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Question Mark on the Arbitrability of Disputes Arising out of Public Contracts in Brazil

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A judge of the public law courts of the State of São Paulo concluded that a dispute arising out of a turn-key agreement entered into by a State-owned company and several construction companies for the construction of a new underground line in the city of São Paulo should not have been referred to arbitration.

The dispute between the Companhia do Metropolitano de São Paulo ("Metrô") and the Consórcio Via Amarela (a consortium of Brazilian construction companies) arose after the constructors decided to change the tunneling methodology employed in the construction of the new underground line and sought compensation from Metrô for the additional costs incurred. After a dispute board recommended Metrô to compensate the Consórcio, the matter was referred to arbitration under the ICC Rules. In a partial award rendered in 2009, the ICC tribunal held Metrô responsible for the additional costs, with quantum to be fixed in a second award on the basis of an independent expert report. The disputing parties, however, did not agree on the scope of expert evidence to be produced. According to the Consórcio, the expert report should be limited to the assessment of the expenses incurred by the constructors in the new tunneling methodology. Metrô, on the other hand, argued that the expert report should determine whether the additional costs incurred by the Consórcio comply with market prices.

After the tribunal decided in favor of the Consórcio, Metrô filed a writ of mandamus to the public law courts of the State of São Paulo seeking an order compelling the ICC tribunal to broaden the scope of the expert evidence. An interim measure was granted, but the Court of Appeals of the State of São Paulo provisionally suspended its effects on grounds that the disputing parties would incur in significant costs if the tribunal-appointed expert had to assess the market prices of the new tunneling methodology.

In a subsequent ruling, however, the judge of the public law courts concluded that the matter should not have been referred to arbitration. According to the decision, while State-owned companies are not prevented from submitting disputes to arbitration, the dispute between Metrô and Consórcio arises out of a public contract, which therefore involves inalienable (non-waivable) rights ("direitos indisponíveis"), and, therefore, it falls outside the requirements set forth in the Brazilian Arbitration Law. In its writ of mandamus, Metrô does not challenge the validity of the arbitration clause or the jurisdiction of the ICC tribunal and, thus, the writ of mandamus could not be used to set aside the partial award or granted to prevent the ICC tribunal from rendering the

final award. Nevertheless, the judge of the public law courts decided to report the case to the Public Prosecutor's office of the State of São Paulo.

While this decision does not have immediate practical effects for the case, it raises some relevant issues concerning the arbitrability of disputes arising out of public contracts in Brazil.

In 2005, the Brazilian Superior Court of Justice decided that State-owned companies are not prevented from entering into arbitration clauses and submitting their disputes to arbitration. The Court pointed out, however, that the dispute may only be submitted to arbitration if it arises out of a contract in which the State-owned company is carrying out an economic activity in the private sphere; if the State-owned company enters into a contract in the exercise of public authority rights and duties — such as in the turn-key agreement entered into by Metrô and the Consórcio —, the dispute is not arbitrable.

The fact, however, that a State entity is exercising acts of a public authority does not mean that disputes arising out of public contracts may not be, by definition, subject to arbitration. While public contracts involve certain rights which may not be waived by public authorities, there are other matters which are subject to negotiation and compromise. The Brazilian Law on Government Procurement and Public Contracts ("Lei No. 8.666") provides, for instance, that the parties to a public contract may enter into an agreement and modify the original public contract in order for the economic equilibrium ("equilíbrio econômico-financeiro") of the contract to be maintained. In such cases, the public authority is allowed to negotiate and reach a compromise and, thus, waive its rights. One could argue, accordingly, that, despite the fact that the public contract involves the exercise of a public authority, the dispute is arbitrable.

It is uncertain whether the partial award rendered in the dispute between Metrô and the Consórcio will be challenged on grounds that the matter is not arbitrable. Nevertheless, the decision of the judge of the public law courts of the State of São Paulo reveals the problems concerning the use of arbitration for the settlement of public contract disputes in Brazil.

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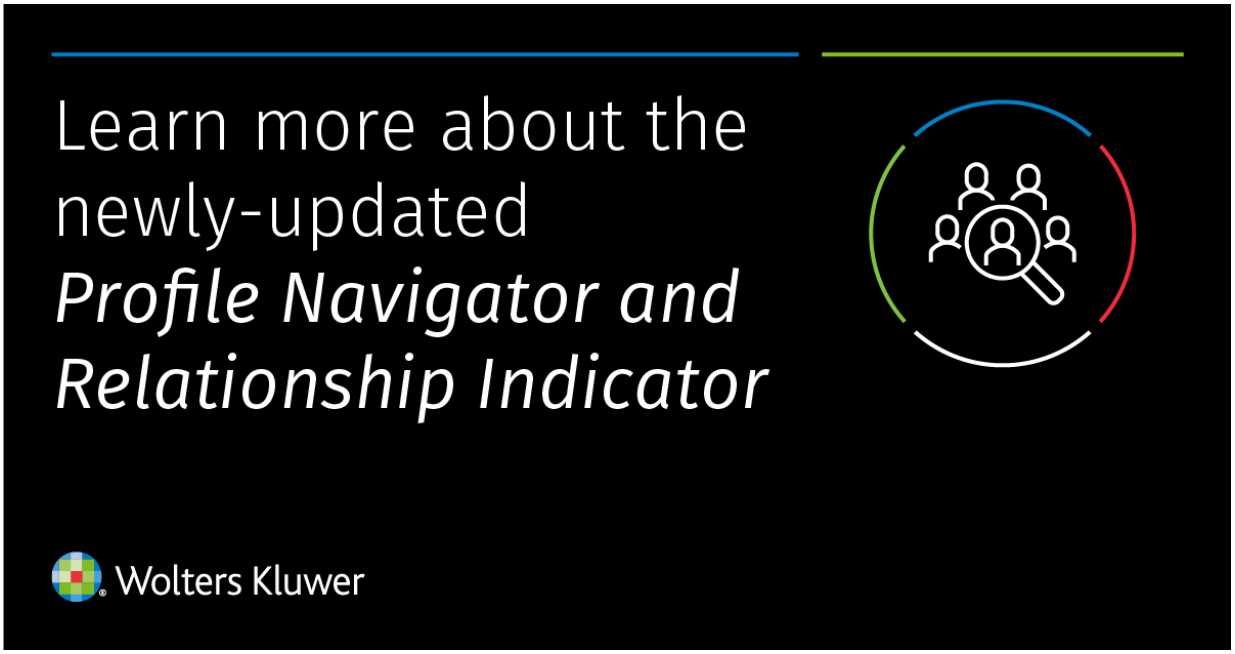

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