ARBITRATION IN THE LIGHT OF THE OPENING OF BRAZILIAN REINSURANCE MARKET

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Brazilian Reinsurance Market

The Brazilian reinsurance monopoly came to an end following the approval of Law n. 126 of January 15, 2007. A new statutory regime represents a long-awaited scenario among local and foreign insurers and tends to enhance the attractiveness of insurance in Brazil. This article aims at providing an introductory comment on the background of the Brazilian insurance industry,[2] with brief remarks on the use of arbitration.

IRB - Brasil Resseguros S.A, a federal government-controlled entity, held the monopoly regarding reinsurance contracts until 2007. *IRB* also held regulatory powers on reinsurance, coinsurance, and retrocession operations and undertook activities to promote the development of the Brazilian insurance market.

Some steps were made during the last decade aimed at modernizing the insurance market. The authorization of investment of foreign capital in the insurance market; the adoption of international regulatory and supervisory standards; and the deregulation of the market (liberalization of premium charges and brokerage commissions for example) were among the measures taken. However, with the opening up of the Brazilian reinsurance market, one of the key measures in modernizing the Brazilian insurance market, was still pending.

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[2] The Brazilian Private Insurance National System consists of (i) the National Council of Private Insurance (CNSP), (ii) the Superintendence of Private Insurance (SUSEP), (iii) the Re-insurers, (iv) the Entities authorized to operate in private insurance; and (v) the Registered Brokers

Statutory Changes: The Backbone

In August 1996, the Brazilian Congress took the first measure to open the market by means of Constitutional Amendment nº 13. As a result, the government's reinsurance monopoly was eliminated at the constitutional level.

Following Constitutional Amendment nº 13, Congress enacted Ordinary Law[3] nº 9932/1999, which (i) transferred the regulatory powers from IRB to the Superintendence of Private Insurance ("SUSEP"); (ii) privatized the IRB; and (iii) regulated the operation of reinsurance companies. However, the Brazilian Supreme Court stayed the effects of this bill because it was not a Complementary Law, which requires the approval by an absolute majority of Congress.

As a result of the Supreme Court ruling, Congress passed *Complementary Law* nº 126, of January, 16th 2007. The new legal regime gave effect to the opening of the reinsurance market in the country. Complementary Law nº 126/07 sets forth the general policy of promoting a competitive reinsurance market in Brazil. The act granted the National Council of Private Insurance ("CNSP") specific and broad powers to regulate the reinsurance market and permit its effective opening. In a *vol d'oiseau*, the act eliminated IRB's monopoly and provided for the reinsurance policy, retrocession and its intermediation, coinsurance operations, insurance placed with foreign insurers, and insurance transactions in foreign currencies.

The following types of re-insurers may carry reinsurance and retrocession business in Brazil:

I - *Local re-insurer*: a re-insurer incorporated in Brazil to carry exclusively reinsurance and retrocession business;

[3] An Ordinary Law requires Congress approval by simple majority

II – *Admitted re-insurer*: a re-insurer based abroad, with representative offices in Brazil, registered as such before SUSEP, according to the requirements established by Complementary Law # 126 and the applicable regulation on reinsurance and retrocession operations; and

III – *Occasional re-insurer*: a re-insurer based abroad, with no representative offices in Brazil, registered as such before SUSEP according to the requirements established by Complementary Law # 126 and the applicable regulation on reinsurance and retrocession operations".

Any foreign carrier incorporated in a tax haven[4] is not permitted to register as a (occasional) re-insurer before SUSEP.

CNSP has the power to establish guidelines for reinsurance, retrocession, and reinsurance brokerage operations, and for the operations of representative offices of admitted re-insurers, including the power to request mandatory clauses in reinsurance and retrocession contracts.

Arbitration and the Brazilian Reinsurance Regulation

On December 17, 2007, CNSP issued Resolution number 168, which contained detailed terms regulating reinsurance and retrocession activities. This Regulation came into force on April 17, 2008[5].

According to Resolution n. 168, reinsurance contracts shall include, *inter alia*, a clause establishing that Brazilian law and jurisdiction are the applicable ones in case the risk covered is located in Brazil, *except in case of arbitration, which shall conform to specific legislation*.

[4] Tax havens are countries or territories in which the income tax is below 20% or those which impose legal restrictions on the access of information regarding shareholders or owners of any entity therein incorporated.

[5] 120 days after the date of publication.

Although it is not clear what *"specific legislation"* the Regulation is referring to, one can assume that it is the arbitral procedural law of the country where the parties have agreed upon to be the juridical *situs* of the arbitration or in Brazil, if the risk covered is located there. Therefore, if Brazil is the place of arbitration, the Brazilian Arbitration Act[6] ("BAA") shall apply. The question that then arises is whether the parties are entitled to select substantive foreign law or general principles of law to decide the merits of the dispute.

Article 2, paragraph 1, of the BAA states that *"[t]he parties may freely choose the rules of law applicable to the arbitration, as long as their choice does not violate good morals and public policy."* Additionally, article 2, paragraph 2 of the BAA sets forth that *"[t]he parties may also stipulate that the arbitration shall be conducted under general principles of law, customs, usages and the rules of international trade."*[7]

However, according to the Brazilian Introductory Law to the Civil Code[8] that sets up the conflict of law rules under Brazilian legal system, contracts must be governed by the laws of the country where they are formed *(lex loci contractus).* Some Brazilian scholars still maintain that the parties to arbitration are not free to choose the law applicable to their transaction; instead, the parties must observe the choice of law rules prescribed by at the Introductory Law to the Civil Code. This view is based on the premise that the principle of party autonomy is limited by public policy grounds, and the conflict rules set forth by the Introductory Law to the Civil Code fall within a matter of public policy; therefore, not being subject of derogation by the parties.

However, in *Total Energie, SNC et al v. Thorey Invest Negocios Ltda*[9], the Sao Paulo 1st Civil Court of Appeal held that the parties are free to choose their rules of law or national law applicable to the merits of the dispute[10].

[6] law n. 9307 of September 23rd, 1996
[7] Unofficial translation for both provisions.
[8] Decree-Law # 4657 of September 4th ,1942.
[9] Interlocutory Appeal # 1.111.650-0 decided on September 24.
[10] Although a doubt still seems to exist, when parties fail to make an express choice.

In *Total Energie*, a Brazilian agent signed a contract with a French manufacturer in Brazil to be performed in Brazil. The clause called for arbitration in Paris, according to French substantive law, under the rules of the International Chamber of Commerce.

The Brazilian party filed a lawsuit arguing that the case should be decided before Brazilian courts, which should apply Brazilian substantive law, as a result of the country's conflict-law rules, but the court ruled that:
"There was no conflict between the Brazilian court authority and the foreign authority, neither regarding situs election, nor in relation to the place where the obligation was to be performed."[11]

Making reference to Article 2 of the BAA, the court held that *"[t]he purpose here is only to respect the contract which, by the way, has its own, expressed ruling, and that's the reason why the parties chose not to leave the case to be decided by state court. Likewise, there is no room to invoke the Brazilian conflict-laws rule, which only would apply if there is no provision in the contract regarding the pertinent applicable law."*[12]

The court ruling issued in 2002 is in line with international standards because it is well accepted that an *"international arbitral tribunal does not owe allegiance to a particular national system of law. Its appointment is not due to the state, but to agreement of the parties; and in applying the law chosen by the parties, an arbitral tribunal is simply carrying out their agreement."*[13]

In addition, under Article 5 of the BAA, *"[i]f the arbitration clause makes reference to the rules of a particular arbitral institution … the arbitration shall be commenced and conducted in accordance with such rules."* Many rules of arbitral institutional

[11] Unofficial translation
[12] *Id.*
[13] Alan Redfern and Martin Hunter – Law and Practice of International Commercial Arbitration, Sweet and Maxwell, 1991 ed. p. 98.

providers confer on the arbitral tribunal, in absence of the parties' express provision, power to pick up the conflict of laws rules it may deem appropriate, or in some circumstances, the arbitral rules confer power to the arbitral tribunal to directly define the rules of law which it determines to be appropriate.

At the current state of arbitration in Brazil, however, parties (and their counsel) should be aware that *Total Energie* seems to suggest that the principle of party autonomy will be upheld as long as the parties have indeed made an unmistakable choice as to the law or rules of law to govern the contract substantive issues. Conversely, the lack of an express provision *may* lead to the revival of the use of outdated conflict-law rules prescribed by at the Brazilian Introductory Law to the Civil Code.[14] It is too early to establish a trend and this comment comes from the opinion on a single case.

Conclusion

Law nº 126 and its related regulations represent an important benchmark for the insurance and reinsurance markets in Brazil. It is part of the process of modernization of the Brazilian insurance model, along with other measures such as the authorization of investment of foreign capital in the insurance market and the adoption of international regulatory and supervisory standards.

Brazil seems to now have a modern legal and regulatory framework to be the base for future development of its insurance market. The express possibility of using arbitration as a mechanism for resolving disputes under reinsurance agreements reveals that the system also contains an important tool for its efficiency. The question will then be whether the Brazilian judiciary when called to rule on issues regarding the enforcement of an arbitration clauses and/or arbitral awards under reinsurance contracts will give full effect to the arbitration clause. Brazilian case-law has shown solid signs in favor of

[14] "*… [l]ikewise, there is no room to invoke Brazilian conflict-law rule, which only would apply if there is no provision in the contract regarding the pertinent applicable law*. Emphasis added. See footnote 11 supra.

arbitration so far. It is expected that this trend continues in the reinsurance industry, where party autonomy is of paramount importance.

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