Arbitration involving State-owned Entities in Rio de Janeiro: We Cannot See the Wood for the Trees

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This post summarises the key features of the Rio de Janeiro State Decree No. 46.245/2018, which regulates arbitrations between state-owned entities and private corporations and came into force on February 20, 2018.

As a brief introduction, and to provide context of the enactment of the referred statute, it is relevant to set forth three pieces of information concerning Brazil. First, according to the World Economic Forum, the country was the ninth biggest economy of the world in 2017. Second, the wide participation of the State in the process of economic development in Brazil is the norm, especially in infrastructure projects. In general, these projects are managed through public-private partnerships (PPP) structured between a state-owned entity on one side, and a private corporation on the other. Third, arbitration is undoubtedly well established in the country as a dispute resolution mechanism, with an increase of 73% in the number of proceedings from 2010 to 2016 (amounting to almost $30 billion in disputes), and Brazil being the seventh jurisdiction in the ICC ranking in 2017.

Moreover, it is noteworthy that Brazilian courts are unable to solve conflicts in an acceptable amount of time: a complex matter involving intense document production and expert evidence – which is often the case in disputes arising from infrastructure projects – can take more than 10 years to be finally settled by state courts. The congestion of the courts is an issue with no foreseeable improvement in the near future, and the situation calls for a way out.

In this backdrop and with an eye towards attracting foreign investment, Brazil has been developing a particular legal framework for arbitrations involving state-owned entities. In the last 15 years, the country has approved dozens of legal provisions authorizing arbitration in the public sector. A landmark of this decisive political move was the amendment of the 1996 Brazilian Arbitration Act, to incorporate the rule in article 1(1) in the sense that "direct and indirect state-owned entities may use arbitration to resolve conflicts related to negotiable and pecuniary matters" (the first author of this post was part of the committee that drafted the bill). This valuable initiative is even more essential considering that Brazil has not signed the 1965 Washington (ICSID) Convention, preventing the country from offering this avenue to attract investors.

Following this national trend, the State of Rio de Janeiro has taken an advanced step with the

enactment of Decree No. 46.245/2018 (the second author of this post was part of the committee that drafted the bill). The recently issued statute provides that all entities owned by the State of Rio de Janeiro may participate in arbitral proceedings. In what relates to the arbitrability of disputes, the statute is broad, allowing state-owned entities to resolve through arbitration all conflicts related to pecuniary claims, except those in connection with the narrow concept of acta iure imperii.

Despite being a progressive statute, there are still special requirements imposed on the parties that are subject to its rules. According to the Decree, Brazilian Law is applied mandatorily to the arbitrations involving state-owned entities – there can be no ex aequo et bono ruling –, the City of Rio de Janeiro must be chosen as the seat, and the parties have to adopt Portuguese as the language of the arbitration.

Although the requirements seem to limit the parties' autonomy, there appears to be no downside to such limitations. Brazilian Law is inspired by European Law, notably Portuguese, French, Italian and German law, and thus will be familiar to foreign investors in general. Moreover, Brazilian state courts are arbitration-friendly and unbiased towards foreign parties – in fact, the Brazilian Constitution guarantees equal treatment between nationals and non-nationals. Hence, Brazil is a trustworthy seat. As for the language, parties can agree on bilingual arbitration, choosing Portuguese (mandatory) and, for example, English (optional).

The Decree only allows for institutional arbitration, prohibiting parties from opting for ad-hoc arbitration. As a rule, private service providers can only enter into contracts with state-owned entities after participating in and winning a public bid. In theory, the same process could be applied when choosing the arbitral institution. However, instead of demanding a public bid between arbitral institutions, the Decree only requires that the institution be registered with the Rio de Janeiro State Attorney's Office. In other words, there is no need for a public bid to choose the arbitral institution, which will avoid bureaucracy. To be accepted in this registration system, to which both domestic and foreign institutions are eligible, the institution must have at least 5 years of regular existence and be able to present evidence of conducting at least 15 arbitrations yearly.

To be eligible, the institution also needs to have an address in the state of Rio de Janeiro. At first glance, this last requirement could be deemed too restrictive. However, the Decree does not require the entity to have an office in the state – in fact, the arbitral institution only needs to provide a place to receive written submissions and documents and to host oral hearings. It is likely that most international arbitral institutions will be able to meet this condition by establishing partnerships with local institutions.

The statute provides that the registered arbitral institution will be chosen by the contracted company, and not by the State – at the signing of the contract in which the arbitration agreement is contained.

Moreover, the arbitral proceedings will be conducted pursuant to the rules of the chosen arbitral institution, which secures the parties' rights to due process. When the private corporation commences the arbitration, it shall advance the costs (arbitrator fees, expert fees and arbitral institutional expenses). However, the private corporation may fully recover from the State or the State-owned entity the amounts disbursed, if it wins the case.

According to the statute, parties are free to nominate the arbitrators that will comprise the arbitral tribunal or the sole arbitrator, following the arbitration rules adopted. There are no personal requirements for the arbitrators, not even nationality. However, under article 12, the prospective arbitrator has to disclose if he/she or his/her law firm is representing third parties against entities owned by the State of Rio de Janeiro in other arbitrations or legal proceedings. Furthermore, the prospective arbitrator must reveal if he/she or his/her law firm is representing third parties in cases

with connections to the matter submitted to arbitration.

This rule does not implicate the automatic challenge or replacement of the arbitrator who is a member of a law firm in such circumstances. It is merely a duty of disclosure, as generally required in international commercial arbitration (see item 3.4.1. of the IBA Guidelines). Additionally, this requirement should be interpreted in connection with article 11, which states that the prospective arbitrator cannot have a direct or indirect economic interest in the award to be rendered in the case.

The Decree also imposes a high degree of transparency. It orders that written submissions, expert opinions and arbitral decisions be made public. This is not a duty that falls on the private party: the Rio de Janeiro State Attorney's Office is responsible for displaying all documents for public scrutiny. The statute safeguards commercial secrets from publicity. This is a reasonable compromise between public accountability and the need to protect sensitive commercial information. In addition, the provision ensures that the oral hearings will respect privacy (in camera), meaning that only those parties related to the case are allowed access to the hearing.

In conclusion, the Decree was framed to promote arbitration between state-owned entities and private corporations. Although there are requirements that could be interpreted as limiting the parties' autonomy, the statute has to be praised undisputedly as a step forward and an important initiative to attract foreign investment to the State. In pursuit of this objective, the State of Rio de Janeiro is waiving its prerogative to access Brazilian courts, thus bolstering a more attractive environment for private corporations doing business in Brazil. We perceive the requirements imposed by the statute that may seem at odds with the practice of international arbitration worldwide as minor details in the context of this important move. We cannot see the wood for the trees.