Brazil's Decision to Stay Outside the Investment Arbitration World and Reliable Alternatives for Foreign Investors

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Currently ranked as the largest economy in South America and twelfth largest worldwide,[1] Brazil has traditionally been one of the top destinations for foreign direct investment ('FDI'). According to the latest UNCTAD World Investment Report, in 2021 Brazil continued the trend from previous years and ranked sixth in the top host economies for FDI inflow worldwide.[2] It has also become an important outbound investor and is currently among the top 20 home economies for FDI outflow worldwide.[3]

As an important player in the international investment world, it would be reasonable to expect Brazil to take part in investment arbitration. However, the country has historically chosen to remain outside of it and, to date, has never ratified a traditional bilateral investment treaty ('BIT') nor adhered to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States ('ICSID Convention'), nor even put into place any investor-State dispute settlement ('ISDS') mechanism. Nevertheless, Brazil continues to constantly receive high FDI inflows, and to play an increasingly important role in FDI outflows.

This article addresses Brazil's unique position in the investment arbitration world and outlines a reliable alternative dispute settlement mechanism for its foreign investors.

1 World Bank's Gross Domestic Product 2021 Statistics (2021) <https://databankfiles.worldbank.org/data/download/GDP.pdf> accessed 10 October 2022.

2 UNCTAD, World Investment Report 2022 (2022) p. 4 <https://unctad.org/system/files/official-document/wir2022_overview_en.pdf> accessed 10 October 2022.

3 UNCTAD, World Investment Report 2022 (2022) p. 5 <https://unctad.org/system/files/official-document/wir2022_overview_en.pdf> accessed 10 October 2022.

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Brazil: an outsider to the investment arbitration world

Starting in the late 1950s, BITs have played an important role in providing foreign investors with protective rights and mechanisms, one of which is the investor's option to resort to international arbitration in the event of a dispute against the host State. ISDS is widely adopted by countries all over the world, the vast majority of which have adhered to the ICSID Convention – with currently 157 contracting States.[4]

Yet, Brazil has never adhered to the ICSID Convention, nor to any ISDS mechanism. Indeed, Brazil's history with investment agreements and ISDS mechanisms is unique. Between 1994 and 1999, it did in fact sign 14 BITs. However, due to political opposition within the Brazilian government, none of them were ever ratified.

Brazil spent several years after that as one of the few top economies without any BITs or model investment agreement. In 2015, Brazil at last reappeared on the investment agreements scene, releasing its own model agreement, the 'Investment Cooperation and Facilitation Agreement' ('ICFA'). It has since signed 13 ICFAs, two of which are currently in force.[5]

Nevertheless, Brazil continues to constantly receive high FDI inflows, and to play an increasingly important role in FDI outflows as well

ICFAs are very different from traditional BITs: rather than aiming to protect investment, they seek to facilitate and encourage it by setting rules for cooperation and risk mitigation. The contents of ICFAs are generally very different from those of traditional BITs. Regarding potential disputes, the ICFA approach is to centre on dispute prevention, rather than dispute settlement.

In order to prevent disputes, ICFAs create two institutions to govern the agreement. First, there is the 'Joint Committee, which is made up of government representatives of both States. Among other responsibilities, the Joint Committee supervises the implementation and execution of the ICFA, consulting with the private sector and civil society, as well as resolving any issues or disputes concerning investments in an amicable manner. Second, there are the ombudsmen, referred to as 'National Focal Points.' Each State must appoint its own National Focal Point, whose main responsibility is supporting investors of the other State in its territory. As such, one of the responsibilities of the National Focal Points is to follow up on requests and queries from the investors (or the investors' State) with the relevant public authorities and to prevent disagreements regarding investment matters by collaborating with government authorities and relevant private entities. In general terms, the Joint Committee works on a State-to-State level, while the National Focal Points assist investors by dialoguing with government authorities on their behalf.

ICFAs therefore introduce a new approach to investment disputes, betting on cooperation to prevent them from arising in the first place. However, should these prevention mechanisms fail, the investor will have no other option but to seek its home State's aid, as ICFAs provide only for State-to-State arbitration (under ICFAs, investor-State arbitration is not possible).

Consequently, at present Brazil has no ISDS mechanisms in force and remains a notable outsider to the investment arbitration world.

That said, Brazil's decision to stay out of investment arbitration cannot be deemed as short-sighted or reckless. After over 50 years of BITs and the ICSID Convention, it is clearly a mature and well-founded decision, based on the country's geopolitical interests and position. After all, Brazil has managed to achieve continuously high rates of FDI inflow. Although one cannot accurately

4 Database of ICSID Member States <https://icsid.worldbank.org/about/member-states/database-of-member-states> accessed 10 October 2022.

5 Brazil-Angola ICFA, signed on 1 April 2015 and which entered into force on 28 July 2017; and Brazil-Mexico ICFA, signed on 26 May 2015 and which entered into force on 7 October 2018.

say whether and how this decision has affected Brazil's position in the international investment arena, it appears not to have jeopardised its capacity to attract FDI.

Commercial arbitration against Brazilian public entities

In spite of the lack of an investment arbitration remedy in Brazil, foreign investors can rely on a different, but secure, way to resolve their issues with Brazilian public entities: commercial arbitration.

Commercial arbitration is a well-established method of dispute resolution in Brazil, and is frequently used and widely respected by Brazilian courts. Brazil enacted its own Arbitration Act in 1996 (Law 9.307/1996, 'BAA') and acceded to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards ('New York Convention') in 2002.

In the 26 years that the BAA has been in force, Brazil has developed an arbitration-friendly body of case law that has fostered the expansion of arbitration and its credibility in the country. In fact, Brazil has become a key market for commercial arbitration, not only within Brazil but also worldwide. According to the latest statistics from the International Court of Arbitration of the International Chamber of Commerce ('ICC'), the main international centre for commercial arbitration, Brazil is currently the second-largest user of arbitration worldwide, and the largest in Latin America.[6]

Furthermore, commercial arbitration in Brazil is not solely used by private parties, but also by public entities. The BAA itself expressly states, since its amendment in 2015, that Brazilian public entities may be parties to arbitration. In any case, by that point the Brazilian courts had already built up years of solid case law recognising this option.

In fact, before the BAA was amended, Brazilian public entities had already taken part in several arbitral proceedings, often based on other Brazilian laws that allowed for this option. For instance, the Brazilian Petroleum Law (Law 9.478/97), enacted in 1997, already established that the Brazilian National Petroleum Agency ('ANP') could resort to arbitration. As such, the ANP has been introducing arbitration clauses in virtually all of its draft concession agreements since its first bid in 1998, and is known to have participated in several arbitral proceedings.

Furthermore, the Brazilian Public-Private Partnerships Law (Law 11.079/2004), which governs contracts between Brazil's public authorities and private partners, also has a provision stating that arbitration should be considered as a method of dispute resolution. Most Brazilian public-private partnerships and concession contracts currently contain arbitration clauses.

6 ICC Dispute Resolution Statistics: 2020 <https://iccwbo.org/publication/icc-dispute-resolution-statistics-2020/> accessed 10 October 2022.

More recently, in 2019, Federal Decree 10.025/2019 was enacted, establishing that all disputes between investors and the relevant State or State-owned entities in the port, road, rail, waterway and aviation-transportation sectors may be submitted to arbitration. These are but a few examples that illustrate just how well established commercial arbitration involving public entities is in Brazil.

So although foreign investors who decide to invest in Brazil cannot rely on the traditional arbitration investment system, they are able to resort to commercial arbitration as an effective way to resolve their disputes with Brazilian governmental entities.

Advantages and disadvantages of resorting to commercial arbitration

The use of commercial arbitration against Brazilian public entities is, however, subject to a few restrictions. According to the BAA, it must be based on law (i.e. it cannot be based on equity) and must be public. Other legislation sometimes establishes further requirements, for example Decree 10.025/2019 requires that the arbitration be held in Portuguese, seated in Brazil and governed by Brazilian law. It is worth noting that Brazil is a federation and each of its states and municipalities has jurisdiction to issue its own regulations. Although a local law or decree can never diverge from a federal act (and, therefore, must not contradict

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the BAA), they can set out further details on procedural rules. Therefore, parties interested in contracting with a public entity in particular have to verify whether there are any additional specific regulations that also apply.

At first glance, one might consider these restrictions as disadvantages when compared to investment arbitration. However, on further analysis, they are not so troublesome and resorting to commercial arbitration also has its advantages.

First, although the requirements for the arbitration to be based on law and governed by Brazilian law are certainly restrictive and therefore at least somewhat disadvantageous, they make sense from the overall perspective of the potential disputes involved. In Brazil, public entities must follow the principle of legality, according to which they can only act based on prior-existing legislation. Therefore, it would be quite difficult for an arbitral tribunal to analyse the actions of a public entity (and the disputes arising out of them) without taking into account Brazilian law. We should also bear in mind that this is a specific requirement under Decree 10.025/2019 and, although it may be present in other specific legislation, it is not a general requirement to all arbitrations with public entities in Brazil.

Second, although requiring that the arbitration be seated in Brazil is also undeniably restrictive, it makes sense once we consider the potential need to enforce the arbitral award. According to the BAA, all arbitral awards issued in Brazil may be enforced directly, whilst arbitral awards issued elsewhere need to be recognised by the Superior Court of Justice before they can be enforced in the country.[7] Therefore, as a foreign investor would most likely wish to enforce the award in Brazil, having the arbitration seated in Brazil makes any award directly enforceable without court intervention. It is also worth noting that any award issued in Brazil in a commercial arbitration between a Brazilian public entity and a foreign investor would also be enforceable in any other contracting State of the New York Convention.

Third, when it comes to drafting the arbitration clause, commercial arbitration has an advantage. While in investment arbitration the offer to arbitrate is usually inserted in a treaty and the investor has no say in its contents, in commercial arbitration the investor may have the opportunity to discuss the clause's terms when negotiating the contract. Although in a public bid there may be less margin to propose changes, when negotiating with State-owned companies this may be possible.

Finally, the biggest advantage of commercial arbitration vis-à-vis investment arbitration seems to be the issue of arbitrability. In regards to objective arbitrability, Article 1 of the BAA states that all assignable property rights may be subject to arbitration, which is broader than Article 25 of the ICSID Convention. Furthermore, contractual arbitration clauses that give rise to commercial arbitration are also usually considerably broader than the investment disputes covered by investment treaties. In regards to subjective arbitrability, commercial arbitration also works with a much broader and more straight-forward definition than investment arbitration: while in commercial arbitration foreign investors will be legitimate parties to the arbitration as long as they have duly entered into an arbitration clause, in investment arbitration the concepts of 'investor', 'investment' and even of 'national' entail frequent debates.

As a result, there are less likely to be serious jurisdictional hurdles in commercial arbitration than in investment arbitration (where jurisdictional objections are common and often create substantial delays).

Conclusion

Brazil has clearly made a conscious decision to not adopt any ISDS mechanisms and to remain outside the investment arbitration world. The recent adoption of its own model investment treaty, the ICFA, only corroborates this conclusion. The ICFA introduces a new approach to investment disputes that does not provide for any ISDS mechanism but rather focuses on dispute prevention, offering the parties specific mechanisms to this end. Should these mechanisms fail, the ICFA provides for arbitration exclusively between States.

However, this does not mean that Brazil's foreign investors can never enter into arbitrations against Brazilian public entities – they can do so through commercial arbitration. Commercial arbitration is a reliable and secure method of dispute resolution that acts as a safety net for foreign investors in their disputes against Brazilian public entities. Although in some ways commercial arbitration against public entities can be more restrictive, it has both advantages and disadvantages compared to the traditional investment arbitration approach. All things considered, foreign investors still have options when it comes to settling their disputes with Brazilian public entities. This is valuable information, considering the country's important position as one of the top host economies for FDI inflow.

7 BAA, Arts 31, 34 and 35.