The Arbitration Review of the Americas

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Addressing Issues of Corruption and Arbitration in Brazil

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Summary

Brazil is an arbitration-friendly jurisdiction. The business community embraced arbitration vigorously after the enactment of the Brazilian Arbitration Act (Law N9.307/96) (BAA) in 1996. In 2001, the Supreme Court recognised the constitutionality of arbitration. Since then, Brazilian jurisprudence has adopted a pro-arbitration approach.

The scope of arbitrability in Brazil is wide. Any civil or commercial matter can be resolved through arbitration, provided that the rights at stake are disposable and have a pecuniary nature. Arbitration is admissible even when involving consumer rights, bankrupt companies, state-owned companies and governmental entities.

Recent reforms[1] have made the legal framework of arbitration in Brazil even stronger. Where once limited to high-ticket construction or M&A contracts, arbitration clauses have become standard in many other sectors. In the past decade, even contracts with state entities, resulting from public tenders, provided for arbitration.

Brazil has very experienced and well-structured arbitration centres. The community of arbitrators, mediators and specialised law firms has grown remarkably. This arbitration-friendly environment has made the number or arbitration cases increase dramatically in recent years.

Brazil is also a nation at war against corruption.

Since the launch of Operation Car Wash in 2014, Brazilian prosecutors and legal authorities have been relentlessly fighting corruption. What began as an investigation into money laundering quickly turned into something much greater, uncovering a vast and intricate web of political and corporate racketeering.

Within the context of the Operation Car Wash, thousands of lawsuits have been filed. Hundreds of high-profile executives and politicians have gone to jail, including two former presidents of Brazil. Billion-dollar leniency agreements with local and international authorities were entered. Corruption issues have never been so prominent in the public debate as now.

In light of this scenario, arbitral tribunals in Brazil have been called to deal with issues of corruption on a regular basis. Issues of corruption can be raised in arbitration proceedings in basically three situations:

- when there is corruption within the arbitration proceedings (ie, an arbitrator, neutral expert or witness was bribed);
- when the contract underlying the dispute was procured by corruption; or
- when the contract provides for corruption.

This article will deal with the consequences of corruption tainting the contract underlying the arbitration.

FORMS AND CONSEQUENCES OF CORRUPTION

The definition of corruption under Brazilian law, regardless of whether in the criminal, civil or administrative spheres, requires the involvement of a government entity or a public official.[2] The Brazilian legal framework adopts a broad concept of a 'public official', who is, in general, any individual who works for any, branch or agency of government at any of its levels (federal, state or municipal), or for any state-owned company or entity. The concept of public official is

also extended to anyone who works for a private company that has been engaged to provide public services (such as concessionaries).

On the criminal level, article 327 of Brazil's Criminal Code (Decree-Law No. 2,848/1940) defines a public official as 'anyone who, even if transitorily or without remuneration, holds a public post, employment or function' and further provides that 'anyone who holds a post, employment or function in a government agency, or who works for companies that have been contracted to render services or to execute activities that are typical of the public administration', is also regarded as a public official or public servant.

Brazil's Criminal Code sets forth two forms of corruption, which are considered criminal offences against the public administration:

- article 317 defines the crime of passive corruption as 'to request or receive, for oneself or for another, directly or indirectly, even if outside or prior to assuming the function, but by reason of such function, undue advantage, or to accept a promise of such advantage'; and
- article 333 defines the crime of active corruption as 'to offer or promise an undue advantage to a public official, for him to perform, omit or delay an official act'.

Hence, the legal concept of corruption it not limited to payment of bribes, but rather to offering, promising, requesting or receiving any 'undue advantage' (a similar concept to the idea of 'anything of value' established by the US Foreign Corrupt Practices Act). The mere promise of payment or the mere solicitation of an undue advantage for the official, or a related person or entity, in order that the official act or refrain from acting in the exercise of his official duties, qualifies as corruption. The penalties for corruption range from two to 12 years' imprisonment plus a fine.

Corruption, however, is not only a matter of criminal law, but has several civil implications. Even when the criminal offenders are absolved, their acts of corruption may have civil implications.

The relevant laws dealing with the civil consequences of corruption on contracts are the following.

- The Public Bid Act (Law N8,666/93), which establishes that contracts resulting from public tenders are null and void in case of any illegality in the tender procedure (article 49, paragraphs 1 and 2).
- The Anti-Corruption Act, also called the Clean Company Act (Law N12,846/13), establishes an entire system of civil and administrative liabilities for companies involved in bribery, including a broad set of consequences of corruption on contracts with the public administration. The Anti-Corruption Act also introduced in the Brazilian legal system the 'leniency' mechanism, allowing companies that agree to cooperate with legal authorities (disclosing information and documents proving the acts of corruption) to enter into leniency agreements for the indemnification of state-entities harmed by corruption.
- The Improbity Act (Law N8,429/92), which punishes illicit enrichment of public officials as well as the losses caused to the public treasury as a result of any illicit conduct. Sanctions for acts of improbity are applicable not only to public officials, but also to third parties (individuals or legal entities) who have induced or contributed

to the wrongdoing, or who in any way have benefited from such act, and vary from confiscation of assets or profits that may have been unduly obtained to the detriment of the public treasury to payment of fines or prohibition to enter into contracts with the government, among others.

- The Brazilian Civil Code (Law N10,406/2002), which governs private contracts in general and contains several provisions that may apply to contracts tainted by corruption, as it is also applicable to certain contracts entered by state-owned companies (especially semi-public corporations). In short: contracts providing for corruption are null and void (articles 166 II, 167 and 187) and, therefore, unenforceable, whereas contracts procured by corruption are voidable (articles 145, 146 and 171 II) and can be enforced, if none of the parties seeks to avoid it. In case of voidable contracts, an innocent party can seek the revision of burdensome provisions obtained through corruption (articles 478 and 479) or claim damages for actual losses (article 403), undue payments (article 876) or unjust enrichment of the other party (article 884).

JURISDICTION

In arbitration proceedings, corruption can appear in a variety of forms and circumstances:

- corruption is pleaded by a party;
- the arbitral tribunal suspects that corruption has occurred but the parties do not wish the tribunal to address it; and
- corruption has been proven in the course of the proceedings (irrespective of whether or not it was pleaded by a party).

In the past, arbitration was considered to be an inappropriate forum for deciding claims of bribery and corruption. This idea came from a restrictive view of arbitral jurisdiction and to the arbitral tribunal's lack of authority to impose criminal sanctions. The seminal award refusing jurisdiction to decide upon a corruption case was International Chamber of Commerce (ICC) case 1110 (1963), known as the Lagergren case. Relying on article V(2)(b) of the New York Convention, Judge Lagergren considered that arbitrators should refuse a case that risks infringing public policy. His decision, however, was widely criticised for ignoring the principle of the separability of the arbitration agreement and the underlying contract, presupposing that the corrupt act tainted both.

A different approach has since been taken by subsequent arbitral tribunals. Currently, it seems to be commonly accepted by the international arbitral community and legal scholars that the arbitrators have the power to deal with allegations of corruption made explicitly by one party as basis of its claims or defences. The idea underlying this concept is that the core duty of an arbitral tribunal is to deal with and decide upon all issues submitted by the parties, including corruption. Several arbitral awards further corroborate this view.

It is also well settled that arbitrators should be entitled to deal with allegations of corruption even if it may lead to the nullity of the contract. Based on the doctrine of separability, it is commonly accepted that the separability presumption remains in force even where corruption taints the contract underlying an arbitration, as decided in the English case Fiona Trust.[3]

In Brazil, the separability of the arbitration agreement from the main contract is a rule of law. Article 8 of the BAA prescribes that:

> [a]n arbitration clause which forms part of a contract shall be treated as an agreement independent of the other terms of the contract. A decision that the contract is null and void shall not entail ipso jure the invalidity of the arbitration clause.

A further paragraph adds that:

> [t]he arbitrator has jurisdiction to decide ex officio or at the parties' request, the issues concerning the existence, validity, and effectiveness of the arbitration agreement, as well as the contract containing the arbitration clause.

Several court precedents corroborate the doctrine of separability.[4]

However, the key question is whether the nullity or voidance of a contract tainted by or providing for corruption involve arbitrable rights.

Article 1 of the BAA provides that 'those who are capable of entering into contracts may use arbitration to resolve conflicts related to freely transferable property rights'. Paragraph 1 adds that '[d]irect and indirect public administration may use arbitration to resolve conflicts regarding transferable public property rights'.

The expression 'freely transferable property rights' should be interpreted as to encompass economic disposable rights, which can be freely waived, transferred or negotiated. Labour and employment rights and family law rights, for instance, are generally deemed as non-arbitrable, under the understanding that such rights are not disposable. Certain implications of corruption in contracts with the public administration or state-owned companies may also involve non-waivable rights.

Arbitral tribunals in many jurisdictions have consistently recognised that anti-corruption laws and treaties are an essential part of international public policy and have relied on that to declare null and void contracts tainted by or providing for corruption. There is a general understanding that it is correct to give effect to a transnational public policy to eradicate corruption, since failure to do so would breach the international public policy and render the award unenforceable in most jurisdictions around the world.

In Brazil, however, the implications of corruption are determined by statutory law. There are certain circumstances where statutory law provides for mandatory remedies or imposes certain duties on the government and state entities that are not negotiable and do not involve property rights. These remedies or duties aim at protecting the public interest in general and cannot be waived or in any way transferred or negotiated. In such cases, jurisdiction should be refused on the basis of non-arbitrability of the subject-matter of the dispute, under article 1 of the BAA.

Jurisdiction problems may also arise in cases where statutory law establishes the judicial court as the proper venue to apply sanctions for corruption. We will deal with some examples below.

Nullity Of Public Tenders And Public Contracts

The Public Bid Act (article 49) declares that the competent authority for approving tender procedures 'must annul the bid in case of illegality, ex officio or at the request of third parties' and that 'the invalidity of the tender procedure leads to the invalidity of the contract'.

Brazil's most cited legal scholars, as well as most court precedents, admit that the Public Bid Act imposes a non-waivable duty on the competent authorities to declare the nullity of a contract concluded within an illegal tender process carried out by the public administration. Based on this view, the nullity of a contract resulting from a public tender tainted by corruption would be non-waivable and non-arbitrable.

It is questionable, though, whether damages arising from such annulment can be claimed through arbitration. The public administration is entitled to recover the amounts unduly paid under the illegal contract and to be reimbursed for all costs and expenses incurred with the tender procedure. These issues concern to economic aspects of the annulment of the tainted contract. In such case, the arbitral tribunal would not have to rule on annulment of the contract, but on the proof and measurement of damages.

Acts Of Improbity

Procuring contracts through bribery of public officials is an act of improbity (see above) that holds not only the public official but the briber liable under the Improbity Act.

Acts of improbity are investigated by the Public Prosecutor's Office. The Improbity Act (articles 15, 16 and 17) vests the Public Prosecutor's Office and state entities with exclusive standing to bring action against the public official who committed the wrongdoing and harmed the public administration. The Public Treasury Court is the proper venue to hear improbity lawsuits and to apply the sanctions set forth by article 12 of the Improbity Act.

Commentators and court precedents understand that companies or private individuals involved in acts of improbity cannot be sued alone. The joinder of the public official who participated in the wrongdoing is mandatory. In most cases, however, public officials are not parties to the contract containing the arbitration clause and cannot be submitted to arbitration proceedings.

More importantly, the Improbity Act (article 17 (1)) prohibits 'negotiation, settlement and conciliation' of improbity actions. Hence, actions of improbity are non-negotiable by virtue of law. Most precedents suggest that not even the measurement of damages can be settled or negotiated.

Civil Sanctions Based On The Anti-Corruption Law

The Brazil's Anti-Corruption Law (article 19 I) imposes judicial sanctions on companies involved in corruption. The reference to 'judicial' may imply that these sanctions could only be applied by judicial courts.

Nonetheless, a broad interpretation of the concept of judicial sanctions is also admissible, to encompass not only sanctions applied by a judicial court, but also by jurisdictional bodies with similar powers, such as an arbitral tribunal.

It is widely accepted in Brazil that arbitration, as an alternative dispute resolution method, fulfills precisely the fundamental right of access to justice, provided by article 5 (XXXV) of the Brazilian Constitution' (SERPAL v Continental do Brasil). Moreover, the BAA (article 18) rules that '[a]n arbitrator is the judge in fact and in law, and his award is not subject to appeal

or recognition by judicial court'. Thus, the arbitrators have powers, within the scope of their mandate, to apply the 'judicial sanctions' set forth in the Anti-Corruption Act.

Leniency Agreements

Leniency agreements may also give rise to challenges to the arbitral jurisdiction. As mentioned earlier, the Anti-Corruption Law (article 16) allows legal entities that have practised illicit acts to enter into leniency agreements with the relevant authorities, as long as they admit their participation in the wrongdoing, cease their involvement in the illicit practice and agree to effectively cooperate, on a permanent basis, with the investigation. Under article 16(2), the execution of a leniency agreement shall reduce the amount of the applicable administrative fine by up to two-thirds and shall exempt the legal entity from the civil sanctions set forth in article 19 of that act.

Although the leniency agreement 'does not exempt the legal entity from its obligation to make full restitution for the damages caused' (article 16(3)), the lenient company should not be compelled to pay the same indemnification twice. In this sense, the relevant authorities shall assure that the same indemnification agreed and paid by the lenient company will not be claimed again before other forums.

Thus, the execution of a leniency agreement may affect not only the admissibility of a case on the merits, but also on the jurisdiction, raising questions as to whether the arbitral tribunal should rule a case based on corruption that has already been settled with the competent authorities.

Contracts Providing For Corruption

Like most national systems, Brazilian law draw a distinction between contracts that are procured by corruption and contracts that provide for corruption. Except for contracts concluded as a result of illegal public tenders, contracts procured by corruption are merely voidable at the instance of the innocent party, whereas contracts providing for corruption are null and void.

The difference is that a voidable contract is 'valid and enforceable' until the innocent party takes action to set it aside. Under the Brazilian Civil Code (article 172), an innocent party is not compelled to set aside a voidable contract and may choose to enforce it. Pursuant to article 177, the decision annulling a voidable contract will be effective ex nunc, ie, as of the date of res judicata.

Conversely, a contract null and void is from the outset regarded as entirely ineffective. The nullity cannot be remediated (article 169 of the Civil Code), as it can be raised by any interested party or by the Public Prosecutor's Office (article 168) and can also be declared ex officio by the court (article 168, sole paragraph). A decision declaring a contract null and void is effective ex tunc, as if the contract had never come into existence.

Article 166 of Brazil's Civil Code also states that a juridical transaction (such as a contract)is null when 'its object is illicit, impossible or cannot be determined', 'the common determining motive of both parties is illicit' or 'its purpose is to defraud imperative law'.

The joint intention to commit corrupt acts under the contract may be expressly stipulated or may, as is more commonly the case, dissimulated. In any case, a contract providing for corruption falls within article 166 II, III and IV of the Civil Code, being, therefore, null and void and entirely ineffective from the outset.

It may seem unlikely that a contract that never came into existence according to imperative law could nevertheless still produce a binding agreement to arbitrate. It may seem unreasonable to advocate that the arbitration clause contained in a contract providing for corruption would be a separate agreement. Corruption is at the heart of the contract and, therefore, the illicit object and the illicit common motive of the contract would taint the arbitration clause as well. Although the separability of the arbitration agreement from the main contract is a fixed rule of law in Brazil, the BAA (article 8) prescribes that the nullity of the contract shall 'not necessarily' entail the invalidity of the arbitration clause, making clear that separability is a presumption that might be disregarded depending on the circumstances of the case at hand.

Therefore, it is questionable whether contracts providing for corruption fall under the exceptions to the separability rule. The reason for applying the exception is not the fact that the agreement is null and void from the beginning, but the illicit common motive that led the parties to enter into the agreement. Advocating otherwise would be inconsistent with article 166 of the Civil Code, as the purpose of such rule is to discourage the parties to engage in illicit contracting.

The approach adopted by English courts in the Fiona Trust case may provide a balanced solution of the apparent dichotomy between article 8 of the BAA and article 166 of the Brazilian Civil Code.

In Fiona Trust, the Court of Appeal considered that if arbitrators can decide whether a contract is void for initial illegality, there is no reason why they should not decide whether a contract has been procured by bribery, just as much as they can decide whether a contract has been procured by misrepresentation or non-disclosure. It is not enough to say that the bribery impeaches the whole contract unless there is some special reason for saying that the bribery impeaches the arbitration clause in particular.

If adapted to the Brazilian legal framework, the Fiona Trust approach leads to the following conclusions.

- An arbitration clause contained in a contract providing for corruption is not invalid per se. Under article 8 of the BAA, the arbitration agreement is to be treated separate from the main contract that has an illicit object. The terms and conditions providing for corruption are illegal and, therefore, should be considered null and void pursuant to article 166 of the Civil Code, but the agreement to arbitrate is not illicit and does not violate any imperative law and, therefore, should be regarded as valid and enforceable.
- However, the arbitration agreement should not survive, being null and void from the beginning, when the arbitration clause itself was procured by corruption. When the validity of the agreement to arbitrate is put into question and it is proven that corruption is at the heart of the arbitration clause, arbitral jurisdiction should be refused.

THE POWER TO INVESTIGATE CORRUPTION SUA SPONTE

As mentioned earlier, the BAA (article 18) prescribes that the arbitrator is the 'judge in fact and in law'. Within the scope of their mandate, arbitrators have similar powers to judges, except for coercive and enforcement powers.

Under Brazilian law, judges have the power to seek evidence to establish the facts of the case. To that end, they may request the production of documents, request information to public authorities and government bodies, determine the examination of witnesses, determine inspections, among others; provided, of course, that the principles of due process are respected by communicating new evidence with the parties.

Judges have also the power to raise issues of law, even if not alleged by the parties. The general principles of iura novit curia and da mihi factum dabo tibi ius have long been applied by Brazilian courts. Decisions based on legal issues that have not been raised by the parties are valid; provided, again, that due process has been observed.

Therefore, arbitrators, as judges, have broad powers to investigate the facts and apply the law within the limits of the case at hand, provided that such investigation is determinative to the adjudication of the claims and defences of the parties.

Under article 32 of the BAA, an arbitral award will be null and void if 'it has exceeded the limits of the arbitration agreement'. Hence, the key question is when and why investigate corruption sua sponte. The tribunal should not risk rendering an ultra petita and unenforceable award by inquiring on issues not alleged by the parties.

A sua sponte corruption enquiry and decision present no risk of resulting in an ultra petita award, as long as the corruption issue is relevant to determinate the validity of claims and defences submitted by the parties. For instance, if the contract underlying a dispute is a phony agreement entered to hide the payment of bribes, the tribunal should deny enforcement and reject the parties' claims, under article 166 of the Civil Code. In this case, the tribunal is investigating corruption not for the sake of punishing it as a wrongful conduct, but for determining the validity of the claims.

However, if the evidence before the tribunal suggests that a party procured a contract through corruption, but the other party has not raised that issue to avoid the contract, an inquiry sua sponte by the tribunal seems to be useless, since contracts procured by corruption are merely voidable under Brazilian law. In other words, the arbitral tribunal is not empowered to annul ex officio a contract procured by corruption. Thus, the tribunal will be on much firmer ground in addressing corruption sua sponte when the invalidity of the contract is effected by operation of law and can be declared ex officio.

BURDEN AND STANDARDS OF PROOF

Corrupt activity is not easy to prove, which some scholars understand should justify a lower standard of proof. On the other hand, corruption is a criminal offence with severe consequences to the offender, which may justify a higher standard of proof.

There seems to be a consensus among international tribunals and commentators regarding the need for a high standard of proof of corruption, demanding 'clear and convincing' evidence to prove allegations of bribery 'beyond doubt'. Arbitral tribunals rejected allegations of bribery base on pure 'allusions not supported by evidence and based on suppositions'. Scholars, however, sometimes argue that arbitrators should not deviate from the 'traditional balance of probabilities standard' and lower the burden of proof on a case-by-case basis, where it seems 'reasonable' and 'justified'.

In fact, the standard of proof applied by an arbitral tribunal in any jurisdiction is likely to be strongly influenced by the legal background of its members. Arbitrators with a common law background tend to rely on the 'preponderance of evidence' or 'balance of probabilities',

whereas arbitrators from civil law systems tend rather to rely on their 'inner conviction' with respect to the facts of the case.

In Brazil, civil law country, arbitrators, like court judges, are regarded as the 'addressees' of the evidence[5] and are allowed to rely on their 'free motivated conviction', having discretionary powers to deny useless, irrelevant or protractive requests for production of evidence.

Certain provisions of Brazilian law, however, add more complexity to the debate. The Brazilian Constitution (article 5 (LXIII)), for instance, provides for the right against self-incrimination. The Brazilian Federal Code of Civil Procedure also provides for a similar rule (article 404). Under any of these circumstances, a party to an arbitral proceeding may refuse to produce evidence of alleged acts of corruption, leaving no option to the arbitral tribunal but to shift the burden of proof to the opposing party.

Confidentiality clauses contained in most of the leniency agreements may also hinder the parties' ability to prove allegations of corruption. Such clauses are designed not only to protect the legal entity that has self-disclosed its illicit practices, but mainly to preserve the ability of competent authorities to investigate and prosecute other crimes and other parties. Unauthorised disclosure to non-signatory parties of the leniency agreement, even in the context of confidential arbitration proceedings, may be regarded as a breach of the leniency agreement or, even worse, may impair criminal prosecution of other parties.

Duty To Inform The Authorities

A final issue to consider is whether arbitrators have the obligation to report findings of corruption to relevant authority.

Article 17 of the BAA rules that 'arbitrators shall be considered comparable to public officials for the purpose of criminal law'. Under the Brazilian Code of Criminal Procedure (Decree Law N3.689/1941, article 40), judges are public officials who have a duty to report to the Public Prosecutor's Office suspicions of crime that have come to their attention within the course of court proceedings.

In view of such provisions, some commentators advocate that the arbitrators have a legal duty to report findings of corruption to the authorities. Such a duty would override the duty of confidentiality provided for by most of the arbitration rules in Brazil. Moreover, arbitration proceedings involving state entities are not confidential, pursuant to article 2(3) of the BAA, which establishes that '[a]rbitration that involves public administration will always be at law and will be subject to the principle of publicity'.

However, the extent of the duty to report criminal findings under article 40 of the Code of Criminal Procedure is still controversial in Brazil. Many commentators argue that the decision on whether to report lies with the judge's sole discretion.

A question that arbitrators must consider is whether they are bound by legal privilege or confidentiality under their professional rules of conduct. Lawyers, for instance, are obliged to preserve the confidentiality of any information disclosed to them by clients, including information disclosed in the context of civil litigation, pursuant to Law 8,906/94 and the Code of Ethics enacted by the Brazilian Bar Association. Confidentiality is a principle 'inherent to the legal profession'.

Notes

[1] In 2015, a bill reforming the BAA was approved making important amendments to clarify controversial issues and deal with matters not previously regulated. The amendment confirmed that state entities can submit disputes to arbitration, restating what had already been authorised by many specific laws such as the Concessions Act (Law N8.987/95), the Petroleum Act (Law N9.478/97), the Electric Power Act (Law 10.848/2004) and the Public-Private Partnerships Act (Law N11.079/2004).

[2] Private bribery is not regulated by Brazilian legislation.

[3] FionaTrust & Holding Corp & Ors v Yuri Privalov, [2007] EWCA Civ 20, decision of 24 January 2007.

[4] See Superior Court of Justice, Special Appeal N1.550.260 – RS, judgment of 12 December 2017, Presiding Justice Paulo de Tarso Sanseverino; State Court of São Paulo, Interlocutory Appeal N2027249–62.2018.8.26.0000, judgment of 4 July 2018, Presiding Judge Fortes Barbosa.

[5] The following decision of the Superior Court of Justice exemplifies this principle: 'Under our procedural system, the judge is the addressee of the evidence, having the power, according to article 370 of the Federal Code of Civil Procedure, to grant the taking of useful evidence and deny the useless or merely protractive evidence, being such decision, in principle, not considered an obstruction to the right of action and defense' (Special Appeal Number 930.403/RS of 23 June 2009).

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