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Kompetenz-Kompetenz in Brazil: alive and kicking

Felipe Sperandio (Clyde & Co. LLP) · Tuesday, December 10th, 2013 · Clyde & Co.

The Brazilian Superior Court of Justice ("STJ") has issued, on 19 June 2013, a landmark decision addressing the principle of Kompetenz-Kompetenz (Resp. no. 1,278,852-MG *Samarco Mineração S/A v Jerson Valadares da Cruz*). The decision deals with the allocation of competence between arbitral tribunals and national courts to decide on the validity of an arbitration agreement. The STJ reasoned, for the first time, that court review on this issue is only permitted at two procedural stages: (i) in proceedings to set aside an arbitral award; or, (ii) in proceeding to resist the recognition and enforcement of an arbitral award.

Facts

Samarco Mineração S.A. ("Mineração") entered into an agreement to build mining pipes through land owned by Gerson Valadares da Cruz ("Cruz"). Cruz alleged that Mineração caused damage to his property during the construction works. Cruz, therefore, filed an interim measures request before the national courts, the purpose of which was to obtain the production of evidence supporting the existence of the alleged damage and its quantification. The parties having entered into a settlement agreement, the courts did not reach a decision on the interim measures application. The settlement agreement provided that the questions of liability for, and the quantum of, any damage to the property would be resolved by expert determination. The settlement agreement also contained an arbitration clause that incorporated CAMARB institutional rules.

The expert found that Cruz was not entitled to any compensation for the alleged damage. Cruz disagreed with the expert's determination, and filed a second set of legal proceedings to: (i) annul the settlement agreement; (ii) annul the arbitration clause (on several grounds); (iii) obtain compensation for the alleged damage; and, (iv) obtain a freezing order over the expert's fees. This second set of legal proceedings was consolidated with the interim measures proceedings initially filed by Cruz.

The first instance judge entrusted with these proceedings ruled that the validity of the arbitration clause should be decided by an arbitral tribunal and, as a result, dismissed Cruz's proceedings without analyzing their merits.

Cruz appealed arguing that Brazilian courts are empowered to review the validity of an arbitration agreement since the Federal Constitution provides that no one should be deprived of access to the courts.

The Brazilian Arbitration Act ("BAA") provides, in relevant part in this context:

"Art. 8, sole para. ***The arbitrator is competent to decide, ex officio or at the parties' request, the issues concerning the existence, validity and effectiveness of the arbitration agreement****, as well as of the contract containing the arbitration clause*".

Although the BAA provides for the principle of Kompetenz-Kompetenz, it does not provide any guidance to national courts on how to implement it.

On appeal, the Minas Gerais State Court of Appeal ("CA") defined the question for consideration as being whether the validity of an arbitration clause (such as the one contained in the settlement agreement) could be determined by a Brazilian court where arbitral proceedings have not yet been commenced.

To address the question the CA focused on the following provision of the BAA:

"Art. 20. *A party wishing to raise issues as to the jurisdiction, suspicion or impediment of an arbitrator or arbitrators, or as to the nullity, invalidity or ineffectiveness of the arbitration agreement,* ***must do so at the first possible opportunity after the commencement of the arbitral proceedings***".

The CA combined the two articles referred to above (i.e., Art. 8 and 20 of the BAA) and ruled as follows:

• the Kompetenz-Kompetenz principle addressed in art. 8 of the BAA is applicable only where an arbitration has been commenced;

• in the present case, the parties had not filed a request for arbitration;

• for that reason, the national court was, according to the CA, empowered to decide on the validity of the arbitration agreement.

Accordingly, the CA overturned the first instance decision and decided that: "*parties may request to set aside an arbitral award, in national courts, on the basis of an invalid arbitration agreement; hence, there is no reason to prevent parties from requesting that [an arbitration agreement be invalidated] before any arbitration has been initiated. The request for annulment of the arbitration clause certainly can be examined by the judiciary, and the first instance proceedings should not have been dismissed*".

Mineração appealed to the Superior Court of Justice ("STJ"), and the STJ concluded as follows:

• first, an arbitral tribunal has exclusive jurisdiction to decide the merits of the dispute arising out of or connected to a contract which contains an arbitration clause;

• second, the arbitral tribunal and Brazilian courts have a 'coexisting jurisdiction' to rule on the existence, validity, extension and efficacy of the arbitration agreement;

• third, such coexisting jurisdiction 'alternates' according to the procedural stage reached during the course of arbitration.

What did the STJ mean by a coexisting jurisdiction that alternates? The decision's reasoning clarified that national courts ultimately have jurisdiction to examine the validity of the arbitration

agreement. But this jurisdiction of the domestic courts may be triggered by the parties only after an award has been handed down, i.e., in proceedings to set aside the award; or proceedings to resist the recognition and enforcement of the award. The STJ reached this conclusion by relying on two further articles of the BAA:

"Art. 32. ***An arbitral award is null and void if***:
I – ***the arbitration agreement is null and void***;
(…)
Art. 33. ***The interested party may submit to the State Court having jurisdiction an application for the setting aside of the arbitral award, in the cases foreseen in this Law***".

The STJ therefore rejected the CA's interpretation of art. 20, and determined: "*the competence between* [the arbitral tribunal and the national courts] *alternates during different procedural stages, that is, the judiciary can only act after the arbitral award*".

The decision attributed particular relevance to the fact that the arbitration clause incorporated institutional rules. The reasoning is not as clear as one would have expected, but it seems to be based on an assumption that every set of institutional rules provides for mechanisms to decide on challenges to the validity of the arbitration agreement. And the existence of such provisions would confer competence on the arbitral tribunal to rule on jurisdictional objections.

The STJ therefore overturned the CA´s decision, and the parties will now proceed to dispute the validity of the arbitration agreement before an arbitral tribunal.

Commentary

The New York Convention ("NYC") imposes on contracting states, including Brazil, the obligation to enforce arbitration agreements. But national courts may not refer parties to arbitration where: "[a court] *finds that the said agreement is null and void, inoperative or not capable of being performed*" (art. II.3).This provision therefore implies that the arbitration agreement could be subject to interlocutory court review before, or simultaneously with, the arbitral proceedings.

In light of the above, the NYC does not allocate jurisdictional competence with respect to an arbitration agreement as between the arbitral tribunal and the relevant national courts. Legal systems, consequently, implement the principle of Kompetenz-Kompetenz according to their own national laws. This raises two questions: (i) when can a court review be applied for? – and, (ii) what is the extent of such a review?

The STJ's decision, in turn, provides clarity on how to implement the principle of Kompetenz-Kompetenz in Brazil. It is true that the STJ had enforced the principle in previous cases. However, this was the first time that the STJ manifestly allocated the arbitral tribunal's and national court's power to rule on jurisdictional challenges.

By contrast with common law jurisdictions, the STJ's decision does not necessarily bind the lower courts in Brazil. But the STJ is the highest competent court to rule on arbitration related matters and its decisions are therefore very persuasive. For this reason, in practice, similar interlocutory challenges to the validity of an arbitration agreement are likely to be interpreted in accordance with the STJ's decision.

The STJ has clearly determined that a court review of the validity of the arbitration agreement, in

cases where this incorporates institutional rules, is permitted only after an award has been handed down. The STJ´s rationale is of interest for international arbitration practitioners in two respects.

First, the rationale applies to any institutional arbitration agreement, irrespective of whether it provides for the arbitration seat to be in Brazil or elsewhere. This will inhibit parties from trying to annul, in Brazilian courts, arbitration agreements that provide for a seat outside Brazil. Unfortunately, there are a few ongoing cases in which Brazilian lower courts have accepted jurisdiction over such reviews; even though the best view is that the validity of an arbitration agreement must be challenged at the seat of the arbitration.

Second, the rationale grants exclusive competence to the arbitral tribunal, up to handing down of the award, to review the validity of an arbitration agreement. And this is more supportive of the arbitration proceedings than the NYC (art. 2, III).

To implement the above, the STJ found that the principle of Kompetenz-Kompetenz is not without its limits, but these only apply at two keypredetermined stages in any arbitral proceedings, i.e., the arbitration agreement may only be reviewed by a national court in: (i) proceedings for the recognition and enforcement of any award; or, (ii) proceedings to set aside any award. This ruling may result in the situation where an arbitral tribunal may have to be constituted just to rule on its lack of jurisdiction. This is not an ideal scenario. However, this unfortunate result is counter-balanced by the benefit of preventing parties from halting arbitration by simply requesting the annulment of an arbitration agreement (anti-arbitration suits) in the congested Brazilian courts – in which any court review will invariably drag on for years.

Conclusion

Brazilian courts, especially the STJ, have been shaping the concept of Kompetenz-Kompetenz over the last few years. Case law is evolving constantly to fill in gaps left by the national law. However, some issues are yet to be tested. For instance, do parties waive their right to challenge the validity of the arbitration agreement in national courts if they do not exercise it during the arbitral proceedings, and according to the applicable institutional rules? The issue of whether Brazilian courts should apply a *prima facie* or a *de novo* test when reviewing a jurisdictional decision given by an arbitral tribunal also remains untested.

The BAA is currently under revision. Its drafting committee now has the opportunity to codify this, and other, recent STJ pro-arbitration interpretations of the concept of Kompetenz-Kompetenz. It is also a chance to provide straightforward guidance for judges and parties unfamiliar with arbitration. In this respect it is noteworthy that the leading judge in the STJ´s decision discussed above, Justice Luis Felipe Salomão, is the Chair of the drafting committee in charge of the New BAA.

Has the STJ delineated the ideal approach towards Kompetenz-Kompetenz? The diversity of approaches implemented by different legal systems indicates that there is no such thing as a model approach. Instead, each country has to develop its own rules for a healthy interplay between national courts and arbitral tribunals.

Indeed, the rationale for the STJ’s ruling involves recognition that the principle of Kompetenz-Kompetenz has certain constraints. However, by carefully limiting the procedural stages at which a court is empowered to review an arbitration agreement, the STJ made a choice in favor of arbitration.

Access to the Decision in Portuguese.

This entry was posted on Tuesday, December 10th, 2013 at 11:45 am and is filed under Arbitration Agreements, Jurisdiction of the arbitral tribunal, kompetenz-kompetenz, Latin America
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