

High Court of Justice rules that arbitration cannot decide on set-off of claims involving companies undergoing judicial reorganization

Introduction

Under Brazilian law, the concept of objective arbitrability, as established by the Arbitration Law (Law No. 9,307/1996), refers to disputes involving rights of a patrimonial nature, provided that such rights are freely disposable by the parties involved.

A recent amendment to the Brazilian Bankruptcy Law (Law No. 11,105/2005) established that the commencement of judicial reorganization proceedings by a distressed company does not entail the inability to submit disputes to arbitration.

Under such provisions, the Brazilian High Court of Justice ruled that set-off involving claims subject to reorganization proceedings lacks objective arbitrability and, therefore, may not be settled through arbitration.

Facts

The dispute arose from an arbitral award that recognized the validity of a set-off of reciprocal claims between a distressed company (the Plaintiff) and its creditor (the Defendant), based on contractual provisions and facts that occurred prior to the commencement of the reorganization proceedings initiated by the Plaintiff.

The Plaintiff filed an action for annulment of the arbitral award, arguing that the portion of the decision recognizing the set-off exceeded the limits of the arbitration agreement, as it involved a non-disposable patrimonial right and should, therefore, be annulled.

The Trial Court ruled against the Plaintiff's action, holding that the possibility of set-off fell within the merits of the arbitration and, therefore, was not subject to judicial review in an action for annulment of the arbitral award. The Plaintiff lodged an appeal before the State Court of Appeals.

The São Paulo State Court of Appeals denied the Plaintiff's appeal, holding that the controversy met the objective arbitrability requirement, given that the set-off was effected prior to the commencement of the judicial reorganization proceedings. The Plaintiff filed a special appeal, and the case was submitted to the High Court of Justice.

Decision

The High Court of Justice admitted the special appeal and determined that the dispute concerned the scope of the Arbitral Tribunal's jurisdiction to rule on set-off of claims involving a distressed company.

As a starting point, the Court distinguished between the concepts of objective and subjective arbitrability, referencing Article 1 of the Brazilian Arbitration Law. The Court explained that set-off is, in principle, a legal mechanism that may be resolved through arbitration, as it typically involves a freely disposable patrimonial right.

However, the Court emphasized that, when one of the parties is undergoing judicial reorganization, matters involving the performance of claims and obligations held by the distressed company must be submitted to the reorganization proceedings, in observance of the collective rights of creditors.

The Court further noted that, when set-off involves a claim subject to the effects of reorganization proceedings, it cannot be deemed a freely disposable patrimonial right, thereby excluding the possibility of arbitration due to the absence of objective arbitrability.

Additionally, the Court clarified that the Bankruptcy Law solely addresses subjective arbitrability, providing that the mere fact a party is undergoing judicial reorganization does not, by itself, preclude the submission of disputes to arbitration.

The Court also stressed that there was no question regarding the arbitral tribunal's jurisdiction to decide the underlying dispute, but only as to the possibility of satisfying a claim held by the distressed company in preference to other creditors. The High Court ruled that such matters fall exclusively within the jurisdiction of the court overseeing the reorganization proceedings.

Based on these grounds, the High Court of Justice ultimately partially annulled the portion of the arbitral award that had recognized the set-off of claims subject to judicial reorganization.

Comment

Although not binding, this is a landmark decision at the intersection of arbitration and judicial reorganization in Brazil. The High Court of Justice offered clear guidance on the limits of objective arbitrability in insolvency contexts, establishing that arbitration cannot serve as a mechanism to circumvent the collective rights framework imposed by reorganization proceedings.

The decision confirms that, while arbitration clauses remain valid and enforceable in disputes involving distressed companies, their applicability must be carefully assessed when the claims in dispute are subject to judicial reorganization. In such cases, party autonomy to resolve disputes privately must yield to the mandatory provisions of the Brazilian Bankruptcy Law, which aim to preserve the integrity of the reorganization process and ensure equal treatment of creditors.

This interpretation reinforces legal certainty by harmonizing two fundamental pillars of Brazilian commercial law — arbitration and judicial reorganization — ensuring that neither operates to the detriment of the other.