INVESTMENT PROTECTION UNDER THE MEXICAN ENERGY REFORM

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Abstract

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1. Introduction[3]

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 procurement 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 rescission 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 have been provoked by the Comissa v. Pemex case. In such case claimant pursued constitutional litigation (amparo) parallel to the arbitration in order to have the administrative 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*

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[3] Herfried Wöss, *'Arbitration under the Mexican Energy Reform: the lessons of Pemex v. Commisa'* Kluwer Arbitration Blog, 7 November 2014, http://kluwerarbitrationblog.com/2014/11/07/arbitration-under-the-mexican-energy-reform-the-lessons-of-commisa-v-pemex/; Herfried Wöss, *'El Arbitraje y la Reforma Energética'* Energía a Debate (January 2015) http://energiaadebate.com/el-arbitraje-y-la-reforma-energetica/.

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. The Mexican Supreme Court rules upon petition of Comissa in 2006, hat the unilateral rescission of the project agreement by Pemex was constitutional and within its exorbitant power, and that the administrative rescission was an act of State, which could only be challenged in ordinary administrative litigation. The execution of the US$300 million arbitration award is still pending with US federal courts in New York.[4]

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 by a state entity. 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. Once the state entity has opted for administrative rescission of the project agreement, arbitration becomes redundant.

The Comissa 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. Whereas in France contract termination or events distorting the contractual balance trigger indemnification 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 non-arbitrability 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 administrative rescission in favour of project agreements based on commercial law and party autonomy as regards Pemex and the Mexican Federal Electricity Commission, with the exception of contracts to be entered with the Mexican National Hydrocarbons Commission (CNH). As regards the letter, the law prohibits compensation in case of administrative rescission.

2. The Mexican Energy Reform

The Mexican Energy Reform overhauled both the oil & gas and the electricity sectors allowing investment in areas previously reserved to the state. Whereas the contracts with Pemex, the Mexican Electricity Commission (CFE for its acronym in Spanish) are governed by commercial law and fully arbitrable, contracts with the Mexican Hydrocarbons Commission are hybrid contracts where both commercial law as well as the French law institution of the *contrat administratif* is applicable, in particular, as regards the administrative rescission, which is considered an act of authority or of State which leads to the non-arbitrability of the administrative rescission and its consequences. Combined with the

[4] Jennifer Cabrera, Dante Figueroa, Herfried Wöss, The administrative contract, non-arbitrability, and the recognition and execution of awards annulled in the country of origin: the case of Commissa v. Pemex, (2016) 32 Arbitration International 1, 125-48, http://arbitration.oxfordjournals.org/content/early/2015/09/25/arbint.aiv057.

prohibition of compensation for the sunk investment or profit lost, the administrative rescission in contracts with CNH gives rise to significant political risk and may provoke investment arbitrations due to the lack of other reasonable available legal remedies.

2.1. Pemex and the Electricity Market

Under the new Ley de Petróleos 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 amiable 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*. Pemex has extended arbitration clauses from the ICC to other institutions such as the LCIA.

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 refer 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. The new CFE contracts refer to arbitration before the London Court of International Arbitration (LCIA).

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 in 2006 on the non-arbitrability of the administrative rescission and termination as a consequence of the Comissa 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 commercial 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. However, the rules of arbitration are now contained in the Manual

on Dispute Resolution, which applies to the electricity wholesale market.[5] Arbitration is between The National Centre for Energy Control (CENACE), Market Participants, Transporters and Distributors subject to an arbitration agreement that has to refer to arbitration administered by the International Centre for Dispute Resolution of the American Arbitration Association.[6]

The Energy Regulatory Commission resolves disputes with respect to interconnections and disputes of companies of the energy sector with the National Energy Control Centre. Contracts with landowners 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 non-arbitrability 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.

2.2. Oil and Gas Exploration and Production Contracts

Oil and gas exploration and production contracts with the National Hydrocarbons Commission are governed by commercial law, subject to the imperative provisions contained in the Hydrocarbon Law, as expressly established in article 22 of the new Hydrocarbon Law as of August 11, 2014 and its future regulations. This is confirmed in article 97 of the new Hydrocarbons 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 Hydrocarbons 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 Hydrocarbons 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 Hydrocarbons Law and refer to gross non-performance of the contractor.

Article 21 of the new Hydrocarbon law provides for arbitration of oil and gas exploration and production contracts subject to the Mexican Commercial Code as *lex arbitrii*. The administrative rescission and termination is expressly excluded from arbitration as a matter of non-arbitrability *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-equipped to hear cases on complex infrastructure projects.

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[5] Acuerdo por el que se emite el Manual de Solución de Controversias, Official Gazette of the Federation, March 16, 2016.

[6] Section 3.5.1. (General Provisions) of the Manual on Dispute Resolution for the Wholesale Electricity Market.

Contracts under the Hydrocarbon law may be considered as *hybrid* contracts based on commercial law but containing elements of the French law institution of the *contrat administratif* as regards the exorbitant power of the state to unilaterally rescind the contract.

Article 20, paragraph 6, of the new Hydrocarbon 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.[7] Whereas under the French notion of the *contrat administratif* the state has ample obligations of compensation in case of the interference in the contractual balance,[8] the Hydrocarbon law expressly prohibits any kind of compensation, even in case the state receives a benefit through the sunk investment received from the contractor.

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 Hydrocarbons 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 agreements 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.

2.3. Political Risk through Non-Arbitrability of the Administrative Rescission and the Prohibition to pay Compensation

In case of administrative rescission of the National Hydrocarbons Commission, the authority opts out of arbitration with all its consequences. The administrative rescission follows an administrative procedure under public law contained in the Hydrocarbons Law. The act of administrative rescission is an act of state. This means that the legality of the administrative rescission and its consequences such as damages in case of illegal administrative rescission have to be judged by federal administrative courts. Those courts are not particularly equipped to hear complex gas and oil project cases and not familiar with complex damages claims. Additionally, the CNH is not allowed to pay compensation in case of administrative rescission even if it receives substantial benefits from the sunk investment such as oil and gas and the corresponding reserves found by the Contractor. Administrative litigation in a complex contract case is likely to take 10 years.

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[7] "Como consecuencia de la rescisión administrativa, el Contratista transferirá al Estado sin cargo, ni pago, ni indemnización alguna, el Área Contractual. Asimismo, se procederá a realizar el finiquito correspondiente en términos de las disposiciones jurídicas aplicables y de las previsiones contractuales."

[8] Héctor A. Mairal, 'The Doctrine of the Administrative Contract in International Investment Arbitration' in: Borzu Sabahi, Nicolas J. Birch, Ian A. Laird, José Antonio Rivas (eds.), *Essays in Honor of Don Wallace, Jr.* (Juris Publishing 2014) 417-31.

Article 20 of the Hydrocarbons Law reads that:

The Federal Executive Power, through the National Hydrocarbons Commission, may rescind administratively the Contracts for the Exploration and Production and recover the Contractual Area only in case of the following grave causes:[9]

I. In case the Contractor omits to commence or suspends the activities foreseen in the Exploration or development plan for the Production in the Contractual Area, during more than 180 calendar days, without justification or authorisation of the National Hydrocarbons Commission;[10]

II. In case the Contractor does not comply with its minimum work performance engagement, without justification, under the terms and conditions of the Exploration and Production Contact;[11]

III. In case, the Contractor assigns partially or totally the operation or the rights conferred under the Exploration and Production Contract, without the prior authorization under the terms of article 15 of the Law;[12]

IV. In case of a grave accident caused intentionally or negligently by the Contractor, which causes damages to installations, deaths y and loss of production.[13]

V. In case the Contractor remits intentionally or without justification, information or false or incomplete reports, or omits them, to the Ministries of Energy, Finance and Public Credit or Economy, or the National Hydrocarbons Commission or the Agency, with respect to production, cost or any other relevant aspect of the Contract;[14]

VI. In case the Contractor fails to comply a definitive resolution of federal jurisdictional organs, which constitute res judicata,[15] *o*

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[9] "El Ejecutivo Federal, a través de la Comisión Nacional de Hidrocarburos, podrá rescindir administrativamente los Contratos para la Exploración y Extracción y recuperar el área Contractual únicamente cuando se presente alguna de las siguientes causas graves:"

[10] I. Que, por más de ciento ochenta días naturales de forma continua, el Contratista no inicie o suspenda las actividades previstas en el plan de Exploración o de desarrollo para la Extracción en el Área Contractual, sin causa justificada ni autorización de la Comisión Nacional de Hidrocarburos;

[11] II. Que el Contratista no cumpla el compromiso mínimo de trabajo, sin causa justificada, conforme a los términos y condiciones del Contrato para la Exploración y Extracción;

[12] III. Que el Contratista ceda parcial o totalmente la operación o los derechos conferidos en el Contrato de Exploración y Extracción, sin contar con la autorización previa en términos de lo dispuesto en el artículo 15 de esta Ley;

[13] IV. Que se presente un accidente grave causado por dolo o culpa del Contratista, que ocasione daño a instalaciones, fatalidad y pérdida de producción;

[14] V. Que el Contratista por más de una ocasión remita de forma dolosa o injustificada, información o reportes falsos o incompletos, o los oculte, a las Secretarías de Energía, de Hacienda y Crédito Público o de Economía, a la Comisión Nacional de Hidrocarburos o a la Agencia, respecto de la producción, costos o cualquier otro aspecto relevante del Contrato;

[15] VI. Que el Contratista incumpla una resolución definitiva de órganos jurisdiccionales federales, que constituya cosa juzgada, o

VII. In case the Contractor omits, without justification, any payment to the State or delivery of Hydrocarbons to the same, in conformity with the periods and terms stipulated in the Contract for Exploration and Production.[16]

With respect to the procedure for the administrative rescission, the following paragraphs read:

The Contract for Exploration and Production establishes the causes for its termination and rescission foreseen in this article.

The declaration of administrative rescission requires prior notification of the Contractor of the cause or causes invoked and is governed by this Law and its Regulations. Once notified the cause, the Contractor may respond within 30 calendar days and present any pertinent evidence.

Once the aforementioned term has lapsed, the National Hydrocarbons Commission has to resolve the administrative rescission within 90 calendar days taking into consideration the arguments and evidence presented by the Contractor. The determination whether to administratively rescind the Contact has to be duly founded, motivated and communicated to the Contractor.

If the Contractor resolves the issue that led to the rescission, the procedure in course remains without effect, prior acceptance and verification by the National Hydrocarbons Commission and applying, if applicable, the corresponding fines in conformity with the present Law.

Article 20, paragraph 6, of the Mexican Hydrocarbons Law contains the prohibition of payment of an indemnification in case of administrative rescission:

As a consequence of the administrative rescission, the Contractor transfers to the state without charge, payment, or any kind of indemnification, the Contractual Area. Likewise, the parties proceed with the settlement under the terms of the applicable legal provisions and the contractual stipulations.[17]

The transfer of the Contractual Area has to be performed according to the conditions established in the Contract. The Contractor maintains the goods and installations which are not tied or exclusively accessory to the recovered area. The administrative rescission does not exempt the Contractor from its obligation to remedy any damages and loss of income caused, in the terms of the applicable legal provisions.

As regards dispute resolution, article 21 of the Hydrocarbons Law establishes that *"Regarding disputes in reference to Contracts for the Exploration and Production, with the exception of*

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[16] VII. Que el Contratista omita, sin causa justificada, algún pago al Estado o entrega de Hidrocarburos a éste, conforme a los plazos y términos estipulados en el Contrato para la Exploración y Extracción.

[17] "Como consecuencia de la rescisión administrativa, el Contratista transferirá al Estado sin cargo, ni pago, ni indemnización alguna, el Área Contractual. Asimismo, se procederá a realizar el finiquito correspondiente en términos de las disposiciones jurídicas aplicables y de las previsiones contractuales."

the those mentioned in the foregoing article, those contracts may provide for alternative dispute resolution, including arbitration under the terms of Title Four of Book Five of the Mexican Commercial Code and international treaties in the matter of arbitration and dispute resolution of which Mexico is a party." This means that the administrative rescission is excluded *ratione materiae* from arbitration as an act *de iure imperii*.

The second paragraph of article 21 of the Hydrocarbons Law commands that the National Hydrocarbons Commission and the Contractors may not apply foreign law. The arbitral procedure is subject to the following:

(i) The applicable law is federal Mexican law;
(ii) The language of arbitration is Spanish, and
(iii) The award is based on law and shall be obligatory and binding for both parties.

The reference to foreign law in article 21 of the Hydrocarbons Law apparently refers to the governing law of the Contract. The reference to Mexican law is notoriously to the *lex arbitri.* Article 22 of the Hydrocarbons Law establishes that the Contracts for Exploration and Production are governed by the Law and its Regulations and as supplementary source of law, mercantile law and common law (civil law).

Therefore, the Hydrocarbons Law establishes a numerated list of grounds of administrative rescission. Administrative rescission leads to a unilateral opting out from arbitration with the consequence that its legality and the corresponding consequences may only be challenged before the Federal Court for Fiscal and Administrative Justice or through a constitutional Complaint before District and Collegiate Courts, which may be attracted by the Mexican Supreme Court.

In the light of the express provision of any payment of the sunk investment to the Contractor and a fairly underdeveloped jurisprudence on damages law in Mexico, the Contractor will not recoup its investment even if the state obtains a considerable bargain in case of administrative rescission. This might violate international investment law under certain circumstances.

2.4. Administrative Rescission in Oil Exploration and Production Contracts with the Mexican National Hydrocarbons Commission and Arbitration

The grounds for administrative rescission are repeated in Clause 23.1 (Administrative Rescission) of the Contract.

The arbitration clause used in the most recent contract published by the National Hydrocarbon Commission shows awareness of the political risk caused by the decision of the Mexican legislator to allow the Commission to opt out from arbitration through the administrative rescission. The arbitration clause contains a series of safeguard to reduce discretion of the authority as may be seen from the final version of the contract for the fourth call for public tender in the Round 1 of public tenders, dated May 16, 2016:[18]

[18] Bases de Licitación (Bidding Guidelines) CNH-R01-L04/2015.

Clause 26.1 (Applicable Law) of the Contract refers to Mexican law as the governing law of the Contract. In this respect it is important that the Contractor does not acquire ownership of oil and gas. Clause 26.2 (Conciliation) of the Contract provided for optional conciliation under the UNCITRAL Conciliation Rules. However, the conciliation procedure does not apply in case of administrative rescission under the Contract and the applicable law. According to paragraph 4 of Clause 23.2 (Prior Investigation) of the Contract, the parties have to appoint (*"deberán nombrar")* an independent expert in order to determine whether the Contractor has violated obligations under the Contract which could give rise to administrative rescission under Clause 23.1 (Administrative Rescission) of the Contract. During the Prior Investigation, the independent expert and the Contractor may prepare reports with respect to the possible ground for administrative rescission which have to be rendered within the time limit agreed between the Parties. According to Clause 26.3 (Qualities of the Conciliator or Independent Expert) of the Contract, the independent expert has to show an at least 5 years of experience in the matter related to the ground of administrative rescission. It calls the attention that the opinion of the independent expert is not binding to the Parties or any Governmental Authority.[19]

The exclusive venue for the administrative rescission under Clause 26.4 (Federal Tribunals) is before Mexican Federal Tribunals. However, in case that the Federal Tribunals declare that the grounds for administrative rescission were not met, then the Contractor may pursue a damages action before the arbitral tribunal established under Clause 25.5 (Arbitration) of the Contract with respect the damages caused by the unfounded administrative rescission, in their quantification.

Any other dispute that has not be resolved through conciliation, as applicable, may be submitted to arbitration in conformity with Clause 26.5 (Arbitration) of the Contract subject to ad hoc arbitration under the UNCITRAL Rules of Arbitration with the Secretary General of the Permanent Court of Arbitration as the nominating authority. Each party has to nominate its arbitrator and the president will be appointed as provided for under the UNCITRAL Rules of Arbitration. The language of arbitration is Spanish. The applicable law Mexican Federal law as established in Clause 26.1 (Applicable Law) of the Contract, and the place of arbitration is The Hague in the Netherlands. Each of the Parties has to bear its own cost.

According to Clause 26.7 (Non Suspension of Activities) the Contractor may not suspend its activities of exploration or production of oil during the any dispute resolution procedure, save where the National Hydrocarbons Commission rescinds the Contract. The Contractor expressly waives any right to diplomatic protection (Clause 26.8 of the Contract), however, retains all rights recognized under international treaties (Clause 26.9 of the Contract).

[19] "Las opiniones de dicho experto no serán vinculantes para las Partes ni para alguna otra Autoridad Gubernamental."

2.5. Contractual Damages Claims in case of illegal Administrative Rescission

According to Clause 23.5 (Effects of the Administrative Rescission or Contract Rescission), paragraph (a), of the Contract, in case of administrative rescission by the Mexican Hydrocarbons Commission, Contractor has to pay to the Commission any penalties referred to in the Contract as well as direct damages and loss of profits. The reference to direct damages and loss of profits has to be understood as exclusion of consequential damages and loss of profits. The last paragraph of Clause 25 (Indemnification) of the Contract expressly establishes that *"[w]ithout prejudice to the above, in no case the Parties shall be responsible for loss of income as from the notification of the rescission of the Contract."*

Damages claims of the Contractor against the Hydrocarbons Commission are only admissible when the Federal Tribunals rule that the administrative rescission of the Commission was made without due ground. Only in this case may the Contractor claims damages and lost profits in arbitration. However, according to the second paragraph 26.4 (Federal Tribunals) of the Contract such claim is limited to the effects of the illicit contract rescission. As already mentioned, disputes resolution including litigation before Federal Tribunals does not suspend the activities of the Contractor, save in case of contract rescission by the Commission.

Therefore, the damages claim refers to the following situation: In case the Federal Tribunal declares the administrative rescission as inadmissible, the Contractor seems to be obliged to continue with its activities under the Contract and may only recover the financial impact caused by the Suspension of the Activities under Clause 26.7 (Non-Suspension of Activities) of the Contract, which permits the suspension of activities in case of administrative rescission by the Commission.

In case the Federal Tribunal admits the ground or grounds invoked by the Commission, Contractor is barred from arbitration under Clauses 26.4 (Federal Tribunals) and 26.5 (Arbitration) and is likely to be subject to the payment of penalties, direct damages and indemnification under Clauses 23.5 (Effects of Administrative Rescission or Contract Rescission), paragraph (a) and 25 (Indemnification).

2.6. Hypothetical Case

An investor signs a gas exploration and production agreement for 25 years; it invests US$30 million and finds gas reserves with a value of several billion USD. Due to the market situation it does not obtain the financing to start drilling, incurs in considerable delay and, violates the corresponding milestone in the project agreement. In the mean time, the host country changed governments and a populist president comes to power. The new government decides to rescind the project agreement with the investor and enter a new project agreement for the same production area with a political crony. Investor is barred from recovering its sunk investment due to the express prohibition in the law. It might go for administrative litigation in order to obtain a judgment declaring the administrative rescission illegal and then continue with commercial arbitration, or opt for investment arbitration.

3. State Responsibility in Case of Administrative Rescission

Administrative rescission raises various issues: (1) the unilateral opting out from arbitration might amount to a denial of justice in the light of the expected length of local court procedure and the inexperience of federal administrative courts with complex contracts; (2) the express prohibition of compensation and any kind of payments, such as in article 20 of the Mexican Hydrocarbons Law may amount an illegal expropriation of the income generating investment underlying the Contract. The prohibition of compensation includes the sunk investment of the Contractor; and (3) an administrative rescission might amount to a violation of the fair and equitable treatment standard in international investment protection law. The fact that an administrative rescission might be considered legal by a local tribunal, does not mean that it cannot violate international law, provided the that the threshold of international tort law standards is being met.[20] Below, the authors analyse issues that may arise in an investment arbitration arising from a claim involving administrative rescission.

3.1. Applicable Law: Choice or Conflict?

The determination of the law applicable to the contract and the agreement on dispute resolution are often regarded the most sensitive legal issues in an investment dispute. Typically, investment arbitration embraces the notion of party autonomy, making as the default authority the parties' agreement on choice of law.[21] In the absence of such an agreement, the options range considerably but, in general, the applicable law will be from one of three different legal frameworks:[22]

(1) international law, consisting of applicable treaties, customs and general principles of law;

(2) contracts, including administrative contracts and domestic forum selection clauses; and

(3) national laws of the disputing parties, including statutes like Mexico's 2014 Hydrocarbons Law.[23]

While complex contracts generally include an arbitration clause particularizing dispute resolution, there may be instances of redundancy, overlap, or conflict amongst the laws applicable to the dispute.[24] Accordingly, the Parties' choice of law is an important

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[20] Herfried Wöss, 'Systemic Aspects and the Need for Codification of International Tort Law Standards in Investment Arbitration', in: A.K. Bjorklund, J.P. Gaffney, F. Gélinas, H. Wöss, *Comprehensive Economic and Trade Agreement between the European Union and Canada (CETA)*, TDM 1 (2016).

[21] ICSID Convention, Article 42, ICSID Additional Facility Rules, Article 54, 2010 UNCITRAL Arbitration Rules, Article 35.

[22] For instance, ICSID Convention, Article 42 requires tribunal's to apply the "law of the [Host] State … and international law". The 2010 UNCITRAL Arbitration Rules, Article 35 requires the tribunal to apply the law that it "determines to be appropriate" and "in accordance with the terms of the contract" and to take into account any applicable "usages of trade."

[23] Jeswald Salacuse, *The Three Laws of International Investment* (OUP, 2013).

[24] Ivar Alvik, *Contracting with Sovereignty* (OUP, 2011) at 144-146. See also Christoph Schreuer, "Calvo's Grandchildren: The Return of Local Remedies in Investment Arbitration" (2005) The Law and Practice of International Courts and Tribunals 1 at 8.

consideration in determining whether an administrative contract claim is ripe for international investment arbitration, especially when the chosen law allows the host State to plead its administrative law as a defense to a treaty claim.[25]

3.2. The Contract as an Income Generating Investment

Large-scale investments are usually established to last for several decades and the investment contract has emerged as a championed medium to customize the rights, risks, tasks, and responsibilities of the parties involved. It is understandable that nearly all investment treaties list "contracts" as covered by the term "investment".[26] A contract may also be regarded as an investment by determining whether the contract is an income generating asset whereby the income stream comes from a third party (i.e. the market). These kinds of contracts are considered as atypical synallagmatic contracts, synallagmatic triallagmas or symbiotic contracts whereby the parties contribute assets of any kind and the income derives from a third party which is the market, and not from one of the contractual parties. Income generating contracts are income-generating investments and structurally distinct from typical synallagmatic contracts whereby one party delivers goods or services and the other pays in exchange.[27]

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[25] While it is recognized as a rule of customary international law that "[a] party may not invoke the provisions of its internal law as justification for its failure to perform a treaty" (Vienna Convention on the Law of Treaties, Article 27), tribunals have declined jurisdiction and stayed proceedings to give full effect to the terms of the underlying contract, including exclusive forum selection clauses. For decisions in which tribunals declined jurisdiction, see *Toto Costruzioni Generali S.p.A. v. Lebanon*, ICSID Case No. ARB/07/12, Award, 2 June 2012. But see *Toto Costruzioni Generali S.p.A. v. Lebanon*, ICSID Case No. ARB/07/12, Award Concurring Opinion of Judge Schwebel, 24 May 2012, casting doubt on the legal effect of this position. For decisions in which tribunals have stayed proceedings, see *SGS Société Générale de Surveillance S.A. v. Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, 29 January 2004. But see *SGS Société Générale de Surveillance S.A. v. Philippines*, ICSID Case No. ARB/02/6, Dissenting Opinion of Antonio Crivellaro to the Decision of the Tribunal on Objections to Jurisdiction, 29 January 2004 (where Crivellaro opined the two dispute settlement agreements – one under the treaty and one specified in the contract – were complementary of one another and not mutually exclusive).

[26] See e.g. 2008 Mexico Model BIT, Article 1, online: http://investmentpolicyhub.unctad.org/Download/TreatyFile/2860, accessed 5 August 2016.

[27] Adriana San Román Rivera, Herfried Wöss, *Damages in International Arbitration with respect to Income Generating Assets or Investments in Commercial and Investment Arbitration*, Yukos Special TDM 5 (2015) and Journal of Damages in International Arbitration Vol. 2 (2015) 37-62. See also Herfried Wöss, Adriana San Román Rivera, Pablo T. Spiller, Santiago Dellepiane, *Damages in International Arbitration under Complex Long Term Contracts*, OUP 2014, p. [*]. L. Yves Fortier, Stephen L. Drymer, 'Indirect Expropriation', in: *ICSID at 50*, Chapter 25, 348, at 353. Thomas Wälde and Abba Kolo, 'Environmental Regulation, Investment Protection and "Regulatory Taking" in International Law' 50 ICLQ (2001) 811, at 835. With respect to the contracts with the Mexican Hydrocarbons Commission, the income of Contractor under the Contract derives from the sale of the Hydrocarbons Produced under Clause 2.1 (License) and Clause 15.2 (Commercialisation of the Contractor's Production) of the Contract subject to payment of remuneration and royalties to the state under Clause 16.2 (Remuneration for the State) of the Contract. This is without prejudice to the sunk investment of the Contractor which would be recouped by the income stream generated through the investment.

3.3. Administrative Rescission as an Act *de iure imperii*

Not every breach of an investment contract can be regarded as a breach of an investment treaty.[28] To add clarity to the matter, some tribunals distinguish between acts *iure imperii* and *iure gestionis* over contract-based claims.[29] If the impugned measure affecting an investment contract involves an exercise of sovereign powers, tribunals will generally entertain the claim. If the impugned act is an exercise of an ordinary contracting party, the claim will fail as it can be addressed by different legal framework (e.g. local remedies) and would not give rise to a violation of international law. Whether administrative rescission by the host State may be characterized as a sovereign or commercial act in every jurisdiction is beyond the scope of this article. However, as administrative contracts generally involve concessions affecting the public interest, there is a strong argument that any unilateral action by the host State affecting the contract would constitute a sovereign act.[30] Moreover, as any minor or trivial contract disputes would not survive scrutiny under the generally high thresholds of treatment upheld by the international standards of investment protection, the distinction seems less relevant for tribunals faced with an administrative contract dispute under an investment treaty.[31]

3.4. Requirement to Exhaust Local Remedies

International investment law, in principle, allows foreign investors to forego the customary international law requirement to exhaust local remedies before pursing international dispute resolution.[32] As litigation before domestic courts is often perceived as lacking objectivity, dispensing the requirement to exhaust local remedies advertises international investment

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[28] *Impregilo S.p.A. v. Pakisatan*, ICSID Case No. ARB/03/3, Decision on Jurisdiction, 22 April 2005, para. 260.

[29] See e.g. *Suez, Sociedad General de Aguas de Barcelona, S.A.and Vivendi Universal, S.A. v. Argentine Republic*, ICSID Case No. ARB/03/19, Decision on Liability, 30 July 2010, para. 153.

[30] *Siemens A.G. v. Argentina*, ICSID Case No. ARB/02/8, Award, 6 February 2007, paras. 255-256.

[31] The existence of the so-called umbrella clause, where the State commits itself to respect contractual obligations entered into with foreign investors, may be one exception to this general observation. See generally Anthony Sinclair, "Umbrella Clause" in Marc Bungenberg et al eds, *International Investment Law* (Hart, 2015) 887 at 923-924 (listing cases expressing support for and against the view that a simple breach of contractual obligations could amount to a violation of the umbrella clause) and 941-944 (addressing the distinction between governmental and commercial obligations and concluding that there is no basis to add a governmental qualification to the scope of the umbrella clause that is not evident in the text of the umbrella clause). Regarding the situation in Mexico, administrative rescission is already viewed as an act *de iure imperii* as confirmed by the June 23, 2006 judgment of the Second Chamber of the Mexican Supreme Court, which as the result of the parallel litigation of Commisa in the case of Commisa v. Pemex, where by the Supreme Court rules that the unilateral rescission by the state of an administrative contract is a *"special privilege of the States, which places it in a distinct and more favourable situation than which governs for those individuals that contract with it."*[31] The Court that *"[w]hen an administrative entity exercises its right of rescission, private parties contracting with that public entity retain the right of access to the administration of justice by the courts."* (Cited in *Amparo en Revisión 358/2010*, Eleventh Collegiate Court in Civil Matters for the First Circuit (25 August 2011) at 14). Attribution of the administrative rescission to the National Hydrocarbons Commission is established in Article 28, paragraph 8, of the Mexican Federal Constitution, which refers to the National Hydrocarbons Commissions as a regulatory organ of the government in energy matters. Administrative rescission by the National Hydrocarbons Commission would, therefore, most likely be considered as an act *de iure imperii* and attributable to the Mexican state (See also: *Crystallex International Corporation v. Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/112, paras. 471-84).

[32] For example, the Preamble to the ICSID Convention states, "while such [investment] disputes would usually be subject to national legal processes, international methods of settlement may be appropriate in certain cases."

arbitration as an attractive, politically neutral option. Foreign investors, however, are not granted unfettered access to the arbitration process and the exhaustion rule remains quite active in determining consent (i.e. securing the tribunal's jurisdiction or demonstrating admissibility of the claim) to investor-state dispute settlement[33] and informal, and occasionally muted, role in proving violations of certain substantive standards of protection (e.g. denials of justice).

3.5. Domestic Forum Selection Clauses in Contracts

Where the Parties expressly include a forum selection clause in their contract, tribunals appear torn between accepting,[34] staying[35] or dismissing[36] the proceedings.[37] For the most part, interpretation of these clauses is restricted to upfront jurisdiction and admission issues; but they offer some insight into how a tribunal ought to interface with municipal law obliging foreign investors to local remedies. In *SGS v Philippines*, while contemplating whether an alleged contract violation could also violate the applicable BIT's umbrella clause, a majority of the Tribunal applied a two-part test. It first placed emphasis on the notion of party autonomy undergirding the contractual relationship between the Parties and posed against it whether the BIT or ICSID Convention overrode the Parties' contractual agreement.[38] In answering the question in the negative, the Tribunal then questioned the character of investment protection as a legal framework and found that the treaty was not designed to override specific commitments entered into by the Parties.[39]

Conversely, several tribunals have adopted a more sceptical approach to exclusive forum selection clauses. Most poignantly is the so-called "Vivendi principle", which views forum selection clauses incapable of constituting a waiver of recourse to investment arbitration.[40]

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[33] See e.g. ICSID Convention, Article 26 (Caveats exclusion of the traditional exhaustion rule with the phrase "unless otherwise stated and permits Contracting States to "require the exhaustion of local remedies as a condition of its consent to arbitration under [the ICSID] Convention".). See also ICSID Model Clauses, Clause 13 online: <https://icsid.worldbank.org/ICSID/StaticFiles/model-clauses-en/14.htm>.

[34] See e.g. *Waste Management, Inc. v. Mexico*, ICSID Case No. ARB(AF)/00/3, Award, 30 April 2004. *CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Decision of the Tribunal on Objections to Jurisdiction, 17 July 2003, para. 76.

[35] *SGS Société Générale de Surveillance S.A. v. Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, 29 January 2004. But see *SGS Société Générale de Surveillance S.A. v. Philippines*, ICSID Case No. ARB/02/6, Dissenting Opinion of Antonio Crivellaro to the Decision of the Tribunal on Objections to Jurisdiction, 29 January 2004. *Compañiá de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3, Award, 21 November 2000, para. 78. *Compañiá de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3, Decision on Annulment, 3 July 2002, para. 98.

[36] See e.g. *Toto Costruzioni Generali S.p.A. v. Lebanon*, ICSID Case No. ARB/07/12, Award, 2 June 2012. But see *Toto Costruzioni Generali S.p.A. v. Lebanon*, ICSID Case No. ARB/07/12, Award Concurring Opinion of Judge Schwebel, 24 May 2012.

[37] While this is Schreuer's second category of condition precedents, the case law is informative to the newly proposed category of recourse to domestic administrative proceedings as a requirement of the national law.

[38] *SGS Société Générale de Surveillance S.A. v. Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, 29 January 2004, para. 139.

[39] *Id.*, para. 141.

[40] *Compañiá de Aguas del Aconquija S.A. and Vivendi Universal S.A. v. Argentine Republic*, ICSID Case No. ARB/97/3, Award, 21 November 2000, para. 53-54. See also *Lanco International Inc. v. Argentina*, ICSID Case No. ARB/97/6, 8 December 1998, para. 26.

Taking this principle a step further, in *Salini Costruttori v Morocco*[41] and *Consortium RFCC v Morocco,*[42] the tribunals determined that if the requirement to resort to local remedies is an obligation of the national law, then the forum selection clause is not an accurate reflection of the Parties' autonomy. The *SGS v Philippines* Tribunal contemplated this scenario also but reserved for a footnote its advisement that the "mere fact that 'administrative jurisdiction cannot be selected by mutual agreement' does not prevent the investor agreeing by contract not to resort to any other forum."[43] As it stands, the case law appears divided when resort to local proceedings is obligatory under municipal law and invoke a deeper inquiry into the purpose and nature of investment arbitration as an alternative dispute resolution mechanism to domestic proceedings as well as the (presumed) negotiating equality between the contracting parties at the time the contract was formed.

3.6. Relevant International Tort Law Standards

3.6.1. Denial of Justice

Denial of justice typically involves a significant degree of (uncorrected) maladministration of justice by the national legal system.[44] Under the denial of justice standard, for an investor to allege a violation it is necessary that all the available judicial remedies have been exhausted.[45] The rationale connecting the exhaustion rule to the denial of justice standard is the notion that national justice systems are imperfect but self-correcting. If, however, reasonable recourse to effective local remedies is unavailable, a tribunal may deem the exhaustion rule a futile exercise or mandatory precondition.[46] Where local administrative courts are ill-equipped to hear highly complex contract claims, a unilateral opting out from arbitration may be considered a denial of justice, in particular, where the violation of the Contractor of the project

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[41] *Salini Costruttori S.p.A. and Italstrade S.p.A. v. Morocco*, ICSID Case No. ARB/00/4, Decision on Jurisdiction, 31 July 2001, para. 27.

[42] *Consortium RFCC v. Morocco*, ICSID Case No. ARB/00/6, Decision on Jurisdiction, 16 July 2001, para. 31.

[43] *SGS Société Générale de Surveillance S.A. v. Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, 29 January 2004, nn 68. But see *SGS Société Générale de Surveillance S.A. v. Philippines*, ICSID Case No. ARB/02/6, Dissenting Opinion of Antonio Crivellaro to the Decision of the Tribunal on Objections to Jurisdiction, 29 January 2004 (Crivellaro regards the jurisdiction of national and international dispute resolution mechanisms do not necessarily override or replace one another). See also *Flughafen Zürich y Gestión e Ingeniería IDC, S.A. v. República Bolivariana de Venezuela*, Caso CIADI No. ARB/10/19, para. 333.

[44] Jan Paulsson, *Denial of Justice in International Law* (CUP, 2005), p. 53.

[45] *Pantechniki S.A. Contractors & Engineers v. Albania*, ICSID Case No. ARB/07/21, Award, 30 July 2009, paras. 96-97.

[46] *Ambiente Ufficio S.P.A. and others v. Argentina*, ICSID Case No. ARB/08/9, Decision on Jurisdiction and Admissibility, 8 February 2013, paras. 607-608; *ST-AD GmbH v. Bulgaria*, PCA Case No. 2011-06(ST-BG), Award on Jurisdiction, 18 July 2013, para. 365. But see *Ambiente Ufficio S.P.A. and others v. Argentina*, ICSID Case No. ARB/08/9, Dissenting Opinion of Santiago Torres Bernardez to the Decision on Jurisdiction and Admissibility, 2 May 2013, paras. 384-6 (Bernardez rejects the majority's reasoning finding that it is *de lege fernenda*); *ECE Projektmanagement International GmbH and Kommanditgesellschaft PANTA Achtundsechzigste Grundstucksgesellschaft mbH & Co v. Czech Republic*, PCA Case No. 2010-5, Award, 19 September 2013, para. 4.746.

agreement seems to be justified or the sanction of administrative rescission is in clear disproportion with the violation.[47]

3.6.2. Expropriation

Tribunals are divided on the applicability of the exhaustion rule to claims of unlawful expropriations involving investment contracts. Where tribunals view the exhaustion rule as irrelevant, the *Saipem v Bangladesh* Award is the leading example, which inculcate that "[a]s a matter of principle, exhaustion of local remedies does not apply in expropriation law."[48] In contrast, a parallel string of jurisprudence suggests importation of the exhaustion rule to evaluate alleged unlawful expropriations. For example, in *Abengoa v Mexico* the Tribunal determined that the failure to pursue readily available local remedies could be considered an act of negligence that could result in the loss of right to compensation from the alleged claim of unlawful indirect expropriation.[49]

A tribunal must also turn its attention to whether administrative rescission amounts to an unlawful expropriation. Direct expropriations usually involve a physical and legal transfer of the investment. Indirect expropriations result where physical and legal transfer may not take place but the government measures have an effect equivalent to a direct expropriation. The standard typically involves the eradication of an essential component of a protected right or neutralization of its use or benefit. The expropriation is considered illegal when the host State fails to satisfy the treaty requirements of a lawful expropriation, which generally require the host State to ensure its expropriatory measure(s) was made for a public purpose, in accordance with the due process of law, in a non-discriminatory manner, and promptly accompanied by adequate compensation. As suggested earlier, it seems unlikely tribunals would find minor contractual violations sufficient to satisfy the high threshold test to demonstrate an expropriation has taken place.[50]

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[47] Whereas in France competent administrative courts rule on conflicts related to the *marchés publiques*, in most Mexico and many Latin American countries administrative courts are ill-equipped to hear highly complex contract, the length of trials may be up to 10 years and there is little experience in damages claims, which are the core of the vast majority of investment arbitrations.

[48] *Saipem S.p.A. v. Bangladesh*, ICSID Case No. ARB/05/07, Award, 30 June 2009, paras. 179-180. See also *Frank Charles Arif v. Republic of Moldova*, ICSID Case No. ARB/11/23, Award, 8 April 2013, para. 345; *CME Czech Republic B.V. v. Czech Republic*, UNCITRAL, Partial Award, 13 September 2001, para. 417.

[49] *Abengoa, S.A. y Cofides, S.A. v. Mexico*, ICSID Case No. ARB(AF)/09/2, Award, 18 April 2013, paras. 627-628. (For the *Abengoa* Tribunal, it regarded its task was to assess whether the claimant-investor was negligent in failing to seek out redress from local forms of justice.). See also *Lauder v. Czech Republic*, UNCITRAL, Award, 3 September 2001, para. 204; *Generation Ukraine, Inc. v. Ukraine*, ICSID Case No. ARB/00/9, Award, 16 September 2003, paras. 20.30, 20.33; *SGS Société Générale de Surveillance S.A. v. Philippines*, ICSID Case No. ARB/02/6, Decision of the Tribunal on Objections to Jurisdiction, 29 January 2004, para. 161; *Waste Management, Inc. v. Mexico*, ICSID Case No. ARB(AF)/00/3, Award, 30 April 2004, para. 174-175. *Venezuela Holdings, B.V. and others v Venezuela*, ICSID Case No. ARB/07/27, Award, 9 October 2014, para. 301.

[50] See e.g. *Flughafen Zürich y Gestión e Ingeniería IDC, S.A. v. República Bolivariana de Venezuela*, Caso CIADI No. ARB/10/19, para. 454.

3.6.3. Fair and Equitable Treatment

Like investor-state jurisprudence on expropriation, the exhaustion rule has seeped into the corpus of FET case law involving investment contracts.[51] In its most extreme form the *Parkerings v Lithuania* Tribunal specifies that only in a limited set of circumstances would an investor avoid resort to local remedies.[52] Other tribunals, however, have demonstrated a willingness to act as a substitute forum and engage with municipal law to determine its relevance[53] and utility.[54]

As a legal standard, FET safeguards a foreign investor from a host of mistreatments. One manifestation of this guarantee is the principle of proportionality. To effectively address the Parties' competing interests in a FET claim, tribunal are increasingly employing a proportionality analysis as an auxiliary principle to help mete out justice.[55] Proportionality analysis is often used in the domestic sphere and may involve weighing the objective of a state's measure against the degree of interference on a citizen's constitutional rights and freedoms.[56] In determining whether the treatment was unfair and inequitable in the circumstances, a proportionality analysis typically requires the tribunal to ask to what extent the host state may interfere with a foreign investment. This inquiry may involve weighing several factors, such as the purpose of the government measure, the importance of the interest protected, the importance of the interest held by the investor, the availability of alternative and less intrusive measures, the degree of interference and a cost-benefit analysis.[57]

Where the host state's conduct is inequitable and unfair by disappointing the investors' legitimate expectations derived from an administrative contract or acts in arbitrary, discriminatory, or non-transparent manner, a proportionality analysis may operate as a middle ground between holding firm to an informal exhaustion rule and completely disregarding claimants who are too quick out of the gate. The focus of inquiry thus remains on the host State's interference but also accounts for militating factors, such as the effective availability, engagement or exhaustion of local remedies, whether the treaty employs a fork-in-the road

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[51] See e.g. *Waste Management, Inc. v. Mexico*, ICSID Case No. ARB(AF)/00/3, Award, 30 April 2004, para. 116.

[52] *Parkerings-Compagniet AS v. Lithuania*, ICSID Case No. ARB/05/8, 11, Award September 2007, paras. 316, 448-452.

[53] *CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Award, 12 May 2005, para. 246. Upheld on annulment, see: *CMS Gas Transmission Company v. Argentina*, ICSID Case No. ARB/01/8, Decision of the ad hoc Committee on the Application for Annulment of the Argentine Republic, 25 September 2007.

[54] *Sempra Energy International v. Argentina*, ICSID Case No. ARB/02/16, Award, 28 September 2007, paras. 167, 262-268. But see *Sempra Energy International v. Argentina*, ICSID Case No. ARB/02/16, Decision on Argentine Republic Application for Annulment of the Award, 29 June 2010 (Annulling the 2007 Award but for a reason unrelated to the above mentioned statement).

[55] Marc Jacob and Stephan Schill, "Fair and Equitable Treatment: Content, Practice, Method" in Marc Bungenberg et al (eds) *International Investment Law* (Hart, 2015), 738.

[56] See e.g. *Canadian Charter of Rights and Freedoms*, Part I of the *Constitution Act*, 1982, [*Charter*] s 1. See also *R v Oakes*, [1986] 1 SCR 103.

[57] Benedict Kingsbury & Stephan Schill, "Investor-state Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law" IILJ Working Paper 2009/6 (Global Administrative Law Series) online: <http://www.iilj.org/publications/documents/2009-6.KingsburySchill.pdf> at 21-40.

provision or time-bars investment claims, whether the contract includes stabilization clauses or a forum selection clause that express the Parties' reasonable expectations, expertise of the local remedies in relation to the complexities involving resolution of a long-term complex contact dispute, etc., in addition to assessing the procedural fairness and substantive justice visited upon the foreign investor in light of the accused government mischief that may collectively assist the tribunal in reconciling the parties' colliding interests.

4. Conclusion

A "perfect storm" is an expression that describes an event where a rare combination of circumstances will aggravate a situation drastically. The legal setting under Mexico's energy reform has the markings of a perfect storm in waiting. Under the 2014 Mexican Hydrocarbons Law, Mexico is not obliged to indemnify a foreign investor for unilaterally terminating or changing an administrative contact.[58] The current status of Mexican law restricts complaints of this nature to local administrative courts for redress.[59] As a Latin American country, Mexico's legal tradition draws on the civil law legal tradition and is influenced by the Calvo Doctrine. In *Loewen v United States*, Mexico filed a NAFTA Article 1128 submission, which solidifies Mexico's intention to leave open the possibility that local remedies may precondition investment arbitration. On this point Mexico wrote: "Mexico consistently has taken the position both in oral argument and in written submissions that the State's legal system as a whole must be examined to determine whether there has been a breach of the NAFTA."[60]

Although the initial approach was to exclude implicit versions of the exhaustion rule from international investment law, the requirement has survived and has taken on a new and expanding role. For claims involving denials of justice, judicial finality appears to be the base requirement. For expropriation and FET claims, several decisions suggest foreign investors ought to consider available and effective local remedies prior to advancing their claims to international arbitration. Despite the exhaustion rule's informal existence, its repeated acceptance and application in investor-State dispute settlement means a sacrifice of certainty and predictability in international investment law in favour of providing local authorities an opportunity to self-correct. At a macro-level, it puts into question the normative function of international investment as an alternative to domestic tribunals.[61] At a micro-level, prudent investors are faced with a difficult decision to pursue local remedies, potentially wasting money and time and exposing themselves to further injury attributable to the host State, or to take chance on investor-State arbitration, hoping to skillfully distance their arguments away any discussion on the exhaustion rule. For the host State, it is an opportunity to install multiple levels of review within its domestic legal infrastructure to delay investment arbitration or, for the sake of clarity, expressly include or exclude the exhaustion rule into their treaty

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58 Mexico Hydrocarbons Law, Article 20(6).

59 Mexico Hydrocarbons Law, Article 21.

60 *Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3, Mexico's NAFTA Article 1128 Submission, 9 November 2001, p. 7.

61 Campbell McLachlan, Laurence Shore, Matthew Weiniger, *International Investment Arbitration: Substantive Principles* (OUP, 2007) at 128 ("[O]ne of the purposes of investment arbitration is to provide a neutral forum for dispute resolution of investor-State disputes.").

negotiating practices.[62] An opportunity Mexico is pressing for advantage.

But, international investment law operates distinctly from municipal law and where indemnification is unavailable through domestic means - as is the situation under the 2014 Mexican Hydrocarbon Law - a foreign investor may seek compensation under an applicable investment treaty. To accept otherwise would permit Mexico, and like-minded national law-makers, to override their international obligations with domestic law. The emphasis tribunals place on party autonomy indicates parties may proactively concretize their expectations; but, undoubtedly, greater clarity and consistency would benefit all stakeholders and enhance the credibility of the system.

[62] See e.g. US-Ecuador BIT, Article II(3)(b). ("A measure may be arbitrary or discriminatory notwithstanding he fact that a party has had or has exercised the opportunity to review such measure in the courts or administrative tribunals of a Party.").