Angela Di Franco

DISPUTE RESOLUTION IN BRAZIL

Angela Di Franco heads the firm's dispute resolution practice. She has tried hundreds of cases to final verdict in over 20 years with the firm and has resolved many cases through arbitration and other methods of alternative dispute resolution (ADR). She has served the São Paulo state court system as a mediator and been a featured lecturer on ADR.

Rafael Zabaglia is a senior associate in the firm's dispute resolution practice, having been lead trial counsel on many cases and represented clients in appeals before federal and state courts. He is experienced in transactional matters, having worked for two years with the firm's M&A and corporate practice, and one and a half years in the M&A and corporate practice of Morrison & Foerster LLP in New York.

Ms Di Franco and Mr Zabaglia have handled matters as diverse as M&A deals, corporate arrangements, shareholder actions, commercial contract disputes, aviation product liability, enforcement of judgments, and reorganisation and liquidation of businesses. They also counsel clients on risk assessment regarding potential and outstanding disputes, and have both been listed among Brazil's top dispute resolution practitioners in *Chambers & Partners*' global and local rankings.

GTDT: What are the most popular dispute resolution methods for clients in your jurisdiction? Is there a clear preference for a particular method in commercial disputes?

Angela Di Franco & Rafael Zabaglia: Court litigation still is by far the prevailing method of dispute resolution in Brazil; contracts for the trade of goods and services are usually governed by Brazilian law and any disputes are usually submitted to Brazilian courts. Arbitration has gained a lot of traction over the course of the past 15 years in relation to more sophisticated commercial transactions – it has been a staple in domestic and cross-border M&A deals, project financing and other investment-related transactions.

Alternative dispute resolution methods (ADR) such as mediation and expert determination are still unusual in the practice of commercial disputes as parties are usually afraid that consenting to ADR before litigation or arbitration may be perceived by the opposing party as a sign of low confidence in the merits of the claim (ie, some sort of 'weakness'); many contracts do contain 'escalation' clauses – mandating the parties to negotiate a resolution of any dispute in good faith for a given period (usually 30 to 60 days) before engaging in litigation or arbitration – but the parties usually simply stall for time and do not meaningfully pursue a settlement in this period.

GTDT: Are there any recent trends in the formulation of applicable law clauses and dispute resolution clauses in your jurisdiction? What is contributing to those trends? How is the legal profession in your jurisdiction keeping up with these trends and clients' preferences?

ADF & RZ: It is not uncommon nowadays to see contracts governed by English or New York law and having international arbitration (usually under the ICC Rules) as the prevailing dispute resolution mechanism in the context of cross-border deals. As Brazilian companies seek to attract foreign investment and acquire goods and services in the international market, they have become more flexible in that respect. We now have a statutory rule setting forth that the parties are generally free to resolve disputes stemming from international contracts abroad (article 25 of the 2015 Code of Civil Procedure). And although the validity of governing-law clauses might still be disputable in Brazilian courts, this tends not to be an issue now as long as the matter is being litigated or arbitrated in a jurisdiction that favours the autonomy of will in the determination of applicable law.

On the flip side, domestic arbitration might no longer be such an obvious choice as far as the cost–benefit analysis goes, as some clients have opted to submit their commercial disputes to the judiciary. On the one hand, the quality and predictability of the decisions entered by courts specialised in commercial, corporate and reorganisation law have been increasing; on the other hand, some domestic arbitration chambers have a greater workload than they can handle, with adverse effects on the timing and quality of service.

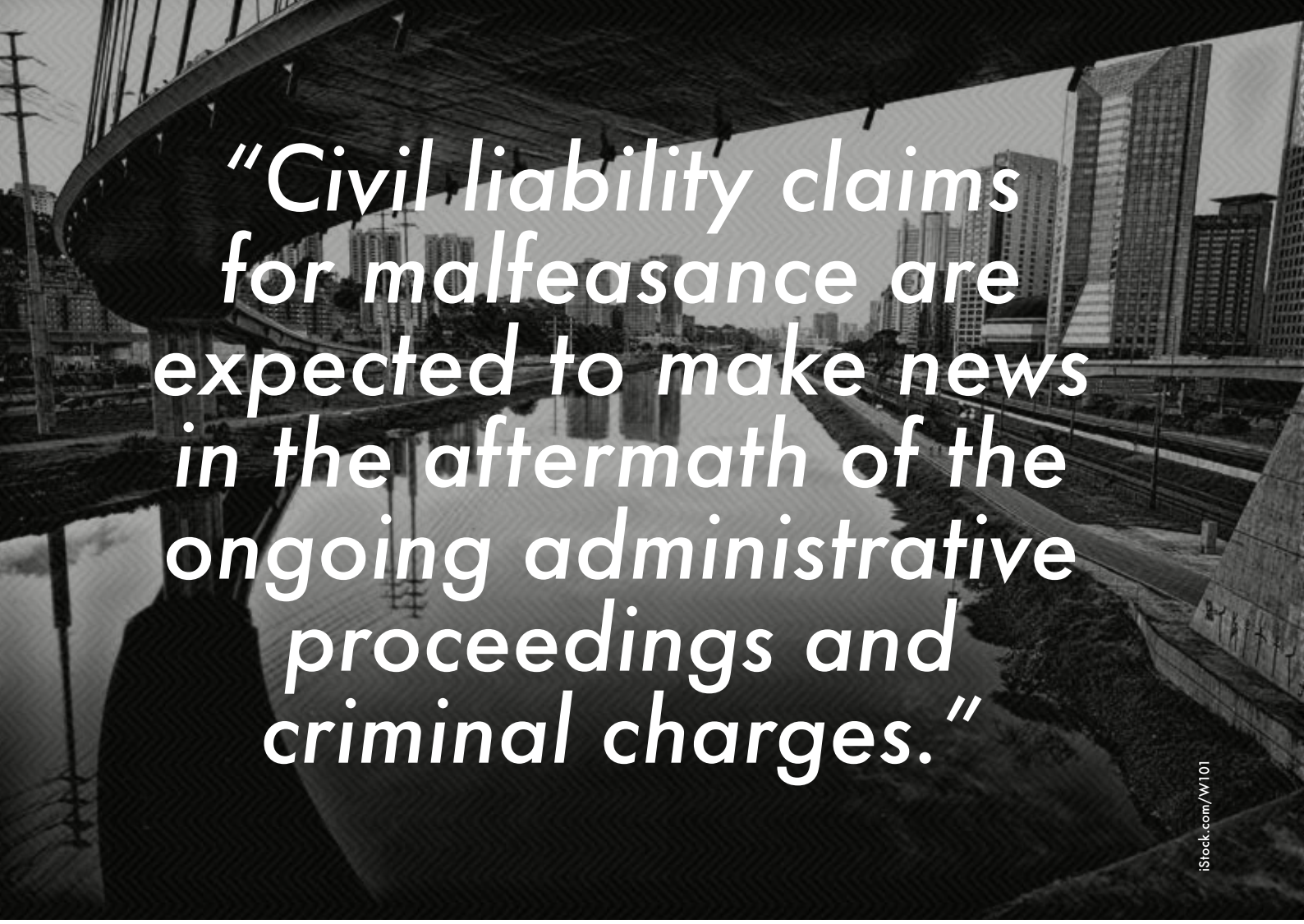
> *"Besides the adoption of escalation clauses, some clients want to introduce tailor-made carve-outs to standard arbitration rules."*

Arbitration clauses are themselves becoming more complex. Besides the adoption of escalation clauses, some clients want to introduce tailor-made carve-outs to standard arbitration rules (preliminary injunctions, interim measures, choice of arbitrators, and so forth); others choose to have the arbitration seat in a venue that is neither the parties' nor the arbitration chamber's, or to have the arbitration conducted both in Portuguese and in English – decisions that increase cost – and interpretation of the applicable law may also become more problematic.

Keeping current (academic papers, industry news and so forth) is of course essential, but what we deem paramount for Brazilian practitioners in cross-border deals is to communicate efficiently with the client's foreign co-counsel to make sure that arbitration clauses will work both in Brazil and in the jurisdiction chosen by the parties, as questions about the enforceability of the arbitral award could arise further down the road. Top-tier Brazilian firms have been encouraging not only M&A, but also dispute resolution attorneys to study or work abroad as a way to facilitate communication and to make sure that legal concepts can be correctly adapted from UK and US common law systems to the Brazilian civil law system and the other way around.

GTDT: How competitive is the legal market in commercial contentious matters in your jurisdiction? Have there been recent changes affecting disputes lawyers in your jurisdiction?

ADF & RZ: These are very competitive times for Brazilian dispute resolution attorneys. It is already a very saturated market, with over two dozen very qualified local law firms, with different profiles ranging from specialised boutiques to full-service powerhouses. In addition, although foreign attorneys must take the Brazilian Bar examination to practise Brazilian law and represent clients in Brazilian courts of law, many top-tier foreign firms



have been settling in the country to compete for arbitration work, which does not require formal qualification to practise law under the 1996 Arbitration Act.

It would be hard to point to one or two specific recent changes in the market with an immediate impact on commercial contentious matters. Non-legislative changes have been taking place gradually. For example: (1) the increasing exchange with foreign practitioners not only in the context of arbitration, but also in some high-profile court proceedings (such as civil liability claims stemming from mass torts in cases of environmental disasters, air crashes and product recalls, or global-scale antitrust and insurance disputes) has influenced Brazilian practitioners in many different ways, from legal interpretation to negotiation techniques to evidence production; and (2) the growing complexity of commercial transactions requires from dispute resolution lawyers the mastering of accounting and business structures to better represent the clients. On the legislative front, several statutes were enacted in 2015 that directly affect litigation, arbitration and ADR – respectively, a new Code of Civil Procedure (Law No. 13,105), an update to the Arbitration Act (Law No. 13,129) and a Mediation Act (Law No. 13,140).

GTDT: What have been the most significant (by value or impact) recent court cases and litigation topics in your jurisdiction?

ADF & RZ: Judicial reorganisations of high-profile businesses have been on the rise for the past couple of years given the country's ongoing economic struggles. The utmost example of this trend is Oi, the leading fixed-line carrier and fourth largest wireless carrier in the country. Oi's insolvency filing last June was the largest ever in terms of indebtedness (over 65 billion reais) and will be a very challenging process considering that Oi is a publicly traded corporation in a regulated sector with debt issued in Europe and the United States via Dutch special purpose vehicles and holding certain interests and assets in Africa. On top of that, alternative restructuring plans are likely to be proposed by outside investors, and local telecoms watchdog Anatel will have to consent to all material changes in the business. Oi's reorganisation will involve nearly all top-tier Brazilian firms in some capacity, and will also involve some international firms in connection with foreign debtor-in-possession (DIP) financing and with aspects of cross-border insolvency. There will be sophisticated work in connection with insolvency, regulatory, capital markets, corporate, tax, international, contract, employment and

labour law, and probably banking and M&A work as well, depending on the sources of DIP financing targeted by Oi and its largest creditors.

Investigations in connection with Operation Car Wash and other corruption and embezzlement schemes have also kept Brazilian firms and courts busy. Civil liability claims for malfeasance are expected to make news in the aftermath of the ongoing administrative proceedings and criminal charges.

Court precedents on domestic and international arbitration always draw a lot of attention from both arbitration attorneys and litigators. The Arbitration Act was enacted in 1996 and only in late 2001 did the Supreme Court affirm its constitutionality, so we have only 15 years' worth of case law. Many controversial aspects have already been addressed by the Superior Court of Justice (the highest Brazilian court with jurisdiction over non-constitutional affairs), but the view of courts of law on the Arbitration Act is still very relevant for practitioners when counselling clients on whether to opt for arbitration and designing the most suitable strategy for the dispute itself.

While lawsuits of a collective nature such as class actions filed either by the Public Prosecutor or civil associations are fairly common in connection with environmental matters and consumer protection, interest in them has been renewed lately in connection with antitrust and competition law (repression of cartels, dumping, market manipulation, etc) and corporate governance and shareholder activism (accountability of principals and controlling shareholders for wrongdoings or loss in share value). Not many of those lawsuits have been filed yet, but this is something to keep an eye on.

GTDT: What are clients' attitudes towards litigation in your national courts? How do clients perceive the cost, duration and the certainty of the legal process? How does this compare with attitudes to arbitral proceedings in your jurisdiction?

ADF & RZ: Clients seem to be realistic about the pros and cons of legal process and arbitration after having embraced domestic arbitration wholeheartedly following the Supreme Court's affirmation of its constitutionality 15 years ago.

The costs of litigating claims are evidently lower than arbitrating them. Litigating in some states like São Paulo is not in itself cheap as court fees, expert fees and appeal fees could well exceed 100,000 reais and perhaps even 200,000 reais depending on the complexity of expert evidence to be produced (plus the costs of the party's own legal counsel). That is hefty for small enterprises and one could argue that it is at any rate too expensive in light of the excessive duration of lawsuits and the perceived unpredictability of court decisions. But the fact that domestic arbitration expenditures tend to amount to 1 million reais or more in many chambers (plus the costs of the party's own legal counsel) certainly does no favours to the adoption of arbitration among small and even midsize enterprises –


Rafael Zabaglia

THE INSIDE TRACK

What is the most interesting dispute you have worked on recently and why?

We have recently assisted the former controlling shareholder of a publicly traded home appliance retail chain in an international arbitration under the ICC rules with seat in Paris. Our client prevailed over the publicly traded food retail chain to which it sold the company and was awarded more than 450 million reais in damages as consideration owed to it based on a certain share value appreciation formula. This matter involved counsel in the United States and France as well.

If you could reform one element of the dispute resolution process in your jurisdiction, what would it be?

Regardless of the innovations introduced by the new Code of Civil Procedure, the parties still have very little incentive to refrain from challenging an unfavourable lower court decision – costs of appealing are relatively low and the appeal more often than not will immediately stay enforcement of the ruling. Stay should be the exception, not the rule, and the appellant should be subject to greater economic burden if the lower court ruling is upheld.

What piece of practical advice would you give to a potential claimant or defendant when a dispute is pending?

Avoid being emotional about winning the dispute; an ingrained dispute-oriented mentality may harm your interests in the long run. If you are claimant, you may have invested many years and tons of money and end up with a pyrrhic victory (which is particularly true in litigation). If you are defendant, keeping the dispute going may backfire: not only are costs high in Brazil but applicable interest rates while the dispute is pending may be greater than low-risk investments such as sovereign debt. Disputes are tools to solve problems and should be used efficiently – acting to gain leverage to settle the claim in favourable terms rather than gambling on an uncertain outcome (much) later is frequently the most efficient approach.

Angela Di Franco & Rafael Zabaglia
Levy & Salomão Advogados
São Paulo
www.levysalomao.com.br

and thereby prevents larger businesses from incorporating arbitration into all of their contracts with those smaller businesses.

Lawsuits in Brazil still take too much time despite the transition from paper to electronic filings over the course of the past three years: on average, it will take something between eight to ten years for a commercial lawsuit to make it through the lower court, the court of appeals and the Superior Court of Justice or the Supreme Court. The 2015 Code of Civil Procedure purports to reduce the number and duration of lawsuits by simplifying the procedural rules, limiting the filing of appeals, extending the cases in which higher courts' precedents will be binding to lower courts and increasing the economic risks of litigation (greater attorneys' fees and imposition of daily fines for failure to comply with court orders), but whether it has accomplished this is something to be appraised five or ten years from now. Arbitrations take much less than eight years to unfold, of course, thanks to the lack of an appeal phase, but the bad news is that their duration has on average increased to two or three years, which is somewhat disappointing to those parties expecting a swifter resolution of their dispute.

Certainty of the decisions may be the aspect in which arbitration has the upper hand over litigation in the clients' view. Clients strongly feel that arbitrators deliver more consistent and technical rulings on business law than judges, although they have at times felt frustrated with arbitrators' conduct being not sufficiently proactive during hearings and examinations, or whose awards do not contain in-depth assessments of the parties' arguments. Clients are particularly worried that judges may not be familiar with market practices or knowledgeable about industry-specific regulation (especially in infrastructure and project finance disputes) or corporate and M&A law. However, there is a chance that this perception will change given the judiciary's efforts to have courts specialise in business law.

GTDT: Discuss any notable recent or upcoming reforms or initiatives affecting court proceedings in your jurisdiction?

ADF & RZ: There has been a plethora of recent legislative initiatives and reforms affecting litigation practice in Brazil. As for reforms, the most significant one was obviously the enactment of a new Code of Civil Procedure in 2015, which has brought several significant changes: (1) it is harder to file appeals in certain circumstances;

(2) parties are allowed to agree upon a schedule for, and the conduct of, court hearings, evidence production and other procedural acts, as if they were in an arbitration proceeding; (3) the binding effect of certain court precedents upon lower courts has been strengthened; and (4) ADR is incentivised because a mediation hearing is now a mandatory step prior to the filing of defence. As for initiatives, there are not one but two separate bills in the Congress for the introduction of a new Commercial Code as the 1850 Commercial Code was revoked upon enactment of the 2002 Civil Code, and this has been the cause of very heated debate among scholars as many believe that the Civil Code suffices for commercial affairs and that immense transaction costs will kick in with a new Commercial Code. Furthermore, another bill addressing the lifting of the corporate veil is in the works and may already supersede in part the Code of Civil Procedure enacted last year.

The way litigators work has also been strongly affected by four non-legislative initiatives by the judiciary. The first is the shift from paper to electronic filings, which began in 2013 and is now prevalent. The second is the improvement of the courts' online databases so access to case law is now easier, which in turn impacts the way lawyers bring forth their arguments and the way courts enter their decisions. The third one is the growth in the number and attendance of seminars in which judges and attorneys interact with foreign practitioners; for instance, model legislation issued by the United Nations Commission on International Trade Law on cross-border insolvency, which is not binding in Brazil, is now the topic of more studies and debates than ever before and has even been invoked by the judge responsible for the Oi reorganisation proceedings to accept the insolvency filing by two foreign subsidiaries of Oi. The fourth is the specialisation of judges and justices in business law in São Paulo and Rio de Janeiro, which are the country's two main business hubs. These changes require more sophistication from lawyers: in the past the mere possession of relevant information unknown to the opposing counsel would sometimes suffice to convince a non-specialised court, but this is no longer enough. The fact that whole case files on similar disputes and also specific precedents are readily available online to all attorneys levels the playing field, and the fact that courts are more knowledgeable about the specificities of the market and business law reduces the leeway for superficial or inaccurate arguments.

GTDT: What have been the most significant (by value or impact) recent trends in arbitral proceedings in your jurisdiction?

ADF & RZ: Third-party funding (TPF) has become available in domestic arbitrations over the past three years or so by the efforts of local asset managers and entrepreneurs. Leading foreign players have not entered the Brazilian market yet, but it would be no surprise if they did so in the near future; an aggressive expansion of TPF could be fuelled by the steady growth in the number of arbitration disputes in Brazil and the fact that many local companies are currently in financial distress and have been looking for ways to limit their budget for commercial disputes. The Arbitration and Mediation Centre of the Chamber of Commerce Brazil–Canada (CCBC), which is currently the largest arbitration chamber in Brazil, has recently issued specific regulation on TPF to mitigate the risk of conflicts of interest between funders and arbitrators, but TPF may still spark a lot of controversy until the market becomes mature.

The interaction between arbitration and ADR also tends to be in the spotlight. The 2015 Mediation Act may have effects on arbitration as (1) mediators are now prohibited from acting as arbitrators or serving as witnesses in disputes regarding the subject matter of the mediation; (2) arbitration must be stayed if parties have previously agreed to an escalation clause and the mediation has not been completed within the period or under the conditions set forth in the clause; and (3) information produced or shared during mediation is deemed confidential and may not be subsequently disclosed in related arbitration. Also, dispute boards and adjudications, two ADR methods not regulated by statute, have become more common in the context of construction and infrastructure agreements that also contain arbitration clauses; ADR seeks to prevent, or at least simplify, arbitration further down the road, and discussions over the boundaries and effectiveness of each dispute resolution mechanism in complex disputes may ensue.

GTDT: What are the most significant recent developments in arbitration in your jurisdiction?

ADF & RZ: The most relevant recent development in arbitration was the enactment of Law No. 13,129/2015 to amend and update the 1996 Arbitration Act. Its content is not really innovative

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but rather a codification of existing case law on the Arbitration Act. That is not surprising. Brazil is nowadays seen as one of the most arbitration-friendly jurisdictions in Latin America, mostly because of the judiciary's supportive interpretation of the Arbitration Act: instead of affirming their jurisdiction over disputes submitted to arbitration and then challenged in court, as they might otherwise have done, courts have consistently safeguarded the validity and lawfulness of arbitration, arbitrators' rights and jurisdiction, and the binding nature of arbitration agreements and the existence of implied consent to arbitrate.

Pursuant to Law No. 13,129/2015, the government and the entities it owns or controls are now expressly allowed to choose to arbitrate their disputes as long as those disputes regard alienable rights and the arbitration files are not sealed. This means that foreign investors may be able to submit many contractual disputes against the government to arbitration as opposed to litigating in Brazilian courts, which tend to be pro-government. Earlier this year the CCBC was the first chamber to clearly regulate the publicity of arbitrations involving the government, in advance of an expected increase in demand. We anticipate this field to be the new frontier of the competition between local and international law firms, but foreign clients should beware when retaining counsel: it is our understanding that administrative law in Brazil substantially differs from common law systems in many respects, so international firms may not be well suited to handle those matters without having an experienced local firm on board as well.

Law No. 13,129/2015 has also expressly vested arbitrators with the power to enter partial awards, to grant any injunction or relief after commencement of the arbitration and to have the relevant court of law simply carry out any act mandated in the arbitration without review of its merits.

"Courts have consistently safeguarded the validity and lawfulness of arbitration, arbitrators' rights and jurisdiction, and the binding nature of arbitration agreements and the existence of implied consent to arbitrate."

The downside of new legislation passed in 2015 – the new Code of Civil Procedure and Law No. 13,129/2015 – is that this was a missed opportunity to correct at least two distortions. With regard to the Code of Civil Procedure, the rule pursuant to which the defendant to a lawsuit must present its jurisdictional defences (such as the existence of an arbitration agreement binding upon the claimant) simultaneously with – and not prior to – filing its defence on the merits was maintained, which means that the defendant will still have to incur costs with attorneys twice and the claimant will have access to the defendant's arguments before arbitration has even started. As for Law No. 13,129/2015, language contained in the bill allowing companies to arbitrate employment disputes against the companies' top management was eventually vetoed by the President; Brazilian labour and employment courts are very protective of workers for historical reasons related to the low qualification and instruction of the average worker and it seems unfair to us that individuals as sophisticated as executive officers can benefit from that level of protection as well.

How popular is ADR (eg, mediation, expert negotiation) as an alternative to litigation and arbitration in your jurisdiction? What are the current ADR trends? Do particular commercial sectors prefer or avoid ADR? Why?

ADF & RZ: ADR has not gained much traction in Brazil yet, but we expect this to change in light of efforts on both the judicial and the legislative fronts: Brazilian courts are overwhelmed (as of the end of 2014, there were officially around 100 million lawsuits pending, 28.5 million of which were filed in 2014 alone) and widespread adoption of ADR would come in handy.

The judiciary has been promoting ADR through campaigns and seminars, capacitating mediators and expert negotiators, and implementing specific programmes to submit certain disputes (family affairs, consumer rights, etc) to those specialists. On top of that, Law No. 13,140/2015 was enacted to regulate mediation systematically for the first time, and the 2015 Code of Civil Procedure also contains several rules to incentivise it.

Banks and telephone companies have been partnering with the judiciary to implement innovative ADR programmes to prevent litigation. Banks, for instance, have very recently acceded to a government-sponsored online mediation system and also opened an ADR facility in the city of São Paulo to review and settle lawsuits immediately after they have been filed by clients. It is still unclear whether other sectors with very large numbers of standardised consumer-related claims, such as airlines, will follow suit.