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'Steps in the right direction'

*Cesar A. Guimarães Pereira*¹ explores how Brazil has gradually come to embrace arbitration of disputes – and why investors should take comfort

FOR A LONG time, arbitration was not a usual form of dispute resolution in Brazil due to procedural difficulties. A new arbitration law was enacted in 1996, but came into full practical application only after 2001, when the STF [Brazilian Supreme Court] rejected a constitutional challenge against the law. In 2002, Brazil ratified the New York Convention of 1958. Since then, ADR (alternative dispute resolution) has been thriving.

In 2009, CBAr [Brazilian Arbitration Committee], an arbitration think-tank, issued a report in which it examined almost 800 state and federal court rulings from 1996 to 2008 involving arbitration. Most large-scale contracts now provide for arbitration, and the infrastructure sector is no exception. Since the country is not a member of ICSID [the International Centre for the Settlement of Investment Disputes], domestic and international arbitration plays an essential part in the protection of investments in Brazil.

MULTITUDE OF AGREEMENTS

Infrastructure contracts, often developed under project finance arrangements, typically involve a multitude of agreements. Most of them are purely private, such as construction contracts and insurance policies. However, some of the key contracts are directly or indirectly linked to the government. In many cases, the sector at hand is subject to strict government regulations, which affect the substance of the contracts. In others, the activity to be carried out is either a government monopoly (such as oil and gas) or a public service (e.g., water supply, energy or ports).

The main contract in an infrastructure arrangement is often a government concession (franchise), granted after a public tender. Other government contracts may also be there. BNDES, Brazil's government-owned development bank, is commonly in charge of funding a large part of infrastructure projects. Pursuant to Brazilian law, such government contracts attract the application of a particular set of rules distinctly different from those applicable to private contracts.

If in private contracts Brazilian arbitration law and practice are consistent with those existing in most other arbitration-friendly jurisdictions, the matter can take a twist where government contracts are involved. Certain law specialists will argue that matters of public interest cannot be subject to arbitration, and this premise led some courts, including the Brazilian Court of Accounts (TCU), to initially reject altogether the possibility of arbitration in government contracts. Fortunately for foreign and domestic investors and contractors, the opposite



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view has since prevailed.

In the wake of the Superior Court of Justice (STJ) rulings of 2005 and 2006 in a series of cases involving power purchase agreements and a port sector contract, arbitration in certain government contracts has become commonplace. Law scholars and courts generally reject the previous objections and consider it admissible for contractual financial claims to be settled by arbitration. Such court rulings concede that the Brazilian arbitration law of 1996 gave sufficient basis for arbitration in government contracts and no specific statutory provision was required.

Even so, several federal and state statutes, either general or applicable to specific sectors,

have expressly provided for arbitration. The most comprehensive examples are those of Laws 11.079 (public-private partnerships/PPPs) and 11.196 (government concessions), of 2004 and 2005. They establish specific requirements: the arbitration must be conducted in Portuguese and in Brazil. There is no obstacle against the use of an international arbitration centre, provided that the proceedings take place in Brazil – which, under Brazilian arbitration law, makes the outcome a domestic award, not subject to recognition prior to enforcement. The applicable material law in government contracts will generally be Brazilian law, but public procurement regulations allow some latitude in the choice of law and forum in some international contracts (article 32, § 6, of Law 8.666).

The enthusiasm concerning arbitration in infrastructure contracts has led to local statutes regulating arbitration agreements entered into by state and local governments. The state of Minas Gerais, arguably the most active in Brazil in carrying out PPPs, enacted Law 19.477 in 2011. Although the act regulates closely the substance of the arbitration agreement and therefore creates some procedural difficulties, it should be praised for the state commitment it represents.

Arbitration, like ADR methods in general, is about freedom, trust and accountability, and this translates into good faith. At all levels of government, Brazil has learned that, by showing reliability and instilling confidence, it will attract investment and investors. Encouraging and advancing arbitration as a form of dispute resolution are steps in the right direction. ■

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All-comers welcome

Foreign and domestic investors can expect equal treatment, as well as strict enforcement of contracts in court. So says Marçal Justen Filho, founder and senior partner of Brazilian law firm Justen, Pereira, Oliveira & Talamini, in a wide-ranging interview about the key legal issues in Brazilian infrastructure

WHAT ARE THE KEY LEGAL ISSUES IN RELATION TO PRIVATE INVESTMENT IN BRAZILIAN INFRASTRUCTURE?

MJF: The current outlook in Brazil favours investments in the field of infrastructure. The last few years have brought political stability alongside a strong economic momentum. And there is an immediate need for infrastructure investments, which go far beyond the requirements for the coming World Cup and Olympic Games.

Many of these investments in infrastructure will be made with public funds, by means of government contracts. These contracts require a public tender for the selection of the contractor. Another system will be public-private partnerships (PPPs), which also rely on public tenders for selection of the private partner.

WHAT ARE THE STRENGTHS AND WEAKNESSES OF BRAZILIAN LAW IN AN INFRASTRUCTURE CONTEXT?

MJF: Brazil has a stable and sophisticated regulatory framework in several areas, such as telecommunications, energy and ports. However, considerable advances could be made in sectors such as railroads and airports. The legislation in these sectors is scant in some respects, occasionally leading to difficulties and legal risks for the private investor. This became evident during the recent bid for the concession for a high-speed train project, in which all prospective bidders seem to have refused to bid due to uncertainties in the project.

Another difficulty involves the general system for enforcement of credits against government agencies, which can be time-consuming and cause mistrust in investors. The lack of investor-state arbitration (ICSID) is sometimes viewed as a shortcoming.

Brazilian legislation addresses such difficulties by granting the private partner in PPPs a specific system of guarantees and enforcement of credits. It also allows for domestic or international arbitration. In all government contracts, the private contractor is generally protected against the economic effects of uncontrollable circumstances.

DO REGULATORY FRAMEWORKS TEND TO WORK IN INVESTORS' FAVOUR? WHAT IMPROVEMENTS NEED TO BE MADE?

MJF: Several improvements could be implemented to overcome regulatory difficulties that increase risks to investors. Currently, the most



Marçal Justen Filho

important bottlenecks in Brazilian infrastructure are in the air and land transport sector.

The air transport legislation is dated and imprecise. ANAC, the National Civil Aviation Agency, faces many difficulties in achieving its objectives, mostly because almost all airports are fully operated by INFRAERO, a government agency.

There are already signs of change. The recent creation of the Civil Aviation Secretariat led to changes in the legislation of ANAC and INFRAERO. The government has also made clear its intention of granting the concession of some important airports to private exploitation under a PPP system.

Roads suffer from poor planning and an overall lack of investment, which leads to expensive projects and an uneven coverage of paved roads. A relatively low percentage of highways in Brazil are paved, mostly in the more developed

south and south-east regions.

Railroads are not widely used, serving mostly for the transport of grains to be shipped by seaports. The regulatory agency responsible for the railroads has recently passed new resolutions changing the rules for the usage of railroad tracks, though it is still early to gauge its effects and acceptance by the current operators. A project for the construction of a high-speed passenger train connecting São Paulo and Rio de Janeiro is in the planning stages.

Overall, despite the current shortcomings, recent policies, such as the PAC [Growth Acceleration Program], show that the government is aware of its difficulties and is making use of Brazil's economic boom to improve on infrastructure.

IS THERE A TRACK RECORD OF CONTRACTS BEING EFFECTIVELY ENFORCED?

MJF: Yes. Brazilian legislation concerning infrastructure contracts is thorough in ensuring their enforcement. Moreover, both the government and the courts have generally demonstrated their intent of establishing a safe environment for the enforcement of all contracts signed. When the terms of the contract are not followed, the other party may request in court specific performance, including injunctive relief or financial compensation.

The Brazilian legal system allows for full judicial review of government actions, and the state can be brought to court – or arbitration in some cases – to comply with contracts or give compensation for any breach.

During the 1990s, a dispute relating to certain state government PPPs in the toll road sector gave rise to strong case law stressing the binding force of government contracts and the duty to comply with the contractual conditions.

“Several improvements could be implemented to overcome regulatory difficulties that increase risks to investors”

ARE FOREIGN INVESTORS ABLE TO HAVE AS MUCH CONFIDENCE IN THE LEGAL AND REGULATORY FRAMEWORKS AS DOMESTIC INVESTORS?

MJF: Yes. There is no reason for foreign investors to fear they may be treated differently from domestic investors. Once a contract is signed, the nationality of the investor is irrelevant for the allocation of the risks of the contract. It should be noted that, in 2010, public procurement regulation was changed to establish a margin of preference to products made in Brazil (a “Buy Brazilian Act”). Even in its narrow field of application, this rule relates only to bidding procedure, not to contractual conditions or performance.

S&P TOLD US IN AN INTERVIEW THAT MOST BRAZILIAN PROJECT FINANCE DEALS HAVE BEEN STRUCTURED “TO RELY MORE ON CORPORATE OR SPONSOR SUPPORT RATHER THAN ON ROBUST LEGAL AND STRUCTURAL SEPARATENESS ELEMENTS”. THEY ALSO ADDED THAT “TRANSACTIONS [HAVE] TO RELY MORE ON THE CREDITWORTHINESS OF THE PROJECT ASSETS THAN ON SPONSOR SUPPORT”. DO YOU AGREE WITH THIS VIEW AND WHAT IS BEING DONE TO ADDRESS THESE ISSUES?

MJF: Law 11.079, enacted in 2004 and relating to PPPs, seeks to ensure that project finance is based on the creditworthiness of the project itself and not on corporate sponsorship. Its article 9 requires a Special Purpose Company (SPC) as the vehicle for the PPP. Another condition that aims to advance a pure project finance system is the provision requiring the public partner (government) to offer security for its obligations under the PPP, be it through performance bonds or special government funds. This measure improves the quality of the private partner’s receivables under the PPP and makes it easier for non-recourse project finance to be viable.

HOW WOULD YOU EVALUATE THE APPETITE OF LOCAL BANKS TO ENTER INTO PPP AGREEMENTS? MANY OF THE TRANSACTIONS SEEM TO BE HIGHLY DEPENDENT ON BNDES.

MJF: BNDES, the Brazilian National Social and Economic Development Bank, is a crucial part of Brazilian economic policy. BNDES serves as an effective means of financing government undertakings. It ensures less costly financing for infrastructure projects that might not

seem profitable to the private enterprise otherwise. Other government-controlled banks, such as Banco do Brasil and the Caixa Econômica Federal also finance a great number of public projects.

It should be stressed that, in PPPs, public financing cannot be higher than 70 percent of the total financing of the project, ensuring that the partnership is never wholly dependent on public funds. Law 12.431, passed in late 2010, grants tax exemptions for private

investment in several areas, seeking greater private investments in infrastructure.

IS THE FEDERAL GOVERNMENT YET TO ENGAGE IN ‘TRUE’ PPP CONTRACTS (EXCEPTING LOCAL REGIONS AND MUNICIPALITIES)? IF SO, IS THERE AN OBSTACLE TO PPP DEVELOPMENT IN BRAZIL?

MJF: Public contracts with the private sector are common in Brazil, including with the federal government. However, true PPP contracts, in which the government is responsible for part or all of the private partner’s earnings in the performance of a public service, are quite new in Brazil.

These contracts were introduced by Law 11.079, passed in 2004. The law imposes several contractual, administrative and fiscal conditions for the creation of a PPP. These requisites and the newness of PPPs may explain the relatively scarce cases of true PPP at the level of federal government. However, there are numerous PPPs in operation mostly at state level.

Several projects currently under study by the federal government may be developed through PPPs, such as the proposed high-speed train and the concession of airports to private enterprise. The concept of PPPs is widespread, and this system is expected to be used in a variety of government and government-related activities.

MEXICO CREATED A NEW TYPE OF INSTRUMENT LAST YEAR ALLOWING DEVELOPERS TO LIST THEIR PROJECTS ON THE STOCK EXCHANGE, THUS FACILITATING ACCESS TO FUNDING FROM INSTITUTIONAL INVESTORS. WHAT MEASURES, IF ANY, ARE BEING CONSIDERED TO ATTRACT THESE SOURCES OF LONG-TERM CAPITAL IN BRAZIL?

MJF: Brazilian infrastructure projects resulting from public contracts are not listed on the stock exchange. However, the companies that exploit the projects may choose to go public. Most large infrastructure operators in Brazil have done so in various areas such as toll road concessions, port terminals, railroads, energy and telecommunications.

The government has also taken several measures to attract long-term investors, as is the case with the tax exemptions created in 2010 by Law 12.431 and the creation of an investment fund based on the Social Security funds. ■