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Brazil Warms To The Global Procurement Market Further With New Chile Treaty, But Still No Arbitration For Investors

Natalie Yarrow, Pedro Henrique Martins (Herbert Smith Freehills) · Friday, October 19th, 2018 · Herbert Smith Freehills

Brazil has been notoriously reluctant to enter into treaties with other States that provide for the protection of investors and investments, viewing them as detrimental to the host State and its national investors. Brazil has no bilateral investment treaties in force, a limited number of its own treaties, named Cooperation and Facilitation Investment Agreements (CFIAs), and is not a signatory to the International Centre for Settlement of Investment Disputes Convention (ICSID Convention). To date, however, this approach has not limited Brazil's attractiveness to foreign investment, with Brazil being a leading recipient of foreign direct investment.

Yet over the last few years, Brazil's attitude towards agreements aimed at promoting investment has softened as its own national industries have eyed up opportunities in foreign markets. We have recently seen Brazil enter into a suite of public procurement agreements (PPAs). These PPAs aim to ensure open, fair and transparent conditions of competition in the government procurement markets. Chile is the latest State to enter into a PPA with Brazil, which provides rules for the mutual increase in the participation of Chilean and Brazilian companies in public procurement bids by establishing bilateral equal treatment and internationalisation of procedures.

Brazil's PPAs represent an interesting approach to tapping into the global public procurement market, a move which has the potential of unlocking billions in revenue, while remaining outside the traditional model of investment agreements. While they include some investor-friendly provisions, they nevertheless limit the direct recourse of investors against the State. The Chilean PPA is silent on dispute resolution, and the Chilean CFIA, whose definition of investment would likely encompass public procurement contracts, reserves arbitration for States only. As such, investors with qualifying contracts under the Chilean PPA will be confined to pursuing any dispute through the national courts or by escalating the dispute to the State level.

Background

Earlier this year, Brazil executed the Acordo de Contratação Pública entre a República Federativa do Brasil e a República do Chile, the PPA with Chile, which aims to expand bilateral trade between the two countries with regard to public procurement processes. This follows the execution of the same type of agreement with the Mercosur (comprising Brazil, Uruguay, Argentina and Paraguay) in December 2017, and with Peru in April 2016, the latter being included within a broader agreement comprising provisions related to investments and services. All three PPAs will enter into force in January 2019. Additionally, the Brazilian government has reported that it is currently negotiating further agreements pertaining to public procurement provisions with Mexico, the European Union and the European Free Trade Association.

In addition to this, Brazil has been an observing member of the Government Procurement Agreement (GPA) since August 2017. The GPA is a plurilateral agreement within the framework of the World Trade Organization whose goal is to open public procurement markets mutually among its State parties.

These events form part of a move of the Brazilian government to enter into the global public procurement market, which is estimated to generate USD 3.4 trillion per year. In the past decades, Brazil has been reluctant to open its internal market for foreign providers of goods and services out of fears that granting the equivalent treatment to foreign companies as that given to Brazilian ones could prevent or hinder its discretion to foster its national industries. This perception seems to have shifted, however, due to the bilateral nature of PPAs allowing Brazilian companies to expand their portfolio abroad. According to the National Confederation of Industry of Brazil, Argentina alone offers a USD 81.5bn market to Brazilian investors, followed by Peru (USD 12bn) and Chile (USD 11bn). That, together with the other countries of the Mercosur, leaves a USB 109bn potential market waiting to be accessed. Furthermore, if the remaining agreements currently under negotiation are signed, this could pave the way for an estimated USD 2trn in public procurements.

Key protections and features of the PPAs

National treatment

As a means to achieving this greater participation in the global public procurement market, the PPAs provide a legal framework that aims to place international companies on a level playing field with Brazilian companies with regard to their competitiveness as well as to facilitate their participation in public bids. The PPAs therefore include specific provisions with regard to national treatment and non-discrimination (Article V(1)(2) of the Chilean PPA; Article 4.4(2) of the Peruvian PPA and Article 6 of the Mercosur PPA), stating that "immediate and unconditional" treatment shall be granted to goods/services providers of the parties in relation to any contracts covered by the relevant PPA.

Non-preferential rules of origin

In the past, many have viewed preference margins as the greatest obstacle to foreign investors seeking to do business with the Brazilian government. In an attempt to tackle this, a specific provision has been included in the PPAs to establish that the parties shall apply the non-preferential rules of origin provided for in Article 1.2 of the Agreement on Rules of Origin of the WTO to contracts covered by the PPAs (Article 12 of the Chilean PPA; Article 7 of the Peruvian PPA and Article 7 of the Mercosur PPA). The WTO Agreement on Rules of Origin determines the country of origin of a product for purposes of international trade. Non-preferential rules of origin are those which apply in the absence of any trade preference — that is, when trade is conducted on a most-favoured nation basis. In Brazil, the general law applicable to public procurement processes is Law n. 8,666/1993. Article 3 allows the Brazilian government to exercise discretion over how it wishes to develop its national industry, providing, for example, the possibility of establishing preference margins that allow national products and/or services to be up to 25% more expensive than foreign products and/or services. The PPAs seem to derogate from the application of the national rule and grant the possibility of discussing the matter under internationally agreed rules.

Dispute Resolution

In contrast to the Mercosur PPA, the Chilean PPA does not contain any mechanism for dispute resolution. As the Chilean PPA deals with a sub-set of investment, namely public contracts, it may be read in the wider context of the Chilean CFIA, signed in November 2015. The definition of "investment" in the Chilean CFIA is considerably broad, including "contractual rights, including turnkey, administration and other similar agreements" (Article 1.4(d)). Public contracts covered by the PPAs could therefore potentially fall within the Chilean CFIA's scope.

The arbitration agreement provided for in the Chilean CFIA (and also the Peruvian CFIA) is *ad hoc* (Article 25 and Annex 1, Chilean CFIA). The arbitration agreement only applies to the State parties to the Chilean CFIA, i.e. Chile and Brazil, and not to either of their investors. In addition, the ad hoc provision can only be triggered after extensive attempts through various means of solving the dispute amicably (Article 24, Chilean CFIA). Such amicable mechanisms include an ombudsman for each Government to address the foreign investor's complaints, and also a Joint Committee, which will issue a recommendation for the disputing parties. If none of these methods succeed, or if the parties dispute the Joint Committee's recommendations, the dispute can then be submitted to arbitration.

What this means is that, if a dispute arises under the Chilean PPA, only the State can submit the claim to arbitration. In addition, the Chilean CFIA does not contain an umbrella clause, in contrast to some BITs, meaning that an investor does not have the possibility to elevate a potential breach of contract with a State to a breach of an international treaty. An investor therefore has no recourse to arbitration and must pursue its claim through the national courts, unless the investor's home State wishes to bring the claim itself. Otherwise, arbitration only remains an option for foreign investors if the contract entered into with the Brazilian public authority includes an arbitration clause and the dispute concerns patrimonial rights, such as rights to assets of a commercial nature.

Comment

The approach to dispute resolution adopted in the Chilean PPA and Chilean CFIA is unsurprising given Brazil's distrust of investor-state arbitration. In practice, the lack of recourse to investor-state arbitration does not seem to have dampened foreign investors' interest in the country so far. Brazil has been a regular receiver of foreign direct investment in the past decade, including foreign companies becoming shareholders of SPVs for infrastructure projects. It can be inferred from the lack of such mechanisms in the Chilean PPA and Chilean CFIA that Brazil is not concerned that the lack of investor-state arbitration will have any negative consequences for future investment.

However, there is a softening in Brazil's attitude and the execution of the PPAs may also suggest that Brazil is reviewing its past position with regard to protectionist measures. Brazil introduced the PPA/CFIA model to offer a greater balance between investor protection and the host State's development agenda. Some might argue that, particularly with regard to concession agreements, whose long-term duration and high value usually require a greater level of certainty when it comes to dispute-solving mechanisms (compared to a single-time provision of goods), the PPAs could have provided a good opportunity for Brazil to adopt an approach more aligned with international practice with regard to investor-state disputes with a view to attracting investments to a sector that has high demand for qualified contractors.

It is unlikely that we will see a change in stance on investor-state arbitration any time soon. However, as Brazil’s domestic industries expand and the outflow of investment increases, it may be interesting to see if that stance softens further.

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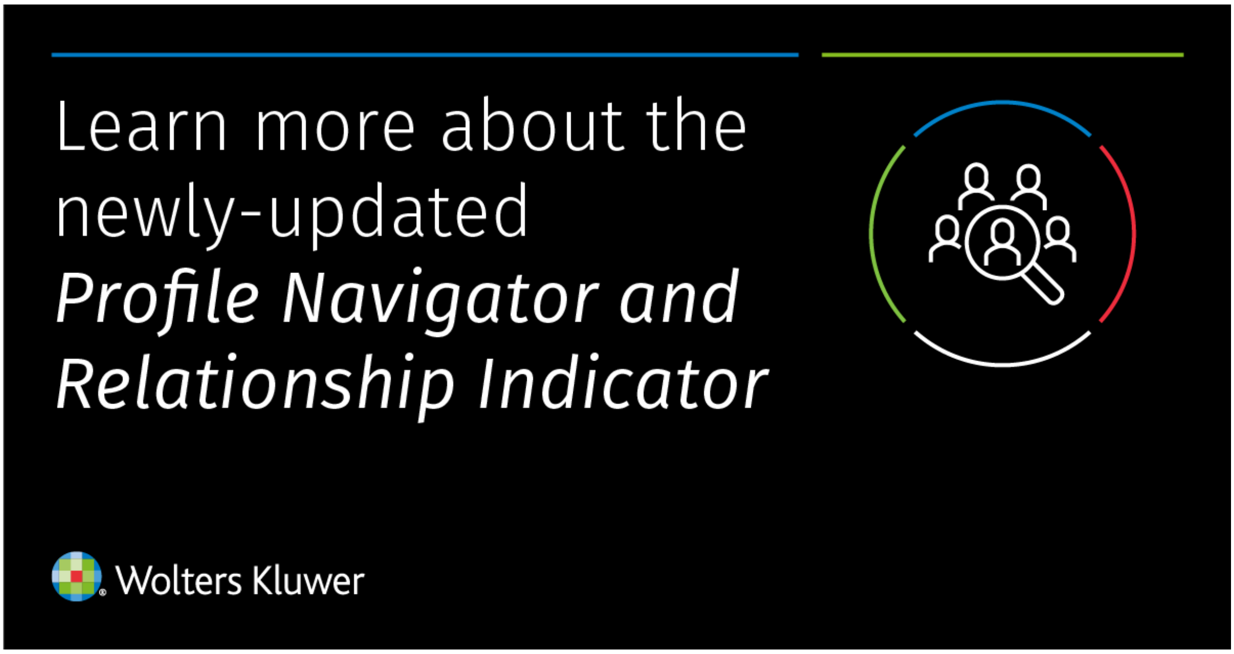

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