Arbitration and the Power Sector in Brazil

Kluwer Arbitration Blog
May 6, 2013

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Please refer to this post as: Gilberto Giusti, 'Arbitration and the Power Sector in Brazil', Kluwer Arbitration Blog, May 6 2013, http://arbitrationblog.kluwerarbitration.com/2013/05/06/arbitration-and-the-power-sector-in-brazil/

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One of the segments of the infrastructure sectors in Brazil that have lately triggered the greatest amount of disputes are the power generation, distribution and trading sectors. In effect, there's little disagreement in Brazil nowadays that, just as with other sectors that could also be mentioned here (such as oil and gas, sanitation, ports, etc.), in the power sector in general the arbitrators and the lawyers defending the interests of the litigants must have expertise in or at least deeper technical knowledge of the matter in controversy, namely as a result of the complex regulations that followed the introduction of the new regulatory framework for the Brazilian power sector through Law No. 10,847 and Law No. 10,848 of 15 March 2004.

And one of the main reasons for this phenomenon consists of the fact that the new Brazilian regulatory framework brought about great novelties and requirements to be observed by the contracting parties, which calls for more technical, speedier and effective resolution of the relevant disputes. More than that, the market's systemic and integrated structure itself, from power generation to power trading, more than ever requires that arbitrators have ample and deep knowledge of the area, so that the decision on individual contractual disputes will rely upon the foundations and logic behind the system.

More specifically, without disregarding the legal principles that guide the Brazilian legal system, in particular the law on obligations contemplated by the Brazilian Civil Code (Law no. 10,406 of 10 January 2002), the arbitrator to whom a controversy over a power trading agreement, for instance, is submitted, will be expected to have deep knowledge of the logic behind electric power prices in the Brazilian market. The arbitrator must understand, for instance, that (i) the Brazilian generation landscape relies essentially on energy from hydroelectric plants and, therefore, depends on rainfall seasonality and (ii) as a consequence, there is a high level of uncertainty over future short-term power costs which market agents must face and cope with, which is thus a risk confined to the power sector, (iii) long-term power purchase agreements are used by market agents for the very purpose of mitigating such risk, and (iv) claims for revision of the original economic and financial conditions of agreements or allegations of acts of God or force majeure as grounds for exclusion of liability in the course of an agreement should be entertained and decided taking due account of such specific characteristics of the power market.

Notwithstanding, many other specific features of the power sector could be mentioned here, such as that power purchase agreements (PPA) usually back project finance structures –in which context, for instance, the arbitrator should be careful to pursue, preferably, measures that secure strict performance of the agreement by the defaulting party instead of declaring the agreement promptly terminated, thereby avoiding the deleterious cascade effects of an extreme measure.

As a result of all these factors, experience has shown that extrajudicial resolution of contractual disputes between several power market agents is the mechanism that better meets the need for greater expertise or at least greater knowledge of the matter by arbitrators –what has been acknowledged and even corroborated by the Brazilian Legislative Branch, considering that, in the last ten years, several laws have been enacted, revised and/or amended in order to promote the adoption of arbitration for resolution of disputes mainly in infrastructure sectors, such as electricity, energy, sanitation and transportation. It is important to note that recently, in Brazil, during the discussions about the enactment of the new Code of Civil Procedure, there has been a substantial debate related to the inclusion of provisions that will further enable and contribute to the development of arbitration –both domestic and international– within the Brazilian territory.

In the power generation sector, for example, a great diversity of investors, such as private equity, venture capital and pension funds, insist on having arbitration clauses in their agreements. Concession contracts themselves, executed with the government authorities, have contained arbitration clauses for some time –Law No. 8,987/95 of 13 February 1995, which regulates the concessions and permissions for the rendering of public services, was amended by Law No. 11,196/05 of 21 November 2005 to include arbitration as a method for resolving disputes, in its Article 23-A:

> *"Art 23-A. The concession agreement may provide for the use of private mechanisms for resolving disputes arising from or related to the contract, including arbitration, to be held in Brazil and in Portuguese, under the terms of Law No. 9,307 of 23 September 1996"*

remembering that, although viewed with a certain mistrust not so long ago, the current majority stand in Brazil is that a State and its entities may, in fact, elect arbitration as a dispute resolution method for conflicts of an economic nature, i.e. those dealing with disposable property rights and obligations. [fn]The Brazilian Superior Court of Justice recognized that mixed capital companies can be submitted to arbitration, regardless of specific legislative authorization: *AES Uruguaiana vs. CEEE* case (Superior Court of Justice. Second Chamber. Special Appeal No. 612.439/RS, Reporting Justice João Otávio de Noronha, ruled on 25 October 2005). This understanding was confirmed in other cases, such as *TMC vs. Minister of State for Science and Technology* (Superior Court of Justice. First Section. Writ of Mandamus No 11.308/DF, Reporting Justice Luiz Fux, ruled on 9 April 2008), and *Petróleo Brasileiro S/A – PETROBRAS vs. Tractebel Energia S/A* (Superior Court of Justice. Third Chamber. Special Appeal No. 954.065/MS, Reporting Justice ARI PARGENDLER, ruled on 13 May 2008). In the first case mentioned above, it was expressly decided that: *"Contract is valid when signed by the mixed capital companies exploiting economic activity such as production or commercialization of goods or services (Brazilian Federal Constitution, art. 173, § 1) and stipulating arbitration as the means to solving any disputes arising from the adjustment."* (Superior Court of Justice. Second Chamber. Special Appeal No. 612.439/RS, Reporting Justice João Otávio de Noronha, ruled on 25 October 2005).[/fn]

In the power distribution sector, concession contracts in general do not mention

arbitration as a dispute settlement mechanism because most of them were executed a long time ago. However, power distribution companies, on adhering to the Chamber of Electrical Energy Commercialization (*Câmara de Comercialização de Energia Elétrica* – CCEE) [fn]The 'power spot market chamber', a nonprofit private association that succeeded the Power Wholesale Market (Mercado Atacadista de Energia Elétrica – MAE) and is in charge of maintaining and supervising the Brazilian Electric Power Sector.[/fn] and executing power purchase agreements in the regulated market, are currently obliged to resort to arbitration, according to the CCEE Trading Convention (National Electric Power Agency – ANEEL Normative Resolution 109/2004). [fn]ANEEL – *Agência Nacional de Energia Elétrica* is the Brazilian Electricity Regulatory Agency, whose main objectives are to provide favorable conditions for the electricity market to develop in a balanced environment among agents, for the benefit of society.[/fn] In fact, arbitration as a method for resolving disputes involving power trading is not an innovation, since it has emerged together with the creation of the Power Wholesale Market (*Mercado Atacadista de Energia Elétrica* – MAE) (Provisional Measure – MP 29/2002 of 7 February 2002) and ratified after it was succeeded by CCEE (Law No. 10,848/2004 of 15 March 2004).

More specifically, Law No. 10,848/04, in line with Law No. 10,433/02 of 24 April 2002 (which still governed the Power Wholesale Market (*Mercado Atacadista de Energia Elétrica* – MAE), provides in Article 4:

> *"§ 5 The rules for resolving any disputes between members of the CCEE shall be established in the commercialization convention and in their by-laws, which should contain the mechanism and the arbitration agreement, pursuant to Law No. 9,307 of 23 September 1996; § 6 Public companies and mixed capital companies, their subsidiaries or controlled companies, that are holders of concession, permission and authorization are authorized to join CCEE and to adhere to the mechanism and to the arbitration agreement provided for in § 5 of this article".*

This dispute resolution method is valid and mandatory for all CCEE agents (generation, distribution and trading agents, and consumers), and is provided for in the CCEE Trading Convention.

Finally, power trading can be carried out within both the regulated contract

environment (*Ambiente de Contratação Regulada* – ACR) and the non-regulated contract environment (*Ambiente de Contratação Livre* – ACL). In the first case, the relevant agreements provide for adhesion to the CCEE Trading Convention (and, therefore, mandatorily contain an arbitration clause that must be observed under penalty of fine, in accordance with the Decree No. 5,177/04, the CCEE bylaws, the ANEEL Homologation Resolution 531/2007 and the ANEEL Normative Resolution 274/2007); in the latter case, the dispute resolution method (arbitration or judicial) may be freely chosen by the parties to the agreement, but the option for arbitration has become increasingly frequent for all the reasons stated above.

Notably, the arbitration agreement provided by the CCEE Trading Convention provides for arbitration under the Rules of the FGV Arbitration Chamber in Rio de Janeiro, and, as a relevant peculiarity, expressly requires that the FGV Arbitration Chamber divulges to the entire power sector and all its agents the content of each and every one of the requests for arbitration filed and arbitral awards rendered based on it [the arbitration agreement provided by the CCEE Trading Convention] –aiming at conferring transparency and consistency to the market and the awards to be rendered as to the conflicts that arise out of it. According to the up-to-date case records, as from 2008, more than thirty (30) arbitrations have been commenced and more than ten (10) arbitral awards have been rendered in these circumstances so far.

Hence, arbitration and the power market seem to have built a solid marriage in Brazil, and the arbitrator's expertise –or at least his profound knowledge of the matter in controversy– has proved to be a decisive factor in the growing number of arbitrations in the power sector. As stated by Ms Solange David, current CCEE Legal Manager,

> *"[T]he resolution of controversies related to commercialization of electric energy is a doubly challengeable activity. First, due to the special characteristic of this commercialization, which does not represent simply the act of negotiating electric energy's sale and purchase, but also the accomplishing of several norms, rules and procedures that regulate the activities of the agents acting in the electrical sector. Second, because the themes arising from these controversies may contain technical elements of such a complexity and profundity that require wide and varied knowledge of the sector, besides specialized knowledge regarding certain aspects." (In: A arbitragem no âmbito da Câmara de Comercialização de Energia Elétrica (CCEE). Revista de*

Arbitragem e Mediação, São Paulo, v. 05, n. 16, p.33-37, jan./mar. 2008).

In addition, it is worth observing that the number of arbitrations tends to grow proportionally to the growth of the sector itself. The Ten-Year Energy Plan (*Plano Decenal de Expansão de Energia* – PDE 2020) disclosed by the Energy Research Company (*Empresa de Pesquisa Energética* – EPE), a planning entity reporting to the Ministry of Mines and Energy, is under public consultation. According to the PDE 2020, in the next 10 years the total power demand in Brazil is expected to increase by more than 60 percent. This increase will call for investments in the order of R$190bn in the generation sector, R$46bn in the transmission sector and another R$90bn in the distribution sector.

As a conclusion, there is no doubt whatsoever that the scenario outlined above –for obvious reasons– has encouraged extrajudicial dispute resolution professionals to enhance their technical and legal expertise in this fascinating and increasingly promising sector in Brazil.