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SCOTUS CLARIFIES RELATIONSHIP BETWEEN NEW YORK CONVENTION AND STATE LAW DOCTRINES OF EQUITABLE ESTOPPEL

Written by Gerold Zeiler

THE FACTS

Outokumpu Stainless USA, LLC ("Outokumpu") is the legal successor of Thyssen Krupp Stainless USA, LLC ("Thyssen Krupp"). The latter had entered into three contracts with F.L. Industries, Inc ("F.L. Industries") for the construction of cold rolling mills at Thyssen Krupp's steel manufacturing plant in Alabama. After executing these agreements, F. L. Industries entered into a subcontractor agreement with GE Energy Power Conversion France SAS, Corp. ("GE Energy").

The contracts between Outokumpu and F.L. Industries contain arbitration clauses for any disputes "between both parties in connection with or in performance of " these contracts. The contracts define the term "Parties" to include subcontractors like GE Energy.

According to Outokumpu, GE Energy's motors failed by the summer of 2015, resulting in substantial damages. In 2016, Outokumpu and its insurers filed suit against GE Energy in Alabama state court. GE Energy removed the case to federal court under 9 U.S.C. §205, which authorizes the removal of an action from state to federal court if the action „relates to an arbitration agreement . . . falling under the [New York] Convention. GE Energy then moved to dismiss and compel arbitration, relying on the arbitration clauses in the contracts between F. L. Industries and Outokumpu.

THE LOWER COURTS

The district court held that GE Energy qualified as a party under the arbitration clauses because the contracts defined the terms „Seller" and „Parties" to include subcontractors like GE Energy.

The Eleventh Circuit reversed the District Court's order compelling arbitration. The court interpreted the New York Convention to include a requirement that the parties actually sign an agreement to arbitrate their disputes in order to compel arbitration. It then held that GE Energy could not rely on state-law equitable estoppel doctrines to enforce the arbitration agreement as a non-signatory because, in the court's view, equitable estoppel conflicts with the Convention's signatory requirement.

THE UNITED STATES SUPREME COURT

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT the Unites States Supreme Court dealt with the question whether the New York Convention conflicts with domestic equitable estoppel doctrines that permit the enforcement of arbitration agreements by non-signatories. The Court held that it does not (GE Energy Power Conversion France SAS v. Outokumpu Stainless USA, LLC, No. 18-1048 (June 1, 2020)).

Chapter 1 of the Federal Arbitration Act (FAA) permits courts to apply state-law doctrines related to the enforcement of arbitration agreements. Section 2 of that chapter provides that an arbitration agreement in writing „shall be . . . enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." The court held that this provision requires federal courts to „place [arbitration] agreements upon the same footing as other contracts." But it does not „alter background principles of state contract law regarding the scope of agreements (including the question of who is bound by them)."

And further: "The 'traditional principles of state law' that apply under Chapter 1 include doctrines that authorize the enforcement of a contract by a non signatory. … For example, … arbitration agreements may be enforced by non signatories through assumption, piercing the corporate veil, alter ego, incorporation by reference, third-party beneficiary theories, waiver and estoppel."

This does not conflict with provisions of the New York Convention: "Article II(1) requires '[e]ach Contracting State [to] recognize an agreement in writing.' But "the text of the New York Convention does not address whether nonsignatories may enforce arbitration agreements under domestic doctrines such as equitable estoppel. The Convention is simply silent on the issue of nonsignatory enforcement." The New York Convention therefor "does not prevent the application of domestic laws that are more generous in enforcing arbitration agreements."

Read the Court's full decision here.

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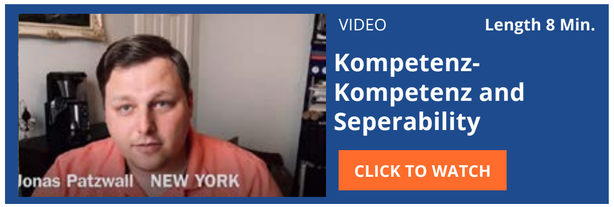

SHIPPING AND TRANSPORTATION: THE FIRST AND NINTH CIRCUITS PUSH BOUNDARIES OF FAA SECTION 1 EXEMPTION

Written by Jonas Patzwall

Section 1 of the Federal Arbitration Act ("FAA") contains an important exemption from its applicability: employment contracts "of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce." 9 U.S.C. §1. That may surprise at first glance, but enacted February 12, 1925, the drafters of the FAA knew how to operate in a pre-New Deal constitutional environment. Then, Congress' power to regulate interstate commerce pursuant to the Commerce Clause of the U.S. Constitution was understood narrowly, but certainly covered traditional areas of industry that spanned the several states such as railroads and trade based on navigable waters (recall the Merchant Marine Act of 1920 "Jones Act" was enacted June 5, 1920).

From the perspective of an American in 1925 it was firmly in Congress' grasp to regulate those classes of workers, but hardly others. By exempting the classes of workers Congress was able to regulate from the scope of the FAA, Congress arguably intended to strike employment contracts as a whole from the scope of the FAA – however, neither that interpretation, nor a narrow understanding of the Commerce Clause survived. Halfway into the 20th century, the Commerce Clause had been turned into a powerful tool for the federal legislature and only the Ninth Circuit held out with insisting that employment contracts were broadly excepted under the FAA, see Craft v. Campbell Soup Co., 177 F.3d 1083 (9th Cir. 1998).

Finally, in Circuit City Stores, Inc. v. Adams, 532 U.S. 105 (2001), the U.S. Supreme Court cleaned house (abrogated the Ninth Circuit's decision in Craft) and held that that only employment contracts of transportation workers were exempted from FAA, strictly narrowing the scope of the exemption to few workers. This was in line with the new times and a long-standing push to broaden the FAA's purview. Since then a popular understanding has been – though not directly forced by language used in the Court's decision – that the exemption covers only those workers that actually transport people or goods across state lines. See, e.g., Eastus v. ISS Facility Servs., Inc., 960 F.3d 207 (5th Cir. 2020); Wallace v. Grubhub Holdings, Inc., No. 19-1564, 2020 WL 4463062 (7th Cir. Aug. 4, 2020).

Slot in a recent and important decision in the U.S. Court of Appeals for the First Circuit: Waithaka v. Amazon.com, Inc., 966 F.3d 10 (1st Cir. 2020) recently held that the FAA's exemption for "workers engaged … in interstate commerce" covers all transportation workers moving goods or people within the flow of interstate commerce, even if they do not physically cross state lines during their work.

n July 17, 2020, the First Circuit ruled that local Amazon delivery drivers (fulfilling the last leg of an interstate transportation of goods) cannot be compelled to arbitrate disputes under the FAA. The court concluded that these drivers may invoke the Section 1 exemption, carefully noting that the court did not "[consider] the scope of the exemption since the Supreme Court held in Circuit City Stores, Inc. v. Adams, that this provision is limited to employment contracts of 'transportation workers.'" Waithaka, 966 F.3d at 13 (internal

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citations omitted).

In Waithaka, the court embarked on a long journey in statutory interpretation, revisiting interpretations of the FAA and the Supreme Court's decision in Circuit City Stores, even basing its argument on what the court perceived to be the most likely understanding of the FAA in its historical setting of the 1920s. Id. at 18 et seq.

The First Circuit found support for its functional interpretation (basically asking whether the worker fulfills a function in interstate commerce) referencing other acts of Congress at the time such as the Federal Employers' Liability Act ("FELA"), particularly FELA's jurisdictional language. Interestingly, FELA's language underwent meaningful change when Congress replaced language providing for coverage of "all employees of a carrier engaged in interstate commerce" with that covering "[e]very common carrier by railroad while engaging in commerce between [the States] [...] while he is employed by such carrier in such commerce" (45 U.S.C. § 51 (1908)) after the Supreme Court held that the earlier version went beyond Congress's Commerce Clause power, as it was then understood, and was therefore unconstitutional. See The Employers' Liability Cases, 207 U.S. 463, 498-99 (1908).

The court in Waithaka went on to consider FELA precedents, and the text, structure, and purpose of the FAA, finding that it faithfully adhered to the ejusdem generis canon, invoked by the Court in Circuit City Stores and carried out the Supreme Court's instruction that it must construe the residual clause of Section 1 consistently with the specific preceding categories of workers – "seamen" and "railroad employees". Id. at 23. It found that "these groups, defined by the nature of the business for which they work, demonstrate that the activities of a company are relevant in determining the applicability of the FAA exemption to other classes of workers." Id. at 23.

Unsurprisingly, the court concluded that workers like Waithaka are transportation workers "engaged in ... interstate commerce," regardless of whether the workers themselves physically cross state lines.

This is an important development as it marks a turn in recent FAA interpretation. The Waithaka decision is in the spirit of the Ninth Circuit's decision in Craft in that both set their sights on constraining the applicability of the FAA by interpreting the language of Section 1 in a way that limits the power of employers to enforce arbitration clauses in employment contracts. This is not a new phenomenon and considerations of what is generally perceived as worker protections have battled an expansive understanding of the FAA in many different instances in the past decades. To come full circle, very recently, the Ninth Circuit has also taken the opportunity and has endorsed the First Circuit's advance in its own decision in Rittmann v. Amazon.com, Inc., No. 19-35381, 2020 WL 4814142 (9th Cir. Aug. 19, 2020).

For employers in the transportation field, these decisions are of great relevance. Most employers in the United States choose arbitration to resolve disputes with current and former employees. The transportation industry employs a tremendous number of individuals and only recently a move to push back on arbitrability of employment contracts and related disputes has picked up new steam. The decisions in the Ninth and First Circuit could potentially render entire industries exempt from the application of the FAA, local delivery drivers are only one of many classes of workers who predominantly work locally as part of a global, national or just regional network of supply chains and logistical networks – all could potentially be found to participate in interstate commerce under the permissive view under Waithaka or Rittmann. With courts in other federal circuits being less concerned with excepting workers from the FAA, the Supreme Court could be called upon soon to clarify its stance in Circuit City Stores – we will be following closely. Read the full Waithaka opinion here; and Rittmann here.

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Meanwhile:

- In 2019, the US Supreme Court decided in Henry Schein, Inc. v. Archer and White Sales, Inc. that courts could deny arbitration if the arbitrability argument was "wholly groundless," even if the parties had agreed that such decision was "clearly and unmistakably" allocated to the arbitral tribunal. Read the full decision here. The reader will recall that the arbitration agreement in question excluded arbitration for "actions seeking injunctive relief. Based on this exclusion, on remand, the Fifth Circuit ruled that the arbitration clause at issue did not in fact "clearly and unmistakably" allocate the relevant question to the arbitrators. On 15 June 2020, the United States Supreme Court again granted certiorari. This time, the question presented and to be resolved is whether a provision in an arbitration agreement that exempts certain claims from arbitration negates an otherwise clear and unmistakable delegation of questions of arbitrability. We look forward to get this question answered next year. Meanwhile, read the petition here.

- 28 U.S.C. Section 1782 allows for U.S. courts to assist foreign tribunals in gathering evidence. The question is what qualifies as a foreign tribunal and whether this term must be understood in a broad way to include commercial arbitration tribunals.
- In early July of 2020, the Second Circuit returned its decisi-

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on in the matter In Re Guo, No. 19-781, 2020 WL 3816098 (2d Cir. July 8, 2020). There, the Second Circuit affirmed the district court's ruling which had concluded that CIETAC arbitration is a private international commercial arbitration outside the scope of § 1782(a)'s "proceeding in a foreign or international tribunal" requirement. Read the full decision here.

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Primer:
28 U.S.C Section 1782

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Arbitration Law

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EXTENSION OF ARBITRATION CLAUSES TO REGULATOR – ZEILER FLOYD ZADKOVICH SECURES LANDMARK DECISION BEFORE THE AUSTRIAN CONSTITUTIONAL COURT

Written by Markus Schifferl

Zeiler Floyd Zadkovich recently represented a claimant in an energy arbitration, where the issue of "sukzessive Kompetenz" took center stage in the jurisdictional phase. The question arose, whether an arbitration agreement had replaced both the preliminary jurisdiction of the administrative authority E-Control, the governmental regulator for electricity and natural gas markets, and the jurisdiction of the civil courts or whether E Control's preliminary jurisdiction was mandatory in a way that it was not touched by the arbitration clause and only the subsequent proceedings would be held before an arbitral tribunal and not a national court.

The arbitral tribunal found that it had jurisdiction. The regulator, E-Control, also concluded that the parties by entering into an arbitration clause had opted out of E-Control's jurisdiction. Upon appeal by the respondent, the case eventually ended up before the Austrian Constitutional Court.

THE LEGAL FRAMEWORK

In some legal areas, e.g. tenancy, family or energy law, Austrian law stipulates that a prospective plaintiff, before being able to seize the courts, must address a regulator or other administrative body, which will render a preliminary decision. Such decision ceases to have legal effect once the plaintiff initiates legal proceedings before the competent court. The German legal term for this is "sukzessive Kompetenz,"a term that indicates that a preliminary decision of an administrative body will be followed by court litigation of the same matter if a party chooses not to be happy with the outcome of the regulatory proceedings and thus lodges a civil law suit.

THE DECISIONS OF E-CONTROL AND OF THE ARBITRAL TRIBUNAL …

… AND FINALLY THE CONSTITUTIONAL COURT

In a decision rendered on 26 June 2020, the Constitutional Court distinguished between claims under public law and such under private law: Public law claims solely fall within the jurisdiction of administrative authorities including special administrative courts. Such claims are not arbitrable and therefore cannot be decided by an arbitral tribunal. An arbitration clause will render no effects as to such claims.

By contrast, civil law claims are arbitrable unless arbitrability is explicitly excluded. Hence, it is undisputed that by concluding an arbitration agreement parties may exclude the jurisdiction of the civil courts. The question remains whether in energy related matters an arbitration agreement can also substitute the preliminary jurisdiction of the Austrian regulator E-Control.

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In line with the decisions of the arbitral tribunal and the regulator, the Constitutional Court held that to be the case. It noted that the system of "sukzessive Kompetenz", at least in the case at hand, serves to alleviate the work-load of the civil courts by requiring the parties to first obtain a decision by an administrative authority, which in many instances will be respected and thereby render subsequent court proceedings unnecessary. This reasoning does not apply if the parties opt for an arbitral tribunal excluding the jurisdiction of civil courts altogether. In such case, the civil courts are not burdened with an additional workload in the first place, as the case will be decided by an arbitral tribunal.

Against this background, the Constitutional Court found no imperative public interest in keeping the preliminary jurisdiction of E-Control in place and concluded that the parties, by concluding an arbitration agreement, could indeed substitute and have substituted the jurisdiction of not only the civil court but also of E-Control.

The judgment of the Constitutional Court is a landmark decision. It clarifies for the first time, and once and for all, that in cases of successive competence parties may exclude not only the jurisdiction of the civil courts but also of the energy regulator. Read the full decision here (in German language).

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Meanwhile:

- The Austrian Supreme Court dealt with an annulment claim based on an alleged violation of public policy. The Court's opinion is of great interest: The Court introduced a test, which so far has been used only in different circumstances, asking whether the matter in dispute has a close connection to Austria (seat of the arbitration). As a general principle, the Court held, a close connection to Austria makes it more likely that a violation of the applicable law amounts to a violation of Austrian public policy. On the other hand, a very loose connection to Austria, or no connection at all, would be a very strong argument against a violation of Austrian public policy. The Court thereby firmly established the intensity of the connection of the matter to Austria as one factor in the test to examine an alleged public policy violation. Read the full decision here.

Additional Content on this topic:

GUIDE
Guide to Austrian Arbitration Law
44 Pages
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ENGLAND V. FRANCE – APPLICABLE LAW TO THE ARBITRATION AGREEMENT REVISITED

Written by Alfred Siwy

What is the applicable law to the arbitration agreement is the subject of an ever-broadening divide between the jurisprudence of English and French courts. The courts of the two countries, which already came to diverging results on the scope of an arbitration agreement in Dallah ten years ago, have clashed again in the case of Kabab-Ji S.A.L. v. Kout Food Group. A Paris-seated tribunal applying French law extended the scope of an arbitration agreement contained in a contract to Kout, although Kout was not a signatory to the contract. The English Court of Appeal refused to enforce the award in January 2020, holding that the tribunal had wrongly asserted jurisdiction over Kout. The Paris Court of Appeal six months later, however, upheld the award upon a challenge. The conflict between the two judgments shows the consequences of the different approach taken to the question of the law applicable to the arbitration agreement.

BACKGROUND

Al Homaizi Foodstuff Company („AHFC"), a Kuwaiti operator of fast-food franchises, and Kabab-Ji, a company seated in Lebanon, concluded a Franchise Development Agreement (the "FDA") in 2001. The agreement included a choice of law

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clause stipulating that English law governed the contract ("This Agreement shall be governed by and construed in accordance with the laws of England") and an arbitration agreement providing for ICC arbitration in Paris. The arbitration agreement itself contained no choice of law clause.

After conclusion of the FDA, AHFC became a subsidiary of Kout. In 2015, Kabab-Ji initiated arbitration against Kout, even though it was not a signatory to the FDA and the arbitration agreement. While Kout objected to the tribunal's jurisdiction, the tribunal found that Kout had become a party to the FDA under the applicable French law. It held that the scope of the arbitration agreement was determined by French law as the law of the seat of the arbitration and that the choice of English law did not extend to the arbitration agreement. Further, it held that under French law the arbitration agreement extended to Kout even though it was not a signatory to the FDA and the arbitration agreement. Kabab-Ji was awarded USD 6,7 million and interest against Kout.

Kout challenged the award before French courts.

THE DECISION ON THE ENGLISH COURT OF APPEAL

During the ongoing challenge proceedings, Kabab-Ji sought enforcement of the award in England. In January 2020, the Court of Appeal ruled that English law applied to the arbitration agreement as the parties' choice of English law to the FDA extended to the arbitration agreement (Kabab-Ji SAL (Lebanon) v Kout Food Group (Kuwait) [2020] EWCA Civ 6 (20 January 2020)). It held that a choice of law in a contract, if there is no indication to the contrary, applied to all its terms, hence also the arbitration agreement. The choice of Paris as the seat of the arbitration could not, in the view of the English court, override this express choice of law (ibid. para 68).

The court then held that under English law, the No Oral Modification clause of the FDA prevented a novation of the FDA under which Kout could have become a party to the FDA and its arbitration clause (ibid. para 79). Under article 103(2)(b) of the English Arbitration Act, the recognition and enforcement of an award can be refused if "the arbitration agreement was not valid under the law to which the parties subjected it or, failing any indication thereon, under the law of the country where the award was made." As the court considered that the parties had subjected the arbitration agreement to English law, it refused enforcement of the award.

THE DECISION OF THE FRENCH COURT OF APPEAL

Six months after the decision of the English Court of Appeal, the Paris Court of Appeal ruled on the challenge (CA Paris, pôle 1 – ch. 1, 23 jun. 2020, n°17/22943 (Court of Appeal)). The French Court explicitly held that it was in no way bound by the findings of the English Court of Appeal, holding that its powers to review the award "cannot be limited by the existence of foreign decisions interpreting the Agreements and the arbitration clause and applying English law to them".

Contrary to the English Court of Appeal, the French Court held that the choice of English law did not extend to the arbitration clause and that in the absence of such express choice of law, French law applied to the arbitration clause.

The Court then sided with the reasoning of the award on the extension of the FDA and the arbitration clause to Kout. As a result, the Paris Court dismissed the challenge.

ANALYSIS

The decisions described above bear strong resemblance to the Dallah case in which the UK Supreme Court refused the recognition of a French award, which was upheld by French courts. In that case, however, both the UK and the French courts agreed that French law applied to the arbitration agreement. The UK Supreme Court held that the Government of Pakistan could not be bound by the contract and the arbitration clause because it was not a signatory to the contract and there was no common intention for it to be a party to the arbitration agreement. The Paris Court, however, had held that Pakistan was the "true party" to the transaction and hence was bound by the arbitration agreement. In Kabab-Ji, however, the rift between the two courts is greater as the courts came to different conclusions regarding the law applicable to the arbitration agreement.

The dilemma is a result of the fact that both the French and the English courts are not bound by each other's decisions on the scope of the arbitration clause but each will decide this question anew. The English High Court had refused to make a final decision on the enforcement application until the challenge had been decided finally by the French courts. To the contrary, on appeal the Court of Appeal stated that the judge of the High Court had erred when adjourning the application, perhaps in hope that the French courts would set the award aside and conflicting judgments could be avoided. Both the English Court of Appeal and the French Court of Appeal emphasized the irrelevance of the respective other court's judgment. In light of the fact that Regulation 1215/2012 does not apply to arbitration and therefore in absence of a legal basis on which such court decisions could be recognised, their approach is correct, if unsatisfying.

While both approaches to determining the law applicable to the arbitration agreement, choice of law of the contract

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extends to the arbitration clause or law of the seat are valid approaches, the uncertainty created by the diverging approaches bears significant risks for parties. The winning party in the arbitration faces the risk of the award not being enforced in some jurisdictions or being set aside in the state of origin depending on which law is applied to the arbitration agreement. Had the award in the Kabab-Ji case followed the approach taken by the English Court of Appeal, it may have been set aside by French Courts. The adherence to the law of the seat, while avoiding this risk, rendered the award unenforceable in England. An obvious solution would be to include a specific choice of law clause in the arbitration clause. In particular in cases in which enforcement in England seems a possibility, it would be prudent to do so at the drafting stage. Practice, however, shows that such choices are rarely made.

It should be noted that the approach taken by the English Court of Appeal does not reflect a uniform approach under English law. In several cases, the Court of Appeal has held that if the parties have not made a choice of law clause regarding the arbitration agreement, the law applicable to the arbitration agreement is "more likely to be the law of the seat of arbitration than the law of the underlying contract." (C v D [2007] EWCA Civ 1282; cf also Sulamerica CIA Nacional De Seguros SA v Enesa Engenharia SA [2012] EWCA Civ 638). Hence, the decision in Kalab-Ji, while in line with UK jurisprudence (Channel Tunnel Group Ltd v Balfour Beatty Ltd [1993] AC 334), perhaps was not the only possible solution.

Meanwhile:

- The High Court in London used creativity to grant a conditional anti-suit injunction where the existence of an arbitration agreement was the cause of dispute ([2020] EWHC 1078 (Comm), 5 May 2020). Blatant violations of forum selection and arbitration clauses will generally face anti-suit injunctions. But what happens when the existence of the contract containing the arbitration agreement is itself the cause of the dispute? The English High Court recently granted a conditional anti-suit injunction against the filing of an action in Singapore where the underlying contract required arbitration. The problem for the Court was that the anti-suit applicant's position in the underlying claim was that the contract containing the arbitration agreement did not exist as between the parties to the dispute. Cockerill J's decision is effectively that a party cannot have it both ways – it cannot, on the one hand, bring an action in a forum under a contract alleged to exist, and then on the other hand refuse to take on the burden of the arbitration agreement contained within that contract. This highlights the English Court's creative approach to enforcing arbitration agreements and demonstrates the broad powers of the Court in granting anti-suit injunctions even where they do not neatly fit into the pre-existing categories of these injunctions. Read the full decision here.

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GUIDE
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48 Pages
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MEXICO – BETTER NOT BE LATE

Written by Andrea de la Brena

THE ISSUE AT STAKE

In Mexico in 2019, the Third Collegiate Court in Civil Matters of the First Circuit held that parties to a case were permitted to object to a court's jurisdiction on the grounds of the existence of an arbitration agreement at any time up until a final decision on the merits of the case (Third Collegiate Court in Civil Matters of the First Circuit, Amparo Directo 159/2019, Judgment dated August 2019.). This would allow the respondent to legally contest the case up until immediately before the court reached a final judgment and to decide whether or not to object to the jurisdiction of the court depending on the outcomes expected. On 20 May 2020, the Mexican Supreme Court reversed this decision (https://www2.scjn.gob.mx/ConsultaTematica/PaginasPub/DetallePub.aspx?AsuntoID=262754).

WHAT HAPPENED?

Pecaltepex, S.A.P.I. de C.V. ("Pecaltepex") and Respondents concluded a series of agreements which contained arbitration clauses. When a dispute arose between the parties, Pecaltepex initiated state court proceedings despite the arbitration clauses. The Respondents replied to the claims. In their reply, the Respondents did not object to the court's jurisdiction. Only after having filed the reply did the Respondents raise the issue of the arbitration clauses and object to

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the jurisdiction of the state court. However, the first instance judge dismissed this objection based on Article 1464 (I) of the Commerce Code. Article 1464 (I) was introduced into the Commerce Code in 2011. It stipulates that an objection to the jurisdiction of a court owing to the existence of an arbitration clause must be made in the first reply to the merits of a case.

This is where the story should have ended. However, the Respondents' appealed this first instance decision and, surprisingly, the Seventh Civil Chamber of the Superior Court of Justice of Mexico City revoked the decision.

THE APPELLATE COURT DECISION

Pecaltepex challenged this decision through amparo directo proceedings but the Third Collegiate Court in Civil Matters of the First Circuit upheld the appellate decision on the following grounds:

The Court started its analysis by referring to the Supreme Court's interpretation of the implications of the 2008 reform to Article 17 of the Mexican Constitution. Pursuant to this reform, access to alternative dispute resolution mechanisms, including arbitration, was incorporated as a constitutional right. The Court noted that according to the Supreme Court, when parties agree to submit their disputes to arbitration they are exercising a constitutional right.

Article 1424 of the Commerce Code stipulates that on request by one party, the court must refer the parties to arbitration if the dispute is covered by an arbitration agreement, "except when it is evidenced that this agreement is null and void, inoperative or incapable of being performed". Article 1424 does not establish a time limit to exercise this right. According to the Court, the only limit to this objection is that it must be raised before a final decision on the merits of a case and that the other party must have the opportunity to comment. Therefore, the Court found that a procedural deadline such as the one contained in Article 1464(I) cannot trump the constitutional right to choose an alternative dispute resolution mechanism.

THE SUPREME COURT DECISION

Pecaltepex appealed the Court's decision before the Supreme Court. The Supreme Court reversed the Court's decision in its virtual session dated 20 May 2020 based on the following reasoning:

A correct interpretation of Article 17 of the Mexican Constitution reveals that, although it is true that parties have the right to opt to submit their disputes to arbitration, it is also true that they – the parties – have the right to vary the arbitration agreement either expressly or tacitly by, for example, allowing the dispute that has arisen between them to be resolved by the courts.

Therefore, if one of the parties to the arbitration agreement submits the dispute to the courts and the respondent fails to raise a jurisdictional objection when submitting his/her reply, he/she tacitly waives the right to arbitrate the dispute. Article 1424 of the Commerce Code cannot be interpreted in an isolated manner; it must be interpreted systematically in connection with Article 1464. Article 1464(I) regulates the deadline by which the right contained in Article 1424 must be exercised. Therefore, any jurisdictional objection has to be raised in the first reply to the merits of a case.

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THE BACKLASH ON INVESTMENT ARBITRATION – A TALE OF TWO CONTINENTS

Written by Andrea de la Brena & Alfred Siwy

Investment arbitration has been subject to intense public criticism and debate for several years. Recently, states have taken action in this regard. Both the state parties to the NAFTA and the member states of the European Union have made significant steps towards restricting or abolishing access to investment arbitration. The United States, Mexico and Canada Agreement ("USMCA") has entered into force on 1 July 2020 between the member states of NAFTA. On 29 August 2020, the Agreement for the Termination of intra-EU Bilateral Investment Treaties will enter into force. While the former leaves a small number of cases which can be arbitrated, albeit under the heavy burden of the exhaustion of local remedies and a significant reduction of the substantive protection, the Termination Agreement has abolished the possibility of intra-EU investment arbitration completely.

INVESTMENT PROTECTION UNDER THE USMCA – LIMITS TO INVESTORS' SUBSTANTIVE PROTECTION STANDARDS AND ACCESS TO THE DISPUTE RESOLUTION PROCESS

After long and intense negotiations, on 1 July 2020 the USMCA entered into force, including the changes introduced by its December 2019 Protocol of Amendment. The USMCA is a revision of the nearly 25-year-old North American Free Trade Agreement ("NAFTA"). The USMCA substitutes Chapter 11 NAFTA on investment protection by introducing a new Chapter 14 (denominated "Investment"). Annex 14-D of Chapter 14 provides the dispute settlement mechanism for investor-state disputes between the United States and Mexico.

The following sections will address some of the main changes introduced by the USMCA which limited the investor's substantive investment protection standards and access to the dispute settlement mechanism.

SUBSTANTIVE PROTECTION STANDARDS

Article 14.1 USMCA largely follows the definition of the term "investment" contained in the 2004 US BIT Model. It clarifies that the generally accepted constitutive elements of an investment (i.e., the commitment of capital or other resources, the expectation of gain and profit, or the assumption of risk) are required. However, the USMCA now contains a list of assets that do not constitute an investment including: "(i) an order or judgment entered in a judicial or administrative action"; and (ii) claims to money deriving from contracts for the sale of goods or services - or from the extension of credit in connection with such contracts. Hence, the USMCA excludes certain investments from the scope of protection that would likely have been protected under NAFTA.

Further, the USMCA severely limits the available substantive protection standards. Only investment made pursuant to a contract concluded with a national authority of the host state in certain sectors, such as oil and gas, power generation, telecommunications, transportation and infrastructure, enjoy protection under the common substantive standards (so-called "covered contracts"). Investors without such covered contracts are protected only by the National Treatment and Most-Favoured Nation standards and from direct expropriation. The most relevant standards in practice, the protection from indirect expropriation and the fair and equitable treatment standard are no longer available. The USMCA therefore significantly lowers the protection standard available to investors.

Further limitations have been included regarding the individual standards which are available. Most prominently article 14.8 USMCA together with Annex 14-B contains the rules on expropriation and compensation. Annex 14-B sets out the criteria for assessing whether there has been indirect or creeping expropriation. It provides that the following factors shall be considered with respect to whether indirect expropriation has taken place: (i) the economic impact of the measure; (ii) the extent to which the measure interferes with reasonable investment-backed expectations; and (iii) the character of the measure, including its object, context and the government's intent. The provision requires that the investor's protected rights are weighed against the state's regulatory right by providing that non-discriminatory regulatory measures which are designed and applied to protect legitimate public welfare objectives do not constitute indirect expropriation, except in rare circumstances. This definition provides host states with significant leeway to argue that that no expropriation has taken place.

DISPUTE SETTLEMENT

The possibilities of arbitrating disputes between investors and host states have been significantly reduced.

First, the USMCA does not provide for arbitration of disputes between US or Mexican investors, on the one hand, and Canada, on the other hand or between Canadian investors and the US or Mexico on the other. Therefore, the USMCA

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dispute settlement mechanism only covers disputes between investors and Mexico or the US. Mexican investors will still have a potential avenue for claims against Canada under the Comprehensive Agreement on Trans-Pacific Partnership (CPTPP) (and vice-versa for Canadian investors).

Second, with regard to disputes between US investors and Mexico and vice versa, the USMCA includes provisions which will deter investors from pursuing their rights in arbitration. Article 5 of Annex 14-D USMCA stipulates the "Conditions and Limitations on Consent." It requires as a first step that the investor makes an attempt to settle a claim through consultation or negotiation. If this turns out not to be successful, article 5 re-introduces the requirement of the exhaustion of local remedies before bringing a claim under arbitration. This ancient requirement had long been abolished in investment arbitration but has now raised its head again. Hence, an investor must first run through all available instances of the national court system before being entitled to go to arbitration. This provision, however, gets more relevant due to the four-year statute of limitations for investment-related claims under non-covered contracts and the three-year limit under covered contracts. Hence, the investor must ensure expeditious proceedings before national court.

SUMMARY

The possibility to arbitrate disputes under NAFTA was widely used and provided investors with an effective remedy against measures of the host state. The USMCA has effectively eliminated these rights for all investors. Only investors in certain sectors with contracts concluded with the host state can still invoke substantive protection, but also these investors will face significant difficulties in enforcing their rights.

The blow caused by the reduction of the substantive standards and the effective impossibility to arbitrate may be somewhat cushioned for the time being by Annex 14-C, which stipulates that disputes deriving from an investment established or acquired before the termination of NAFTA and still in existence when USMCA enters into force, can be arbitrated under the rules set out in Chapter 11 NAFTA. Though it should be noted that there is a sunset provision limiting the time in which to commence such proceedings to three years after the termination of NAFTA.

THE TERMINATION AGREEMENT

The ECJ in Achmea (Judgment, 6 March 2018, C-248/16) decided unequivocally that arbitration agreements contained in bilateral investment treaties ("BITs") were incompatible with articles 267 and 344 TFEU. Since then the EU Commission and several member states of the European Union have been pushing towards the abolishment of intra-EU investment arbitration, which has produced a considerable case load in the past. These efforts have now produced the Termination Agreement, which essentially abolishes investment arbitration in intra-EU settings.

THE TERMINATION OF THE BITS

Most significantly, the Termination Agreement provides in its articles 2 and 3 that the BITs listed in its Annex A (a list of all intra-EU BITs) are terminated and that the sunset clauses in such treaties (i.e. clauses which provide for the possibility of invoking BITs in certain circumstances also after their termination) "shall not produce legal effects". The Agreement explicitly stipulates (article 5) that arbitration clauses contained in intra-EU BITs cannot serve as a legal basis for new arbitration proceedings (i.e. proceedings initiated after 6 March 2018, the date of the Achmea decision).

The Agreement includes common provision for both for new arbitration proceedings and for arbitration proceedings which were initiated before 6 March 2018, referred to as pending proceedings. In both settings, the host states shall "inform" the Arbitral Tribunal about the Achmea judgment and ask any national court, including courts outside the EU, to set any award aside that affirms jurisdiction and to deny recognition and enforcement of such an award.

THE POSSIBILITY OF SETTLEMENT NEGOTIATIONS

In pending proceedings, the investor under article 9 of the Agreement now has the right to ask for a "Structured dialogue" with the host state in view of settling the dispute within six months after the termination of the respective BIT under the Termination Agreement. The dialogue, which essentially consists of settlement negotiations including a facilitator, requires that the arbitration is suspended and if an award has been rendered, the suspension of enforcement proceedings.

The availability of a settlement procedure depends largely on whether a court or the ECJ has found that a measure complained of by the investor is contrary to EU law (article 9(3) through (5)). Where a court has confirmed this, the state "shall" enter into settlement negotiations. If a court has denied this, a host state "shall not" do so. Where this is unclear or disputed, which in practice will be the most common case, settlement proceedings "may" be entered into. If the dispute on the compatibility of the measure with EU law is pending before national courts of the ECJ, the initiation of settlement proceedings shall be suspended until the court reaches a decision.

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If the parties cannot reach an agreement in their settlement negotiations within six months, the parties will each make a final offer to the facilitator who will then make a final settlement proposal to the parties. The parties can then decide whether to accept or reject the proposal.

PROCEEDINGS BEFORE NATIONAL COURTS

An investor can initiate proceedings before national courts under article 10 of the Termination Agreement. In order to do so, the investor must withdraw the claim in the arbitration or renounce the enforcement of an award already rendered but not yet enforced. The proceedings must be initiated within six months after

- the termination of the Bilateral Investment Treaty
- the rejection of the request of the host state to start settlement negotiations or
- the last of the parties submitted their final offer to the facilitator in the settlement negotiations.

Under article 10(2), however, proceedings before national courts can only be based on violations of EU or national law, not the BITs (which are terminated).

This option will be unattractive for the investor for several reasons. First, due to the (perceived) bias of host state courts and their inexperience with dealing with such cases, the chances of success in such proceedings will be far lower than before international tribunals. Second, the basis of the claim must be found in EU law or national law. Neither commonly include any substantive protection standards which would come near to those included in BITs. Therefore, the possibility of starting national court proceedings is no substitute for investment arbitration.

SUMMARY

The Termination Agreement abolishes the possibility of intra-EU investment arbitrations once and for all. While its impact on proceedings pending under the ICSID Convention will likely be subject to a wide range of diverging decisions, the Treaty makes clear that national courts will no longer be available to enforce awards in intra-EU cases. This will make such arbitration to a substantially unattractive for investors.

On European level discussions have been ongoing on the possibilities of installing a body providing protection to investors on a European level. These negotiations have not come anywhere close to a result. Nevertheless, the Termination Agreement has once and for all cut off the possibility of arbitration, leaving a gap in the protection of investors.

For additional information and queries, please contact andrea.delabrena@zeilerfloydzad.com or alfred.siwy@zeilerfloydzad.com

Additional Content on this topic:

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NEWS & EVENTS

TEAM

| Chicago

Katherine Georginis joined our Chicago office this past August, as an Associate. Katherine is an Illinois qualified attorney and is admitted to the US District Court for the Northern District of Illinois.

| New York

Nicholas Paine joined our New York office as Of Counsel. Nick is a Texas and New York qualified attorney, and specializes in maritime litigation, particularly personal injury defense.

| Vienna

Mgr. Ondrej Cech LL.M. joined our office in Vienna in July 2020. He is a Czech-qualified attorney with four years of experience in international dispute resolution. He has recently finished an LL.M. at Columbia Law School and will support the firm's international arbitration team.

| Vienna

Gaudenz Küenburg joined our Vienna office as a Junior Associate, after spending six months as a Legal Assistant at our Mexico office. Gaudenz specializes in dispute resolution and international commercial law.

EVENTS

| Disputes for breakfast
ARBITRATION | Friederike Schäfer
Neues aus Paris: ICC Arbitration in 2020
13.11.2020, 9 am

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