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Reaffirming Arbitration: The Brazilian Superior Court of Justice Decides on the Persistent Debate of Public Entities' Participation in Arbitration

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Brazil is internationally recognized as an arbitration-friendly jurisdiction. As a signatory to the New York Convention, its arbitration framework is modeled on UNCITRAL Model Law, and its highest courts actively support and promote arbitration.

Despite this, the participation of Brazilian public entities in arbitration remains a subject of debate, even though legislative reforms aimed at resolving this issue were introduced nearly a decade ago (*see* Law No. 13,129/2015). This ongoing debate is exemplified by the recent judgment of the Brazilian Superior Court of Justice (STJ) in REsp No. 2.143.882/SP (*ETE Equipamentos de Tração Elétrica Ltda., CEBRAF Serviços Ltda. and Schneider Electric Brasil Ltda. v. União*), which we discuss below.

The STJ's Decision in REsp No. 2.143.882/SP

The underlying dispute pertained to a contract signed in 1976 between Ferrovia Paulista S.A. (FEPASA), a former state-owned rail transport company, and Consórcio Brasileiro Europeu, a private company, for the electrification of railways in São Paulo. FEPASA was later absorbed by Rede Ferroviária Federal (RFFSA), a federal state-owned company. When RFFSA was disbanded in 2007, the Federal Government assumed its contractual obligations, including an arbitration agreement in the original contract.

When RFFSA initiated litigation for breach of contract, the respondent invoked the arbitration clause to request that the dispute be resolved through arbitration. The Federal Government objected, claiming the arbitration agreement was invalid, as it lacked legislative authorization to arbitrate at the time it inherited the contract. A Federal Regional Court (TRF-3) sided with the Federal Government, ruling that the Federal Government could only be submitted to arbitration after the entry into force of Law No. 13,129/2015 that expressly allowed arbitration with public entities, and prohibited arbitration on grounds of the principle of the unavailability of the public interest.

Upon appeal, however, the STJ overturned this decision. Citing previous case law, the court

reaffirmed the distinction between primary public interest (which cannot be arbitrated) and secondary public interest (which can). The Supreme Court maintained that the public interest is fundamentally about the proper application of the law, which can coexist with arbitration.

The STJ ruled that the Federal Government, having inherited the rights and obligations of RFFSA, was bound by the arbitration clause in the contract. This ruling upheld the prevailing position concerning the transferability of arbitration clauses. This indicates that, unless an explicit reservation is made in the assignment of the contractual position, the effects of the arbitration clause will extend to the assignee.

Moreover, the STJ decision in the REsp No. 2.143.882/SP can contribute to settle the highly debated topic of the validity of arbitration agreements entered by Brazilian public entities before the Law nº 13.129/2015 entered into force.

The Legislative Reform and the Persistent Debate

The debate over the participation of public entities in arbitration should have been conclusively settled with the 2015 amendments to the Brazilian Arbitration Act (Law No. 9.307/1996) by Law No. 13.129/2015. This law clarified that direct and indirect public administration may use arbitration to resolve disputes concerning transferable property rights.

Before this amendment, the question of whether public entities could arbitrate their disputes had been contentious. While specific sectors, such as oil, gas, and telecommunications, had regulatory provisions allowing specific regulatory agencies and state-owned companies to arbitrate, there was no general rule for state-owned enterprises or public entities. Legal scholars and courts debated whether public entities needed explicit legislative authorization to arbitrate or whether the state's capacity to contract inherently allowed for arbitration.

Over time, case law evolved to allow state-owned enterprises to bring property-related claims to arbitration. This is based on the recognition of the difference between primary public interest (which involves protecting society's interests and cannot be submitted to arbitration) and secondary public interest (which involves the state's property interests and can be submitted to arbitration), as established in the judgment of MS n. 11.308/DF (*União v. TMC Terminal Multimodal de Coroa Grande SPE S/A*) by STJ in 2006.

Later on, by adding a clear provision on the subject, the 2015 amendment sought to put an end to this controversy.

However, the issue resurfaced in *Conflito de Competência No. 151.130* (*American International Group Inc. Retirement Plan et. al. v. Câmara de Arbitragem do Mercado et. al.),* decided by the STJ in 2019. In that case, minority shareholders initiated arbitration against the Federal Government, seeking damages for losses in Petrobras' share value (the Brazilian state-owned oil company), which they attributed to the purported negative impacts of corruption within the organization, revealed by Operation Car Wash.

The STJ found that the Federal Government, despite being Petrobras' majority shareholder, could not be compelled to arbitrate because it lacked legislative authorization to enter into an arbitration agreement, even after the passage of Law No. 13.129/2015.

A Course Correction – the validity of the arbitration clause as a matter of contractual good faith

The STJ's decision in REsp No. 2.143.882/SP marks a notable departure from its previous ruling in the *Conflito de Competência No. 151.130*. The court rejected the argument that public entities were barred from arbitration before 2015, and it did so while asserting that the government is also bound by good faith when entering int arbitration agreements.

It held that restrictive interpretation raised by the Federal Government contradicts the prevailing legal doctrine at the time and diverges from existing precedents set by both the STJ and the Federal Supreme Court. Specifically, the understanding that the Arbitration Law applies to contracts containing an arbitration clause, even if they were executed before its enactment.

With this decision, the STJ corrected its course. In doing so, the court reinforced that arbitration clauses in contracts predating the 2015 amendments remain valid and enforceable, even for public entities. it reasserted that arbitration agreements do not necessarily oppose public interest, and that the Federal Government has to act in good faith when entering into arbitration agreements.

The latter STJ decision also protected the legitimate expectations of private parties who contract with the government and the principle of good faith. It found that it would not be legitimate for the government to claim damages for breach of the contract while trying to avoid its arbitration agreement.

The principle of contractual good faith entails honouring the legitimate expectations of the parties to an arbitration agreement. While entertaining that the Federal Government cannot pursue compensation for a breach of contract while simultaneously attempting to invalidate its arbitration clause, the decision contributed to asserting the principle of *pacta sunt servanda* (the binding nature of contracts) regarding arbitration clauses.

This principle is crucial for maintaining the viability of arbitration practice and curbing undesirable opportunism from economic agents, including the Public Administration. In this sense, the parties adhering to the arbitration agreement must act in good faith and facilitate its enforcement, rather than creating obstacles to its effectiveness, even if it is the Government itself.

Conclusion

The STJ's decision in REsp No. 2.143.882/SP strengthens the position of arbitration in Brazil by ensuring that public entities must adhere to arbitration agreements, promoting greater legal certainty and protecting the legitimate expectations of private parties contracting with the government. This ruling helps to curb opportunistic behavior and reinforces the principle that public entities, like private ones, must honor their arbitration agreements in good faith, thus bolstering the reliability and attractiveness of Brazil as a forum for arbitration.

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