

DELIVERING INFRASTRUCTURE: INTERNATIONAL BEST PRACTICE MEXICO'S CONSTRUCTION INDUSTRY¹

Roberto Hernández García

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I. Introduction

1. IMPORTANCE OF THE MEXICO-EUROPEAN UNION RELATIONSHIP

For many years, European companies have been active in Mexico and in order to develop stronger relationships, a free trade agreement was recently concluded.² Activity may therefore grow as European

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² The Free Trade Agreement between Mexico and the EU, which entered into force on July 1st 2000. For more information visit: http://www.economia-bruselas.gob.mx/english/mexico-eu_fta.htm

and Mexican companies do strengthen their relationships and more commercial activity results.

In the construction sector, European companies have developed many of the most important infrastructure projects in Mexico with great success. It is important therefore for European firms to understand the real situation and know about the challenges to be faced in Mexico's construction sector, since there will be many more projects in the future because of the need for infrastructure in different areas of the country.

II. General aspects of construction projects in Mexico

Most of the major and more relevant construction projects are carried out for the Mexican Federal Government by private companies under a public works contract scheme. Therefore, this paper focuses on the regulations and background to infrastructure procurement, rather than contracting among private parties.

The Mexican Federal Government spends approximately \$5.7bn (or ...5.7bn) of its budget per annum on public works.³ Each year, many projects in the electricity, oil, petrochemical, health and water sectors are put out to tender by the Mexican Government, under the rules of:

- a)* the Mexican Constitution;
- b)* the various free trade agreements concluded between Mexico and different countries;
- c)* national laws;
- d)* administrative regulations; and
- e)* the various criteria of different authorities.

The next section looks at the legal basics of procurement in Mexico, and the third section considers some issues and problems in this area, and the actions taken by the public and private sector in order to promote better regulation and better projects.

³ This number does not include privately financed projects.

III. The legal framework of public works in Mexico

1. THE MEXICAN CONSTITUTION

Article 134 of the Mexican Constitution establishes the principles for the procurement of goods, services and public works for the Federal Government, as follows:

“The economic resources to be used by the Federal Government and the Government of Mexico City, as well as of their respective public administrations, shall be administered with efficiency, effectiveness and honesty.

The purchase of goods, leases, rendering of services of any kind, and procurement of public works, shall be awarded or executed through public bids and public invitations in order that any person can freely present solvent proposals in closed envelopes, that will be opened in public acts, in order to guarantee to the Mexican State, the best available conditions according to price, quality, financing, opportunity and other relevant circumstances.

When the bids referred to in the last paragraph are not ideal in order to guarantee such conditions, laws shall provide the bases, procedures, rules, requirements and other elements in order to demonstrate the economy, efficiency, effectiveness, impartiality and honesty that guarantee the best conditions for the State.

The management of federal public economic resources, shall be attended to in accordance with this article.

Public Officers shall be liable for the compliance with these requirements in the terms of the Fourth Title of this Constitution”.

The content and interpretation of this article is essential in order to understand the legal framework, as well as other issues in the procurement of public works today.

2. INTERNATIONAL FREE TRADE AGREEMENTS

Mexico has concluded various free trade agreements with different countries, for example Chile, Colombia, Costa Rica, Israel, Nicaragua and Venezuela. Two of these free trade agreements are especially important because of the daily economic activity that they represent:

first, the North America Free Trade Agreement⁴ (concluded between Mexico, Canada and the United States of America), and secondly the Free Trade Agreement concluded between Mexico and the European Union referred to above. Both agreements include a special procurement chapter that provides rules for parties participating in the purchase of goods and the construction of public works.

3. LAWS AND REGULATIONS

The procurement of goods and services (not related to public works) are regulated under the Purchase of Goods, Leases and Rendering of Services in the Public Sector Law,⁵ while the procurement of public works and the rendering of services related to public works are regulated under the Public Works and Related Services Law.⁶

Both laws, issued by the Federal Congress, have specific regulations for their execution, issued by the executive branch. These are the Administrative Regulations of the Public Works and Related Services Law,⁷ and the Administrative Regulations of the Purchase of Goods, Leases and Rendering of Services in the Public Sector Law.⁸

4. THE VARIOUS CRITERIA OF DIFFERENT AUTHORITIES

According to the Public Works and Related Services Law, the Ministry of the Comptroller (SECODAM)⁹ and the Ministry of Finance¹⁰ have the authority to interpret the law for “administrative effects”.

⁴ North American Free Trade Agreement (NAFTA) which entered into force on January 1st., 1994.

⁵ Ley de Adquisiciones, Arrendamientos y Servicios del Sector Público, 2000.

⁶ Ley de Obras Públicas y Servicios Relacionados con las mismas, 2000.

⁷ Reglamento de la Ley de Obras Públicas y Servicios Relacionados con las mismas, 2000.

⁸ Reglamento de la Ley de Adquisiciones, Arrendamientos y Servicios del Sector Público, 2001.

⁹ Secretaría de la Contraloría y Desarrollo Administrativo.

¹⁰ Secretaría de Hacienda y Crédito Público.

5. OTHER LAWS AND SOURCES

Any situation not covered by the Public Works Law may be dealt with according to the terms of the Mexican Federal Civil Code, the Mexican Civil Procedure Code or the Federal Law of Administrative Procedure. Court judgments are also relied on to provide general principles for the interpretation of the law.

IV. Development of construction projects before/after the mid 1990s

1. CHANGES IN PROCUREMENT METHODS

Before the 1990's, all public works were undertaken with money from the Mexican Government budget. After the mid 1990s, there was a move by the Federal Government to use different procurement routes in order to execute projects utilising the economic resources (financing) of private companies, especially in the electricity, natural gas and petrochemical sectors. Therefore, procurement methods such as build-own-operate-transfer (BOT); build-lease-transfer (BLT) and financed public works (FPW), have been developed on different occasions according to the needs of the Mexican Government. This has caused an important change of perspective in the treatment of construction projects, especially from the legal point of view.

2. THE MEXICAN CONSTRUCTION CRISIS

Further, in the mid 1990s there was an economic crisis in Mexico, which affected all areas, including construction. The crisis caused delay in the execution of many projects, as well as the disappearance or bankruptcy of many Mexican companies (which lost all their money on specific projects (for example toll roads) or due to their lack of resources where unable to execute the projects in a healthy way. This also resulted in the increased participation of foreign companies (most of them European and American) in place of national companies. Because of the conclusion of free trade agreements, there have been

an increased number of foreign companies, which in turn has made their presence in the country easier.

3. CHANGES IN THE MEXICAN POLITICAL SITUATION

One party having ruled the country for 75 years, in 2000 clean and democratic elections resulted in political change. The transition started smoothly several years ago when opposition parties began to win local government elections, as well as local and Federal Congress seats. This caused all political players to observe the others' practices. As a result, many anti-corruption and transparency institutions were created and actions initiated. Major infrastructure projects (the tenders, the need for the project and its efficiency) began to be audited and investigated. Public officers also started to be investigated and punished for actions or omissions that damaged the public interest by breaching the law.

V. Searching for better practice in the construction industry

1. A LEGAL FRAMEWORK THAT ALLOWS ALL (OR MOST) PARTICIPANT'S INTERESTS TO BE SATISFIED

Many, both in the public and the private sector, feel that Mexican law has to be clearer and more efficient in the context of construction projects, especially the major and more complex ones. This is because Mexican law tends to be extremely strict in this area, not allowing, in many cases, agile and efficient actions to be taken, and running the risk of:

- a) Public officers becoming involved in an investigation that can result in an administrative punishment, or quick resolutions of issues.
- b) Not solving diverse project issues in reasonable time.
- c) Delaying the solution of disputes arising on projects, or claims from contractors.

Both the public and private sector are looking for modifications in the law in order to promote the best conditions for tendering and executing construction projects.

2. A MORE EFFICIENT AND SAFER WAY TO AWARD CONTRACTS (MARKET-PRICE)

There is a common concern that projects have to be awarded, according to law, to the lowest bidder, because in many cases projects have been awarded to companies offering an extremely low and unreal bid. As a result many construction projects could not be completed. Under the law:

- a) If two or more bidders comply with all technical and financial requirements, the project must be awarded to the one who offers the lowest price; but
- b) Government officers must check if the price is reasonable for the execution of the project.

These principles, which are apparently logical, tend to be difficult to apply in practice, resulting in difficult situations. If, for example, there are two bids and one is unreasonably low, the government officers will certainly award the contract to the company making the low bid (on the basis that they are complying with the law) thus putting the outcome of the project at risk. Say, instead, that the government officers consider that such a low bid is unreasonable and award the contract to the higher, but reasonable, bidder (again on the basis that they are complying with the law). Then the bidder which offered the lower price can challenge the award under the terms of Article 134 of the Constitution and related laws, regulations etc, on the basis that the project has to be awarded to the lowest bidder. The lower bidder would have a real chance of winning the challenge.

Some recent proposals have looked at the possibility of awarding contracts to the middle price bidder, excluding the highest and lowest. This is done in other countries but would require a constitutional amendment which is not a viable option in the present climate. The

public and private sector in Mexico are searching for a better alternative in order to solve this fundamental problem.

3. A MOVE TOWARDS BETTER CONTRACTS

According to Mexican practice, a draft of the contract is included in the tender documents, and there is no opportunity to negotiate its content before or after the contract is awarded. When contractors require clarification or consider that amendments to the contract are necessary, they ask for clarification or amendments during a period of questions and answers in the course of the bidding process. In some cases an amendment is accepted by the client; in other cases, the client does not accept it, even if the amendment is needed or logical. It is in the client's discretion.

Following on from that, there is a trend for industry bodies and associations to jointly review bid documents and draft contracts, and try to make them clearer and easier to use. There is also interest in achieving logical, practical and efficient risk allocation in order to make projects cheaper and more efficient. The public and private sector are joining efforts in some areas (such as electricity) in order to review the general tender terms and some extremely controversial clauses. Some changes have been made to the bidding process as a result of these discussions. There is a move, which may or may not be successful, to define clearer contracts.

4. A MORE SECURE WAY TO EXECUTE THE CONTRACTS (ANTI-CORRUPTION AND EFFICIENCY)

Several years ago, the Ministry of Comptroller (SECODAM), which is in charge of the auditing and control of public works, was strengthened in order to promote a fierce anti-corruption plan. Since this change, several officers have been sentenced and punished in administrative, civil and even criminal courts. This has meant that on a number of projects, the public officers acting on behalf of the client do not take any action in order not to be punished. This severely affects the efficiency of the works, because if there is any discussion

between client and contractor, the responsibilities over shadowing the officers may affect their decisions.

The private sector and media have begun to severely criticise this situation in order to push the authorities into responding reasonably to the actions or omissions of public officers carrying out their functions, and help projects not to come to a halt because of their fears. Nevertheless, with some instances of scandalous corruption in the oil government company (involving the inappropriate use of money), the issue is pretty difficult because its political aspects.

5. A MORE EFFICIENT WAY TO SOLVE DISPUTES

Until recently, the only way to solve disputes arising under Federal public works contracts was through Federal courts. Now, several alternative dispute mechanisms have been included in the contracts, such as:

- administrative mediation;
- arbitration;
- independent expert determination.

All of these methods are being used and each has pros and cons.

Administrative mediation. This has been used for some time, but was not formally included and regulated under the Public Works and Related Services Law until 2000. The mediator is the Ministry of Comptroller (SECODAM), which is the authority in charge of officers' responsibilities.

It works as follows: the contractor presents a written document to the SECODAM explaining the need to start a mediation process and the issues to be discussed. The SECODAM invites the public client to attend meetings and try to solve the issues in no more than 60 working days. If the parties reach no agreement, they are free to go to the courts or arbitration, but the mediation will end automatically at the end of such time.

In order to make this method more efficient:

- There is a need to train mediators and professionalise them;

- In many cases, disputes result from a lack of definition in the law and regulations (for example, how to recognise extra costs derived from specific circumstances). In these cases, the mediator has to ask for the intervention of another authority in order to get an official comment, but time is needed to do this and the time for the mediation process is limited.
- The 60 working days may be too long or too short a period. When the 60 days are up, the mediation automatically ends by law. It would be sensible if the parties could agree a longer period.

Arbitration. This dispute resolution method has been included since the first financed public contracts were signed, because the law expressly recognises such an arbitration as legal, notwithstanding that all public works contracts and their regulations are considered to be of ‘public order’, and most public order issues can not be solved by arbitration. As a result there is a need for more arbitrators who are involved full time in the construction industry, and professional associations (engineers and lawyers) intend to develop programmes to this end.

The only issue that has not been considered yet, is that in its contracts the government is proposing commercial arbitration institutions for the administration of arbitration, forgetting that under Mexican law, public works contracts are not commercial. There is a need for this to be resolved in order to avoid problems in the future. There have been some proposals that specific authorities act as arbitrators, but recent judicial decisions have determined that when authorities act as arbitrators, the award is a government act, and can be challenged in the same way as any government act, reducing and voiding the effect of an arbitral award.

Independent expert determination. At the same time as arbitration, independent experts were included in contracts as an alternative method of dispute resolution and this started with the very first financed projects. At the time experts were included in contracts, there was not enough local training and understanding of expert determination. Therefore, problems have been experienced. Nevertheless, it is important to start defining accepted principles in the engagement and work of experts, in order to fully utilise expert determination,

and so that it is not just seen as an interim step before going to arbitration. This method is still little used, due to the lack of national experience, specific regulation and previous cases.

6. USE OF ELECTRONIC MEANS OF COMMUNICATION

The internet has proved to be an efficient way to divulge information in real-time. The Federal Government has promoted more extensive use of electronic means of communication for various matters, for example:

- A special web-site called ‘Compra-Net’ (which can be translated as ‘Buy-Net’) administered by the Ministry of Comptroller (SECODAM), which includes information on bids in the whole country, as well as the regulations at federal and local government levels. Firms can download the bid documents through this system.
- The submission of bids through the internet in various bidding processes. This has not been used as a general rule (its use is discretionary for public clients), and users are still not 100% confident of presenting their bids by this means.
- The publication of Awards Challenge procedures resulting from the (Government) client’s non compliance with laws, rules or the tender documents, as well as the publication of challenges to the award of contracts.
- The publication of full texts of the law, regulations, criteria and internal guidelines published by public entities for the procurement of public works.

There are three issues that have to be considered:

- The internet is not yet accepted by law (issued by the Federal Congress) as an official way to divulge public information. It has only been accepted in administrative regulations issued by the executive power. By law the *Official Gazette* is the only recognised way to divulge and make effective rules of general application.
- Information on the internet has to be updated daily.

- There is a need for more secure systems in order to make users more confident of participating through this medium.

VI. Conclusions

Many important projects have been undertaken in Mexico, and there will be many more to come in the construction of energy, petrochemical, and water facilities. Authorities, industry associations and private participants are pushing to improve the regulations, environment and conditions, bearing in mind the importance of such projects for the Mexican Government and the business opportunities they represent for contractors. Although there are issues that have to be solved, and problems arise every day, the fact that there is an open discussion between the public and private sectors means that there is the possibility of better regulation —and therefore better projects— in the future.