

# The Institute for Transnational Arbitration

A Division of  
The Center for American and International Law

Printed by the  
Dedman School of Law at Southern Methodist University



Volume 22

Spring 2008

Number 2

## RECENT SET-BACKS IN ENFORCEMENT OF ARBITRATION AWARDS: WHISPERS OF REVOLUTION OR POCKETS OF RESISTANCE?

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This article examines recent developments in arbitration law in two important jurisdictions: Brazil and India. These developments — the annulment of the *Itiquira v. Inepar* award in Brazil and



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the *Venture Global Engineering v. Satyam Computer Services* decision in India — suggest that arbitration's continued progress still faces opposition. These decisions are not isolated incidents, either, as several Latin American states have recently announced steps to limit the ability of foreign investors to bring disputes with the state to arbitration.

The question raised is whether these recent developments indicate the beginnings of a revolution against arbitration or represent merely remaining pockets of resistance. It is probably too soon to answer this question, and we conclude that these two decisions are either outliers (Brazil) or addressable through careful drafting (India). However, developments of this sort — as well as those in Latin America — bear monitoring for clues as to whether, taken together, they represent a trend, or the beginning of a trend, away from continued growth in the use of arbitration as the principal method of resolution of international commercial disputes.

### The *Inepar* Decision — Are Pre-Dispute Arbitration Agreements Still Enforceable in Brazil?

On January 30, 2008, the Court of Appeals of Paraná, in Curitiba, Brazil, annulled a 2005 arbitration award rendered by an ad hoc tribunal seated in Brazil and applying the ICC

arbitration rules. The case — *Inepar S.A Indústria e Construções* (*Inepar*) v. *Itiquira Energética S.A.* (*Itiquira*) — produced a wave of criticism in Brazil<sup>2</sup> and elsewhere when the Court annulled a final award in favor of *Itiquira* on the basis that the detailed arbitration agreement in the relevant contract, which called for arbitration and specified the appointment of the tribunal, an appointing authority, a venue in Brazil, and selected procedural rules (ICC) and languages (Portuguese and English), was not sufficient to require the parties to arbitrate.<sup>3</sup> The Court refused to give any effect to the facts that: (i) the losing party, *Inepar*, had initiated the arbitration, relying on the arbitration clause it later challenged, and (ii) the parties had drawn up and signed terms of reference specifying the jurisdiction of the tribunal.

### Background to the Award

In 1998, *Itiquira*, a subsidiary of a U.S.-based energy company,<sup>4</sup> executed an EPC contract with *Inepar* for the construction of a hydroelectric power plant in Mato Grosso, Brazil. Construction on the project fell behind schedule, and by mid-2001 there were substantial delays. *Itiquira* ultimately terminated the EPC in December 2001; it subsequently replaced *Inepar* as contractor and completed the plant. Following a period of negotiations, *Inepar* launched an arbitration in June 2002 against *Itiquira*, relying on the arbitration agreement in the EPC, in which *Inepar* sought US\$ 20 million as compensation for allegedly wrongful termination. In July 2002, *Itiquira* answered and filed its counterclaim against *Inepar* for breach of the EPC, seeking US\$ 70 million (later raised) in damages.<sup>5</sup> The presiding arbitrator was agreed and appointed in September 2002.

The parties then filed written submissions of claims and counterclaims in October and November 2002, and in March 2003, they agreed on and signed terms of reference.<sup>6</sup> There followed extensive written submissions, examinations of expert witnesses and oral hearings, including final merits hearings in August and November 2004. At no time during the arbitration did either party raise a plea to the jurisdiction or otherwise question the arbitration agreement, the terms of reference or the tribunal's jurisdiction.

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In September 2005 the tribunal rendered a final award granting Itiquira relief on its counterclaims against Inepar in the full amended amount sought of approximately US\$ 120 million. The tribunal also granted a portion of Inepar's claim, in the amount of US\$2.5 million. The tribunal reached its decision by majority vote, with one arbitrator issuing a dissent.

Amongst the myriad challenges to the award filed by Inepar<sup>7</sup> was one based on the alleged lack of a post-dispute submission agreement, called in Portuguese a *compromisso*.<sup>8</sup>

### ***The Issue – Is a Compromisso Still Required under Brazilian Law?***

Prior to 1996, arbitration agreements in domestic arrangements were governed by the provisions of the 1916 Civil Code and the 1973 Civil Procedure Code, pursuant to which they were considered “promises to contract” and were not specifically enforceable.<sup>9</sup> A “submission agreement” (the *compromisso*) was required to resolve the dispute by arbitration, but the requirements for such an agreement (e.g., the details of the dispute, the names and addresses of the arbitrators, etc.) made it practically impossible to create an effective pre-dispute arbitration agreement.<sup>10</sup> Even in international commercial contracts, which were subject to the 1923 Geneva Protocol, the ability to compel arbitration of a dispute based on a pre-dispute arbitration agreement was uncertain.

In 1996, Brazil enacted Law 9.307 (Arbitration Law), which substantially overhauled the law on arbitration in Brazil. Although Brazil was not at the time of enactment a signatory to the New York Convention (Convention), the provisions of the Arbitration Law mirrored many of the features of the Convention on enforcement of arbitral awards. The constitutionality of the Arbitration Law was confirmed by the Federal Supreme Court<sup>11</sup> in 2001.<sup>12</sup> Brazil has also acceded to the Convention, which entered into force for Brazil on September 5, 2002.<sup>13</sup>

The *compromisso* or submission agreement concept survived into the Arbitration Law, although its use was limited to very specific situations. Article 3 the Arbitration Law provides that “parties can submit their disputes to arbitration by virtue of the arbitration agreement, consisting of the arbitration clause and the *compromisso*.” An “arbitration clause” is defined in Article 4 as an “agreement by which the parties to a contract undertake to submit to arbitration the disputes which may arise with respect to that contract”. The *compromisso* is defined in article 9 as “an agreement by which parties submit an existing dispute to arbitration.”

The issue then arose: does Article 3 require both an arbitration agreement and a *compromisso*? The answer is no, and the key provisions of the Law on this point were Articles 5 – 7. Article 5 describes the situation where the parties have clearly agreed on the procedures for their arbitration; it provides:

*If the parties refer in the arbitral clause to the rules of an arbitral institution or specialized entity, arbitration shall be initiated and proceed in accordance with these rules; the parties may also establish the agreed procedure for the initiation of the arbitration in the same clause or in another document.*

Article 6, in contrast, addresses the situation where the parties have included an arbitration agreement, but that agreement does not provide the details of the arbitration – i.e., where the parties agree to arbitrate, but do not provide much beyond a bare recitation that they have agreed to arbitrate. Article 6 provides:

*Failing a prior agreement on the procedure for initiating arbitration, the interested party shall communicate to the other party its intention to initiate arbitration by mail or any other means of communication, with proof of receipt, requesting its presence for the conclusion of the submission agreement at a certain day, hour and place.*

Article 7 deals with the reluctant party where there is a bare agreement to arbitrate, but no details:

*If there is an arbitral clause and if one party resists the initiation of the arbitration, the interested party may request that the other party be summoned to make an appearance in court for the conclusion of a submission agreement;*

*§ 7 - The court decision that admits the request shall constitute a submission agreement.*

In other words, the focus was on whether the arbitration clause contained sufficient details to proceed immediately to arbitration. The *compromisso* survived both as a mechanism to start an arbitration where there was no pre-dispute arbitration agreement *or* where there was an arbitration agreement that was not “complete” – and even then, the court could simply compel arbitration and its order would be the *compromisso*. The courts in reviewing these provisions began to refer to arbitration agreements under Article 5 – such as agreements that selected an institution's rules of arbitration –

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as “full” arbitration clauses. Agreements under Article 6 were called “empty” clauses.<sup>14</sup>

In 1999, the São Paulo Court of Appeals held that the *compromisso* was not required in Article 5 cases.<sup>15</sup> This position and the reasoning behind it was later confirmed in the Supreme Court in the *M.B.V. Commercial and Export Management* case in 2001, where it ruled:

*the article-seven action is reserved for the “blank” arbitral clauses, i.e., those in which there is no prior agreement on the manner of initiating the arbitration (...). In the other kinds of clauses, when a contractual dispute encompassed by the clause arises, the next step is the commencement of the arbitration according to the rules of the institution referred to by the parties or according to what is set out in the clause itself (...). To understand differently would be to render useless the Brazilian arbitration system.*

All of the foregoing sets the stage for the Inepar challenge to the award in the Paraná Court of Appeals.

#### ***The Inepar Decision – Resurrection of the Compromisso?***

Despite the relatively clear guidance by the Supreme Court, Inepar alleged regardless of the arbitration agreement in the EPC Contract being “full” or “empty,” the parties were required to sign a *compromisso* before the arbitration could be validly conducted. Because no such *compromisso* had been signed, Inepar argued, the entire arbitration was invalid and the award should be annulled.

The district court (court of first instance) in Curitiba rejected this argument summarily, ruling that

*[i]n addition to the fact that the parties have previously agreed on the rules to be followed in the arbitration, based on a “full arbitration clause,” [Inepar] entirely participated in the proceedings without raising, ..., any objection regarding the absence of the compromisso. To bring this point only before the state court, [after the award is rendered], undoubtedly violates the principle of good faith and party autonomy.<sup>16</sup>*

Inepar took this decision on appeal, however, and was successful. There, the Court of Appeals of Paraná, in a 2-1 decision, determined that the *compromisso* was required and could not be waived even if a “full” arbitration agreement existed. The majority’s reasoning was based primarily on alleged public policy concerns about arbitration. The majority held that jurisdiction is a state power, which cannot

be waived or delegated, such as to arbitration, without full compliance with any relevant legal requirements. In the view of the majority, Article 6 of the Arbitration Law applies to *all* arbitration agreements, not just to “empty” agreements. In the event that there is a “full” arbitration agreement, such as that in the EPC Contract, the terms of that “full” agreement can be repeated in the *compromisso*, which the reluctant party can be forced to sign under Article 7, but this formality cannot be waived.

The majority acknowledged both the signing of the terms of reference and Inepar’s participation without challenge in the arbitration, but held that these facts were irrelevant, because the issue – transference of jurisdiction from the courts to arbitration – was one of public policy that could not be waived.

The dissenting judge wrote that Inepar’s challenge was barred by Article 20 of the Arbitration Law, which provides that a “party raising a plea regarding the jurisdiction ... shall do so at the first opportunity ... after the initiation of the arbitration”.

It is impossible to square this decision with the already-long and growing list of Brazilian cases in which the courts have reached the opposite conclusion and upheld pre-dispute arbitration clauses.

Because the *Inepar* decision is contrary to a decade of favorable arbitration decisions in other Brazilian states and in the SCJ, it is widely viewed as likely to be reversed on further appeal, either to an *en banc* hearing of the Paraná Court of Appeals or to the SCJ.<sup>17</sup> Looking at the decision in context, however, it is difficult to conclude that this represents a reason to consider Brazil an unreliable arbitration jurisdiction. It is true that it suggests lingering hostility to arbitration amongst the judiciary. However, this decision is one negative event in a decade’s worth of positive jurisprudence following the Arbitration Law and adhering to the Convention. Enforcement may remain slow in Brazil, but that is a systemic problem with the courts, and is not caused by problems with the Arbitration Law. Thus, unless there are further decisions that take up the majority’s reasoning, it seems reasonable to conclude that *Inepar* is – and will remain – an outlier with little long-term significance.

#### ***The Venture Global decision – Are Awards in India Now Easier To Set Aside?***

On January 10, 2008, the Supreme Court of India issued its judgment in *Venture Global Engineering v. Satyam Computer*

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*Services, Ltd.* That case arose out of a challenge in India to an arbitration award rendered in London under the rules of the London Court of International Arbitration (LCIA) that ordered Venture Global Engineering (VGE) to transfer its shares in a joint venture to Satyam Computer Services, Ltd. (Satyam).

VGE argued that it should be permitted to challenge the award as contrary to the public policy of India under a part of the Indian Arbitration and Conciliation Act 1996 (the Arbitration Act) that had previously been interpreted broadly to allow awards to be challenged if they violated substantive provisions of law. The Supreme Court of India agreed, thus opening the door to allow Indian courts to consider challenges to awards under a standard approaching an error of law. However, the Court also said that parties may opt out of those statutory provisions under the terms of their arbitration agreement, which means careful and informed drafting of arbitration clauses is essential.

### **Background**

Satyam and VGE entered into an agreement to form a joint venture in India. The agreement provided that it was to be governed by the law of Michigan, but it also said that at all times the shareholders of the Indian venture would act in accordance with the India Companies Act and other applicable Indian laws. After several years, Satyam alleged that VGE had defaulted, and it sought to exercise its contractual right to call the shares of the joint venture. The parties arbitrated the dispute in London under LCIA Rules, and the arbitrator ordered VGE to transfer its shares in the joint venture to Satyam. VGE contended that the share transfer ordered by the arbitrator would violate the substantive law of India.

VGE filed suit in India to set aside the award, and Satyam filed suit in Michigan to enforce the award under the New York Convention. Although the Indian Arbitration Act has provisions expressly applicable to foreign awards under the Convention like this one, VGE sought to set aside the award under a general provision of the Arbitration Act that allows awards to be set aside if they are “in conflict with the public policy of India.” (Arbitration Act § 34(2)(b)(ii)) In 2003, the Supreme Court had broadly interpreted the same provision in a case known commonly as “Saw Pipes” – *Oil & Natural Gas Corporation, Ltd. v. Saw Pipes*. VGE sought to use the *Saw Pipes* interpretation in this case.

Although courts may decline to enforce a foreign arbitral award under the Convention if it is contrary to the local country’s “public policy,” that provision under the Convention

is usually considered to apply narrowly only to fundamental national policies rather than errors of local law. In contrast, in *Saw Pipes*, the Indian Supreme Court held that the public policy provision of section 34 could be used to set aside an award “if the award is contrary to the substantive provisions of law.” The issue in *Venture Global Engineering* was whether that provision in Part I of the Act applied to international awards, notwithstanding that Part II of the Arbitration Act is expressly applicable to the enforcement of awards under the Convention.

### **The Decision**

The Supreme Court of India held that section 34, which allows awards to be set aside if they contravene “public policy,” does apply to international awards. The Court was strongly influenced by the fact that the relief ordered by the arbitrator — the transfer of shares of an Indian company — could be effectuated only under Indian law. Therefore, the Court said that Indian courts could review whether the award violated Indian law, and it chastised Satyam for seeking to enforce the award in the U.S. and to avoid review by the Indian courts. The Supreme Court said that the public policy of India includes (a) “the fundamental policy of India,” (b) “the interests of India,” (c) “justice or morality,” or (d) “if it is patently illegal.” It remains to be seen whether that standard allows courts to review awards for legal error, or if the error must be more fundamental and, if so, how to distinguish the two.

Importantly, the Supreme Court said that parties may opt out of the provisions of Part I of the Arbitration Act. It held that those provisions are mandatory for domestic arbitrations seated in India, but not for arbitrations held outside India. For international arbitrations, the Court said that the parties may “by agreement, express or implied, exclude all or any of its provisions.” Thus, anyone contracting with an Indian party should consider (1) establishing the seat of the arbitration outside of India, and (2) expressly including in the arbitration clause a provision excluding Part I of the Arbitration Act.

The Court’s decision in *Venture Global Engineering* has broad implications. It appears part of a trend of Indian courts to subject arbitration awards to greater scrutiny and interference, even though the Arbitration Act was enacted in 1996 to make awards more enforceable and to reduce the Court’s role. It gives the Indian courts more authority to review the merits under Indian law of any arbitration award issued in another country, thus making the enforceability of international arbitration awards in India more uncertain.

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For parties entering into agreements with parties that have assets in India that may be necessary to satisfy an arbitration award, they should consider including provisions expressly excluding certain portions of the Indian Arbitration Act.

## Conclusion

Brazil and India are both countries with well advanced legal rules to promote and enforce international arbitrations. Yet in these two cases, the courts interpreted their statutes in ways many would find unexpected and declined to enforce arbitration awards against local entities. It remains to be seen whether they represent broader trends limiting the enforceability of awards. At the very least, both decisions illustrate the tensions felt by courts in certain similar economies when called upon to approve the resolution of legal disputes outside the local court systems.

## ENDNOTES

- 1 The authors are partners in the international dispute resolution practice of Vinson & Elkins LLP. Mr. Loftis is chair of the practice and is based in the firm's London office. Mr. Atkins is a co-head of the firm's litigation section and is based in Washington, D.C. The authors gratefully acknowledge contributions by Dr. Cesar Pereira of Curitiba, Brazil and Professor Mauricio Gomm-Santos of the University of Miami.
- 2 See, e.g., Mauricio Gomm-Santos, "Swimming Against the Tide," 23 Mealey's Int'l Arb. Rptr. (2) 1 (February 2008).
- 3 To illustrate the level of detail in the arbitration provision, here it is in pertinent part in English translation:  
"77.2 Any disputes or controversies arising from or in connection with the Contract ... may be submitted by either Party to arbitration. Any arbitration initiated hereunder shall be heard and determined by three (3) arbitrators (the "Tribunal"). ..., one arbitrator shall be appointed by the Party of Parties seeking the arbitration, and one arbitrator shall be appointed by the other Party. ...the Party appointed arbitrators shall, in turn, appoint a third arbitrator who shall serve as presiding arbitrator of the Tribunal. If the Party-appointed arbitrators cannot reach agreement on a presiding arbitrator of the Tribunal and/or if one Party refuses to appoint its Party appointed arbitrator within said third day period, the appointing authority for the implementation of such procedure shall be the International Chamber of Commerce pursuant to the Rules of Conciliation and Arbitration of the International Chamber of Commerce (the "Rules").... The arbitration shall, in all cases, continue in accordance with the Rules.  
Unless otherwise expressly agreed in writing by the parties to the arbitration proceedings:
  - (i) The arbitration proceeding shall be held in Curitiba, Brazil;
  - (ii) The arbitration proceedings shall be conducted in the Portuguese language with simultaneous translation in English and the arbitrators shall be fluent in both the Portuguese and English languages.
  - (iii) The arbitration proceedings shall be conducted in accordance with the Rules, effective as of the date of the Contract, and
  - (iv) Judgment upon the award may be entered in any court having jurisdiction over the Party or the assets of the Party owing the judgment, or application may be made to such court for judicial acceptance of the award and an order of enforcement, as the case may be."
- 4 The authors' firm acts for that company, including advice in relation to enforcement in the *Inepar* case. The opinions expressed in this article are the authors' own and not those of the client or of Itiquira.
- 5 Copies of the pleadings are in the authors' files.
- 6 Although the arbitration agreement (see supra note 3) called for arbitration under the ICC Rules, the parties agreed to proceed as an *ad hoc* arbitration applying the ICC Rules.
- 7 It was raised both as an affirmative challenge and in defense to Itiquira's enforcement action.
- 8 This has essentially the same meaning in this context as the French term *compromis*.
- 9 Gomm-Santos, supra note 2, at 2.
- 10 *Id.*, n.12; citing art. 1.074, Brazilian Code of Civil Procedure.
- 11 Brazil has two supreme tribunals: the Supreme Federal Tribunal (Supreme Court) and the Supreme Court of Justice (SCJ). The former hears primarily constitutional matters, while the latter is the court of last resort in commercial and civil matters.
- 12 *M.B.V. Commercial and Export Management Establishment v. Resil Industria e Comercio Ltda.*, Agravo Regimental Em Senten fa Estrangeira N. 5206-7, Reino Daespanha (decided December 2001).
- 13 UNCITRAL, Status – 1958 Convention On the Recognition and Enforcement of Foreign Arbitral Awards, found on May 28, 2008, at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/arbitration/NYConvention\\_status.html](http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention_status.html)
- 14 Gomm-Santos, supra note 2, at 2-3.
- 15 *Renault do Brasil S.A. et al. v. Carlos Alberto de Oliveira Andrade*, Revista de Direito Bancario, do Mercado de Capitais e da Arbitragem, n. 7, January-March 2001, p.336.
- 16 Gomm-Santos, supra note 2, at 5 (translating decision).
- 17 *Id.*