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# The Recognition Of The Competence-Competence Principle Upon Concession Contracts In Brazil: Legal Certainty Provided For Foreign Investors

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# Commentary

## The Recognition Of The Competence-Competence Principle Upon Concession Contracts In Brazil: Legal Certainty Provided For Foreign Investors

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### I. The Case

On October 11, 2017, the Brazilian Superior Court of Justice ("STJ"), the highest competent court to rule on arbitration-related matters, rendered a landmark decision on the proceeding CC 139.519-RJ[1], addressing the Competence-Competence principle applicability upon concession contracts related to the Oil & Gas exploration in Brazil. In a legal dispute brought by the Brazilian state-run company Petróleo Brasileiro S.A. ("Petrobras") against the Brazilian oil and gas regulatory agency, the National Agency of Petroleum, Natural Gas and Biofuels ("ANP"), the majority of STJ judges ruled that the arbitrator should decide based on (i) his own competence and (ii) the validity of the arbitration convention in the concession contract.

This remarkable decision was later confirmed by the Brazilian Superior Court in other cases such as REsp No. 1550260/RS[2], REsp No. 1597658/SP[3], and CC No. 151.130/SP[4].

### II. The Issues Under Dispute

The dispute arose in 2014, after ANP's administrative decision to merge small oil fields under Petrobras' concession (known as *Parque das Baleias*) with other fields awarded to other companies at the same bidding process, which was undertaken back in 1998, in order to create one single oil field (called *Campo de Jubarte*).

The reasoning of the administrative decision, which was followed by the enactment of an administrative resolution by ANP, was justified by the Brazilian agency as a necessary measure to "*substantially increase the public revenues without, however, affecting the economic viability*" of the ongoing concession contracts[5]. In fact, the most meaningful effect of the administrative decision would be the increasing of the royalties income due by Petrobras pertaining to the concession contract from BRL17.3 Billion to BRL44 Billion (from approximately US$4.1 Billion to US$11 Billion[5]), over the remaining term of the concession contract (from 2014 to 2033). An outstanding impact over the net revenues expected by Petrobras.

Although Petrobras had strong legal arguments to contest ANP's decision to change the concession contract rules 16 years after its signature, the Brazilian agency refused to review its position. Thereafter, based on the arbitration convention in the concession agreement, Petrobras commenced an arbitration procedure against ANP before the International Chamber of Commerce ("ICC") (registered as CCI no. 20196/ASM[6]) in Rio de Janeiro, Brazil, seeking to declare null and void ANP's administrative decision to merge the oil fields.

ANP, in turn, initiated judicial measures in order to stay the arbitration proceeding – it argued the lack of competence of the arbitrators, as well as the invalidity of the arbitration agreement. ANP advocated that only a national court would have jurisdiction to decide the merits of the case since there was "public interest" involved. That is, as the case at hand was related to a "non-disposable equity rights", a private court could not render a decision regarding the issue.

Furthermore, ANP contended that since there was a direct interest of the State of Espírito Santo upon the allocation of the royalties related to the exploration of the fields, and the State was not a party to the concession contract, the arbitration convention could not be imposed over it. According to ANP's reasoning, an arbitration clause can only be imposed upon the contract parties who have consciously agreed to the establishment of such arbitration. As contended by ANP, the acceptance of the Petrobras standpoint would otherwise curtail the State of Espírito Santo's defense.

Once notified to pay the royalties charged by ANP, Petrobras sought an injunction before the arbitration tribunal to suspend the administrative decision – in order to halt any attempt of the Brazilian agency to collect any amount greater than that consented by the parties under the concession contract – while the merits of the decision were under dispute. Conversely, ANP filed an anti-suit injunction before the Federal Tribunal of the Second Circuit, which granted to both ANP and the State of Espírito Santo the right to collect the new royalties amount from Petrobras. The court decision also recognized the competence of the federal courts to decide the merits of the case, despite the existence of an arbitration convention on the concession contract.

Because of the existence of two conflicting decisions regarding the same matter, Petrobras filed a motion before the STJ requesting for the recognition of the prevalence of the arbitration clause, and thus of the arbitrators' decision.

## III. The Decision

The majority of the STJ decided that, since there was an arbitration clause indicating the ICC Brazil as the competent tribunal to resolve contract disputes, ICC arbitrators must be the *first* judges of their own jurisdiction.

According to the STJ, the Brazilian legal order, including those laws that govern the Oil and Gas sector, provides for arbitrator competence to decide prior to any judicial body on both its own jurisdiction over a case brought before the arbitration court, and on the validity of the arbitration convention set forth on the concession contract. Moreover, arbitrators should be the first to decide on whether the arbitration clause mutually agreed by the parties should prevail, even in case of involvement of a public third party interest.

Although there was a public interest surrounding the case, according to the STJ, the issue was not related to a non-disposable equity rights. According to the Tribunal's reasoning, not all public equity rights are non-disposable. In the case, since the government has allowed a private party under a concession contract to explore a public equity (i.e., oil and gas fields), the public equity rights are therefore disposable. As noted by the Tribunal after an extensive review of several judicial decisions, it was also of public interest to dispose these equity rights for the exploration of the national mineral resource. Therefore, the issue in question is subject to arbitration.

The STJ also decided that the State of Espírito Santo might intervene in the ongoing arbitration proceeding, albeit it has not agreed to the arbitration convention, in order to protect its interests in the allocation of the oil blocks royalties.

## IV. Consolidation of the Understanding

This landmark decision has opened the path for other cases to be interpreted in the same way, consolidating the understanding in the Brazilian legal order that the arbitral tribunal is the first to judge its own competence and that public entities may be subject to arbitration. On May 7, 2018, STJ has reaffirmed the applicability of the Competence-Competence principle in another case involving Petrobras (CC No. 151.130/SP). This time it was the Federal Union that had opposed the arbitration procedure.

Several minor shareholders have started arbitral proceedings against Petrobras and its major shareholder, the Union, based on the arbitration agreement in the Petrobras bylaws. The claim seeks payment of damages suffered by minor shareholders due to the drastic devaluation of Petrobras assets after the exposing of a corruption scheme through Brazilian Federal Police operation "Car Wash" ("Operação Lava Jato").

Soon after the arbitration request was filed by the minor shareholders, the Union started proceedings at federal courts requesting its exclusion from the arbitration procedures under the grounds that the Union was not bound to the arbitration commitment in Petrobras bylaws.

The federal courts understood that the Union should be excluded from the arbitration and that it had exclusive competency to judge claims seeking damages from the Union. However, STJ overruled the federal courts' decision, sustaining that the arbitral tribunal should be the one to judge its own competency, based on the Competence-Competence principal. In other words, STJ ruled that the participation of the Union in the arbitration was to be decided by the arbitration tribunal, and not by the federal courts under penalty of unlawful interference of the judiciary power in the arbitration.

As ruled by STJ, the applicability of the Competence-Competence principle is a guarantee to access the arbitral jurisdiction and it aims to respect the will of the parties that opt for arbitration as the dispute resolution method.

## V. Conclusion

The recent decisions rendered by the STJ on the Petrobras cases provides legal certainty to Brazilian legal order. It ensures the application of the Competence-Competence principle upon concession contracts and disputes involving public entities. It is true that the STJ had already enforced the principle in previous cases; however, this STJ's decision has brought additional clarity regarding the allocation of the arbitral tribunal's and national court's powers to rule on jurisdictional challenges, even when there are public interests in dispute.

Moreover, by recognizing the application of the Competence-Competence principle to concessions contracts, the STJ's Justices have also accorded the arbitration practice performed in Brazil to the best international practice, and to the Transnational Petroleum Law principles. The effects that might arise in the short- to mid-term, as a result of the proper legal conditions provided, are the enhancement of investments – mainly by foreign investors – not only in the oil and gas sector, but also in all sectors where the public interest is present.

## Endnotes

1. *See* STJ, CC No. 139.519/RJ, Reported Judge Regina Helena Costa, decision rendered on 10/11/2017, published by official gazette on 11/10/2017. Retrieved from http://www.stj.jus.br.

2. *See* STJ, REsp No. 1550260/RS, Reported Judge Paulo de Tarso Sanseverino, decision rendered on 12/12/2017, published by official gazette on 3/20/2018. Retrieved from http://www.stj.jus.br.

3. *See* STJ, REsp No. 1597658/SP. Reported Judge Nancy Andrighi, decision rendered on 05/18/2017, published by official gazette on 08/10/2017. Retrieved from http://www.stj.jus.br.

4. *See* STJ, CC No. 151.130/SP Reported Judge Nancy Andrighi, decision rendered on 05/07/2018, published by official gazette on 05/09/2018. Retrieved from http://www.stj.jus.br.

5. On August 28, 2018, the currency rate was BRL 1.00 to US$ 0.24.

6. *See* International Chamber of Commerce – ICC, case file CCI No. 20196/ASM. ■

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