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Mixing Righteous and Sinners: Summary of the Odebrecht Corruption Scandal and the Peruvian Jailed Arbitrators

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A recent case has shocked the international arbitration community: *pre-trial detention* was issued against three renowned arbitrators. Their crime? Determining their fees based on the amount of the dispute and having meetings with both parties to discuss the applicable rules and who will act as the Chairperson. In other words, behave as any other arbitrator would have.

What happened in this case?

As it is worldwide known, the Brazilian company Odebrecht admittedly bribed different authorities in order to adjudicate infrastructure projects in Latin America. Peru was no exception, and the confession of Odebrecht's key executives in 2017 led to a national campaign to investigate what really happened and who was involved.

Odebrecht bribed different governmental authorities to secure auctions for construction projects in Peru. To arouse no suspicion, Odebrecht usually offered a competitive price. Once the company was responsible for the project, it started requesting contract modifications on those projects to significantly increase the contract price. To avoid the control of the Peruvian anti-corruption agency, Odebrecht used arbitration awards to give 'legal' appearance to the surcharges.

In most of those cases, the Brazilian company appointed the same arbitrator – Horacio Canepa –, overlooking the independence and impartiality rules and practices. Odebrecht succeeded in most of those arbitrations and obtained surcharges up to six times the original contract price.

The confession of Odebrecht's executives allowed the Peruvian Prosecutor's Office to find the evident: Mr. Canepa had been bribed by Odebrecht and issued awards to benefit the company in exchange of generous amounts. Also, on September 2017, the Prosecutor's Office found out that Mr. Canepa paid government authorities and other arbitrators on behalf of Odebrecht to illegally arrange the arbitrations result.

Apparently, Mr. Canepa pleaded himself guilty and requested to be treated as a protected witness and, in exchange, he would identify all the arbitrators that were part of the Odebrecht scheme. This fact has not been confirmed by the Prosecutor's Office, but members of the arbitration community and journalists believe it to be truth.

On January 2018, the Peruvian Prosecutor's Office launched an investigation against all the arbitrators pointed by Mr. Canepa, although he only provided evidence to support an accusation – wire transfers to the arbitrators' accounts- for thirteen of them. The other three arbitrators that got involved in the investigation (Fernando Cantuarias, Franz Kundmuller and Mario Castillo, all three renowned arbitrators in the Peruvian market) were accused based on similar grounds: determining their fees based on the complexity of the case, determining the tribunals' fees without using the fees chart of the Lima Chamber of Commerce ("LCC"), which is set forth in its Administrative Regulations; and, in the case of Mr. Cantuarias and Mr. Kundmuller, holding a case management conference with the parties to define the procedural rules and appoint the Chairperson.

The Prosecutor's Office accused the arbitrators of specific passive bribery, aggravated collusion, aggravated illicit association and money laundering, and requested the Court to issue a pre-trial detention against them. In some cases, this request was grounded on an alleged flight risk of the arbitrators because they 'have numerous resources' and 'go to different conferences and events all over the world'. On November 4, 2019, the Court in charge of the Investigation of Crimes of Corruption issued a pre-trial detention order against the accused arbitrators, accepting the Prosecutor's theory of the crime.

Finally, on November 28, 2019, the Peruvian Court of Appeals reversed the Criminal Court's decision and issued a personal recognizance order for Mr. Cantuarias, Mr. Castillo, Mr. Kundmuller and five other arbitrators. The Court of Appeals reasoned that the evidence presented by the Prosecutor did not support pre-trial detention and that the Criminal Court mistakenly considered suspicious standard practices of arbitration such as the case management meetings or the fees calculation procedure.

Why this case is a bad precedent for arbitration?

Both the Peruvian Prosecutor's Office and the Criminal Court showed little understanding of the institution of arbitration. Because of that, they are inferring that a crime was committed even in cases where the arbitrators only acted following the international practice.

First, the Prosecutor's Office considered that Mr. Cantuarias, Mr. Kundmuller and Mr. Castillo received an 'indirect bribe' because the tribunal's fees were not only higher than those of the LCC's fee's chart but also were raised in different occasions. Their theory was simple: since the arbitrator's fees were higher than the LCC standard, the difference in the amounts had to be a bribe. However, the arbitrations where those arbitrators were involved were ad-hoc arbitrations, and therefore, the LCC fee's scale chart was not applicable.

Also, the Prosecutors are not taking into consideration that article 71 of the Peruvian Arbitration Law allows arbitrators to increase their fees based on the complexity of the case or the amount of work.[1)] In the cases where the three arbitrators were involved, the parties constantly increased their claims and counterclaims, which led to a rise in the arbitrator's fees. Said practice is standard in the arbitration market and dully authorized by Peruvian law.

Second, even if the LCC Administrative Rules were applicable, the Prosecutor's thesis considered that the arbitrator's fees should be calculated not by using the amount on dispute, but the amount that the tribunal ordered be paid in the final award. Said proposition, again, reflects a lack of

understanding of the arbitration system, as the arbitrators must define their fees *before* the award to allow the parties to calculate how much the dispute will cost them. All the rules of different arbitration institutions point in that direction.[2)] Also, accepting the Prosecutor's thesis would create a perverse incentive, as arbitrators would receive no fees in cases where no award of damages is ordered in an award.

Lastly, case management conferences or meetings are also a common practice in international arbitration. The Prosecutor's Office is considering those meetings as illegal and irregular because it is applying the judge's impartiality standards to the arbitrators. The Prosecutor's theory is that the arbitrators were contacted by both Odebrecht and the Peruvian Transport Ministry (the other party in the case) before the arbitration commenced to coordinate the appointment of the Chairperson.

However, holding a meeting or conference to determine the rules and appoint the Chairperson is also a common practice in international arbitration. The International Board Association Guidelines on Conflicts of Interest in International Arbitration considers that there is no conflict of interest if arbitrators have initial contact with a party prior to the appointment, provided that the contact is limited to the arbitrator's availability and qualifications to serve, or to the names of possible candidates for a Chairperson.

Recently the International Board Association (IBA) sent a letter to the Peruvian Ministry of Justice explaining the above-mentioned rule and why it should be considered in the arbitrators' case. Along with the IBA, members of the arbitration community such as the International Chamber of Commerce (ICC) and the Spanish Club of Arbitration – among others – have expressed their concerns about the Prosecutor's and Court understanding of the arbitrators impartiality and fees calculation procedure.

What can be done?

The development discussed in this post shows that arbitration as an institution is not understood by some prosecutors or judges. This is an alarming situation for the Latin America arbitration community. Corrupt arbitrators must face justice for their actions. However, there cannot be a presumption that all arbitrations are conducted illegally just because one of the parties was involved in corrupt activities. Moreover, common international practices of arbitration, such as the case management conference/meeting, the determination of the Tribunal fees based on the amount in dispute, or setting of a tribunal's fees taking into consideration the complexity of the dispute, cannot be considered as 'bribe evidence' to send an arbitrator to prison.

The arbitration community must make special efforts to connect and educate the judiciary systems around Latin America. While arbitration as a system has gained a lot of adepts and is rising in popularity, there are still a lot of legal practitioners who have little knowledge of arbitration practices and rules. That is particularly dangerous when those practitioners are the ones who will determine whether an arbitrator committed a crime or only acted according to international practice. If the current status continues, more honest arbitrators are going to face criminal charges and even prison, as ignorance is not only dangerous but bold.

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References

?1 Peruvian Arbitration Law. Article 71.-"The Tribunal fees and secretary fees will be established in a reasonable basis, taking into account the amount of the dispute, the dimension and complexity of the case, the time dedicated by the arbitrators, the arbitration activity and the generally accepted uses and customs of the arbitration institution (…)".

?2 *See*, for example, International Chamber of Commerce Rules of Arbitration, at Art. 38; London Chamber of Commerce Arbitration Rules, at Art. 2 of Appendix III; American Arbitration Association Commercial Arbitration Rules and Mediation Procedures, Administrative Fee Schedules.

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