Kluwer Arbitration Blog

CBAr 23rd International Arbitration Conference: Contractual Incompleteness and the Limits of Consent

Caroline Gomes de Moura (Demarest Advogados) · Saturday, September 28th, 2024

The 23rd CBAr IAC was a resounding success. The second day of the Conference included a first Panel on the Circulation of Contractual Models and Infrastructure Arbitrations, a second Panel on Contractual Incompleteness and Infrastructure Arbitrations, and a third Panel on the Limits of Consent, Arbitrability, and Judicial Review in Infrastructure Arbitrations.

Below, we summarize the most pertinent discussions from the second day of the Conference.

Contractual Incompleteness and Infrastructure Arbitrations

The second panel, moderated by Flávia Bittar (Partner, Flávia Bittar Advogados), focused on contractual incompleteness and infrastructure arbitrations. The panel featured Fernando Marcondes (Partner, MAMG Advogados), who discussed planning issues, delay & disruption, and private autonomy; Charles H. Brower II (Of Counsel, Miller Canfield), who addressed gaps in infrastructure contracts; and Lucila Hemmingsen (Partner, King & Spalding), who explored methods for quantifying compensation in infrastructure disputes.

Fernando Marcondes discussed the importance of contract planning, emphasizing that it is essential for pricing and execution. He noted that contracts often lack complete information, sometimes intentionally due to the impossibility of preventing all the issues on major construction projects. In this sense, he explains that these deviations must be continuously reflected in the planning of the project to avoid losses, and mechanisms like risk event pricing help manage this incompleteness.

He defended that proper risk management can lead to cost savings. Marcondes highlighted that most arbitrations focus on delays and cost overruns, while the timeline of events is the most crucial aspect to be considered to understand the cause of each damage event. To conclude, Marcondes shared his experience with NEC contracts in Peru, where there has been a significant use and positive outcomes from dispute boards. Within two years, he mentioned that numerous claims were presented to the dispute board, impacting positively the project's progress.

In this connection, it is relevant to mention that the Public Administration in Brazil has been adopting dispute boards in their administrative contracts in several cities, including São Paulo, Belo Horizonte, and Rio de Janeiro where there are already local regulations authorizing such adoption. The new Public Procurement and Administrative Contracts Law (Law No. 14.133/21)

provides for the use of dispute boards at the federal level, which encourages other cities to implement this practice in their contracts.

Charles H. Brower II addressed the topic of gaps in infrastructure contracts, exploring the limits and possibilities of arbitrators' intervention. He defined genuine gaps as situations where (i) there is no general condition defined in the contract; (ii) there is no provision in law; and (iii) there is no disposition that could cover the situation implicitly.

Answering the question whether arbitrators can define these gaps, Brower argued that parties can set criteria for arbitrators to fill these gaps and that arbitrators should respect these criteria. Nonetheless, if the parties define that the arbitrators are not authorized to fulfill the gaps or to define it based on a certain criterion, Charles believes that this should be respected.

When defining the gaps, Brower suggested that arbitrators should use reasonable principles or community standards rather than assumptions about the parties' intentions. He concluded by emphasizing that arbitrators should not attempt to define gaps based on what the parties might have intended, as the gaps may have been intentionally left due to a lack of information at the time of signing.

This partially contradicts, however, the provisions of the Brazilian Civil Code, which expressly states in Article 112 that in declarations of intent, more attention should be given to the intention embodied in them than to the literal meaning of the language. Therefore, when entering into contracts where Brazilian law is applicable, if such an interpretation is truly not desired, it is recommended that this be explicitly indicated in the contracts.

Lucila Hemmingsen as the last speaker of the panel discussed methods for quantifying compensation in infrastructure disputes, focusing on the limits and possibilities of contractual provisions. She advocated for the principle that parties should be placed in the position they would have been if the fault had not occurred.

Hemmingsen explained that price methods vary based on the type of damage and documentation and gave some examples of the most famous of them. She described the total cost approach, often used in common law, when individual damages cannot be differentiated; the extended delay approach which, for instance, considers additional costs for each day of delay; and pre-liquidated damages which focus on the date of occurrence since calculation is predefined.

Hemmingsen highlighted the importance of considering case law in the construction's location, as the definition of damages can vary by country. She cited an ICC case Refinería de Cartagena S.A.S. v. Chicago Bridge & Iron Company NV (previously covered here) that is a great example of analysis of risk allocation in the construction industry and a guidance on how to quantify damages and establish causation in complex construction projects. This decision was indeed highly significant and distinctive as it considered inapplicable liability caps, delved into a thorough analysis of gross negligence, and the lack of damage mitigation in the project. Furthermore, it made a comparison between the concept of gross negligence typical of civil law and gross negligence in common law.

The Limits of Consent, Arbitrability, and Review of Administrative Acts in Infrastructure Arbitrations

The third panel, moderated by Mariana Cattel Alves (Partner, MAMG Advogados), focused on the limitations of consent, arbitrability, and judicial review in infrastructure arbitrations. The panel featured Marilda Rosado de Sá Ribeiro (Partner, Renno Penteado Sampaio Advogados and Professor, University of the State of Rio de Janeiro), who discussed the *ius variandi* (the state's right to alter the terms of a public contract) in Brazilian law; Vera Cristina Caspari Monteiro (Professor, Fundação Getúlio Vargas), who addressed the annulment of administrative acts and exorbitant clauses; and Francisco Paulo De Crescenzo Marino (Partner, Francisco Marino Advogados and Professor, University of São Paulo), who explored the effectiveness of the arbitration clause against third parties in infrastructure disputes.

Marilda Rosado de Sá Ribeiro drew a parallel between the concept of *ius variandi* in investment arbitrations and the sovereign acts of public administration in its contracts, despite Brazil not having investment arbitrations. She highlighted the relevance of *ius variandi* in investment arbitrations, where the ability of the state to unilaterally modify contractual terms must be balanced against the need to ensure stability and predictability for investors, thereby safeguarding their legitimate expectations and fostering a favorable investment climate.

Ribeiro emphasized the importance of legal certainty for foreign investors, particularly in the energy sector, and discussed the "Brazilian Model of Investment Arbitration"—BRAMIA, referring to a discussion held previously here, dealing with the Brazilian scenario that historically refused to ratify any treaties containing recourse to arbitration. In this model, arbitration with state entities is always contract-based and, thus, categorized as commercial. The Brazilian state, as a contracting party, is subject to the rules stipulated in the contract and cannot arbitrarily breach them without any penalty. This, along with legal provisions, is fundamental to ensuring clarity and legal security for foreign investors.

Vera Cristina Caspari Monteiro delved into the arbitrability of the annulment of administrative acts and exorbitant clauses (name used by the Brazilian doctrine to provisions that grant the public administration special prerogatives in contracts to protect public interest). She explained that exorbitant clauses represent administrative powers in benefit of the administrative party to terminate the contract, to direct, supervise or monitor its execution, among other prerogatives.

She argued, however, that public administration does not have absolute power, because, even when the administration unilaterally terminates the contract, the other party is entitled to all losses and damages, including lost profits, which does not place them in an unusual or inferior position.

Indeed, these types of disputes are arbitrable under Brazilian law, since when the State enters as a contracting party, it subjects itself to all the obligations agreed upon. Therefore, it involves available rights that can naturally be arbitrable. This is because the Brazilian Arbitration Law states in its Article 1 that capable persons may use arbitration to resolve disputes related to available patrimonial rights. Then, Monteiro provided case studies where arbitral tribunals reviewed administrative acts, confirming the arbitrability of such issues. She finished her speech arguing that these acts are contractual rather than administrative, supporting their arbitrability.

Francisco Paulo De Crescenzo Marino discussed the effectiveness of arbitration clauses against third parties in infrastructure disputes, focusing on subcontractors, insurers, and financiers which he identified as the main characters on the disputes of this nature. Marino highlighted the theoretical frameworks of contractual coalition and subcontracting, concluding that coalition alone was not sufficient for extension due to potential conflicts of interest and lack of consent. However,

he identified several factors that could justify exceptions, such as broadly drafted arbitration clauses, incorporation by reference, direct billing clauses, back-to-back clauses, stipulation in favor of a third party, direct action, and assignment of scope.

Regarding insurers, Marino questioned whether transmission was automatic and whether prior knowledge was required. He noted extensive jurisprudential analysis and the STJ's evolving position, particularly in international transport cases, where prior knowledge of the arbitration clause was a key consideration. As previously reported here and here, in these cases, the STJ concluded that the transmission of the arbitration agreement by subrogation would not be contrary to the fundamental principles of Brazilian public policy and therefore related disputes shall be submitted to arbitration. For financiers, Marino identified factors influencing their binding to the arbitration clause, including various arrangements, third-party beneficiary claims, transfer of contractual positions, and step-in rights. In conclusion, Marino asserted that while there was a common core involving third parties and subrogation, each case has unique particularities that must be considered.

Conclusion

The second day of the 23rd CBAr IAC Conference featured insightful discussions on contractual incompleteness and the limits of consent, arbitrability, and judicial review in infrastructure arbitrations. The panels highlighted the importance of thorough contract planning, effective risk management, and the role of dispute boards in resolving issues promptly. The discussions were very practical and technical, underscoring the importance of due planning both in drafting contracts and during their execution to avoid major problems. They also explored the challenges of addressing gaps in contracts, the methods for quantifying compensation, and the arbitrability of administrative acts and exorbitant clauses. The discussions underscored the need for clear legal frameworks and the balance between regulatory intervention and legal security for investors.

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