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Lessons from Perú's Legacy in Public Procurement: A Successful Approach to Follow and Mistakes to Avoid

Alonso Bedoya · Friday, December 14th, 2018

The recent Petrobras – Lava Jato government fraud scandal that hit Brazil hard and swept through other Latin American countries has also greatly affected Perú. According to Marcelo Odebrecht (a Brazilian businessman and the former CEO of Latin America's largest construction company), more than US$29m was paid in bribes between 2005 and 2014 in Perú (US$788m in the whole of the Latin American region). It is publicly known that Odebrecht, a large infrastructure company, acted as the agent to bribe high-level government authorities in order to win tenders. However, in Perú , the introduction of a mandatory private dispute resolution framework for public procurement using conciliation and arbitration has helped to contain corruption for the most part.

Perú has greatly evolved during the past two decades in the context of its arbitration laws and policymaking, to the extent that by the latter part of 2014, the Lima Chamber of Commerce alone had administered more than 3,000 cases with a total combined value of US$ 4,435,535,355.20.[1)] This reflects the vast array of circumstances in which arbitration has been used to solve conflicting issues.

Responsively, Perúvian legislators decided to implement arbitration as a means of bypassing national judicial courts in order to settle governmental and private entity disputes. The result was that in 1998, Perú enacted the now-repealed Public Procurement Act Nº 26850, which prescribed in Article 41[2)] that any government-private party disputes under public procurement contracts be mandatorily resolved through conciliation or arbitration processes. Today, the original Act Nº 26850 (now Public Procurement Act Nº 30225, amended by Legislative Decree Nº 1444) still seeks to embody an effective conflict resolution procedure in order to encourage generous national and international investment.

Current Law

Public Procurement Act 30225 establishes the following key provisions: a) contracting parties are free to decide the means by which they will resolve their disputes regarding the execution of public procurement contracts, and may choose between conciliation or arbitration (this is non-negotiable between the parties) to solve matters such as the execution, interpretation, resolution, non-existence, ineffectiveness or invalidity of any given contract, with the provision that cases in which the nullity of the contract is discussed must be submitted to arbitration, b) public officials are liable

to administrative sanctions if they do not use arbitration to resolve disputes, c) the government allows two types of arbitration: ad hoc and institutional; the latter being conducted by an institution accredited by the Supervisory Body of Public State Procurement (OSCE), d) for a lawyer to perform as ad-hoc arbitrator, the practitioner needs to be registered in the National Registry of Arbitrators (RNA) under OSCE administration, and meet all its requirements. The lawyer must also be specialized in arbitration and public procurement contracts as well as in administrative law.

Highlights of Mandatory Arbitration in Public Procurement Contracts

As arbitration is mandatory, the mechanism has spread to the extent that even the smallest municipality in Perú is required to use arbitration to resolve disputes. This condition and other pro-investment measures have greatly benefited the Perúvian government, as private domestic and foreign investment has greatly increased. Arbitration has also allowed for the resolution of public procurement disputes to be expedited. This is demonstrated by the research that has been carried out by the PUCP (Pontificia Universidad Católica del Perú), which shows that in 2014 the duration of public procurement arbitrations was less than a year in 70% of cases, and only 6% of cases continued beyond 24 months. The short time periods for resolving disputes and the fact that the Perúvian government was considered a private party within public procurement disputes (and thus equal to any other private entity), incentivised foreign investors to do business in Perú, by promoting a sense of stability and predictability. Foreign investors involved in complex contracts such as EPC or turnkey agreements for the engineering and construction of large-scale, infrastructure projects such as hydroelectric plants, reservoir dams and highway systems do not need to be members of a BIT-signatory state with Perú in order to use arbitration as a dispute resolution mechanism, thus avoiding the unpredictability of the Perúvian court system.

Errors to Avoid

As mentioned above, the Perúvian legislation in public procurement gives parties the opportunity to choose between ad hoc and institutional arbitration. Even though arbitral institutions provide many benefits to parties that cannot be found in ad hoc arbitration, the vast majority of parties prefer ad-hoc arbitration. More than 70% of public procurement arbitrations are resolved by ad hoc arbitration, with only 30% conducted by an institution.

This continuous growth of arbitration for public procurement disputes may be due to the fact that arbitration is regarded as a pro-private contractor system, as most cases are decided in favour of the company rather than the Perúvian government as per the studies conducted by the PUCP. However, arbitration is not immune from accusations of corruption.

The main issue facing Perúvian ad hoc arbitrations is the absence of rules on how arbitrators have to conduct procedures in line with the standards of fairness and impartiality. By failing to issue awards in a timely manner, failing to restrict ex parte communications, failing to limit document production and failing to clarify the number of hearings that will be required, they undermine the stability and predictability of procedures and outcomes. Other issues include a lack of transparency and exorbitant fees being charged by arbitrators which do not correlate either to the time invested or to the complexity of the dispute.

As a result of a lack of institutional oversight, the Lava Jato influence was able to taint some public

procurement arbitrations involving Petrobras/Odebrecht by nominating inexperienced arbitrators who welcomed ex parte engagements to deal with affairs of public interest.

Final thoughts: Amendment

It has been 20 years since Perú first introduced a mandatory legal framework for public procurement disputes. In general terms, this measure has successfully brought a stable legal framework to the country by generating predictability and transparency in relation to the outcome of a dispute. In fact, given the special characteristics of arbitration and in particular its expeditiousness, there is no doubt that it has become the mechanism that currently provides greater advantages to individuals and even to the State itself. However, there is still room for improvement when it comes to Perúvian arbitration. Institutional Arbitration should be prioritized over ad hoc arbitrations, to prevent future Lava-Jato scenarios in arbitration proceedings. In addition, the Perúvian State role during the execution of public procurement contracts ought to be intensely monitored. More than 95% of public procurement disputes originate due to the lack of contractual management of the State (not for example, failing to make payments on time or not honouring other contractual terms), thus bringing claims against the State.

On reflection, it would be a solid step forward for Perú to ensure transparency by removing ad hoc arbitration as an option for resolving public procurement disputes, despite the fact that doing so will entail making drastic modifications to the current arbitration regulations and public procurement laws. Further, it is of utmost importance to promote training in public procurement and in arbitration, particularly in regions where large infrastructure projects are being procured. Hopefully, similar mandatory private dispute resolution frameworks for public procurement can be used throughout Latin America, Europe and Asia to promote arbitration and combat corruption, emulating the successes and avoiding the mistakes experienced in the Perúvian model.

References

?1 Roger Rubio, María Belén Saldaña, Arbitration World (international series), Perú Arbitration P. 739, Fifth Edition, Thomson Reuters UK.

?2 Law No. 26850. Article 41 °. – “When a discrepancy arises between the parties in the execution or interpretation of the contract, this will be defined through the extrajudicial conciliation or arbitration procedure, as agreed by the parties.”

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