INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES

In the Matter of the Arbitration between

DUKE ENERGY INTERNATIONAL PERU INVESTMENTS NO. 1, LTD.

Claimant

and

REPUBLIC OF PERU

Respondent

ICSID Case No. ARB/03/28

PARTIAL DISSENTING OPINION OF ARBITRATOR DR. PEDRO NIKKEN

1. The Award signed is the result of a careful and exhaustive discussion by the Tribunal on the different factual and legal issues raised by the Parties. The legal issues, already sufficiently complex in and of themselves, had to be analyzed by the Tribunal in an unusual context since the guarantee of legal stability was granted not through an international instrument, but through a private contract, executed under the framework of the Peruvian Civil Code. I should first of all convey my respectful acknowledgment of my colleagues' efforts in considering with intelligence, accuracy, professionalism and sense of justice all the pleas from the parties as well as all the legal problems that we identified.

2. I concur with my colleagues in the conclusion that the guarantee of legal stability was breached because SUNAT's assessment of the merger between Norperú Egenor and Power North ("the merger") involved a substantial change in the interpretation and application of the Merger-Revaluation Law (MRL) that prevailed at the time the guarantee was granted to the investor and at the time of the merger itself. The evidence furnished and the circumstances within which the merger was decided show that, according to the uncontested interpretation of the MRL at that time, the only requirement for invoking the tax benefits of the MRL was a formal corporate merger, without regard to the economic significance of the operation.

3. While I therefore agree with my colleagues on the breach of the guarantee of legal stability in respect of the merger, I respectfully dissent on the estoppel issue related to the merger. It is uncontested that the assessment imposed by SUNAT on the tax benefits obtained through the merger was in contradiction with the favorable vote for the same merger by the representatives of Electroperú (a State enterprise) at the board meeting and at the shareholders' meeting of Norperú Egenor. It is also true that several state agencies with mandates related to the privatization (particularly CEPRI-ELP) were informed about the merger, and that they did not object to it. Nevertheless,

it is my view that such a contradiction does not, by itself, constitute a breach of a rule of law resulting in the responsibility of the State vis-à-vis the investor.

4. The Tribunal has concluded that the vote of the representatives of Electroperú in Norperú Egenor, one of whom was Mr. Sanchez Gamarra, President of CEPRI-ELP, concurrently with the knowledge of the merger and its tax benefits on the part of CEPRI-ELP itself and other Peruvian agencies, created a situation of estoppel with respect to SUNAT's ability to object later to the merger. In the analysis of the Tribunal, the approval by those State agents of the merger must be understood as the approval by the State itself, so that it was estopped from objecting to the merger afterwards, and could not invoke the independence and the exclusive competence of SUNAT in tax matters in order to justify its assessment of Egenor. The Tribunal has emphasized that, *"(i)n international law, it is possible for entities and agencies other than the national tax service to bind the State to a particular position concerning transactions with tax implications*."(Para. 432)

5. *Estoppel*, as a rule of international law, and the doctrine of *actos propios*, in the context of Peruvian law, are, beyond any doubt, applicable law for the Tribunal. The rule of law by virtue of which *Venire contra factum proprium non valet* prevents any person, and particularly the State, from taking action or making representations that would contradict acts or representations adopted in the past, in detriment to another party. As Vice-president Alfaro observed in his separate opinion in the case of *Temple of Preha Vihear*, *"a State party to an international litigation is bound by its previous acts or attitude when they are in contradiction with its claims in the litigation."*

6. *Estoppel*, as well as the doctrine of *actos propios*, compels consistency in the behavior of every person in its relations with third parties. The State, in particular, must act in a consistent manner. Nevertheless, consistency cannot be understood either as the inexorable command of past over future or as creating an absolute duty not to challenge in the future any act by a State's agent. As the Tribunal recognizes, by virtue of estoppel, "the State assumes the risk for the acts of its organs or officials which, *by their nature*, may reasonably *induce reliance* in third parties. As such, what

is relevant for estoppel is that there has been a declaration, representation, or conduct which has in fact induced ***reasonable reliance*** by a third party, which means that the State, even if only implicitly, has committed not to change its course." (Para. 246; italics from the Award, emphasis added).

7. A decisive component of estoppel is the reliance induced in the other party by the reasonable appearance created by an agent of the State. As stated in the award, at issue is "the reasonable appearance that the representation binds the State". (Para. 247) The appearance is "reasonable" when, within the specific circumstances of the case, the act or representation creates confidence in the other party that it expresses a position that will not be contradicted in the future. "Reasonableness" also refers to confidence: circumstances should be such that any third party, in the same position, could rely on the act or representation as expressing a position that is binding on the State. "Reasonableness", as any other standard, does not operate in a void, but in light of the particular circumstances of each case. The analysis must take into account what the concerned parties knew or are deemed to have known.

8. As recognized in the Award, "the competence, or rather, *the manifest lack of competence*, of a State organ is relevant, given that no one can reasonably have confidence in representations or statements coming from an organ which manifestly lacks the competence to make them." (Para. 247). Incompetence is *manifest* when it cannot be unknown to the other party. Borrowing the language of Article 46 of the Vienna Convention on the Law of Treaties (also mentioned in the Award) and the principle underlying that provision, for the conduct or representation of an organ of the State to give rise to estoppel, it must be *unambiguous*, i.e. *in accordance with normal practice and in good faith*, it should be perceived by third parties as the expression of a position of the State that is incompatible with the possibility of being contradicted in the future. In the same sense, it must be understood that an agent or organ of the State that acts outside the sphere of its competence does not bind the State when its lack of competence should be objectively evident for any third party acting in conformity with usual practice and in good faith.

9. In relationships between States, the degree of incompetence of the agent of the State required in order to exclude estoppel has the highest threshold: the incompetence must affect a norm of fundamental importance in domestic law, which cannot be unknown to any State. It is normal that, *in accordance with normal practice and in good faith*, a State need not know the legal order of another State beyond the level of fundamentals, and that it should be able to trust other States to respect their own domestic law.

10. The relationship between a State and an investor, however, is not identical to the relationship between two States. An investor must know the legal order of the State within whose jurisdiction he has invested, at least in respect of the fundamental issues connected with his economic activity. The tax law is one of them. This does not mean that an investor must have exhaustive knowledge of the tax regime and the interpretation of the tax laws. But there are certain fundamental rules that an investor has to know, among them the rules that determine which organ can approve or object to tax accounting and within what delays it must exercise its powers. If an agent of the State that is manifestly incompetent in tax matters has approved a taxable act, every investor must know that the tax authority remains entitled to object to it within the prescribed period. The only facts creating a reasonable appearance that a taxable act will not be challenged in the future are either its approval by the tax authority or the expiration of the term within which it can be challenged. In other words, the approval of a taxable act by an official or an agency manifestly incompetent in tax matters cannot, by itself, create a *reasonable appearance* inducing an investor (national or foreign) to rely on the invulnerability of that act, in the sense that it could not be objected to by the tax authority within the prescribed period. Every investor knows or must be deemed to know that the approval by an incompetent organ is not legally incompatible with the possibility that the competent tax authority will assess a taxable act in the future.

11. The International Court of Justice has opined several times on the general requirements that must be met in order to invoke estoppel. One of them consists in *a*

conduct, declarations and the like made by a State which clearly and consistently (d'une manière claire et constante) evinced acceptance by that State of a particular régime.[1] In my view, an investor cannot reasonably conclude that a tax matter has been approved in a *clear and consistent way (d'une manière claire et constante)* by the State if the tax authority has not intervened at all in the so-called approval and if the period prescribed for assessment is still open.

12. This view is consistent with normal practice in privatizations. When the seller of the privatized company's shares is a State enterprise, it is understood that all tax operations and the financial statements of the privatized company have been approved by its owner (that is to say, by a State enterprise). However, normally the sale and purchase agreement includes a clause by which the selling company assumes responsibility for any hidden tax liabilities. This means that the tax authority continues to be entitled to assess the privatized company, even if its operations and their tax effect have been approved by the prior shareholders (agents of the State) and by the agencies in charge of the privatization. Consequently, there is no guarantee that the tax authority will not object to the tax operations approved by the seller. In case of assessment by the tax authority, however, the liability is assumed by the seller. That was the case for Egenor's privatization in 1996. The sale and purchase agreement between Electroperú and Dominion (Inversiones Dominion Perú S.A.) included a clause according to which the seller (Electroperú) assumed liability for *"any tax, interest, surcharge, or fine, without exception, resulting from any formal or material failure to comply with tax obligations"*[2] by Egenor up to the closing date (clause 11.9.1).

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[1] North Sea Continental Shelf: Judgment, I. C. J. Reports 1969, p. 26, para. 30; Military and Paramilitary Activities in and against Nicaragua (Nicaragua v. United States of America), Jurisdiction and Admissibility, Judgment, I.C.J. Reports 1984, p. 392, para. 51; Land, Island and Maritime Frontier Dispute (El Salvador-Honduras), Application to Intervene, Judgment, I. C. J. Reports 1990, p. 118, para. 63; Land and Maritime Boundary between Cameroon and Nigeria, Preliminary Objections, Judgment, I. C. J. Reports 1998, p. 275, para. 57.

[2] …*"cualquier tributo, interés, recargo o multa, sin excepción, que resulte de cualquier incumplimiento formal o material de obligaciones tributarias".*

13. Every foreign investor knows or must be deemed to know that the approval by the State shareholders, or the agencies in charge of privatization, of the tax accounts of a company that is privatized does not extinguish contingent tax liabilities nor precludes audit and/or assessment by the tax authority. Moreover, it is a general principle of law that the seller is responsible for hidden liabilities and/or defects (*"vicios ocultos"*) in what is sold, as established in articles 1503 and following of the Peruvian Civil Code.

14. The Tribunal was presented no evidence relating to how hidden liabilities (whether or not tax related) were addressed in the share transfer agreement between Dominion and Duke. The relationship between those companies was not a matter for this arbitration; moreover, what they may have agreed on this issue was not relevant in determining the breach of the guarantee of legal stability by Peru, as the Tribunal has concluded. Nevertheless, as regards estoppel, any agreement on hidden liabilities between Dominion and Duke could have been relevant in determining the extent to which Duke relied on the approval of some of Egenor's practices by Electroperú and other agencies as "immunization" of Egenor against the objections that SUNAT could later make against those practices.

15. In my opinion, the favorable vote for the merger by the representatives of Electroperú on the board and at the shareholders' meeting of Egenor cannot be construed as representing the State's position on the legality of the merger or as creating a reasonable expectation that SUNAT would not object to it. Electroperú was a minority shareholder in Egenor. Its representatives at the shareholders' meeting and on the board did not contribute to designing the merger proposal, which came from Egenor's management. The company's legal adviser indicated, ***<u>only verbally</u>***, that the merger would generate certain tax benefits. This legal opinion, certainly provided in good faith, did not present any possible controversial aspect, nor did it include reference to or examination of different interpretations of the MRL; accordingly, it was also accepted in good faith, and did not imply approval of one particular interpretation of the law over possible alternative interpretations. The transaction was

presented by the legal adviser as something absolutely clear and undisputable, and therefore no particular conclusion should be drawn from the regular and unanimous approval by the shareholders and directors, including minority shareholders, to which the proposal was presented.

16. The representatives of Electroperú must be permitted to commit the same mistake that the other shareholders and directors made. Their status does not give particular weight to such mistake (they did not "have to know" that the application of the MRL was questionable) and they did not have the authority to prevent future taxation consequences, since that would be clearly beyond their area of competence. In this context, it is difficult to attribute particular significance to the vote of Electroperú's representatives, much less that of being an unequivocal act through which the Peruvian State approved the fiscal legality of the merger, in such a way that not even SUNAT, the only competent organ of the State in tax matters, could assess or examine it.

17. The uncontested context of the merger approval, including its tax benefits, is understandable because the practice and the interpretation of the MRL prevailing at that time did not raise particular doubts about the legality of the tax benefits. That was probably the reason the legal adviser did not raise the issue, and why the members of the board and the shareholders did not require any explanation about the MRL mechanism. That was the "stabilized" interpretation that was ignored by SUNAT's assessment, resulting in the breach of the guarantee of legal stability. But that is not a matter involving estoppel; it is a different ground of State responsibility under the LSA, as identified in the Award. The absence of any objection to the merger from State agencies, and the favourable vote of the members of the board and the shareholders of Egenor, may be explained by the fact that the issue was not controversial. In other words, the basis of the investor's *legitimate expectations* was the MRL's interpretation prevailing at that time, and not the other State's agents' behavior, which was no more than the expression and the confirmation of such interpretation.

18. In my opinion, if such general practice and such interpretation of the MRL had not existed, the approval of the merger by the representatives of Electroperú and the absence of objections from other Peruvian agencies would not have been sufficient to establish the responsibility of the State on the sole ground of estoppel. Had SUNAT's position before the merger been contrary to the interpretation of the MRL relied on by Egenor, it could have legitimately objected to the tax benefits of the merger; in that case, neither the approval of the merger by the members of the board and the shareholders representing Electroperú, nor the absence of objection to the merger by agencies related to the privatization, could have validated the violation of the tax law, as interpreted by SUNAT.

19. Consequently, in my view, no particular consequences flow from the conduct of the State actors concerning the merger, at least none that would go beyond what is emphasized in paragraph 380 of the Award: such conduct confirms that, at the time of the merger, and up to Duke's investment in Egenor, the prevailing interpretation of the MRL was that all that was required in order to enjoy its tax benefits was a formal merger. The legal stabilization agreement was breached because SUNAT's assessment disregarded the earlier prevailing interpretation, not because the State's agents' behavior concerning the merger, by itself, created a situation of estoppel. Consequently, respectfully I dissent from the conclusions of the Tribunal's majority on this point.

Date: July 22, 2008

Dr. Pedro Nikken
Arbitrator