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To ‘Extend’ or Not to ‘Extend’? An Analysis of the Brazilian Superior Court of Justice’s Judgement in REsp. 1.639.035 – SP

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The debate around the ‘extension’ of arbitration agreements has, once again, been placed under the spotlight in Brazil. The Brazilian Superior Court of Justice (‘SCJ’) recently considered the issue in disputes involving groups of contracts between the same parties. The SCJ ruled in favour of the ‘extension’ of the arbitration agreement contained in the main contract to its ancillary contracts in a multi-contract bank loan operation[1)].

The dispute arose in the context of the financial restructuring of Paranapanema S.A. (‘Paranapanema’), conducted by its financial advisors Banco BTG Pactual S.A. (‘BTG’) and Banco Santander S.A. (‘Santander’). In mid-2007, the parties entered into a Loan Agreement, under which BTG and Santander (the ‘Lender Banks’) would lend R$ 200 million to Paranapanema. The Lender Banks instructed the payment for the loan to be made through the subscription to Paranapanema’s shares.

The arrangement was straightforward: the Lender Banks subscribed to Paranapanema’s securities up to the limit of the loan. Paranapanema, in exchange, assured a minimum market value for its shares. As a means of guaranteeing the Lender Banks’ compensation for the loan, the parties also entered into Swap Agreements (‘Swaps’) under which Paranapanema undertook to reimburse the Lender Banks for the difference between the market price of the shares and the total sum of the Loan Agreement, should the securities not reach the minimum market value promised. The Loan Agreement contained an arbitration clause. The Swaps, however, contained a choice of forum agreement providing for the jurisdiction of State Courts.

As the 2008 financial crisis arose, the Lender Banks sold Paranapanema’s shares, but the parties diverged in relation to Paranapanema’s obligation to pay the difference between the amount of the loan and the amount of the return obtained by the Lender Banks from the sale of the shares during the financial crisis. As a result, Santander commenced arbitration under the arbitration agreement in the Loan Agreement before the CAM/CCBC against Parapanema and BTG.

The Arbitral Tribunal found in Santander’s favour, ordering Paranapanema to reimburse Santander more than R$ 250 million.

Following the Award in Santander’s favour, Paranapanema challenged the Award before a

1st Instance Court in the State of São Paulo on grounds that:

- the Tribunal lacked jurisdiction to resolve the dispute, insofar as Santander's claim arose from the Swaps, which did not contain an arbitration agreement;
- the appointment of the members of the Tribunal by CAM/CCBC had violated the principle of equality between the parties – pursuant to article 21, §2 of the Brazilian Arbitration Act (Statute no. 9.307/1996) –, tainting the procedure as a whole and rendering the Award null[2)].

The 1st Instance Judge set aside the Award for the violation of the parties' right to equal representation, but rejected the argument on the lack of jurisdiction of the Arbitral Tribunal under the Swaps.

Santander and BTG appealed to the São Paulo Court of Appeals ('SPCA') from the decision that set aside the Award under article 32, VIII, of the Brazilian Arbitration Act. Paranapanema also applied to the SPCA appealing the 1st Instance decision that dismissed its request to set aside based on the improper 'extension' of the arbitration agreement. The SPCA upheld the 1st Instance decision on both counts.

The SPCA found that the Loan Agreement, as the main agreement of the group of contracts, set out core provisions for its ancillary contracts, i.e. the Swaps, indicating the existence of connection between the two. The SPCA also ruled that the choice of forum agreement in the Swaps should be considered a subsidiary alternative to the resolution of disputes between the parties[3)].

Following the SPCA's decision, BTG and Paranapanema appealed to the SCJ.

BTG appealed the SPCA's decision on the matter of the deficiency in the formation of the Arbitral Tribunal, but the SCJ did not rule upon the merits of that claim[4)]. Nonetheless, the SCJ did extensively review Paranapanema's appeal on the issue of the 'extension' of the arbitration agreement in disputes arising from group of contracts, upholding the lower instances' decisions. It endorsed the lower instances' ruling in finding that it was possible for the arbitration clause and the choice of forum agreement to coexist and that the Swaps and the Loan Agreement were connected and dependent. The SCJ emphasized that, insofar as the connected contracts related to the same business transaction, they had to be interpreted together. In its ruling, the SCJ also relied upon the 'center of gravity' doctrine, which provides that the main contract establishes a legal framework within which the ancillary contracts must function.

The ruling demonstrates the pro-arbitration approach adopted by Brazilian Courts, but one should still be cautious when addressing this issue.

Although the cornerstone of the debate around the 'extension'of arbitration agreements is the existence of consent – or lack thereof –, the reasoning of decisions on the matter often encompass logical fallacies and, by 'jumping to conclusions', ignore the issue of consent, or, at least, relegate it to second place.

Courts and Tribunals commonly decide the matter looking into whether there is a connection between the relevant contracts or not. However, the existence of connection between certain contracts is insufficient to allow the automatic 'extension'of an arbitration clause to all connected

agreements[5].In fact, the Termopernambuco case[6]is an example where two contracts were considered connected, but retained their autonomy and independence, leading to the dismissal of the ‘extension’of the arbitration agreement plea.

Turning again to Paranapanema, the SCJ went one step further and studied the existence of dependence, not just connection, between the Loan Agreement and the Swaps. Nonetheless, the SCJ failed to examine whether such connection and dependence were enough to demonstrate the parties’ consent to arbitrate. That is to say, the decision ignored that the dependency or connection between particular contracts is not what justifies the ‘extension’ of the arbitration agreement from one to the other, but rather is merely a strong indication of parties’ consent to arbitrate disputes relating to all contracts of the group.

Moreover, in the case at hand, the SCJ repeatedly referred to an ‘extension’ of the arbitration agreement to the Swaps, which may wrongly suggest that the scope of the arbitration agreement had been broadened to encompass a contract other than the one it was originally contained in. In fact, in arbitration practice, there is a relatively solid understanding that the idea of extension is a “misleading concept”[7], because, in general, decisions on the matter are ultimately based on consent.

Albeit the SCJ did not analyse whether the dependence between the contracts had risen to the level of demonstrating consent to arbitrate disputes relating to the whole loan operation, in this author’s view, it did. The dependence between the Loan Agreement and the Swaps was shown by the fact that the latter were nothing more than a guarantee of the payment of the Loan Agreement. Hence, when interpreting their provisions, one should bear in mind that they should be compatible, in the sense that one would never contradict the other. Thus, in light of the characteristics of each of the contracts of the group and how they were linked to each other, the SCJ adopted the most reasonable interpretation, that is to say the interpretation that confirms the existence of parties’ intent to be bound by the same dispute resolution mechanism under all contracts of the group, ensuring that the same body had jurisdiction to decide over the loan (Loan Agreement) and its respective guarantees (Swaps).

References

?1 REsp. no. 1.639.035 – SP, Brazilian Superior Court of Justice, September 18th, 2018.

?2 The issue relating to the appointment of the members of the Arbitral Tribunal will not be discussed in this article, given that the SCJ did not rule upon the matter, because it found that it would require a reexamination of the factual background, as well as of the relevant supporting evidence of the case. According to binding precedents, the SCJ is barred from reexamining the facts of the cases it rules upon, having to limit its decision to any violations of Brazilian federal legislation.

?3 Although the decision was silent in this matter, it is likely that the SCJ intended to limit the use of the choice of forum agreement to instances where use of the arbitration agreement would not be possible, e.g. interim measures requested before formation of the arbitral tribunal, annulment or enforcement of arbitral awards, etc.

?4 See footnote no. 2 *supra*.

?5 Justice Luis Felipe Salomão addressed this aspect of the Judgement in his Dissenting Opinion.

?6 REsp. no. 1.519.041 – RJ, Brazilian Superior Court of Justice, September 1st, 2015.

?7 Bernard Hanotiau, *Non-signatories in International Arbitration: Lessons from Thirty Years of Case Law*, Albert Jan van den Berg (Ed.), International Arbitration 2006: Back to Basics?, ICCA Congress Series, Volume 13, The Hague: Kluwer Law International, 2007.

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