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Petrobras Shareholders’ Brazilian-Law Claims Are Subject to Mandatory Arbitration Provision

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The travails of Petrobras have generated a lot of attention – and litigation – in the past year. On July 30, 2015, District Judge Jed Rakoff, of the Southern District of New York, issued an opinion explaining his prior order largely denying the defendants’ motions to dismiss U.S. securities-law claims filed on behalf of a putative class of purchasers of Petrobras’s sponsored American Depository Shares, which are listed on the *New York Stock Exchange*. ***In re Petrobras Securities Litigation****.* But the court dismissed the claims of purchasers who – in addition to buying Petrobras securities on the NYSE or in other U.S. transactions – had also bought Petrobras securities on the Brazilian stock exchange (the “Bovespa”) and had sought to assert claims under Brazilian law as to those purchases. The court ruled that the Brazilian-law claims were subject to a mandatory arbitration bylaw that Petrobras had adopted in 2002 by board resolution and shareholder vote.

The Petrobras securities litigation arose from allegations that certain company executives had engaged in a scheme with contractors to circumvent the company’s competitive-bidding process and to inflate the price of construction contracts that Petrobras awarded. The inflated bids also had allegedly included “political adjustments” to pay kickbacks to the executives and their political patrons. The plaintiffs contended that this alleged conduct made Petrobras’s financial statements false and misleading by inflating the value of the company’s property, plant, and equipment and by misrepresenting the integrity of the company’s management and internal controls.

Judge Rakoff largely denied the defendants’ motions to dismiss, holding that the plaintiffs had pled the elements of a securities-fraud claim under the Securities Exchange Act.

- The plaintiffs had pled sufficient facts to show that the alleged misstatements were material. And even if the direct financial impact of the conduct was not as great as the plaintiffs had alleged, the SEC’s Staff Accounting Bulletin No. 99 recognizes that a misstatement can be material based on qualitative (as well as quantitative) factors. The qualitative factors here supported a finding of materiality at the pleading stage: the alleged errors in the financial statements were directly related to concealment of a purportedly unlawful bribery scheme; they concerned the core of Petrobras’s business; and the stock price “dropped dramatically when news of the corruption scheme emerged.”

- The court rejected the argument that Petrobras’s statements about its integrity and controls were mere puffery. “[W]hen (as here alleged) the statements were made repeatedly in an effort to reassure the investing public about the Company’s integrity, a reasonable investor could rely on them as reflective of the true state of affairs at the Company.”

- The court also rejected the argument that Petrobras could not be charged with its allegedly corrupt executives’ knowledge under the so-called “‘adverse interest’ exception to the general rule that a corporate executive’s scienter is attributable to the corporation.” According to Judge Rakoff, “[t]his exception applies where an officer acts entirely in his own interests and adversely to the interests of the corporation.” “However, where a corporation benefits to any extent from the fraudulent acts of its agents, the agents cannot be said to have totally abandoned the interests of the corporation.” The court ruled that the plaintiffs had alleged that Petrobras had benefited at least to some extent from the executives’ purported misconduct: the value of its assets had appeared to be higher than it actually was; the stock price had been inflated; and the company had been able to continue to attract investment and complete its expansion plans.

But perhaps more interesting than these rulings on U.S. securities law was the court’s conclusion that the plaintiffs could not sue in the United States under Brazilian law for their Bovespa purchases. Under the U.S. Supreme Court’s 2010 decision in *Morrison v. National Australia Bank*, the U.S. securities laws apply only to transactions in U.S.-listed securities and to other securities transactions in the United States. The plaintiffs thus could not sue under U.S. law for their Bovespa purchases, so they asserted claims under Brazilian securities laws. The court held that those claims were barred by a provision of Petrobras’s bylaws providing for mandatory arbitration.

In 2001, Brazil amended Article 109 of the Brazilian Corporate Law to allow companies to include mandatory arbitration clauses in their bylaws. Petrobras did so in 2002 by board resolution and shareholder vote. Article 58 of Petrobras’s bylaws states that “‘disputes . . . involving the Corporation, its shareholders, managers and members of the Audit Board’ regarding ‘the rules issued . . . by the Brazilian Securities and Exchange Commission . . . as well as in all further rules applicable to the operation of the capital market in general . . . shall be resolved according to the rules of the Market Arbitration Chamber.’”

The court held that these bylaws bound all shareholders who purchased Petrobras stock after the bylaws had been adopted. The court also concluded, based on expert declarations, that rules against adhesion contracts do not apply to arbitration provisions in corporate bylaws. However, the court rejected the argument that the bylaws barred Exchange Act suits arising from purchases of Petrobras securities in the United States. The arbitration provision did not apply to “different claims relating to different securities purchased in different transactions in another country (the United States).”

We will see whether decisions such as this one encourage other countries to adopt legislation authorizing mandatory arbitration of securities-law claims.

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