extraction contracts.14 The administrative contract had formerly been very significant in Mexico’s arbitration experience in energy matters—specifically in the COMMISA case, which will be discussed in the following section of this paper. It is important to mention that the reform did not effect any change on issues of arbitrability in the Public Works and Related Services Act; the Public Sector Procurement,
Arbitration and Investment Protection

Lease, and Services Act; or the Public-Private Partnerships Act (APP). In these cases, administrative rescission, early termination, and—in the case of the APP—any act of authority under the applicable administrative law continue to be non-arbitrable.

Because of the partial upholding of administrative rescission, Mexico’s experience in the COMMISA case is outlined below, where this was a central issue.

COMMISA v. PEMEX

Until the COMMISA case, the inarbitrability of administrative rescission was a latent risk; in arbitration practice, its status as an act of jure gestionis—and therefore subject to arbitration—prevailed. For some scholars, this case illustrates the problematic use of administrative rescission as a legal concept in French contract law. According to French law, the state has exorbitant powers over public contracting in areas such as the modification of contracts, and rescission and unilateral termination without a previous judicial procedure. Administrative rescission is considered an act of authority—or jure imperii—and can only be repealed by an administrative or constitutional trial through amparo proceedings. Therefore, according to French doctrine, an administrative contract cannot be subject to arbitration.

The distinction between acts of jure imperii and of jure gestionis is not only important to determine the arbitrability of a dispute involving the state. It is important to emphasize that this distinction is also relevant in determining when a tribunal may assert jurisdiction over a dispute in which one of the parties is a state. In the United States, this is governed according to the Foreign Sovereign Immunities Act (FSIA), which determined that a U.S. court will not assert jurisdiction over a dispute in which one of the parties is a state, or a government entity of a state, unless it performed a commercial action that demonstrates that it acted as a private entity (an act of jure gestionis) and did not engage in an act of authority (jure imperii).

The foregoing is relevant because PEMEX has been involved in disputes in the United States and, depending on the nature of the activity being disputed, has been considered to be a part of the Mexican state under FSIA. During the legal case “In the Matter of SEDCO Inc.,” which concerns the damage caused by the explosion of the Ixtoc I well in the Bay of Campeche in 1979, PEMEX successfully claimed before a federal judge in Texas that it enjoyed sovereign immunity and the dispute could not therefore be tried in the United States. The federal judge concluded that the exploration and extraction activity that was carried out was exclusively an activity of the Mexican state and, therefore, an act of jure imperii. As a result, in this specific case PEMEX was not subject to U.S. jurisdiction, since it enjoyed sovereign immunity.

The French doctrine of inarbitrability has one important difference with respect to those of Mexico and other Latin American countries. According to French law, any modification of the contractual balance—such as its rescission or termination—requires the payment of an indemnity. The amount of this indemnity includes, as a basic rule, the losses that have
been incurred (damnum emergens) and damages awarded for the loss of reasonably expected profits (lucrum cessans), subject to proper justification. In the case of Mexico, this obligation to indemnify only exists when so-called unrecoverable expenses, or “sunk costs,” are claimed. For some authors, this situation—combined with the inherent inarbitrability of acts of jure imperii—creates considerable political risk, as it might result in arbitration between an investor and the state. This issue will be addressed in the following section. However, it is necessary to analyze the circumstances that gave rise to the COMMISA case and examine which of those regarding the inarbitrability of administrative rescission continue to apply within the context of the energy reform.

In October 1997, the Corporación Mexicana de Mantenimiento Integral, S. de R.L. de C.V. (COMMISA) and PEMEX Exploration and Production entered into a contract based on unit rates and a fixed term for the construction of and services related to two oil platforms in the Bay of Campeche. As a result of alleged noncompliance by the contractor, and after two unsuccessful conciliation attempts, PEMEX administratively and unilaterally terminated the aforementioned contract and applied contractual penalties. In December 2004, COMMISA initiated arbitral proceedings before the International Chamber of Commerce (ICC) and concurrently filed an amparo action that sought to cancel the administrative rescission and the drawdown of bonds in the amount of the contractual penalties. Therefore, COMMISA’s legal strategy was to fight on two fronts: first, in the form of the means of arbitration agreed upon in the contract, and second, through an amparo lawsuit.

Here, it is important to point out that in order to file an amparo lawsuit in Mexico, it must be established that an act of authority violated constitutional rights. By virtue thereof, COMMISA had to argue that PEMEX was carrying out an act of jure imperii and not of jure gestionis. The foregoing notwithstanding, in August 2005 the Fourteenth District Court for Administrative Matters ruled to dismiss the lawsuit, since the challenged rescission was not considered an act of authority.

Considering the circumstances that afterward materialized for the contractor, it appeared that COMMISA had to comply with this resolution. However, COMMISA decided to file an appeal for review with the Sixth Court of Appeals for Administrative Matters, which ultimately determined that an act of authority existed. Considering the relevance of the issue, Mexico’s Supreme Court exercised its power to assume jurisdiction and, in a resolution dated June 2006, ruled that the state’s exercise of its power to unilaterally rescind an administrative contract was constitutional. Based on this ruling, COMMISA was not only unable to overturn the challenged administrative rescission, but the Court also implicitly ruled regarding the inarbitrability of the administrative rescission itself, by deeming it an act of jure imperii. Even though the Court did not expressly state this—since its ruling was limited to the constitutionality of the state’s power to rescind a contract without a prior trial—it did establish the exclusive jurisdiction of the District Court judge to rule on the rescission within the scope of an ordinary administrative trial. In summary, the Court’s ruling in the COMMISA case led to the express exception to arbitrability under federal laws in matters of public works and acquisitions, as well as those related to the
APP.\(^{28}\) Within this context, the only option available to a contractor for asserting claims once an administrative rescission has been carried out is an ordinary administrative trial, which apparently leaves the arbitration clause without any practical effect.

It is necessary to emphasize that while the jurisdictional proceedings initiated by COMMISA were underway—from the District Court to the Supreme Court—the arbitral tribunal had already exercised its full jurisdiction over the case. Therefore, the ICC Tribunal maintained that it had jurisdiction regarding all issues related to the dispute and rejected a motion filed by PEMEX arguing that the tribunal could not hear the issue based on \textit{res judicata}. In October 2007, PEMEX filed a second motion arguing once again that the principle of \textit{res judicata} made the decision lack merit; that COMMISA had actually waived its right to arbitration by filing an \textit{amparo} action; and that administrative rescission constituted an act of authority that could not be submitted to arbitration, since this matter was inarbitrable. However, the arbitral tribunal disagreed with these points and reaffirmed its original decision.\(^{29}\)

While arbitration was pending, two relevant laws underwent significant reforms. The first was the Organic Law of the Federal Court of Fiscal and Administrative Justice,\(^{30}\) which in Article 14, Section VII, establishes that the aforementioned Court has jurisdiction in matters of resolutions “that are adopted in administrative matters regarding the interpretation of and compliance with contracts of public works, procurement, leases, and services that are entered into by the agencies and entities of the federal public administration.” The second law was the Public Works and Related Services Act, which in Article 98 establishes that, as of 2009, “arbitration will not apply to administrative rescission, early termination of contracts, as well as those cases set forth in the regulation of this law.” As will be shown below, this last rule was decisive in the process of the recognition and enforcement of the arbitral award pursued by COMMISA in the United States.

Within this context, the arbitral procedure continued, and the tribunal rendered its verdict in December 2009. In addition to reaffirming its jurisdiction, the tribunal maintained that the principle of \textit{res judicata} was not an impediment to COMMISA’s claim, and that Article 98 of the Public Works and Related Services Act did not apply in this case, because the PEMEX Law expressly authorized the company to agree to arbitral clauses within its contracts. Therefore, the tribunal ruled in favor of COMMISA with regard to the majority of its claims and awarded monetary compensation.\(^{31}\)

In January 2010, COMMISA filed an action for the recognition and enforcement of this arbitral award before the U.S. District Court for the Southern District of New York. It was found by the court to have merit in November 2010, and PEMEX subsequently filed an appeal before the Second Circuit Court of Appeals.

Simultaneously, in January 2010 PEMEX filed for the nullification of the arbitral award before a district court in the Mexican state of Nuevo León. PEMEX argued that the dispute was not subject to arbitration as set forth in Article 1475 of the Commercial Code, and that the award violated notions of public order. The court rejected the nullification suit on the
Arbitration and Investment Protection

grounds that PEMEX had to proceed with the suit in the place where the arbitration had occurred—i.e., Mexico City. PEMEX once again filed a suit with the Fifth District Court in Mexico City, which was also rejected based on partially substantive criteria. The judge ruled that PEMEX had validated the arbitrability of the issue by failing to file an objection in a timely manner to the preliminary award, in which the arbitral tribunal declared that it had jurisdiction, as permitted by Article 1432 of the Commercial Code. Likewise, the judge ruled that the award did not violate notions of public order since it only involved individual interests resulting from a commercial relationship between the parties. PEMEX challenged this decision before the Eleventh Court of Appeals of the Federal District. In August 2011, this tribunal ruled that arbitration was designed to settle disputes between individuals, although administrative rescissions exist for the purpose of safeguarding the state's financial resources; by virtue of this, there were indeed issues of public order at play. The tribunal referred to Article 98 of the Public Works and Related Services Act as the guiding principle to strengthen the arguments for public order being involved, though it denied that this rule was applied retroactively.32

The second legal source upon which the Appeals Court based its ruling was a decision of the Supreme Court of Justice of the Nation.33 This decision was not related to arbitral proceedings, although it maintained that administrative rescissions were acts of authority; rather, by virtue of the fact that acts of authority are not subject to arbitration, the arbitral tribunal that heard the dispute between COMMISA and PEMEX did not have jurisdiction to do so. It is necessary to remember that the Supreme Court, when exercising its power of assuming jurisdiction regarding COMMISA’s amparo suit in 2006, established that COMMISA should have challenged PEMEX’s administrative rescission before a federal court that had jurisdiction over administrative matters. The Appeals Court also agreed with this ruling and, based on this, ordered that the award be nullified.

COMMISA filed a suit seeking damages before the Federal Court of Fiscal and Administrative Justice (the exclusive forum for disputes concerning administrative rescissions, according to Article 98 of the Public Works and Related Services Act, which is currently in effect) in November 2012, although this tribunal rejected the suit by ruling that the deadline for filing had already passed.34 It is important to point out that PEMEX filed other suits after the nullification of the award in order to draw down the bond that COMMISA had posted in order to guarantee the fulfillment of the contract, but an in-depth analysis of this issue is beyond the scope of this paper.

What must be highlighted is the suit filed by COMMISA in the United States for the recognition and enforcement of the arbitral award against PEMEX in that country. First and foremost, COMMISA had to prove that there were no grounds to reject the jurisdiction of the U.S. court based on a lack of “personal jurisdiction”—i.e., minimum contact of PEMEX with the United States. Likewise, it had to prove that there were no grounds to rule that that forum did not have the jurisdiction for recognition and enforcement (forum non conveniens). Therefore, on August 27, 2013, U.S. District Judge Alvin K. Hellerstein handed down a ruling confirming the arbitral award, thereby rejecting PEMEX's petition to dismiss COMMISA's suit.35 It is interesting to note that three days after the ruling was handed
down, KBR Inc., COMMISA’s parent company, filed a notice of investment arbitration in accordance with Chapter XI of the North American Free Trade Agreement (NAFTA). Based on its status as a foreign investor, KBR complained in this suit that the Mexican government had not complied with its obligations to accord it “fair and equitable treatment” as provided by the terms of the treaty, which is an issue that will be analyzed in detail in the following section of this paper.

The procedure for the recognition and enforcement of the arbitral award merits a separate analysis. However, a brief reference to the grounds for the judge’s confirmation of the award provides us with an idea of the consequences that arbitration may have within the context of the energy reform, even when carried out in Mexico and where Mexican law is applicable. Generally speaking, the U.S. District Court concluded that when COMMISA filed its claim against PEMEX, there was no law, precedent, or legal source that would have informed the company that it had to make its claim before a jurisdictional tribunal in lieu of going through arbitration. This conclusion is interesting, because the judge seems to assign no importance to the fact that COMMISA initiated the arbitral procedure and simultaneously filed an amparo motion to challenge the administrative rescission. Within this context, it would seem that COMMISA knew that it had recourse to avenues other than arbitration. As a matter of fact, it can be concluded that opting for parallel litigation had very negative consequences for COMMISA, considering that it motivated the Mexican Supreme Court to determine that administrative rescission was actually an act of authority and not subject to arbitration.

On the other hand, the district court judge concluded that in this case, COMMISA had a reasonable belief that it was entitled to arbitration by virtue of the arbitration clause in the contract. Here, it is worth pointing out that although it might have seemed like a tactical error on COMMISA’s part to have initiated parallel litigation, it is relevant that determining administrative rescission not being subject to arbitration actually renders inoperable any arbitration clause stipulated pursuant to the terms of the contract between PEMEX and COMMISA, considering that it motivated the Mexican Supreme Court to determine that administrative rescission was actually an act of authority and not subject to arbitration.

The U.S. judge emphatically concluded that the decision of the Mexican court to set aside the arbitral award violated basic notions of justice in applying a law and a public policy that were not in effect when the parties signed the relevant contract. Therefore, according to the judge, COMMISA was being denied an opportunity to be heard on the underlying matter—i.e., the substantive part of the dispute. The judge specifically referred to Article 98 of the Public Works and Related Services Act, which, as we have stated, was not in effect at the time of the signing of the contract. Likewise, he accorded fundamental importance to principles of U.S. public policy, but not to principles of Mexican “public order.” However, determining whether issues of public order in the place of enforcement of a court ruling should be weighted more than those of the location where the award was rendered (in accordance with the law with regard to the recognition and enforcement of a foreign award) warrants a more thorough analysis that certainly exceeds the purposes of this paper.
Finally, and very significantly, the U.S. judge concluded that applying any principle of deference to the Mexican court decision was incorrect, considering that the language of the Inter-American Convention on International Commercial Arbitration (the Panama Convention) indicates that it is within a judge’s power not to recognize and enforce an arbitral award that has been declared void in its country of origin, though it is not obligatory. Therefore, as already stated, Judge Hellerstein was granting priority to principles of public policy over the recognized principle of international comity.

In summary, the COMMISA case is a clear example of the complexities that can result from an arbitration proceeding of this nature. Precisely because it concerns the energy sector, this case spawns considerations of public relevance and state interests that certainly exceed the criteria that apply to very complex arbitrations in other fields. As indicated by some commentators on this case, “By converting, during an administrative or constitutional trial, the act of jure gestionis of administrative rescission to a true act of authority of jure imperii, arbitrability ratione materiae is eliminated.” At the end of the day, COMMISA’s right to submit the dispute to arbitration was violated, although the inarbitrability of administrative rescission was a latent risk based on the very existence of this legal concept in French administrative law, and particularly due to the fact that the company initiated parallel litigation through amparo proceedings.

At the time of the preparation of this analysis, an appeal of the U.S. District Court ruling is pending. Attention must be paid to the resulting considerations. However, it is necessary to emphasize that—as has been said—the government contracting process has been abandoned for PEMEX and CFE contracts within the context of the 2013 energy reform, although it continues to be in effect in the case of oil and gas exploration and extraction contracts.

In light of the foregoing information, it is now necessary to attempt to address how the issue of arbitrability in energy matters is dealt with in the case of foreign investment disputes.

The Possibility of Investor versus State Arbitration in the Energy Sector

According to Sornarajah, “Few areas of international law excite as much controversy as that related to foreign investment.” The already recognized international law of foreign investments is a fundamental part of international economic law. At the same time, analysis of the development of this disputed legal area has caused fields of study based on specific sectors to emerge. This is precisely the case of what Schill and others already categorize as “international energy investment law.” As a matter of fact, one of the most important agreements related to investment on an international level is the Energy Charter Treaty (ECT). The ECT reflects a regulatory perspective on investment relationships, placing them within a broader framework of economic, environmental, and social governance.

International foreign investment law includes, as a fundamental element, investment arbitration or investor versus state arbitration, which has evolved over time from the ratification of the International Centre for Settlement of International Disputes (ICSID) Convention (or Washington Convention) in 1966 to more modern free trade agreements.
Arbitration and Investment Protection

(such as NAFTA) and bilateral investment treaties that incorporate the possibility of using this mechanism, in the case that an investor deems that its investment has not been treated in accordance with the standards of protection that such international agreements provide.

Investor protection focuses on what is known as “political risk.” Therefore, in addition to other principles and specific rules, the treaties generally contain rules related to expropriation and principles regarding national treatment and most favored nation status, as well as fair and equitable treatment (FET) and full protection and security. The principle of FET is perhaps the most vague and problematic of all and has given rise to perceived contradictory interpretations by different investment arbitration tribunals. Because it is of particular importance, it will be analyzed below.45

Mexico has signed a sizable number of treaties related to this matter, known as Agreements for the Promotion and Reciprocal Protection of Investments (APRPIs), in addition to treaties that include chapters on investment.46 Within this context, it is obvious that since the energy reform provides for the possibility of private investment—both domestic and foreign—in an area that was formerly exclusively reserved for the state, foreign investors are protected by the disciplines contained in these treaties. A breach of these principles can give rise to the activation of the investment arbitration mechanism; therefore, a relevant question is whether it is possible that an arbitral tribunal in matters of investment can have jurisdiction—at the request of an investor—over a dispute related to foreign investment in the energy sector.

As we have has seen in the first part of this paper, both the PEMEX and CFE laws consider arbitration as a mechanism for the resolution of disputes under the contracts they enter into. For example, Article 115 of the PEMEX Law establishes that this productive state-owned company and its subsidiary productive companies will be able to agree to alternative dispute resolution mechanisms—or arbitration clauses—pursuant to the terms of the applicable commercial legislation and the international treaties to which Mexico is a party. As has been stated, these rules do not contain any exception of arbitrability ratione materiae.

However, disputes that result in investment arbitration are generally not contractual disputes, unless that contract contains an arbitration clause that names the ICSID as the arbitration administrator in accordance with the Washington Convention. Here, it is necessary to remember that inexplicably, Mexico is not a member of this convention and only uses its so-called “Additional Facility” to administer investment disputes.47 Another possibility to dealing with an investment dispute that deals with broader substantive claims would be to include contractual disputes under an “umbrella clause” in the relevant investment treaty;48 analyzing such clauses goes beyond the scope of this paper.

By virtue of the foregoing, it may seem that there is no obstacle to having investment arbitration available to foreign investors within the context of the energy reform. However, it is important to remember that the Hydrocarbons Act left the legal concept of administrative rescission intact; as a result, arbitration clauses can be included in oil and gas exploration and
extraction contracts, but any objection to rescission would not be subject to arbitration. As stated, arbitration related to exploration and extraction is governed by Mexican law.

All of this notwithstanding, what would happen in a case like COMMISA’s—where it was alleged that the contractor was left without any defense—should be determined. Could investment arbitration be requested based on this argument (in addition to others)? It has already been stated that KBR, the parent company of COMMISA, filed a notice of investment arbitration against Mexico in August 2013. It would be interesting to examine this notice—and what has occurred in these proceedings, as of the date of publication of this paper—in an attempt to answer the questions formulated above.

KBR filed the notice of arbitration alleging breaches of different provisions of Chapter XI of NAFTA as well as Article 1503 (2). The same notice contains issues that deserve a more exhaustive legal analysis; however, this paper is limited to issues regarding the jurisdiction of the arbitral tribunal.

KBR demonstrated that it was an investor that had made an investment pursuant to the terms of Article 1139 of NAFTA, since COMMISA is a subsidiary owned by a foreign investor (a wholly owned subsidiary) that directly or indirectly controls the contract rights, which, according to the language of the treaty, represent intangible property acquired with the expectation of their use to obtain an economic benefit.49

A more interesting approach would be to consider the ICC award as a protected investment.50 KBR based its argument on the opinion of two arbitral tribunals that ruled on similar situations. As a matter of fact, in the Mondev case,51 the tribunal concluded that NAFTA had to be interpreted in a broad manner to cover any legal claim that arises out of the treatment of an investment pursuant to the terms of Article 1139. In this respect, the ICC award was the result of an investment carried out by KBR in Mexico. On the other hand, the claimant quotes the decision regarding tribunal jurisdiction in the case of Saipem SpA,52 where the arbitrators concluded that the rights covered by an ICC award were not created through the award itself, but rather arose from the relevant contract. In the words of the tribunal, the ICC award crystallized the rights and obligations of the parties under the original contract in such a manner that determining whether the award can be deemed an investment remained an open question, since the contractual rights “crystallized” by the award represent an investment pursuant to the terms of the relevant investment agreement. This opinion in the Saipem case is interesting; however, the fact that the definition of “investment” is different in every treaty and that its interpretation may likewise vary must be taken into account.

All this notwithstanding, the procedural point that has been disputed until now is related to the rules in Article 1121 of NAFTA, which requires that the claimant provide its express consent to submit to arbitration and waive:

their right to initiate or continue before any administrative tribunal or court under the law of any party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing party that is alleged to be
Arbitration and Investment Protection

a breach referred to in Article 1117, except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing party.\(^{53}\)

KBR emphasized that within the context of the terms set forth in Article 1121, the proceedings it initiated in different forums that are related to the dispute do not involve any payment of damages, since they are enforcement proceedings—in this case, enforcement of the arbitral award. Therefore, KBR explicitly stated in its notice of arbitration that it did not waive its right to initiate proceedings for the recognition and enforcement of the final ICC award in any state that was a party to the New York or Panama Conventions. Likewise, it did not waive its right under the Panama Convention to continue with the existing proceedings before the U.S. District Court for recognition and enforcement of the award. It refused to waive its rights based on the judgment rendered by Judge Hellerstein or its right to continue with the existing proceedings within the scope of the New York Convention for the enforcement of the award in Luxembourg. On the other hand, KBR made a very clear distinction between the contractual dispute that gave rise to the arbitration and the one in which it claimed breaches of the investment protections contained in Chapter XI of NAFTA. Proceedings regarding recognition and enforcement cannot be resolved by measures that are considered to be in violation of international law.\(^{54}\)

In view of this apparent “forum shopping,” Mexico claimed that Article 1121 does apply to the procedures initiated by KBR. Mexico has emphatically argued that the proceedings in New York and Luxembourg are actually proceedings regarding damages. Therefore, because different courses of action exist in different forums, the risk of obtaining double indemnification is genuine and, therefore, the case regarding Chapter XI of NAFTA cannot proceed without a valid waiver filed in a timely manner by the claimant.\(^{55}\) In view of the claimant’s strategy to proceed simultaneously in different forums—curiously, the same thing that happened with COMMISA, which simultaneously initiated arbitration and amparo proceedings against the administrative rescission—Mexico has argued that “Chapter XI of NAFTA was not designed or intended to support the procedural strategy elected by the claimant.”\(^{56}\)

As already stated, the substantive part of KBR’s notice of arbitration affirms that Mexico breached different rules of Chapter XI as well as Article 1503 (2) of NAFTA, which obligates the parties to ensure that state-owned companies do not act in a manner that is incompatible with the disciplines set forth in Chapter XI. Moreover, KBR alleged that Mexico also breached Articles 1102 (national treatment), 1103 (most favored nation treatment), 1105 (minimum standard of treatment), and 1110 (expropriation and indemnification).\(^{57}\)

When KBR established the background, it emphasized a series of events that, from its point of view, was in violation of the principles of investment protection according to Chapter XI of NAFTA. Significantly, KBR referred to the ruling by the Eleventh Appeals Court, wherein it was concluded that the ICC arbitral tribunal could not interfere with PEMEX’s sovereign determination to proceed with administrative rescission of the contract.
According to KBR, the Appeals Court ruling was arbitrary, fundamentally unfair, inconsistent with Mexico’s international obligations, and irreconcilable with the rule of law.\textsuperscript{58} The language used by KBR suggests a possible emphasis on the principle of fair and equitable treatment contained in Article 1105 of NAFTA.\textsuperscript{59} Therefore, for the purposes of this analysis, it is very important to emphasize the following: regardless of the general arbitrability of any dispute arising from an energy project in Mexico, it is possible that there are facts related to the contractual relationship that, in the eyes of the investor, can be considered beyond a breach of contract, meaning that they become so complex that they may entail a presumed breach of international obligations. In particular, KBR’s language in its notice of arbitration makes it necessary to conduct a more thorough analysis of the principle of fair and equitable treatment and how this has been settled by investment tribunals in cases that have involved countries such as Argentina, and by virtue thereof, establish how these cases may serve Mexico in future disputes.\textsuperscript{60}

One fundamental element in the KBR case is the fact that Mexico did not make any claim of arbitrability \textit{ratione materiae}. Even though the reasons may appear obvious from a strictly legal point of view, one must not forget the fact that under NAFTA and other investment treaties, all activities related to the hydrocarbons and electricity industries are expressly reserved for the Mexican state. Article 1101 establishes that “A party has the right to exclusively perform the economic activities set forth in Appendix III and refuse to authorize the establishment of investments in such activities.” Appendix III establishes those reservations:

\textbf{Section A. Activities Reserved for the Mexican State}

Mexico reserves the right to exclusively perform and to refuse to permit the establishment of investments in the following activities:

1. Petroleum, Other Hydrocarbons and Basic Petrochemicals
   (a) Description of activities
      (i) Exploration and exploitation of crude oil and natural gas; refining or processing of crude oil and natural gas; and production of artificial gas, basic petrochemicals and their feedstocks and pipelines; and
      (ii) Foreign trade; transportation, storage and distribution up to and including first hand sales of the following goods: crude oil; natural and artificial gas; goods covered by Chapter Six (Energy and Basic Petrochemicals) obtained from the refining or processing of crude oil and natural gas; and basic petrochemicals.
   (b) Measures:
2. Electricity

(a) Description of activities: the supply of electricity as a public service in Mexico, including, the generation, transmission, transformation, distribution and sale of electricity.

(b) Measures:

Political Constitution of the United States of Mexico, Articles 25, 27, and 28
Electric Energy Public Utility Law

In light of these rules, which have not been amended by Mexico, a relevant question is whether these reservations apply only to the right to restrict investment in these sectors or whether they are broader; i.e., whether they do not permit arbitration (within the scope of an investor versus state proceedings) of any dispute that arises in the energy sector. It must likewise be remembered that in the case of NAFTA, there is a special chapter regarding the energy and basic petrochemicals (Chapter VI), although the disciplines set forth therein only obligate the parties and do not grant any rights to investors; in the event of noncompliance with the rules, the general mechanism for the resolution of disputes set forth in Chapter XX would need to be applied.

According to the theory of international law, reservations should be expressly stated and must clearly establish the areas where the obligations within a treaty are going to exclude or modify the obligation of compliance by either one of the parties.61 One possible interpretation is that the reservation only grants Mexico the right to restrict investments in energy matters, but not to prevent any investor from exercising rights in accordance with international investment treaties.

By virtue of the fact that the reservations are still in effect—and, as far as we know, a reversal has not been requested by any of Mexico’s trade partners—both under NAFTA and the investment agreements concluded by Mexico, it should be determined whether Mexico was able at some time to claim inarbitrability ratione materiae by virtue of those reservations. For some authors and commentators, it may seem that arbitration would only be available in the event that the Mexican government waives the reservation or simply does not make use of the associated rights.62 However, cases like KBR’s demonstrate that the possibility of investment arbitration is real. The success or failure of the arguments of the claimant—particularly in light of the principles of investment protection, such as fair and equitable treatment—would still remain to be seen. The fact that the relevant energy sectors continue to be strategic areas within the constitutional text, along with the maintenance of administrative rescission under the Hydrocarbons Act and other laws, makes the substantive analysis of possible breaches of international law a very complex matter. Ultimately, it is not a minor issue to emphasize the fact that Clause 25.9 of the already quoted contractual model for the second bidding round of PEMEX’s “Round One” establishes that “the contractor shall benefit from the rights recognized under the international treaties to which the state is a party.”63
Conclusion

From a public policy perspective, the energy reform will implement far-reaching changes in the political, economic, and legal spheres in Mexico. Certainly, any process of opening to investment gives rise to the possibility of disputes that need to be settled within an environment of legal certainty. International arbitration in general, and investment arbitration in particular, are tools that serve both the investor and the state to properly resolve disputes that arise in the energy sector.

Nonetheless, there are some issues that still remain unclear and that may cause a contractual dispute to become greater in scope and consequently have a major impact on investors, as well as on the state. The COMMISA case is an enlightening example in this context, particularly when analyzed in light of the subsequent claim of KBR, its parent company, based on Chapter XI of NAFTA.

The elimination of the administrative rescission process from the PEMEX and CFE laws opens the door to arbitrations based on contractual disputes that can be carried out in a proper manner. However, the maintenance of this process—which originated in French administrative law—in the Hydrocarbons Act and other legislative bodies may result in arbitration clauses losing their meaning under specific circumstances, and claims for damages falling under the exclusive jurisdiction of the courts.

Finally, it does not appear that the reservations that Mexico maintains under its investment treaties are, in principle, an obstacle for investor versus state disputes to occur whenever a claim goes beyond breach of contract and involves arguments of perceived arbitrary or discriminatory treatment—or the denial of access to justice—as stipulated in the fair and equitable treatment standard. At the end of the day, a balance must be sought between the legitimate interests and expectations of an investor and the public policy interests of the state, particularly whenever a sector as significant as energy is concerned.
Endnotes


2 Case ICC 13613/CCO/JRF.


5 Decree Reforming and Adding Different Provisions.


13 In the Mexican legal system, an administrative law is one that has been enacted by the legislative branch and applied in the sphere of the executive branch.


15 Ibid., 3.
Arbitration and Investment Protection


19 “In the Matter of SEDCO.”


23 Ashley Stockton, *Corporación Mexicana de Mantenimiento Integral, S. de R. L. de C.V. v. PEMEX Exploración y Producción: U.S. Courts' Narrow Discretion To Confirm Foreign Arbitral Awards that Are Annulled at the Seat of Arbitration*, 22 Tul. J. Int’l & Comp. L. 445. The initial contract contained an arbitration clause that stipulated any dispute would be settled through arbitration to be carried out in Mexico City in accordance with the Rules of Conciliation and Arbitration of the International Chamber of Commerce (ICC).


27 In general, these conclusions are reached by the analysis of the resolution of the Supreme Court carried out by Wöss et al. in “The Administrative Contract.”


29 Stockton, *Corporación Mexicana*, 446.


32 Ibid., 447.

Arbitration and Investment Protection

34 Stockton, *Corporación Mexicana*, 448.

35 Ibid., 57.

36 *KBR, Inc., v. The United Mexican States*.

37 For a summary of the ruling by Judge Hellerstein, see Stockton, *Corporación Mexicana*, 664.

38 Stockton, *Corporación Mexicana*, 51.

39 The principle of international courtesy or “comity” has been analyzed by the United States courts since the nineteenth century in cases of recognition and enforcement of foreign sentences. See *Hilton v. Guyot*, 159 U.S 113, 16 S. Ct. 139, 40 L. Ed. 95 (1895).


43 Ibid., 261.


49 *KBR, Inc., v. The United Mexican States*, paragraph 45.

50 *KBR, Inc., v. The United Mexican States*, paragraph 46.

51 *Mondev International Ltd. v. United States*, Award, ICSID Case No ARB (AF)/99/2; IIC 173 (2002), paragraph 91.

52 *Saipem SpA v. Bangladesh*, Decision regarding jurisdiction and recommendation regarding preliminary measures, ICSID Case No ARB/05/07; IIC 280 (2007), paragraph 127.
53 Emphasis added.

54 *KBR, Inc., v. The United Mexican States*, paragraphs 6-8.


57 *KBR, Inc., v. The United Mexican States*, paragraph 16.

58 *KBR, Inc., v. The United Mexican States*, paragraph 35.

59 Cavazos, *Fair and Equitable Treatment*, 65-92 (analysis of the regulatory content of the FET principle).

60 See Gabriel Cavazos Villanueva, “El Paso Energy International Company v. Argentine Republic,” *ICSID Review* 27 (1): 2012. In this case, the claimant alleged that the breaches of the FET principle were an accumulation of actions rather than a measure in particular.

