Dispute boards and government contracts in Brazil

10.08.2022 11 min read

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The need to resolve increasingly complex disputes has expanded the use of alternative dispute resolution methods in Brazil, including dispute boards and arbitration. Compared to traditional lawsuits, the advantages of these alternative methods are speed, confidentiality and narrower grounds for challenging the decisions made.

In Brazil, despite being present in the nation's legal framework from the early 19th century, arbitration only became firmly established as a dispute resolution mechanism with the enactment of Law 9,307 of 23 September 1996, known as the Arbitration Law.1 Its later consolidation occurred mainly due to the absence of the need for judicial ratification of arbitral awards2 and the autonomy of the parties to choose the mechanism in an arbitration clause or separate arbitration agreement.

Although arbitration also stands out for its confidentiality, when a government entity is one of the parties, the rule of confidentiality must yield to the principle of publicity.3

Despite the several advantages of arbitration, its high costs and the time to resolve the dispute (more reasonable than traditional lawsuits, but also long) made other alternative dispute resolution methods gain prominence.

A current example is the dispute board, which is a permanent committee to monitor contract execution. The purpose of a dispute board is to solve relatively minor issues and disputes arising during the contract execution period, trying to prevent them from becoming the subject of a lawsuit/arbitration.

Compared to traditional lawsuits, the advantages of these alternative methods are speed, confidentiality and narrower grounds for challenging the decisions made.

Although both arbitration and dispute boards end with decisions, their natures and legal effects are different. While arbitrators end up playing the role of judges,4 a dispute board is an advisory body appointed by the parties with expanded powers and functions. The decisions of the arbitral tribunals have the force of a judgment and are not subject to appeals to the judiciary. On the other hand, a dispute board's decision has the force of a contractual amendment, and may be reviewed in an arbitration or by the judiciary, depending on the final form of dispute resolution chosen by the parties in the contract.

Legal framework and main concepts

In 2015, the Federal Justice Council (Conselho da Justiça Federal) approved three statements that set the grounds for the use of dispute boards in Brazil,

especially in infrastructure and civil construction contracts.5 At the time, the aim was to establish dispute boards as a valid alternative dispute resolution method and consolidate essential concepts, which took substantial effort given the lack of information about dispute boards at the time.

Dispute boards were later introduced by the São Paulo Municipal Law 16,837 of 8 February 2018 and, later, at the federal level by Law 14,133 of 1 April 2021 (New Public Procurement and Government Contracts Law).6 Both provide for dispute boards in the context of public works and service contracts entered with government entities and state-owned companies.

Two bills (9.883/2018 and 2421/2021) pending in the Brazilian Congress aim to allow all public administration entities (direct or indirect) to include dispute board clauses in their contracts.

There are three types of dispute boards: (1) the dispute review board (DRB), which only makes recommendations to the parties; (2) the dispute adjudication board (DAB), which has the power to decide and impose solutions; and (3) the combined dispute board (CDB), which can both issue non-binding recommendations and render binding rulings.

In the case of the DRB, normally the rules specify a timeframe for the parties to formally challenge the recommendation issued by the board. Generally, this time limit is contractually defined. In such cases, the party that does not agree with the recommendation can generally refer the matter to arbitration or to the judiciary, depending on what was provided in the contract.

Until a competent arbitral tribunal or the judiciary rules on the matter, the parties are not obliged to comply with the board's recommendation – although, in many cases, the arbitral tribunal or the judiciary may decide on the provisional validity and need to comply with the recommendation.

If neither party formally protests within the period contractually established to formally challenge the recommendation issued by the board, the recommendation becomes contractually binding.

The decisions of the DAB, on the other hand, have a contractually binding effect from the moment they are issued. A party that does not agree with the dispute board's decision can submit the matter to arbitration or judicial review, but until a final ruling is rendered, the parties must continue performing the contract according to the board's decision.

Finally, the CDB – as the name indicates – is a combination of the two previous types. Contractual clauses providing for the use of this type of dispute board should indicate the specific disputes that may trigger recommendations or decisions, as well as the procedure to request each of them.

In any case, parties may also agree to abide by specific dispute board rules, instead of regulating the matter contractually.

Case study: dispute boards and the public administration

In Brazil, a groundbreaking use of the dispute board mechanism, and perhaps one of the most relevant for the resolution of contractual disputes with government entities, involved the agreement for the construction of

Line 4 (Yellow) of the Metro system in the city of São Paulo, between the Companhia Metropolitana de São Paulo (a state-owned company of the São Paulo government) and a consortium formed by the construction companies TIISA – Infraestrutura e Investimentos S/A and COMSA S/A (Consórcio TC Linha 4 Amarela).

The use of the DRB in this case was provided for in the tender documents published in 2003 by Companhia Metropolitana de São Paulo. The project was to be financed by the International Bank for Reconstruction and Development (IBRD), part of the World Bank, which has required the adoption of the dispute board mechanism in contracts worth more than US$50m since 1995. Due to IBRD involvement, the draft contract annexed to the tender notice was the first government contract in Brazil to provide for a dispute board as part of the dispute resolution mechanism.

The tender notice divided the project to build the Yellow Line into three lots, resulting in three turnkey agreements signed in October 2003. The project aimed at implementing a 12.8-kilometre expansion of the Metro (all underground), the complete construction of five and partial construction of four Metro stations, as well as the supply and assembly of systems for the partial operation of the Yellow Line. Together, these contracts exceeded BRL 1.8bn and involved integration of civil works and services with the supply and installation of customised systems and equipment.

From its establishment in 2004 until the completion of its duties in 2015, the DRB intervened in ten disputes and carried out one mediation.

The first intervention occurred in October 2006 and was widely disclosed to the public. The trigger for this initial intervention was a cost increase caused by a change in the project's construction method for Lot 2 requested by the client, in reaction to delays of approximately 14 months in the project's timetable due to expropriation of land issues. This caused the contractor to submit a new execution program extending the initial timetable for 18 months, which prompted the client to request the submission of a new proposal with the tunnel boring machine (TBM) method, also known as the new Austrian tunneling method (NATM).

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In November 2004, the contractor submitted an updated proposal considering the new construction method requested by the client. In May 2005, the client finally recognised the technical feasibility of the proposal and the right of the contractor to be reimbursed for the added costs caused by the delay in expropriating the lands. However, it did not recognise the contractor's right to be reimbursed for the additional costs resulting from the modification of the construction method.

In May 2006, the contractor submitted a new budget for the revised basic design plan. In the same year, the contractor asked the São Paulo state government for immediate approval and payment of the new budget submitted, or the start of negotiations to reach a settlement to avoid an imbalance in the contracting parties' rights and obligations. Due to the refusal of the client to reimburse the additional costs resulting from the alteration of the construction method, the contractor submitted the dispute

to the DRB for the issuance of a recommendation.

In August 2007, the DRB issued its recommendation, based on the consensus of its members. However, the client did not agree with this recommendation and notified the contractor of its intention to resort to arbitration, as stipulated in the contract, to resolve the matter. This action brought the case to the attention of the general public and is considered a watershed moment for the first DRB in a government contract in Brazil.

With the agreement of the consortium, in November 2007 the parties submitted the matter to the International Court of Arbitration of the International Chamber of Commerce (ICC). In June 2009, the court issued the first partial award, recognising the right of the contractor to the rebalance of the economic-financial equation of the contract and reimbursement of the additional costs resulting from the change in the construction method determined by the client.

In response, the client filed a lawsuit for annulment of the arbitral award and pleaded for a preliminary injunction against the contractor, which was assigned to the 13th Treasury Court of São Paulo. In June 2010, the court granted the injunction to allow expert engineering evidence during the course of the arbitration, to examine the balance of the economic-financial equation of the contract and the additional costs caused by the change in the construction method.

The contractor then decided to appeal to the São Paulo Court of Appeals against the injunction. By doing so, the contractor acted against what was stipulated in the contract between the parties, which had national and international negative repercussions. The matter was the subject of an article published by the Global Arbitration Review,7 which described the decision of the São Paulo court as unexpectedly interfering in the arbitral proceeding.

Pros and cons of using dispute boards in government contracts

Although the use of dispute boards is increasingly common internationally, partly due to the requirement for contracts financed by the IBRD worth more than US$50m to adopt this mechanism, its use is still very limited in Brazil.

In part, this can be attributed to limitations created by the law. For example, a restriction exists in the capital of São Paulo, the highest gross domestic product state in Brazil: according to São Paulo Municipal Decree 60,067/2021, which regulates Municipal Law 16,873/18, only contracts for infrastructure projects worth BRL 200m or more can stipulate the use of dispute boards. This causes dispute boards to be a relatively rare mechanism for resolution of disputes in this municipality.

Another limitation on the use of this mechanism is the impossibility of dispute boards to issue final and binding decisions, unlike an arbitral tribunal. When one of the parties does not agree with the dispute board's recommendation or decision, it can resort to arbitration or to court. Indeed, the aforementioned case study, considered to be a pioneering case of the use of dispute boards in Brazil, culminated in arbitration and in a lawsuit.

Despite these hurdles, dispute boards are efficient mechanisms for resolving disputes or even to avoid major ones, especially in long-term government

contracts. With a dispute board, contractual issues, which individually can often be quite simple, do not accumulate and can be solved as they appear throughout the execution period, avoiding major disputes at the end of the contract or even avoiding accumulating disputes that may later hinder its conclusion.

The advantage of using dispute boards also comes from the technical expertise, experience and background of their members, and the practical benefit they can bring to the project with their recommendations and decisions. Their impartiality, independence and absence of conflicts of interest is also crucial for the success of the mechanism.

A survey released by the Instituto de Engenharia in 2020 about dispute boards in Brazil shows that, in 98.7 per cent of the cases in which there was a decision by the dispute boards, it was complied with until the end of the project without being challenged by a subsequent arbitration or judicial proceeding. In 60 per cent of the cases, the contract period ended without any disputes. In addition, implementing dispute boards costs an average of 0.15 per cent of the final cost of the project and are shared between the parties.

Statistics confirm that the dispute board can be a very efficient dispute resolution method in the Brazilian context, especially in government contracts. The positive results of the implementation of dispute boards in government contracts are expected to stimulate their use in an increasingly broader range of contracts, with the maturing of the applicable law.

*This article was written by our partners Ana Cândida de Mello Carvalho and Renan Frediani Torres Peres, and by our lawywer Mariana Ferrão. The text was published by IBA. Click here and find out more.

Notes

1 As observed by Rafael Francisco Alves in his work A inadmissibilidade das Medidas Antiarbitragem no Direito Brasileiro, although the 'arbitral tribunal' was established in Brazil as a legacy of the colonial Ordinances of the Kingdom, and was received in most constitutions along with the Civil Code of 1916 and the Civil Procedure Code of 1973, in reality until 1996 the mechanism was virtually moribund in the country. The reason for that change was the enactment of Law 9,307/96 (Arbitration Law), which eliminated many obstacles to the development of arbitration in Brazil. Among these legal hurdles were the absence of efficacy of arbitration clauses and the need for judicial ratification of arbitral awards, meaning the need for double recognition of foreign arbitral awards.

2 Art 18, Law 9,307/96.

3 Art 2, s 3, Law 9,307/96.

4 Art 18, Law 9,307/96.

5 Statement No 49: ‘Dispute Resolution Committees (Dispute Boards) are a method of consensual conflict resolution, as provided for in § 3 of art. 3 of the Brazilian Civil Procedure Code’; Statement No 76: ‘Decisions rendered by a Dispute Board, when the contracting parties have agreed for their mandatory adoption, bind the parties to comply with them until the Judiciary or the competent arbitration court issue a new decision or confirm it, if sought by the party who does not agree with the board’s recommendation’; and Statement No 80: ‘The use of Dispute Boards, with the insertion of the respective contractual clause, is recommended for construction or infrastructure works contracts, as a mechanism aimed at preventing disputes and reducing of related costs, allowing the immediate resolution of conflicts that arise along the execution of the contracts’.

6 Art 151: ‘In the contractual relations governed by this law, alternative means of preventing and resolving disputes may be utilised, notably conciliation, mediation, dispute resolution committees and arbitration. Sole paragraph. The provisions of the main section of this article shall be applicable to controversies related to disposable pecuniary rights, such as questions related to reestablishment of the economic-financial balance of contracts, the default of contractual obligations by either of the parties and the calculation of indemnities.’ (unofficial translation); Art 154: ‘The process of choosing the arbitrators, the arbitral bodies and dispute resolution committees shall observe egalitarian, technical and transparent criteria.’ (unofficial translation).

7 S Perry, ‘Brazil downplays “anomalous” court injunction’ Global Arbitration Review (11 June 2010, London) https://globalarbitrationreview.com/brazil-downplays-anomalous-court-injunction, accessed 7 March 2022.

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