Peru

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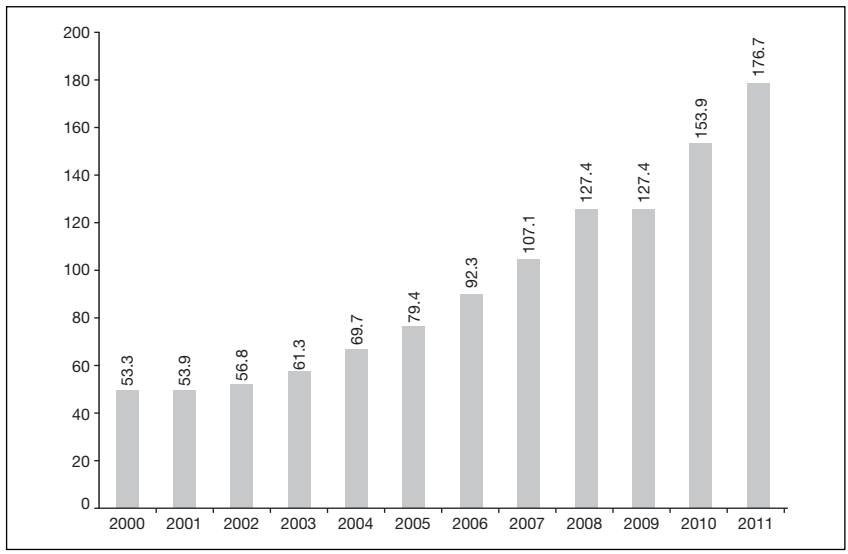
1. Introduction

Peru has experienced significant micro and macroeconomic growth in recent years despite the global economic crisis that has affected other countries so adversely. In 2008, Peru achieved a gross domestic product (GDP) growth rate of 9.8%, and in 2010 and 2011 GDP increased by 6% and 6.5% respectively.

At the end of 2011, with GDP at an equivalent of US$17.6 billion, the Peruvian economy had recorded 10 years of consecutive growth at rates above the Latin American average. The following graph shows Peruvian GDP for the period 2000 to 2011.

Gross Domestic Product 2000–11 (US$ millions)[1]



Source: BCRP. Prepared by: PROINVERSION

In 2012 the growth trend continued. The International Monetary Fund, in its Public Information Notice dated February 14 2013,[2] said about Peru:

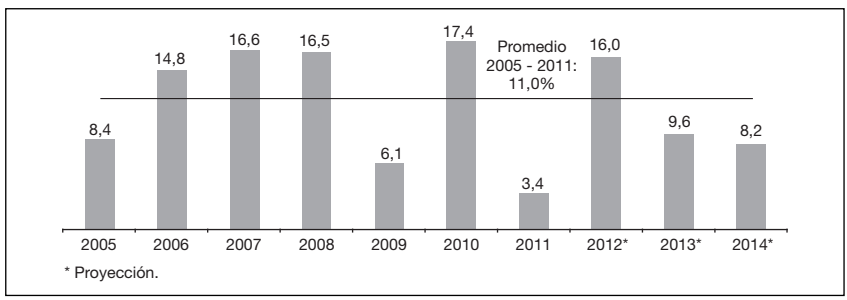
1 See: www.proinversion.gob.pe/0/0/modulos/JER/PlantillaStandardsinHijos.aspx?ARE=0&PFL=0&JER=62.
2 See: www.imf.org/external/np/sec/pn/2013/pn1318.htm.

Strong economic performance and sound macroeconomic management continued in 2012. Economic growth is estimated at 6 percent of gross domestic product (GDP) in 2012, and the economy is near its potential... Economic activity was driven by domestic demand, in particular investment, as the weak external environment is taking a toll on exports and widened the external current account deficit. Inflation declined to 2¾ percent (y-o-y) in December 2012, falling within the inflation target band (1–3 percent) as the adverse supply shocks unwound after being above the upper limit of the target band during the first ten months of 2012.

Moreover, the same source predicts growth in Peru will continue in 2013:

Directors considered near term fiscal policy to be broadly adequate and took note that the 2013 budget targets a surplus. While the current fiscal framework has served Peru well in reducing debt and building public sector savings, Directors saw merit in strengthening the framework by establishing an appropriate anchor which aims at ensuring prudent management of non-renewable resources and intergenerational equity, and enhancing the predictability of public spending.

Impressive though recent GDP growth has been, figures relating to construction activity have been even more positive. In a report prepared by the Banco Central de Reserva del Peru in December 2012[3], sustainable growth in construction activity was recorded as follows:



With this growth in construction activity, concern among professionals to have projects completed on time and in line with the contractual scope has led them to a greater awareness of the need for both better contracts and improved mechanisms to protect their interests.

One of the mechanisms considered particularly important in a contract is the dispute resolution method. Parties are not always at liberty to choose the method for resolving controversies. It will depend on the funding source for projects in Peru. In this context, the following section offers an overview of the dispute resolution methods that are used in the construction industry.

2. Public projects

In contrast with some other countries, in Peru there does not exist a liberal regime

3 See: www.bcrp.gob.pe/docs/Publicaciones/Reporte-Inflacion/2012/diciembre/reporte-de-inflacion-diciembre-2012.pdf.

of dispute resolution methods. That is, parties are not allowed to choose the dispute resolution method they consider most appropriate; it depends on whether or not the project is public or private. And if the project is public, it depends on whether or not the Public Procurement Law and its regulations are applicable. Consequently, there are specific laws that make mandatory the use of certain dispute resolution mechanisms when there is some sort of public financing involved.

In Peru there is no law that regulates all the ways in which the state may contract with a private investor. By contrast, there are different rules – depending on the kind of contract and investment – to be applied to each case. Thus, the Public Procurement Law, for example, regulates all those contracts where the state acquires goods, requires services or needs infrastructure work to be carried out. In other words, the state does not act as a seller. When the state decides to sell goods, other specific rules are applied.

On the other hand, the Concession Law for Public Infrastructure Works regulates all those contracts where the state has previously granted a concession to a private entity for the construction, exploiting and/or operation of an infrastructure work or a public service. In these contracts there is a much larger investment than in those procurements and contracts entered into under Public Procurement Law, basically because of the magnitude of the works.

Meanwhile, the Framework Law on Public-Private Partnership (PPP) regulates contracts where both the state and a private investor are jointly involved in the construction, exploiting and/or operation of an infrastructure project. The private investor obtains a concession awarded by the state too, but in these cases the participation of the state is greater – where experience, technology and efficiency mechanisms combine to benefit both parties.

In all the regulations mentioned above, then, there is a non-liberal regime of dispute resolution methods. The only mechanisms that may be used by parties in public projects are described below.

2.1 Conciliation

Conciliation is considered as an alternative dispute resolution method where parties appoint a recognised, independent and impartial third person who is responsible for carrying out the conciliation process. The conciliator proposes different solutions to assist the parties in resolving the dispute, but does not impose a solution; it is for the parties to decide on the best solution to their controversy. In Peru, conciliation is regulated by the Conciliation Act, which establishes the procedures, general rules and legal institutions of the conciliation process.

Conciliation is a dispute resolution mechanism that can be used by parties in those contracts that are regulated by the Public Procurement Law. Article 52 of this law states in part:

> *Any dispute between the parties about the implementation, interpretation, resolution, absence, ineffectiveness, or invalidity of the contract will be resolved by conciliation or arbitration under the agreement of the parties, having requested the initiation of these proceedings at any time prior to the date of completion of the contract.*

As can be seen, the Public Procurement Law expressly provides for the possibility of resolving disputes during the execution of a contract through conciliation or

arbitration. Because arbitration will be dealt with in the next section, here we confine ourselves to describing conciliation.

In Peru, conciliation is a mechanism that can be used by itself. For example, in contracts where the Public Procurement Law applies, parties may agree to conciliation as the only dispute resolution method, thus excluding arbitration. However, it is unusual for parties to decide on conciliation as the only dispute resolution method. By contrast, conciliation is often chosen by parties as a pre-arbitration mechanism.

Thus, there can be a kind of multi-tiered clause where conciliation is the first method to be used when there is a controversy. If parties do not agree and, therefore, no conciliation is made, they may resort to arbitration as a final mechanism to settle disputes. In consequence, the conciliation mechanism becomes dysfunctional because parties are forced to go into it (as this has previously been agreed) knowing that the controversy will inevitably end in arbitration. That is, parties often have no intention of reconciling, making conciliation an unnecessary step prior to arriving at arbitration.

As stated by Paredes and Gray, "However, reality has delegitimized [conciliation's] function and nature being considered just as a prerequisite to the exercise of judicial action, precisely because of the absence of a culture of conciliation".[4]

When conciliation is used well by parties, disputes can be resolved without the resulting higher costs in terms of time and money. However, this usually happens in few cases because contractors prefer to extend the lifetime of the contract to charge owners the costs, penalties and interests incurred up to the issuance of an arbitration award. Furthermore, there are public officials who prefer not to make decisions regarding disputes in contracts because of a possible audit that could put them in serious trouble.

2.2 Arbitration

Largely as a result of the inevitable inefficiency and slowness of the judicial process, arbitration in recent years has become the dispute resolution method most frequently used by professionals in public works contracts, construction and infrastructure works. Arbitration has been seen as a more effective mechanism to resolve disputes. The dynamic of these contracts does not allow agents (contractors and owners) to run out of time and money as would be the case in a judicial process.

As a result of the nature of construction and infrastructure works contracts, there is a need for a more dynamic and specialised dispute resolution mechanism.[5] Indeed, arbitration was considered such a useful alternative to the judicial process that the

4 Paredes, Gustavo and Gray, Jaime, *"Mecanismos alternativos de resolución de disputas en construcción"*, *Revista de Derecho Administrativo, Círculo de Derecho Administrativo*, Lima, Peru: Year III, No 4, January 2008.

5 We recognise, of course, that arbitration is not a new method. Professionals have been focusing their attention on it in recent years in the search for a better dispute resolution method to be applied in construction contracts. In this regard, we agree with José de Vicente y Caravantes when he says that "It is enough to stop and observe the events taking place in society, the way individuals tend to treat each other, and the way they end simple controversies that separate them, to understand that arbitration should have been one of the primary needs and one of the first practices of mankind." In: Vicente y Caravantes, José de. *Tratado histórico, crítico filosófico de los procedimientos judiciales en materia civil, según la nueva ley de enjuiciamiento*. Madrid: Gaspar y Roig. 1856. Page 11.

Public Procurement Law – as seen in the previous section – established the requirement for its use in cases where conciliation is not the preferred dispute resolution method. This mechanism has become so widely used in contractual practice and, specifically, in public projects, that people might believe it is the only dispute resolution mechanism permitted by law. However, as previously noted, the Public Procurement Law provides for the possibility to use both arbitration and conciliation as methods to resolve controversies. Neither arbitration nor conciliation is excluded and, consequently, it is feasible to agree on either one individually.

Regarding the supposed belief that arbitration is the only dispute resolution mechanism that can be used under the Public Procurement Law, it is appropriate to consider what the State Procurement Tribunal (*Tribunal de Contrataciones del Estado*)[6] of the state Procurement Supervisory Body (*Organismo Supervisor de las Contrataciones del Estado – OSCE*)[7] said about it: "public procurement regulations establish the obligation to arbitrate any disputes that may arise during performance of the contract and regulate certain general provisions regarding the dispute settlement procedure".[8]

Again, while this seems to imply that that arbitration is the only mandatory method to resolve disputes in public projects under the Public Procurement Law, this is not in fact the case. If arbitration is considered as obligatory, it is not because the law so determines but because it has become the custom (contractual practice).

For other projects executed under the Concession Law for Public Infrastructure Works,[9] there is provision for the possible use of arbitration as a dispute resolution mechanism. Article 17 of the Concession Law for Public Infrastructure Works states in part:

> *The State may submit patrimonial disputes regarding the concessions referred to in this law to international or local arbitration, in accordance with the provisions of article 63 of the Peruvian Political Constitution.*

Consequently, this law does not establish the obligation to use arbitration as a dispute resolution method. The wording determines that this mechanism is permissible but not mandatory. It would therefore be possible to agree on the use of conciliation or resort to judicial processes.

However, the wording of Article 17 is not entirely clear. Some professionals think that arbitration is mandatory. For them, the wording "The State may…" means the state may or may not decide to submit controversies to a resolution method. But if the state does decide to submit them, then that mechanism must be arbitration.

In practice, all concession contracts in Peru use arbitration as the dispute resolution method since it provides greater security for the investor. We can therefore say that its use is more a matter of accepted national custom than an obligation enacted in a law.

On the other hand in PPP projects the Framework Law on Public-Private Partnership provides for the mandatory use of arbitration as the only dispute

6 Settlement body for disputes between entities and bidders during the selection process. Applicable sanctions of suspension or debarment to suppliers and contractors violating the law.
7 Specialised technical agency responsible for promoting compliance with public procurement regulation.
8 Pronouncement N° 094-2012/DSU, February 20 2012.
9 Supreme Decree N° 059-96-PCM and Supreme Decree N° 060-96-PCM.

resolution method. Article 9.6 states:

> *Public-Private Partnerships contracts must include arbitration as the dispute settlement mechanism and must include provisions governing the procedure and grounds for renegotiation.*

The parties, therefore, cannot use any other mechanism as there is the express statutory obligation to go to arbitration to settle disputes.

2.3 Dispute boards

There are cases where, despite the fact that an infrastructure project is conducted by the state as a contractual party, the Public Procurement Law is not applied. That is because this particular law assumes that contracts are entered into with public investment involved, and contracts with private investment are excluded from the application of the Public Procurement Law. Contracts executed under specific procedures of international organisms, cooperation agreements and others with the same characteristic are also excluded.

In recent years, there have been contracts signed through certain public entities with some international agencies to grant the necessary financing for major construction projects (especially in the water and sewage disposal sector). These international organisms themselves set rules and mechanisms applicable to contracts signed by the state with a constructor for infrastructure works and large projects.

Similarly, for infrastructure, construction, supervision and consulting projects, the World Bank and the JICA (formerly JBIC; see below), for example, establish specific dispute resolution methods or oblige states to use contract models, such as FIDIC contracts, in which the resolution method applied is either multi-tiered or involves dispute boards (DBs).

Although DBs are becoming better known to professionals in the Peruvian construction industry, there remains much to be done before the method becomes universally used as an efficient tool to resolve controversies in contracts. Peruvian economic growth has encouraged both national and foreign investors to participate in private and public infrastructure projects. Consequently, the construction industry here has become more globalised; more technical construction information has been shared, contracts have been improved by mechanisms developed abroad and more expertise has been acquired.

However, the DB – as an alternative resolution method in construction – has not yet come to be as fully understood and appreciated as it should be. In consequence, although DBs are being used in Peru, there is considerable room for improvement in their usage. There are good arbitrators that have not as yet performed well as DB members; nevertheless, since they already have the knowledge required to resolve disputes, they surely have the capability to acquire sufficient expertise to operate effectively in the DB context.

Many infrastructure projects in Peru have involved financing institutions and international organisations. One which has been more involved in recent years has been the Japan International Cooperation Agency, JICA, mentioned above. This agency has funded many projects in Peru and required the employment of certain contractual mechanisms so that money may be invested more efficiently.