INTERNATIONAL ARBITRATION IN INVESTMENT DISPUTES: THE WASHINGTON CONVENTION, ICSID AND THE POSITION OF BRAZIL[*]

Gilberto Giusti[**]
Adriano Drummond C. Trindade

I. - Introduction

1. - The stance adopted by Brazil on international dispute resolution mechanisms and on arbitration itself was historically well known and – why not? – conservative. Perhaps as a belated heritage of the Calvo Doctrine,[1] the New International Economic Order ideas that Brazil defended in the international arena in the 1960s and 1970s as one of the most active members of the so-called UN G-77, could still be felt in the 1990s. The concept of 'national sovereignty' is still today rooted deeply in the Brazilian legal culture and government, despite the regional integration movements and the prevailing market economy based on the flow of capital. The country's non-accession to the Washington Convention[2] and to the International Centre for Settlement of Investment Disputes – ICSID, which contrasts sharply with the decision made by its Latin American peers, is worthy of note and will be further detailed below.

2. - Brazil has taken an active leadership role in regional integration efforts (as in the case of Mercosur), but has fiercely resisted to yield sovereignty over international commitments as regards other States, particularly when foreign investments and international arbitration for resolution of disputes over the commitments assumed in connection with such investments are involved. An example of this unyielding stance, as shown below, is the non-ratification of bilateral treaties by Brazil, as well as the country's refusal to accede to the Washington Convention.

3. - Another hint is the country's reluctance to accept arbitration as a dispute resolution mechanism, even if conducted internally and among private parties. A Brazilian law regulating arbitration was enacted only in 1996,[3] in an attempt to prevent the parties from refusing to arbitrate or from going to court against arbitration. Even so, the Brazilian Arbitration Law was challenged as unconstitutional, and its applicability was kept on hold until its eventual ratification by the Brazilian Federal Supreme Court.[4]

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[**] *Partner and Associate in Pinheiro Neto Advogados.*

[1] *Naón, Horacio A. Grigera, "Arbitration and Latin America: Progress and Setbacks", in Arbitration International, v. 21, No. 2, 2005, p. 137.*

[2] *Convention on the Settlement of Investment Disputes between States and Nationals of Other States, also known as the Washington Convention, proposed by the World Bank in March 1965 and effective as from October 14, 1966, upon deposit of the 20th ratification instrument of a Contracting State. The text of the Washington Convention is available at http://www.worldbank.org/icsid/basicdoc/basicdoc.htm (visited on July 7, 2005).*

[3] *Law No. 9307 of September 23, 1996, published in the Official Gazette of the Federal Executive on September 24, 1996, effective on November 23, 1996, available at https://www.planalto.gov.br/ (visited on July 7, 2005).*

[4] *Federal Supreme Court, Internal Appeal in Recognition of Foreign Decision No. 5206, Full Bench, judged on December 12, 2001, published in the Official Gazette of the Republic on April 30, 2004, p. 29.*

4. - But the Brazilian approach to arbitration has dramatically changed since then. In addition to acknowledging the Brazilian Arbitration Law as a valid and effective legal instrument, the country has become increasingly responsive to both international arbitration and the ensuing commitments towards the international community. This shift is clearly shown by the country's ratification of the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards[5] and, more recently, of the Mercosur Agreement on International Commercial Arbitration.[6]

5. - All of these factors surely show that Brazil has finally headed towards a greater acceptance and adoption of arbitration (as well as of international arbitration itself) as an effective dispute resolution mechanism. However, there is still a long way to go until the country is on a par with its Latin American peers and with other countries enjoying the same international projection as Brazil. This article will thus address the trails yet to blaze with regard to international arbitration on investment disputes, focusing on the Brazilian stance with regard to the Washington Convention and to ICSID.

II. - History

6. - Until recently, it was commonplace to hear about investors that had lost their assets as a result of arbitrary decisions taken by countries relatively hostile to foreign capital. Whether prompted by political, social or economic bias, the fact is that such events undermined the confidence placed by investors and capital exporters in such countries. After all, the driving force of international investments (as well as of capital investments in general) is the possibility of recovering such investment and its fruits, in the form of interest, products or even socially-oriented results.

7. - But investors were defenceless against the expropriation of their investments by the governments of host countries, as there were no effective channels or mechanisms available to recover what they had lost. In some cases, if an investor had political clout, it could exert pressure on the expropriating State to recover such investment, or at least some of it to mitigate losses. In other events, the investor resorted to its own State for diplomatic negotiations with the expropriating State and potential recovery of investments. But this solution could eventually lead to diplomatic conflicts, and the investor not always obtained the protection expected from its State against the expropriating act of another State.[7]

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[5] ***Promulgated by Decree No. 4311 of July 23, 2002, published in the Official Gazette of the Republic on July 24, 2002, effective on the same date.***

[6] ***Promulgated by Decree No. 4719 of June 4, 2003, published in the Official Gazette of the Republic on June 5, 2003, effective on the same date.***

[7] ***The concept of diplomatic protection remains current in international law and its use continues to be a prerogative of the parties involved in a dispute. Nevertheless, from the moment an arbitration proceeding is initiated at ICSID, the parties are precluded from resorting to diplomatic protection (Article 27 of the Washington Convention). This measure sought to avoid parallel procedures that could run counter to the legal security of the arbitration proceeding. However, once the dispute has been resolved and the arbitral award has been issued, it is possible to seek diplomatic protection should one of the parties fail to comply with the award. In addition, the Washington Convention does not bar informal diplomatic negotiations, provided that they are aimed at settling the dispute under way and not initiating a parallel dispute.***

8. - The alternative was to look to the Judiciary for investment protection. But this course of action faced even higher obstacles. When resorting to the courts of any State involved, the neutrality of jurisdiction would surely come to the fore, the more so if the courts sitting in the place of investment were chosen. In either case, the courts would be subject to political pressure, which would escalate in a direct relation to the values at issue. On the other hand, if the courts of a (neutral) third State were chosen, an unbiased decision could indeed be obtained, but it would hardly be enforced by the defeated party of its own free will. In other words, this decision would figure as a moral victory only; its enforcement would once again be subject to the goodwill of the courts in the country of the defeated party.

9. - As the global capitalism developed and the international flow of capitals intensified, new forms of attack on foreign investments took shape. A mode of "disguised expropriation" came up, where a foreign investment was not exactly expropriated, but the conditions imposed by the host State on such investment were so burdensome that, in practice, they were tantamount to an expropriation. For example, some host States issued rules limiting or impairing capital repatriation or profit remittances; creating specific conditions that rendered a project unfeasible after its proper set-up; or according to a more favourable treatment to investors in other States.

10. - It thus seems that the mechanisms for protection of investments in another State have not kept up with the myriad modes of investment use by the host State so as to confer reasonable protection on investors while also allowing the host State to allocate such investment towards the development of its own social and economic public policies.

11. - There was a growing need for a forum where investors and States could iron out their disputes over these investments. To that end, the International Centre for Settlement of Investment Disputes – ICSID, an entity linked to the World Bank, was created 40 years ago by the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, also known as the Washington Convention, as proposed by the World Bank in March 1965 and effective as from October 14, 1966, upon deposit of the 20th instrument of ratification by a Contracting State.[8] Even though 40 years have gone by since its signing and 144 States are already a party to it, which in and of itself attests that the international community has widely accepted both this instrument and ICSID jurisdiction, Brazil has not acceded to the Washington Convention to date.[9]

12. - The creation of ICSID was mostly due to the incidental role that the World Bank was then playing as a mediator or conciliator for disputes involving international

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[8] ***Note 2 supra.***

[9] ***According to January 2006 data, 155 have signed the Washington Convention, out of which 144 States have deposited their instruments of ratification. Syria is the most recent State that acceded to the Convention. The complete list of Contracting States to the Washington Convention may be found at http://www.worldbank.org/icsid/constate/constate.htm (visited on July 7, 2005).***

investments. The World Bank was resorted to in view of its role of facilitating and viabilizing the flow of capitals as a means of achieving better socio-economic conditions, the more so in developing countries. The creation of ICSID sought to release the World Bank and its staff from this task, while fostering – by creating a specialized body – a culture in which the flow of investments was viewed as a catalyst for development.

13. - However, the driving force for the creation of ICSID was the need to encourage investments without fear of arbitrary and non-indemnified expropriation in an affront to international law rules. Without addressing the actual development associated with or derived from the flow of foreign capitals and investments, which is not the scope of this article,[10] the fact is that, in fostering the flow of capital and investment in other States, such States are allowed to use such funds as channels which, coupled with effective public policies, may potentially bring greater development to the country and its population, provided that such funds are properly managed. Based on this assumption, ICSID seeks to create a forum to discuss and decide investment issues, while building a more stable and predictable scenario for an augmented flow of capital.

14. - Nevertheless, despite the creation of ICSID as a competent forum for resolution of disputes involving international investments, implementation of the Washington Convention was not automatic. Quite the contrary, for more than two decades, practically no disputes were referred to ICSID. In fact, until the mid 1980s, the disputes reviewed by ICSID were founded on the jurisdiction of investment agreements entered into between investors and host States. Given the specific features of such instruments, the requirements for submission of a dispute to ICSID were rarely fulfilled. This scenario, however, has changed dramatically at the end of the 1980s, as a result of the proliferation of bilateral investment treaties.

III. - International Investment Treaties

15. - The pressing need for access to foreign capital in order to foster domestic

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[10] ***On the one hand, it is argued that the flow of foreign investments in a country promotes new technologies and manufacturing techniques, salary increases, enhancement of management and quality control skills, as well as greater access to export markets. On the other hand, it is argued that the negative side of foreign investments is a fiercer competition on the domestic front, poor income distribution, increase in foreign exchange rates and an exaggerated dependence on natural resources, instead of furthering modernization of the economy's productive sectors. One of the major criticisms regarding international investment treaties is the fact that developing countries would ultimately be exchanging sovereignty for credibility. For a detailed analysis of the relation between capital flow, international investment treaties and development, please refer to the United Nations Conference on Trade and Development – Unctad, "Foreign Direct Investment and Development", Unctad Series on issues in international investment agreements, United Nations, New York and Geneva, 1999; Bloningen, Bruce A. and Davies, Ronald B., "Do Bilateral Tax Treaties Promote Foreign Direct Investment?", IMF Working Paper 8834, March 2002, available at www.nber.org/papers/w8834 (visited on May 14, 2005); Tobin, Jennifer and Rose-Ackerman, Susan, "Foreign Direct Investment and the Business Environment in Developing Countries: the Impact of Bilateral Investment Treaties", May 2, 2005, available at http://www.law.yale.edu/outside/html/faculty/sroseack/FDI_BITs_may02.pdf (visited on July 7, 2005); Neumayer, Eric and Spess, Laura, "Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?", revised edition, May 2005, available at http://econwpa.wustl.edu/eps/if/papers/0411/0411004.pdf (visited on July 7, 2005); Hallward-Driemeier, Mary. "Do Bilateral Investment Treaties Attract Foreign Direct Investment? Only a Bit… and They Could Bite, World Bank Policy Research Working Paper 3121, August 2003; Elkins, Zachary, Elkins, Guzman, Andrew and Simmons, Beth, "Competing for Capital: the Diffusion of Bilateral Investment Treaties, 1960-2000," available at http://www.wcfia.harvard.edu/conferences/internationaldiffusion/Papers%20Revised/Competing.pdf (visited on July 7, 2005); and the United Nations Conference on Trade and Development – Unctad, "Recent Developments in International Investment Agreements", UNCTAD/WEB/ITE/IIT/2005/1, August 30, 2005.***

economies requires, as a rule, that host States develop policies that ensure especial and favourable conditions to foreign direct investments when compared to other investments in general. Therefore, capital investments, preferably long-term investments and investments in productive sectors of the economy, are accorded special treatment. The policies of host States, however, must also improve the economic and political environment with a view to reducing investors' risks. One of the most efficient ways of reducing such risk—which is an aspect to which investors tend to pay more attention—is the definition, respect for and effective protection of property rights as a means of protecting the investment made.[11]

16. - However, not all host States have an appropriate institutional framework and a legislation sophisticated enough as to offer effective instruments to protect such investments. The lack of confidence in the rule of law and in the institutions of the host State itself has caused capital exporting countries to look for other means to protect the investments of their nationals. One of the ways of narrowing the gap between the reality of investments and the desired protection and commitment was to create international treaties, whether bilateral or multilateral,[12] with the specific purpose of regulating the investment environment and ensuring investors a minimally acceptable treatment. Thus, during the latest two decades, the international community has witnessed the proliferation of international investment treaties[13] that provide, in general, for investment treatment rules, legal protection under international rules of law (particularly in regard to taxation, profit remittance, capital repatriation and protection against expropriation), and dispute resolution.[14] It is worth noting that such treaties do not constitute, *per se*, a determinant factor in attracting foreign investments, but are certainly part of a set of measures that render a State more attractive for investment purposes.

17. - International investment treaty rules are divided basically into two large groups: the first group consists of rules devised to foster foreign direct investment by eliminating restrictions, applying rules to ensure certain standards of treatment and eliminating discrimination, as well as implementing measures and policies to promote markets; the second group, in turn, comprises rules exclusively aimed at protecting investments.[15] This article focuses on the second group of rules.

18. - Thus, the basic requisite of international investment treaties is to ensure a

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[11] ***Tobin, Jennifer and Rose-Ackerman, Susan, note 10 supra, p. 5.***

[12] ***Notable examples of multilateral treaties with provisions concerning investment protection are the Energy Charter Treaty and the* North-American Free Trade Agreement *– Nafta.***

[13] ***As per data from the United Nations Conference on Trade and Development – Unctad, up to 2004, no less than 2392 bilateral investment treaties had been signed, of which 1,718 were in force. Out of the total number of bilateral treaties signed, 451 involved Latin American and Caribbean States. In "Recent Developments in International Investment Agreements", Research Note Unctad/Web/Ite/Iit/2005/1, August 30, 2005.***

[14] ***United Nations Conference on Trade and Development – Unctad, "Issues Related to International Arrangements: Investor-State Disputes and Policy Implications", TD/B/COM.2/65, January 14, 2005, p. 4. Interestingly, "at the same time as BITs flourished in the 1980s and 1990s, outright expropriations of foreign investors, which were common during the 1960s and 1970s, practically ceased to take place." Neumayer, Eric and Spess, Laura, note 10 supra, p. 10.***

[15] ***United Nations Conference on Trade and Development – Unctad, "International Investment Agreements: Key Issues", Volume I, New York and Geneva, 2004.***

favourable environment to foreign investors, with well-defined procedures for inflow and outflow of funds, protecting property rights and establishing dispute resolution in a jurisdiction other than that domestically available by the host State. This last aspect, in particular, represents the rupture with the Calvo Doctrine, so strongly defended by Brazil and other Latin American countries, under which investors should submit exclusively to local rules and jurisdiction, not being allowed to resort to foreign or international jurisdictions. Other aspects that have become commonplace in bilateral investment treaties comprise the guarantee to give investors the same treatment as that accorded to nationals by the host State, fair and equitable treatment vis-à-vis other investors and under the principles of international law, as well as protection against expropriation by means of rules providing for prompt, adequate and effective compensation. These aspects will be examined below in light of ICSID's past decisions.

19. - Perhaps the major feature that led to the development of ICSID was the provision in international investment treaties of a specific jurisdiction to settle disputes relating to the investments covered by the treaty. The adoption of international arbitration further consolidated ICSID and transformed it into one of the most efficient jurisdictions to settle this type of dispute, particularly in view of its specialization. In fact, the explosive growth of the number of international investment treaties stating ICSID as a possible jurisdiction for settlement of disputes has led to an exponential increase in the number of cases submitted to ICSID jurisdiction. Likewise, throughout the latest two decades, evolution of case law has pointed to the expansion in the scope of the disputes referred to ICSID, which involve essential public policy themes. In brief, international investment treaties have strengthened and consolidated the structure created decades earlier by the Washington Convention, which had remained incipient up to the mid 1980s.

20. - Brazil seems to be far from this universe of international investment treaties. At the time this article was prepared, Brazil had signed 17 bilateral investment treaties or cooperation instruments,[16] of which only four were in effect: those signed with Germany, Canada, Mexico and the United States. Nevertheless, only one of such treaties has regulatory force, as the other three contain only program-related rules. Moreover, none of these four documents provides for rights and obligations similar to those contemplated by current international investment treaties.[17]

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[16] ***Brazil signed the following bilateral investment treaties: (i) with Germany, on September 4, 1963 and on September 21, 1995; (ii) with Belgium and Luxembourg, on January 6, 1999; (iii) with Canada, on January 15, 1998; (iv) with Chile, on March 22, 1994; (v) with South Korea, on September 1, 1995; (vi) with Cuba, on June 26, 1997; (vii) with Denmark, on May 4, 1995; (viii) with the United States, on February 6, 1965; (ix) with Finland, on March 28, 1995; (x) with France, on March 21, 1995; (xi) with Italy, on April 3, 1995; (xii) with Mexico, on October 10, 1990; (xiii) with the Netherlands, on November 25, 1998; (xiv) with Portugal, on February 9, 1994; (xv) with the United Kingdom, on July 19, 1994; (xvi) with Switzerland, on November 11, 1994; and (xvii) with Venezuela, on July 4, 1995. According to a survey conducted by the International Acts Division of the Ministry of Foreign Affairs, at http://www2.mre.gov.br/dai/home.htm (visited on July 16, 2005).***

17 ***Brazil has already ratified some multilateral agreements on arbitration. The most important within the scope of the Mercosur are (i) the Las Leñas Protocol (1992) signed with Argentina, Paraguay and Uruguay, which deals with international judicial cooperation among Mercosur countries and, among other issues, regulates the recognition and enforcement of foreign arbitral awards; and (ii) the Buenos Aires Protocol (1994) signed with Argentina, Paraguay and Uruguay, which sets out the parties' free***

21. - The Investment and Financing Agreement entered into with Germany does not contain the typical rules currently applicable to investments, but rather focuses on the cooperation for economic development of both Germany and Brazil, including the creation of a Mixed Brazil-Germany Committee for Economic Development. Moreover, both countries have exchanged notes, signalling that there is some uncertainty regarding the effectiveness of such Agreement.[18] Subsequently, Brazil and Germany signed the Agreement on Reciprocal Promotion and Protection of Investments in 1995, which was not ratified.

22. - The Declaration of Intent Concerning the Negotiation of a Foreign Investment Promotion and Protection Agreement signed with Canada expressed only the intention to start negotiations based on a non-binding program. At the time, the representatives of Brazil and Canada limited themselves to instructing "the competent officials to initiate negotiations toward the signing of an Investment Promotion and Protection Agreement no later than June 30, 1998".[19] However, such Agreement has not been signed to date.

23. - Along the same lines, the Convention on Cooperation in Joint Investment Promotion signed with Mexico constitutes mere a declaration of intent toward industrial development between the National Bank for Economic and Social Development (BNDES) and Nacional Financiera SNC, IBD of Mexico. In other words, it is an instrument for cooperation between government financial agents in charge of development matters and differs entirely from investment treaties.[20]

24. - Finally, the Investment Guaranty Agreement signed with the United States deals with trade and above all monetary guarantees offered by both the United States and Brazilian Governments to investments made in their respective territories. There is a provision on the settlement of disputes via arbitration; however, only the Contracting Parties would be able to participate in such arbitration proceeding, without the intervention of the investor, which is very similar to the diplomatic protection afforded by the States to their nationals but differs from the concept proposed under the ICSID system.[21]

25. - On December 11, 2002, at the request of the Executive Branch, all the other bilateral investment treaties signed by Brazil were withdrawn from Brazilian Congress,

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will to determine the competent jurisdiction to settle disputes arising from international agreements and authorizes the parties to elect arbitration as a dispute settlement mechanism.

[18] ***Investment and Financing Agreement signed between the Federal Republic of Germany and the United States of Brazil on September 4, 1953, effective on the same date, at http://www2.mre.gov.br/dai/b_rfa_21_61.htm (visited on July 16, 2005).***

[19] ***Declaration of Intent Concerning the Negotiation of a Foreign Investment Promotion and Protection Agreement, signed between the Federative Republic of Brazil and Canada on January 15, 1998, at http://www2.mre.gov.br/dai/investcanada.htm (visited on July 16, 2005).***

[20] ***Convention on Cooperation in Joint Investment Promotion signed between the National Bank for Economic and Social Development (BNDES) and Nacional Financiera SNC, IBD of Mexico on October 10, 1990, at http://www2.mre.gov.br/dai/b_mexi_72_1211.htm (visited on July 16, 2005).***

[21] ***Investment Guaranty Agreement signed between the United States of Brazil and the United States of America on February 6, 1965, effective on September 17, 1965, at http://www2.mre.gov.br/dai/investeua.htm (visited on July 16, 2005).***

where they were pending ratification. At that time, the Minister of Foreign Affairs justified such withdrawal on the following terms: "...one must note that the agreements have never had the political support necessary for their approval, on the one hand, and failed to reflect the current international trends, on the other hand."[22]

26. - However, the proliferation of bilateral and multilateral investment treaties over the recent years, coupled with the growing activities of ICSID, have shown that the international scenario actually points to trends other than those evaluated by the Brazilian Executive Branch in 2002. Moreover, Brazil's position exclusively as a host State deserves a further and more thorough re-evaluation. Even though Brazil is predominantly a host State, its offshore investments have been increasing considerably in recent years. Adoption of international investment treaties and accession to ICSID (which is a specialized forum to settle disputes between investors and host States) would provide greater protection to Brazilian investments abroad.[23]

IV. - ICSID as an Institution

27. - Although ICSID may also be resorted to in mediation procedures, it has become a valuable institution because of the resources made available to the parties for settlement of disputes via arbitration. ICSID is not, in and of itself, a conciliation entity or an arbitral tribunal, but rather an institution having a body of rules and structure that allow for the establishment of mediation and arbitration proceedings. Accordingly, the ICSID Administrative Council lays down rules and procedures to be followed by the parties involved in mediation and arbitration proceedings, as well as administrative rules for management of ICSID itself; while the ICSID Secretariat is in charge of administrative matters such as assisting in the proceedings underway at ICSID.

28. - ICSID has a list of arbitrators that may compose an arbitral tribunal. Each Contracting State will appoint four nominees for such list. However, this does not prevent the parties to an arbitration proceeding from appointing other nominees who are not included in the list to compose the arbitral tribunal instated in accordance with ICSID rules.

29. - Currently, the main developed countries (except for Canada) are signatories to the Washington Convention and have recognized ICSID. Most of the African, Arabian and Asian countries (including China) are members of ICSID. A considerable number of former soviet republics have already signed the Washington Convention, which is pending

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[22] ***Executive Branch Message No. 1080 of December 11, 2002, published in the House of Representatives Gazette on December 13, 2002, pp. 54410-54411. The Minister of Foreign Affairs further alleges that "the absence of similar agreements has not affected Brazil's position as an important recipient of international investments, particularly direct investments, the inflow of which is among the highest in the group of developing countries. Such remarkable performance explains the stability of legal rules within the domestic sphere and the intrinsic force shown by the Brazilian economy since 1994."***

[23] ***The recent problems faced by Petrobras regarding its investments in Bolivia, which is threatening to nationalize the oil and gas industry, could in theory be reviewed by ICSID.***

ratification. Latin American countries removed the restrictions placed in the 1980s, and ratified the Convention in the 1990s. Brazil and Mexico,[24] despite being countries of great importance, still have not signed the Convention.[25]

30. - Throughout its 40 years of existence and more specifically in the last two decades, the ICSID has built a reputation as a body qualified to administer arbitration proceedings. Nevertheless, some issues are still to be improved both from an institutional and a structural standpoint. A serious criticism about ICSID is that it offers a party too many appeals in the arbitration proceeding.[26] This causes arbitration to drag on for years while such party pursues as many appeals as it can, thus protracting a decision on the case and, by implication, an effective response by the arbitral tribunal.

31. - Other challenges to be faced by ICSID, which will ultimately contribute toward solidification of its pillars, consist of giving greater publicity to its procedures. Representatives of the population and civil society that will suffer the effects of the arbitral awards to be rendered by the ICSID tribunals claim transparent procedures and opportunity for public participation in the arbitration proceeding, even as a way of exercising citizenship. As a justification, they allege their right to know which decisions are being taken and on which arguments such decisions are founded, as well as their right to express their opinions on the matter. This could even imply the participation of some groups as *amici curiae* or intervening third parties. Whatever the case may be, a point that should be first analysed is the confidentiality attaching to arbitration which, if on the one hand, is a prerogative of the parties, on the other hand, may involve the population at large when the matter involves public policy.

V. - Disputes at ICSID

32. - The raison d'être of ICSID, among others, is its expertise in international investment disputes. As a consequence, disputes referred to ICSID must involve a State and an investor, in addition to arising out of investment-related issues. These two requisites are known as *ratione personae* and *ratione materiae*, respectively, and are expressly provided for in the Washington Convention.[27]

(i) Capacity to act as a Party

33. - With respect to the *ratione personae* requirement, as a rule disputes submitted to

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[24] ***Notwithstanding the fact that, by applying jointly the Nafta Agreement and the Additional Facility, Mexico has already participated or participates in over ten disputes submitted to the ICSID jurisdiction.***

[25] ***United Nations Conference on Trade and Development – Unctad, "Course on Dispute Settlement: Overview", section 2.1, United Nations, New York and Geneva, 2003, pp 9-10.***

[26] ***Collier, John and Lowe, Vaughan, "The Settlement of Disputes in International Law" (1999), p. 71.***

[27] ***"Article 25 – (1) The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment between a Contracting State (…) and a national of another Contracting State, which the parties to the dispute consent in writing to submit to the Centre. When the parties have given their consent, no party may withdraw its consent unilaterally."***

ICSID must involve a Contracting State to the Washington Convention and a national (a natural person or a juridical person) of the other Contracting State. An interesting aspect is that, when ratifying/acceding to the Washington Convention, the Contracting States may exclude certain matters from the ICSID jurisdiction.[28] Nevertheless, this does not mean that, should a specific case arise, the Contracting Party will not be allowed to submit to the ICSID jurisdiction a matter that had been subject to reservation.

34. - When one of the parties (either the State or the investor) is not subject to the terms of the Washington Convention, the Additional Facility will apply. Therefore, an arbitration proceeding administered by ICSID may be conducted if only one of the parties is a Contracting Party or a national of a Contracting State. The Additional Facility is also available for settlement of disputes that do not arise out of an investment or for fact-finding proceedings. ICSID has witnessed disputes resolved via the Additional Facility in proceedings arising out of the Nafta Agreement, considering that neither Canada nor Mexico are Contracting Parties to the Washington Convention. Notwithstanding the foregoing, the trend is that proceedings submitted to ICSID involve, as a rule, parties to the Washington Convention.

35. - Another point worthy of note is that, under the Washington Convention, for institution of an arbitration proceeding administered by ICSID, both parties must have expressed their consent to ICSID jurisdiction. Therefore, it does not suffice that the States of the investor and of the host State be parties to the Washington Convention; both the investor and the host State must express their willingness to submit the dispute to ICSID. Such consent may take various forms, such as through an agreement to regulate a specific investment between the investor and the Contracting State, or even through the respective concession agreement to regulate the undertaking. As stated earlier, in the past it was commonplace to elect ICSID as the competent forum in investment agreements entered into between States and investors. With the subsequent proliferation of international investment treaties, election of ICSID was included in their provisions concerning dispute settlement.

36. - The consent of each of the parties to submit the dispute to the ICSID jurisdiction may be given in different documents. The domestic legislation of the host State may provide for submission of disputes to the ICSID jurisdiction. In this sense, it is known that more than 30 domestic legislations contemplate such practice.[29] It is also possible that the State consent be given in a bilateral investment agreement entered into with the State of the investor, for instance, or in multilateral conventions, such as the Energy Charter Treaty or the North-American Free Trade Agreement – Nafta.

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[28] ***Article 25 (4) of the Washington Convention. For instance, Saudi Arabia does not accept the ICSID jurisdiction in connection with oil matters and sovereign acts. For its part, Turkey excluded real estate issues from the ICSID jurisdiction. Apud Collier, John and Lowe, Vaughan, "The Settlement of Disputes in International Law" (1999), p. 62.***

[29] ***Ávila, Gabriela Álvarez, "Las Características del Arbitraje del CIADI" (2002), p. 212.***

37. - In this case, *arbitration without privity* is deemed to occur (leading to an actual asymmetry), since the host State will have already consented to the ICSID jurisdiction even before the dispute arises. In practical terms, the State consent under an investment treaty is similar to an irrevocable public offer for arbitration, which remains valid for the duration of the treaty.[30]

38. - By contrast, the consent of the investor can be given not only in the contract entered into with the State concerned, but also in a document such as a letter or declaration, or else, by merely submitting its claim to the ICSID, stating the nature of the dispute and the respondent.

39. - As stated above, the investor must have the nationality of a Contracting State to the Washington Convention that is not the respondent State. As far as natural persons are concerned, the nationality requirement is much easier to be assessed, even when complex situations arise in the events of change of nationality or multiple nationalities. As a consequence, the domestic legislation of each Contracting State gains an important role to the extent that it will provide subsidies to determine the nationality of natural persons. By adopting such system, the Washington Convention repealed concepts such as dominant nationality, which could give margin for more questionings.[31]

40. - However, the issue is still controversial where juridical persons are involved, since it is not always easy to determine the nationality of the investor. To start with, the Washington Convention does not set the criteria for determination of nationality, leaving such determination, just as with natural persons, to the discretion of the domestic legislation of the Contracting States and to the definitions of nationality spelled out in such legislations. ICSID's practice, however, has set two decisive criteria for determining nationality: the place of incorporation and the place of the seat of the juridical person, *i.e.* the State where its headquarters are located.[32]

41. - Nevertheless, it is commonplace for the host State to require that the investor set up a corporation in the country where the investment will be made, so that, from a formal standpoint, the corporation in charge of carrying out the investment would be deemed to have the nationality of the host State, for tax and liability purposes, among others. With the very purpose of resolving such point, the Washington Convention lays down the concept of "foreign control". In this case, even if the juridical person involved in the dispute has been incorporated and has its seat in the territory of the host State, such juridical person will be deemed to be a foreign entity in view of its foreign control, for the purposes of the

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[30] ***Spiermann, Ole, "Individual Rights, State Interests and the Power to Waive ICSID Jurisdiction under Bilateral Investment Treaties", in Arbitration International, vol. 20, No. 2, 2004, p. 180.***

[31] ***Collier, John and Lowe, Vaughan, note 26 supra, p. 65.***

[32] ***Ávila, Gabriela Álvarez, note 29 supra, p. 215.***

Convention.[33] In other words, the juridical person concerned will be deemed to have the nationality of another Contracting State, considering that nationals of such other Contracting State exercises control over the company.[34] Although the Convention does not provide for an objective definition of the term "foreign control", such concept is not extraneous to international law and should be analysed in reliance on the criteria of common legal practice, reasonableness and the very purpose of the Washington Convention.

42. - In practice, the vast majority of disputes submitted to ICSID via arbitration has private entities as complaining parties. To date there are only two cases in which a Contracting State or government entity brought to ICSID a claim against a private party.[35] Despite representing a minority of the cases, both cases set important precedents for future governments to consider the possibility of bringing a claim at ICSID against an investor in default on its obligations.

(ii) Jurisdiction Ratione Materiae

43. - With respect to the ICSID jurisdiction *ratione materiae*, two requirements should be taken into account. The first requirement is that only legal disputes must be submitted to ICSID under the Convention. This means that the existence of a mere dispute between both parties is not enough, *i.e.* there must be a dispute arising out of the existence or scope of rights and obligations, or reparation for a breach already occurred, and not exclusively out of political or economic and commercial reasons. Otherwise, an investor would interfere in political decisions of the host State, which would even violate the sovereignty of such State.

44. - The difficulty, however, lies in the cases of political or economic and commercial decisions which, when implemented, may have legal consequences. In such events, the investor will probably have fulfilled the requirement of "legal disputes" to submit the case to the ICSID jurisdiction. The several cases initiated against Argentina after the 2001-2002 economic crisis have shown that economic policy decisions ultimately have repercussions on the agreements entered into with investors. Despite Argentina's efforts to characterize the absence of *ratione materiae* requirements with a view to ruling out the jurisdiction of the ICSID arbitral tribunals,[36] in actual fact the decisions on jurisdiction matters have been favourable to investors.[37]

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[33] ***Article 25 (2)(b) of the Washington Convention.***

[34] ***Collier, John and Lowe, Vaughan, note 26 supra, pp. 65-66.***

[35] ***Gabon v. Société Serete S.A. (ARB/76/1) and Tanzania Electric Supply Co. Ltd. v. Independent Power Tanzania Limited (ARB/98/8).***

[36] ***One of the arguments frequently invoked by the Argentinean government in the arbitrations submitted to ICSID refers to which instrument had been violated. Argentina alleges that, as a result of the "pesification" of the economy, the concession agreements entered into with investors were violated, which means that the disputes should be submitted to the jurisdiction contractually stipulated. The arbitral tribunals, however, have ruled that the rights attaching to foreign investors protected by bilateral investment treaties are different and separate from those set out in the concession agreements. Ultimately, this means that there may be a violation of rights protected by an international treaty without a similar violation of the concession agreement. Rosa, Paolo di, "The Recent Wave of Arbitrations against Argentina under Bilateral Investment Treaties: Background and Principal Legal Issues", in The University of Miami Inter-American Law Review, vol. 36, No. 1, Fall 2004, pp. 54-56.***

[37] ***The first decision on the merits in the cases involving "pesification" of the Argentina economy in 2002 was handed down***

45. - The second requirement that is important for analysis of the ICSID jurisdiction *ratione materiae* regards the concept of investment, because as a rule only disputes on investments may be submitted to ICSID.[38] Although several bilateral and multilateral treaties provide for concepts of investment, many of them quite broadly,[39] as a matter of fact such concept should be scrutinized primarily in light of the Washington Convention, its supplementary rules and the ICSID practice itself. Therefore, for the *ratione materiae* requirements to be fulfilled, it does not suffice that a treaty have the definition of investment; such definition must be in keeping with the precepts contemplated by the body of rules of ICSID.

46. - The problem is that, during the negotiation of the Washington Convention, the Contracting States were unable to reach a consensus about the definitions proposed by the delegates present.[40] Since no concept of investment was included in the Washington Convention, the ICSID arbitral tribunals are permitted to evaluate, given the circumstances underlying each case, whether the case under review would qualify as an investment in accordance with internationally accepted principles and rules.

47. - As a consequence, despite the high level of subjectivity afforded to the ICSID tribunals, the absence of a defined and closed definition of investment promotes the evolution of such concept over the time. Therefore, evolution of the concept of investment is admitted in accordance with current business practices, instead of limiting it to a stagnant concept defined in the Washington Convention, which concept would call for a series of signatures and ratifications of the Contracting States in order to be changed and modernized. On the other hand, there is still a certain inconsistency in arbitral decisions concerning the scope of the concept of investment, as seen in the landmark cases outlined below, such as Salini and SGS, which to a certain extent does not provide sufficient legal security.

48. - Legal writings have it that two distinct criteria may be used to characterize an investment. By the subjective criterion, it is necessary to verify the will of the parties to make an actual investment that would be supported by the Washington Convention.[41] By the objective criterion, the following points should converge: (i) there must be contributions of capital, assets or rights; (ii) these contributions should occur during a

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on May 12, 2005, in which the arbitral tribunal determined that Argentina pay damages of approximately US$ 133 million, plus interest, to investor CMS Energy.

[38] ***This is without prejudice to arbitrations dealing with issues unrelated to investments, based on the Additional Facility.***

[39] ***Nafta and the Energy Charter Treaty include in the concept of investment even contractual rights, loans and licenses. On the other hand, it is commonplace that bilateral investment treaties include in the concept of investment (i) tangible or intangible assets or any rights over assets such as mortgages, pledges and guarantees; (ii) shares, quotas, debentures or securities representing equity interests in companies or associations; (iii) claims related to financial resources or to compliance with agreements providing for pecuniary obligations; (iv) intellectual and industrial property rights such as copyrights, patents, industrial designs, trademarks, fanciful names or know-how; (v) rights over concessions granted by law or by contract for performance of an economic activity (including concessions for the exploration of and use of natural resources).***

[40] ***Farouk Yala, "The Notion of 'Investment' in ICSID Case Law: a Drifting Jurisdictional Requirement? Some 'Unconventional' Thoughts on Salini, SGS and Mihaly", in 22(2) Journal of International Arbitration 2005, p. 106.***

[41] ***Farouk Yala (2005), p. 106.***

considerable period of time; and (iii) they must involve a certain degree of risk.[42] In addition to these elements, legal writings have taken the stand that the concept of investment, according to ICSID, is closely related to a contribution toward the development of the host State. Such expected character attaching to investments was expressed by the Contracting States when signing the Washington Convention, as shown by the declaration contained in the preamble thereof, which states as pillars of the Convention "the need for international cooperation for economic development, and the role of private international investment."

49. - Given all these factors, coupled with the ample concept that the term 'investment' may assume, the ICSID tribunal decisions have combined subjective and objective criteria. Accordingly, the ICSID tribunals have already recognized the existence of investment in such cases as industrial investments, building of hotels, exploration of natural resources, technical assistance agreements, management agreements and licensing agreements. By contrast, agreements involving the simple sale of products and services would not fall within the concept of investment, since there is no capital transfer aimed at obtaining the much-awaited economic development of the host State.

50. - Notwithstanding the above, such decisions have been inconsistent with respect to the definition of "investment". The difficulty lies in determining what is an investment transaction and a purchase and sale transaction. Even though the application of objective criteria regarding capital contribution, period of time and risk gives the impression that there would be little room for doubts as to classification of such transactions, some decisions of the ICSID tribunals have even qualified as investments capable of being protected by the Washington Convention the construction of highways (without the need for its subsequent operation by the construction company)[43] or inspection contracts and import certifications.[44]

51. - On the other hand, an ICSID tribunal did not recognize as investment the expenses unilaterally made by an investor still during the phase of preparation for an investment project in reliance on a memorandum of intent, while the agreement qualifying such expenses as investments by the host State was not formalized.[45] [46] Likewise, simple commercial agreements, even if pegged to bank guarantees, do not qualify as investment for the purposes of the Washington Convention.[47]

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[42] ***Id; Obadia, Eloïse, ICSID, Investment Treaties and Arbitration: Current and Emerging Issues, News from ICSID, vol. 18, No. 2, Fall 2001.***

[43] ***Salini and Intalstrade v. Kingdom of Morocco (Case No. ARB/00/4).***

[44] ***SGS Société Générale de Surveillance S.A. v. Islamic Republic of Pakistan (Case No. ARB/00/29); SGS Société Générale de Surveillance S.A. v. Republic of the Philippines (Case No. ARB/02/6).***

[45] ***Mihaly International Corporation v. Democratic Socialist Republic of Sri Lanka (Case No. ARB/00/2), in ICSID Review – Foreign Investment Law Journal, v. 17, No. 1 (2002), pp. 142-165. However, an ICSID tribunal admitted, in a case in which there was already a concession agreement between the parties, that the host State recognized that the expenses incurred by an investor to viabilize an investment (pre-investment expenses) would qualify as investment. See PSEG Global Inc., the North American Coal Corp., and Konya Ilgin Elektrik Uretim ve Ticaret Limited Sirketi v. Republic of Turkey (Case No. ARB/02/5).***

[46] ***For a critical analysis of the Salini, SGS and Mihaly cases, see Farouk Yala (2005).***

[47] ***Joy Mining Machinery Limited v. Arab Republic of Egypt (Case No. ARB/03/11). However, in the case involving Fedax***

(iii) Investment Violations

52. - Once the jurisdictions *ratione personae* and *ratione materiae* of the ICSID tribunal have been defined to entertain a certain dispute, it is necessary to analyse whether, in the case concerned, there was an investment violation. For this purpose, the tribunals rely on long-standing concepts of international investment law, such as non-discrimination and expropriation without compensation, fair and equitable treatment, protection and security for the investments. These concepts are broadly dealt with in bilateral and multilateral investment treaties, many of which establish the ICSID jurisdiction to settle disputes arising out of investments. Where no specific provision is set out in a treaty, however, nothing prevents the tribunal from adopting the same concepts in reliance on international law practice, which is equally binding on the States.

53. - When signing an investment treaty, the Contracting States expect good-faith acts from each other, which is also an essential requisite in civil contracts. However, such good faith creates the expectation that the investments of nationals of a State be also accorded a *fair and equitable treatment* by the other State. The major difference of the latter concept in relation to good faith is that, in certain circumstances, it may happen that a State will afford an unfair and unacceptable treatment without necessarily acting in bad faith. Accordingly, by means of a fair and equitable treatment, the host State is expected to adopt a posture that does not adversely affect the basic expectations of the foreign investor. In other words, the host State must act in a consistent, unequivocal and transparent manner as regards the investment to enable the investor to know beforehand the rules that will regulate the investments and the objectives underlying the governmental policies that may affect such investment and administrative practices. This will offer a favourable and foreseeable environment, ensuring a fair and equitable treatment to investors.[48]

54. - Another element supported by international law consists of the protection or even prohibition against discrimination, which translates into the concept of most favoured nation. Under this concept, a foreign investor cannot receive a different or less favourable treatment than a foreign investor of a different nationality. In other words, foreign investors must be accorded the same treatment, regardless of the origin of each of them. Such principle ensures protection against certain types of discrimination by the host State, thus ensuring competitive conditions among investors of different countries.

55. - It is necessary, however, to delimit the extent of the concept most favoured nation. Its application seems clear in cases involving discrimination against the investor origin by

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N.V. v. Republic of Venezuela (International Legal Materials No. 37, 1998, pp. 1391-1398), the ICSID tribunal held that there was an investment consisting of debts arising from overdue promissory notes not paid by the host State to the investor.

[48] ***As stated by the ICSID arbitral tribunal in the case involving Técnicas Medioambientales Tecmed S.A. v. Estados Unidos Mexicanos (ICSID Case No. ARB(AF)/00/2).***

the host State. Nevertheless, application of such concept to other circumstances has been widely debated by internationalists. In one of these cases, an ICSID arbitral tribunal extended the concept most favoured nation to the dispute settlement clause set out in a bilateral investment treaty. In the case at issue, the investor required the application, in its relation with the host State, of a more advantageous dispute settlement clause that, however, was part of another treaty signed between the host State and a third State. On that occasion, the arbitral tribunal admitted that the clause set out in a treaty to which the first State (the investor State) was not a party could be used by it.[49] Based on such precedent, one could admit, at least in theory, that if an international treaty executed among third parties contains more favourable provisions to investors than those set out in another treaty signed between a State and one of the third parties, then such State could avail itself of the provisions of the treaty among third parties. In brief, according to such understanding, the most favoured nation rule would be applicable not only in respect of domestic law rules and the practice of the host State but also in connection with other international treaties and commitments to which such host State is a party, even if not involving the investor and its State of origin.[50]

56. - A third concept to be examined is the notion that the foreign investor should be comparable to the national investor when it comes to benefits and requirements (national treatment). Therefore, any prerogatives granted to nationals should be extended to foreigners. The doubt that may arise concerns economic sectors that the States reserve only to their nationals or establish restrictions as to the participation of foreigners. In these cases, the most frequent practice is to set restrictions based on public policy, health and national security.[51] However, because such concepts are open, there is room to debates concerning what is a matter involving public policy, health and national security.

57. - International law does not provide for any prohibition when it comes to expropriation. Nevertheless, it is necessary to comply with a series of procedures and measures to bring the expropriation in line with the rules accepted by the international community.[52] In this respect, expropriation should meet public interest[53] and not be carried out by the host State in an arbitrary manner. Moreover, as a consequence of the concept of most favoured nation, expropriation should not be carried out on a discriminatory basis. Finally, in an event of expropriation, the host State must pay a prompt and adequate compensation for the investor's losses, i.e. such compensation should not involve a token value or instruments that are not commercially accepted.

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[49] ***Emilio Agustín Maffezini v. Kingdom of Spain (ICSID Case No. ARB/97/7).***

[50] ***For an analysis of the Maffezini case, see Teitelbaum, Ruth, "Who's Afraid of Maffezini? Recent Developments in the Interpretation of Most Favored Nation Clauses", in Journal of International Arbitration, vol. 22, No. 3, 2005, pp. 225-237.***

[51] ***United Nations Conference on Trade and Development – Unctad, "International Investment Agreements: Key Issues", Volume I, New York and Geneva, 2004.***

[52] ***Although a substantial part of the international community recognizes that, in events of expropriation, there must be prompt, adequate and effective compensation, one may not state that such practice is recognized by international law, given the considerable resistance of some developing countries.***

[53] ***Argentina alleges, in the cases in which investors initiated arbitration against "pesification" of the economy in 2002, that such measure involved substantial and clear public interest.***

58. - There is also the implied obligation of the host State to safeguard and protect such investments and assets related thereto against violence and destruction by its nationals. Such protection is understood to apply as well in the event of legislation proposed by any entity linked to the host State for the purpose of depreciating or even expropriating the investment. Furthermore, any measures that might be adopted against the foreign investor should conform to the rules of transparency and due process of law; otherwise, the investor will be unable to assess whether the other forms of protection set forth above were duly observed.

59. - In this sense, "indirect" expropriation is comparable to any interference in the use of property by the host State for the purpose of hindering use of the property/investment by the investor, limiting or impairing its economic benefits. Such indirect expropriation may be verified even in the cases where the host State will not benefit in any way from the restrictive measures imposed by it on the investor.

60. - The commonest criticisms about the adoption of an extremely ample concept of investment violation and expropriation by the ICSID tribunals is that such concepts are so ample that they end up unduly limiting the powers inherent to a sovereign government whose purpose would be ultimately to create and implement public policies for the well-being of the population. By invoking their protection, investors should not avail themselves of an extremely ample concept of investment (and which was hardly desired by the Contracting States to the treaty at the time of its negotiation) for the purpose of reducing a risk that is naturally inherent to the transaction, thus ultimately transferring such risk to the host State.[54]

61. - On the other hand, there is already a new generation of international investment treaties pursuing a balance between a definition of investment that is comprehensive but not extremely ample and issues that should not be covered by the same definition of investment. These new treaties state that adverse economic effects on a certain investment do not in and of themselves lead to the occurrence of indirect expropriation. Non-discriminatory regulatory measures of host States to protect the well-being of their population, such as those related to public health, environment and security, do not constitute indirect expropriation either. More importantly, the protection to foreign investments cannot be pursued to the detriment of the objectives of legitimate public policies.[55] It is up to the arbitral tribunals instituted to analyse investment disputes and if, applicable, the ICSID arbitral tribunals, to determine whether such balance has been achieved in specific cases.

VI. - Arbitration in Brazilian Domestic Law

[54] ***For an in-depth analysis, see Hallward-Driemeier, Mary, note 10 supra.***

[55] ***United Nations Conference on Trade and Development – Unctad, note 13 supra.***

62. - Private commercial arbitration has always been supported by Brazilian law. However, the absence of a binding arbitration clause hindered to a great extent the development of arbitration as a dispute settlement mechanism. This scenario was substantially changed upon enactment of the Brazilian Arbitration Law (Law No. 9307 of September 23, 1996) and its endorsement by case law.

63. - Nine years after enactment of the Arbitration Law in Brazil, arbitration has developed considerably. Arbitration has been increasingly resorted to by companies, and this trend is reflected by the number of arbitration proceedings conducted in Brazil. Court rulings and several legal writings on arbitration have contributed to strengthen such dispute resolution mechanism. More recently, Brazil's accession to the New York Convention and ratification of the Mercosur Agreement on International Commercial Arbitration have further promoted the development of arbitration in Brazil.[56]

64. - Even before enactment of the Arbitration Law, the parties to a contract could stipulate an arbitration clause. Nevertheless, if a dispute arose between the parties and one of them refused to sign the arbitration commitment, the other party would have no effective means to submit the dispute to arbitration. The Arbitration Law was a major breakthrough because it enabled judicial enforcement of the arbitration clause.[57] Likewise, the Arbitration Law also provided that the arbitral award would have the same effects as a court decision, having a *res judicata* status and thus not subject to court revision.[58]

65. - The greatest evolution in this respect was a true change of culture. The conservative approach of Brazilian law led to a new and efficient dispute resolution method. At first, arbitration clauses were included in contracts in which at least one of the parties was foreign, probably more used to arbitration as an efficient dispute resolution mechanism. Currently, it is commonplace to have arbitration clauses in several types of contracts entered into between Brazilian parties.

66. - The major event that marked arbitration in Brazil took place at the Federal Supreme Court. In a case involving recognition of a Spanish arbitral award,[59] a number of issues related to the constitutionality of the Arbitration Law were raised. In brief, the Federal Supreme Court examined whether the arbitration proceeding and the binding nature of the arbitration clause (and its enforcement in court) were in conflict with the Federal Constitution, which establishes that "the law shall not exclude any injury or threat to a

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[56] ***Notes 5 and 6 supra.***

[57] ***Article 7 of the Arbitration Law: "If the commencement of arbitration is resisted by either party notwithstanding the existence of an arbitration clause, the interested party may petition that the other party be served process to appear in court for signing of the arbitration commitment, whereupon the judge shall schedule a special hearing for such purpose."***

[58] ***Article 31 of the Arbitration Law: "The arbitral award has the same effects as a court decision on the parties and their successors, and shall be regarded as an enforceable instrument if unfavourable."***

[59] ***Note 4 supra.***

right from consideration of the Judiciary Branch".[60] During five long years, arbitration was threatened in Brazil. However, the Federal Supreme Court finally ratified the constitutionality of arbitration and recognized the Spanish arbitral award.

67. - The prevailing argument is that the Arbitration Law does not exclude in and of itself from consideration of the Judiciary Branch an actual or threatened injury to a right. In fact, the parties to a contract decide, of their own free will, to settle their disputes by arbitration instead of resorting to the Judiciary Branch, appointing the arbitrator and establishing the applicable rules. Such decision does not constitute a general waiver of the Judiciary Branch, but rather the parties' choice to refer any contractual disputes to arbitration.

68. - Even during the period in which such dispute was under review by the Federal Supreme Court, the Brazilian Arbitration Law was entertained by state courts in specific cases, which commonly discussed the binding nature of the arbitration clause, sometimes taking the stand that such clause did not preclude one of the parties from resorting to the Judiciary Branch and sometimes that it precluded the parties from resorting to the Judiciary Branch given its binding nature—which stand was later ratified by the Federal Supreme Court. In any event, these precedents, which confirm the validity of arbitration in Brazil and the way it should be applied, have emerged gradually and ended up reinforcing a legal culture of arbitration, allowing for expansion of arbitration and a more frequent use of this mechanism.

69. - The growing number of precedents set by court rulings and the increased use of arbitration, coupled with the incorporation of international arbitration rules into the Brazilian legal system and the enforcement of foreign arbitral awards in Brazil, such as the New York Convention, have created a more stable environment, leading to greater acceptance and use of arbitration.

(ii) Arbitration involving Public and Governmental Entities

70. - The above comments are necessary not only to enable proper understanding of the evolution of arbitration in Brazil but also to envisage the greatest obstacles should Brazil eventually submit to ICSID. One of the major hurdles with respect to implementation of the Brazilian Arbitration Law refers precisely to arbitration proceedings brought against public and governmental entities.

71. - In short, discussions on arbitration involving public and governmental entities are restricted to three main aspects, namely: (i) subjective arbitrability, which addresses the persons capable of submitting their conflicts of interest to arbitration; (ii) objective

[60] ***Article 5, XXXV of the Federal Constitution.***

arbitrability, which refers to the types of interests that may be submitted to arbitration; and (iii) examination of jurisdiction when it comes to review of arbitrability issues.

72. - The difficulty faced in connection with subjective arbitrability is related to the strict lawfulness principle. When applied to public and governmental entities, this principle gives rise to the rule that the Public Administration may only perform acts expressly permitted by law. As a result, in the absence of a legal provision that authorizes, in general, direct and indirect Public Administration entities, government-owned companies and mixed-capital companies, for instance, to refer their disputes to arbitration, such parties are not allowed to include arbitration clauses in the agreements they enter into; in fact, such clauses would be void under the strict lawfulness principle in view of the lack of an express legal provision. Advocates of arbitration, however, point out that the strict lawfulness principle should have a limited reach in order to give public entities a minimum of independence, so that they may direct their businesses without violating the lawfulness principle.[61] In this sense, it is argued that since the Arbitration Law determines that arbitration is open to "persons with capacity to contract",[62] there is already a legislative authorization for public and governmental entities.

73. - With respect to objective arbitrability, the point is that the Arbitration Law allows dispute resolution through arbitration only with regard to disposable property rights. However, if public and governmental entities were allowed to take part in arbitration proceedings, one would, as a rule, be instituting arbitration involving non-disposable rights. In this respect, public and governmental entities would be precluded from resorting to arbitration because they represent public interests pertaining to the notion of State itself and, therefore, non-disposable interests.

74. - It is important to stress, however, that public entities oftentimes play the role of private entities. The exceptional rights conferred on the Administration as an instrument to ensure the prevalence of public interest over private interest are not subject to arbitration. On the other hand, disputes involving public and governmental entities as mere agents engaged in economic activities, in which there is no vertical relation between the parties and the public interest is merely indirect, could be referred to arbitration.

75. - Finally, the third aspect involves the definition of competence to entertain the arbitrability issues referred to above. Brazilian law adopts the competence-competence principle (*kompetenz-kompetenz*), under which the arbitral tribunal is competent to define its own competence. In other words, only arbitrators are empowered to define their own jurisdiction. In view of this principle, which is recognized in the Arbitration Law,[63] it is

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[61] ***Petrobras (Brazilian state-owned oil company) was authorized by law to take part in arbitration proceedings (as per Law 9478/97).***

[62] ***Article 1 of the Arbitration Law: "The persons with capacity to contract may avail themselves of arbitration to settle disputes related to disposable property rights."***

[63] ***Article 20 of the Arbitration Law: "Whoever intends to invoke such issues as lack of standing, recusation or disqualification of one or more arbitrators, or otherwise invoke the voidability, invalidity or unenforceability of the arbitration agreement, shall do so after instatement of arbitration, in a timely manner."***

incumbent on the arbitral tribunal to verify and resolve on matters involving nullity of the arbitration clause itself, including subjective and objective arbitrability. Nevertheless, some court rulings in Brazil have been admitting the possibility that arbitrability issues be submitted to the Judiciary, which ultimately translates into relativization of the competence-competence principle.

(iv) Brazil and International Arbitration

76. - When considering the possibility of Brazil submitting to ICSID jurisdiction, it is very important to take into account the problems raised here in connection with the obstacles to the institution of arbitration proceedings involving Brazilian public and governmental entities. Once Brazil becomes a member of ICSID, it will no longer be able to avail itself of the above aspects relating to subjective and objective arbitrability, or even to competence, to avoid observing obligations attaching to foreign investments.

77. - The obligations and commitments to be assumed by Brazil, once it accedes to the Washington Convention, will become obligations supported by international law. In other words, the Brazilian Government's obligation to submit investment-related disputes to arbitration is in no way related to its domestic legislation, but rather to the position voluntarily adopted by it before the international community. Therefore, Brazil cannot invoke the restrictions imposed by the Arbitration Law to escape the obligations set out in the Washington Convention and in investment treaties to which Brazil may become a party.

78. - The Argentinean cases originating from "*pesification*" of the economy in 2001-2002 are again a case in point. The Argentinean State sought to shirk its responsibility regarding foreign investments in the provision of public services by alleging that the disputes referred to arbitration involved rights arising from administrative contracts and not from investment treaties. The arbitral tribunals repealed such allegation when deciding that investors' rights based on international investment treaties are independent and separate from the rights and obligations arising from administrative contracts entered into with the Argentinean State.[64]

79. - In view of this precedent, it would not be surprising if—in arbitration proceedings in which Brazil argues the impossibility of public and governmental entities submitting to arbitration (in this case, the Brazilian State itself)—the ICSID tribunals took the stand that the obligations relating to investment treaties signed by Brazil are independent obligations not subject to Brazilian law. In fact, the Brazilian initiative of acceding to the Washington Convention would in and of itself represent an obstacle to a future allegation of prohibition of arbitration against the Brazilian State. Therefore, both the Brazilian State and the legal

[64] ***Rosa, Paolo di, note 36 supra, p. 54.***

community must be duly prepared for submission to ICSID rules.

VII. - Conclusion

80. - In the last decade, the international legal scenario has witnessed an increase in international arbitration proceedings, particularly those involving investors and States. This fact results not only from the recognition of ICSID as an efficient forum, but also from the proliferation of international investment treaties and the increase in capital flow between countries. This points to an escalation of investments, with investors increasingly resorting to instruments of defence and assurances, including with regard to arbitration via ICSID. Therefore, an increase in the number of arbitration proceedings will be no surprise. This, however, does not necessarily mean that there will be more violations of international investment and similar treaties.

81. - The current scenario is auspicious for Brazil's submission to the ICSID jurisdiction. In addition, non-accession to the Washington Convention and, consequently, to ICSID, is not in consonance with the current economic policy adopted by the Brazilian Government, which fosters the inflow of foreign capital and the opening of the economy. As a result, the historical moment Brazil is experiencing in connection with arbitration is favourable to submission of Brazil to ICSID, not only to provide greater security to foreign investors but also to offer an alternative forum to its own investors, which in the latest few years have been seeking other markets, particularly in Latin America and Africa.

82. - If the Brazilian Government opposition was justified in the past because its market was closed to foreign capital, such obstacle has been removed and capital flow is currently in the forefront. Brazil actively participates in the international capital market and is the destination of several investors, having sought to create a favourable environment to receive and foster such investments. Accession to the Washington Convention and the possibility of having ICSID as an additional and neutral forum for resolution of investment-related disputes will certainly contribute to the development of a more favourable environment for investments in general and for arbitration in Brazil.

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