

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

AWARD

Members of the Tribunal:

Mr. L.Yves Fortier, C.C., Q.C.

Dr. Guido Santiago Tawil

Dr. Pedro Nikken

Assistant to the Tribunal: Mr. Martin J. Valasek

Secretary of the Tribunal: Ms. Natalí Sequeira

Representing the Claimant:

Mr. C. Mark Baker, Mr. Kevin O'Gorman,
Mr. Jonathan Sutcliffe, Mr. Anibal Sabater
and Ms. Sandra March
Fulbright & Jaworski L.L.P.

Mr. Arif H. Ali, Mr. Baiju S. Vasani
and Ms. Kassi D. Tallent
Crowell & Moring L.L.P.

Dr. José Daniel Amado V.,
Dr. Luis G. Miranda Alzamora,
Dr. Italo Carrano and Dr. Bruno Amiel
Miranda & Amado, Abogados

Representing the Respondent:

Judge Stephen M. Schwebel
1501 K Street, NW
Washington, D.C. 20005

Mr. Daniel M. Price (until July 6, 2007)
Mr. Stanimir A. Alexandrov, Mr. Nicolás
Lloreda and Mr. Patricio Grané
Sidley Austin L.L.P.

Dr. Jorge Santistevan
Santistevan de Noriega & Asociados

Date: August 18, 2008

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I. PROCEDURAL HISTORY

A. REGISTRATION OF THE REQUEST FOR ARBITRATION

1. On October 7, 2003, the International Centre for Settlement of Investment Disputes (“**ICSID**” or the “**Centre**”) received a request for arbitration (the “**Request**”) submitted by Duke Energy International Peru Investments No. 1 Ltd. (“**DEI Bermuda**” or the “**Claimant**”), a company organized under the laws of Bermuda. DEI Bermuda is owned by Duke Energy International Latin America Ltd., another Bermudan company, and indirectly, by Duke Energy International LLC (“**Duke Energy**”).
2. The Request was submitted in regard to a dispute with the Republic of Peru (“**Peru**” or the “**Respondent**”) concerning a legal stability agreement concluded between Peru and DEI Bermuda (the “**DEI Bermuda LSA**”). According to DEI Bermuda, Peru has imposed a tax assessment in violation of certain guarantees in the DEI Bermuda LSA. The Request invokes the arbitration provision of the DEI Bermuda LSA.
3. The Centre, on October 9, 2003, in accordance with Rule 5 of the ICSID Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings (“**Institution Rules**”) acknowledged receipt of the Request and, on the same day, transmitted a copy to Peru and to the Embassy of Peru in Washington, D.C.
4. The Request was registered by the Centre on October 24, 2003, pursuant to Article 36(3) of the ICSID Convention and, on the same day, the Secretary-General, in accordance with Institution Rule 7, notified the parties of the registration and invited them to proceed to constitute an arbitral tribunal as soon as possible.

B. CONSTITUTION OF THE ARBITRAL TRIBUNAL AND COMMENCEMENT OF THE PROCEEDING

5. On January 23, 2004, the parties agreed that the Arbitral Tribunal in this case was to consist of three arbitrators, one arbitrator appointed by each of the parties and the third arbitrator who would be the President of the Tribunal to be appointed by agreement of the

parties. In the event that the parties were to fail to appoint an arbitrator or fail to agree on the President of the Tribunal, the Chairman of the Administrative Council of the Centre was to appoint the arbitrators not yet appointed.

6. Claimant, by a letter of January 23, 2004, appointed Dr. Héctor A. Mairal, a national of Argentina, as its arbitrator. Following Dr. Mairal's decision to recuse himself, communicated to the Centre by letter of March 9, 2004, which then communicated the recusal to the parties by letter of March 11, 2004, Claimant, by a letter of March 19, 2004, appointed Dr. Guido S. Tawil, a national of Argentina, as its arbitrator. Respondent, by letter dated February 20, 2004, appointed Dr. Pedro Nikken, a national of Venezuela, as its arbitrator. By agreement communicated to the Centre by letter of May 12, 2004, the parties appointed Mr. L. Yves Fortier, C.C., Q.C., a national of Canada, as the presiding arbitrator.
7. All three arbitrators having accepted their appointment, the Centre, by a letter of June 3, 2004, informed the parties of the constitution of the Tribunal consisting of Mr. L. Yves Fortier, C.C., Q.C., Dr. Pedro Nikken and Dr. Guido S. Tawil, and that the proceeding was deemed to have commenced on that day pursuant to ICSID Arbitration Rule 6(1). In the same letter the Centre informed the parties that Ms. Gabriela Alvarez Avila, Senior Counsel at ICSID, would serve as Secretary of the Tribunal. The Centre informed the Tribunal and the parties, by letter dated August 27, 2007, that Ms. Alvarez Avila would be on leave as of that date, and would be replaced during her absence by Ms. Natalí Sequeira.
8. After consulting with the parties and the Centre, the Tribunal scheduled a first session for July 28, 2004. The parties, by letter from Claimant (with attachment) of July 26, 2004 and letter from Respondent of the same date, communicated to the Tribunal their agreement on procedural matters identified in the provisional agenda for the first session, which had been sent to them by the Tribunal's Secretary.
9. In its letter of July 26, 2004, Respondent informed the Tribunal that it intended to raise objections to the Tribunal's jurisdiction and the admissibility of the claims, that the

parties were unable to agree on the procedure for the jurisdictional phase and that Claimant withheld its agreement to a separate phase on jurisdiction and admissibility. In the same letter, Respondent invoked ICSID Arbitration Rule 41(3), according to which the proceedings on the merits are suspended upon the formal raising of an objection that the dispute is not within the jurisdiction of the Tribunal, and proposed a schedule for written submissions and a hearing on the issues of the jurisdiction of the Tribunal and the admissibility of the claims.

10. The first session of the Tribunal was held as scheduled on July 28, 2004 at the seat of the Centre in Washington, D.C. The parties reiterated their agreement on the points communicated to the Tribunal in their respective letters of July 26, 2004. In light of Respondent's letter of July 26, 2004, indicating its intention to raise objections to the Tribunal's jurisdiction and the admissibility of the claims, the President invited the parties to present briefly their views on these issues and on the issue of possible bifurcation of the proceedings. Having considered the views of the parties and the relevant rules and, after having deliberated, the Tribunal decided to suspend the proceedings on the merits pursuant to Rule 41(3) of the Arbitration Rules and to bifurcate the proceedings. It was decided that each party would submit its observations on objections to jurisdiction and the admissibility of the claims and that the Tribunal would decide at a later stage whether it would deal with these objections as a preliminary question or join them to the merits of the dispute. The remainder of the procedural issues on the agenda for the session, including the time limits for the jurisdictional submissions, were discussed and agreed. All the conclusions were reflected in the written minutes of the session, signed by the President and Secretary of the Tribunal, and provided to the parties as well as to all members of the Tribunal.

C. JURISDICTIONAL PHASE OF THE PROCEEDING

11. In accordance with the agreed schedule, Respondent filed its Memorial on Jurisdiction and Admissibility on October 4, 2004, Claimant filed its Counter-Memorial on Jurisdiction and Admissibility on December 6, 2004, and Respondent filed its Reply on Jurisdiction and Admissibility on January 24, 2005.

12. On February 3, 2005, Claimant requested the Tribunal to grant Claimant an extension until March 11, 2005 to submit its Rejoinder on Jurisdiction and Admissibility. Claimant cited as the reason for this request the fact that the extension would give Claimant approximately the same amount of time to file its Rejoinder as Respondent had to file its Reply. Respondent, in a letter of February 4, 2005, objected to Claimant's request, stating that the extension would unfairly burden Respondent and prejudice its preparation for the pre-hearing conference (which had been scheduled for March 14, 2005) and the hearing itself.
13. Following a further letter from Claimant dated February 5, 2005 and a further letter from Respondent dated February 7, 2005, the Tribunal, by its Secretary's letter of February 7, 2005, communicated to the parties its decision to grant Claimant an extension until March 9, 2005 to file its Rejoinder on Jurisdiction and Admissibility. By the same letter, the Tribunal indicated that the date for the pre-hearing conference (*i.e.*, March 14, 2005) remained unchanged.
14. In compliance with the Tribunal's decision, Claimant filed its Rejoinder on Jurisdiction and Admissibility on March 9, 2005.
15. Following the pre-hearing call with the parties of March 14, 2005, at which the parties had indicated that they were not intending to call any witnesses at the hearing, the Tribunal, through its Secretary's letter of March 15, 2005, requested each party to call one witness of its choice to address the history of the negotiations between Peru and Duke Energy in connection with the issues relevant to jurisdiction. By letter of March 17, 2005, Respondent nominated as its witness Mr. Carlos Herrera. By letter of same date, Claimant nominated as its witness Dr. José Daniel Amado. During the pre-hearing call, the parties confirmed their agreement to the appointment of Mr. Martin J. Valasek, an associate of the Chairman, as Assistant to the Tribunal.
16. In accordance with the schedule agreed on July 28, 2004, the hearing on jurisdiction was held at the seat of the Centre in Washington, D.C. on March 29-30, 2005. The parties were represented at the hearing by their respective counsel, who made presentations to

the Tribunal and examined the witnesses. Members of the Tribunal also questioned witnesses. Present at the hearing were:

Members of the Tribunal: Mr. L. Yves Fortier, C.C., Q.C., President; Dr. Guido S. Tawil and Dr. Pedro Nikken.

Secretary to the Tribunal: Ms. Gabriela Álvarez Ávila, ICSID Secretariat.

Assistant to the Tribunal: Mr. Martin J. Valasek, Ogilvy Renault LLP.

Attending on behalf of the Claimant:

Messrs. C. Mark Baker, Arif H. Ali and Baiju S. Vasani, from Fulbright & Jaworski LLP; Mr. Dean M. Moesser and Ms. Dora Avendaño, from Duke Energy; and Dr. Luis G. Miranda and Dr. Italo Carrano from Miranda & Amado Abogados.

Attending on behalf of the Respondent:

H.E. Eduardo Ferrero, Ambassador of Peru in Washington, D.C.; Dra. Cecilia Blume, Chief of Staff, Ministry of Economy; Dr. Aurelio Loret de Mola, Advisor, Ministry of Economy; Messrs. Alejandro Riveros, Italo Acha and Renzo Villa, Embassy of Peru in Washington, D.C.; Dr. Jorge Santistevan, of Santistevan de Noriega & Gutiérrez, Counsel for Respondent; from Sidley Austin Brown & Wood LLP: Messrs. Daniel M. Price, Stanimir A. Alexandrov, Alan Charles Raul, Nicolás Lloreda, Patricio Grané and Cassidy Pinegar.

17. At the beginning of the hearing, the Tribunal considered Claimant's letters of March 25 and March 28, 2005, and Respondent's letters in reply thereto dated March 28, 2005. The Tribunal decided to admit the additional exhibits which were attached to the parties' letters, inasmuch as these were considered to be helpful to the Tribunal's consideration of the jurisdictional issues, but decided to exclude the content of Claimant's March 28, 2005 letter on the basis that it was an unsolicited and irregular pleading.

18. Following the hearing, the members of the Tribunal deliberated by various means of communication, including a meeting for deliberations in Washington, D.C. on March 30, 2005.
19. The Tribunal's Decision on Jurisdiction, dated February 1, 2006, was communicated to the parties on February 2, 2006. In the Decision on Jurisdiction, the Tribunal decided that:
 1. The dispute submitted by DEI Bermuda was within the jurisdiction of the Centre and the competence of the Tribunal.
 2. Respondent's objections to the admissibility of the dispute based on the finality of the decision of the Peruvian Tax Court were rejected. Respondent's remaining objections to the admissibility of the dispute were joined to the merits.
 3. The costs of the jurisdictional phase of the arbitration were reserved.
20. During the jurisdictional phase, and as is more fully documented at paragraphs 15–18 of the Decision on Jurisdiction, Respondent filed with the Tribunal a Request for Provisional Measures that was subsequently withdrawn. A request by the Respondent for directions under Arbitration Rule 34(2), also made during the jurisdictional phase, was determined by the Tribunal to be moot, as is more fully documented at paragraph 19 of the Decision on Jurisdiction.

D. MERITS PHASE OF THE PROCEEDING

21. On March 2, 2006, the parties submitted an agreed procedural calendar for the merits phase of the proceeding, pursuant to which Claimant's Memorial was due on June 16, 2006, Respondent's Counter-Memorial was due on September 29, 2006, Claimant's Reply was due on December 22, 2006 and Respondent's Rejoinder was due on March 30, 2007. On June 15, 2006, the parties informed the Centre that the parties had agreed to an

extension for the filing of Claimant's Memorial until June 19, 2006. The parties also agreed that Respondent would benefit from six additional days, to be used at its discretion, in connection with its forthcoming filings. Respondent agreed to confirm at a later date how it wished to allocate the additional days.

22. In accordance with the procedural calendar, Claimant submitted its Memorial on the Merits, together with supporting witness statements and expert reports, on June 19, 2006. On September 27, 2006, counsel for the Respondent informed the Centre that – with the agreement of the Claimant – it would file its Counter-Memorial on October 5, 2006, and that such extension would not affect the rest of the schedule as agreed by the parties and confirmed by the Tribunal. Respondent submitted its Counter-Memorial, together with supporting witness statements and expert reports, on October 5, 2006. Claimant submitted its Reply, together with supplemental witness statements and expert reports, on December 22, 2006. Respondent submitted its Rejoinder, together with supporting witness statements and expert reports, on March 30, 2007.
23. Claimant submitted witness statements from the following individuals: Dr. Javier Núñez Carvallo, Mr. John T. Sickman, Dr. José Daniel Amado, Ms. Julie A. Dill, Mr. Mickey J. Peters, Mr. Mark T. Cox IV and Pastor William Gary Narron.
24. Claimant submitted expert reports from the following individuals: Prof. César Talledo Mazú, Prof. Fernando de Trazegnies Granda, Mr. Fritz Du Bois, Prof. Jorge Avendaño, Prof. Rudolf Dolzer, Prof. Thomas Wälde and Mr. Brent C. Kaczmarek.
25. Respondent submitted witness statements from the following individuals: Mr. Alejandro Manuel Alfageme Rodríguez Larrain, Mr. Luis Alberto Arias Minaya, Mr. Gustavo Caillaux Zazzali, Mr. Nelly Natividad del Águila Sánchez, Mr. Carlos Herrera, Mr. Daniel Hokama Tokashiki, Dr. Manuel A. Luna-Victoria Sánchez, Mr. Gastón Miranda Zanardi, Mr. Javier Rodríguez Castro, Mr. Pedro Sánchez Gamarra, Ms. Elizabeth Marcelina Tarmeño Bermuy, Mr. Juan Manuel Tineo Meza, Mr. Javier Tovar Gil, Ms. María del Carmen Tovar Gil, Dr. Elizabeth E. Vásquez Marín, Mr. Pedro José Velarde

Bragagnini, Mr. Pablo Manuel Cueto Saco, Mr. Jean Delboy, Mr. Antero Flores-Aráoz Esparza and Mr. Pedro Pablo Kuczynski Godard.

26. Respondent submitted expert reports from the following individuals: Prof. Alfredo Bullard, Mr. Pablo Bustamante, Dr. Luis Hernández Berenguel, Dr. César Luna-Victoria, Prof. Marcial Rubio Correa, and Prof. Shoschana Zusman Tinman.
27. The parties submitted a joint letter dated April 4, 2007 to the Centre, for transmission to the Tribunal, containing the parties' preliminary views on the conduct of the hearing scheduled for May 8 to 18, 2007. On behalf of the Tribunal, the President held a pre-hearing conference call with lead counsel for each party on April 5, 2007. Among other things, the parties confirmed during that call that they would exchange a list of witnesses and experts that they intended to call at the hearing.
28. The parties submitted a letter to the Centre dated April 13, 2007, for transmittal to the Tribunal, in which they agreed on the list of witnesses and experts that they intended to call at the merits hearing scheduled for May 8 to 18, 2007. According to the parties' agreement, the following witnesses and experts were identified for examination and cross-examination at the hearing: Dr. José Daniel Amado, Mr. Mark T. Cox IV, Prof. Rudolf Dolzer, Mr. Fritz Du Bois, Mr. Brent C. Kaczmarek, Pastor William Gary Narron, Dr. Javier Núñez Carvallo, Mr. John T. Sickman, Prof. César Talledo Mazú, Prof. Fernando de Trazegnies Granda, Prof. Thomas Wälde, Prof. Alfredo Bullard and Mr. Pedro Sánchez Gamarra.
29. On April 26, 2007, on behalf of the Tribunal, the President sent a letter to the parties stating, in relevant part:

In preparation for the hearing on the merits in this matter, to be held in Washington D.C. on 8 to 18 May 2007, each party has notified the other party and the Tribunal as to the witnesses it intends to call for examination and cross-examination. Those that have not been called are Ms. Julie Ann Dill, Mr. Mickey J. Peters (Claimant's witnesses), Prof. Jorge Avendaño (Claimant's expert) as well as all of Respondent's

witnesses and experts except for Prof. Alfredo Bullard and Mr. Pedro Sánchez Gamarra.

Paragraph 3 of Section 19 of the Minutes of the First Session of the Arbitral Tribunal held on 28 July 2004 provides as follows:

A party shall produce at the hearing for examination and cross-examination any witness whose written testimony has been advanced with the written submissions. The Tribunal shall disregard the testimony of any such witness who does not appear at the hearing for examination and cross-examination.

On 18 April 2007, the ICSID Secretariat communicated to the parties the Tribunal's request for clarification as to the effect the Tribunal should give to the declarations of the witnesses and experts that have not been called by the parties, considering the language of paragraph 3 of Section 19 of the Minutes of the First Session. Respondent submitted its comments by letter dated 19 April 2007, and Claimant submitted its comments by letter dated 23 April 2007.

In accordance with the parties' shared understanding, as expressed in the letters referred to above, the Tribunal will consider the written statements of those witnesses and experts who have not been called to testify at the hearing as part of the evidentiary record and evaluate those statements in light of the record as well as the oral testimony of the witnesses and experts called to testify at the hearing.

30. The merits hearing was held at the seat of the Centre in Washington, D.C. between May 8 and May 16, 2007. During the hearing, the parties agreed to close the hearing two days in advance. As Prof. Alfredo Bullard and Mr. Pedro Sánchez Gamarra were not available to present testimony prior to such date, Claimant agreed to waive its right to examine them.

Therefore, the Tribunal did not hear live testimony from any of the Respondent's witnesses or experts.¹

31. The parties were represented at the hearing by their respective counsel, who made presentations to the Tribunal and examined the witnesses. Members of the Tribunal also questioned witnesses. Present at the hearing were:

Members of the Tribunal: Mr. L. Yves Fortier, C.C., Q.C., President; Dr. Guido S. Tawil and Dr. Pedro Nikken.

Secretary to the Tribunal: Ms. Natalí Sequeira, ICSID Secretariat.

Assistant to the Tribunal: Mr. Martin J. Valasek, Ogilvy Renault LLP.

Attending on behalf of the Claimant:

Messrs. C. Mark Baker, Kevin O’Gorman, Jonathan Sutcliffe, Anibal Sabater, and David Chung and Ms. Sandra March, from Fulbright & Jaworski LLP; Messrs. Arif H. Ali and Baiju S. Vasani, Ms. Kassi Tallent and Ms. Lynnea Vanasek, from Crowell & Moring; Dr. Luis G. Miranda and Dr. Italo Carrano from Miranda & Amado Abogados; and Messrs. Dean M. Moesser, Marc Manly and John Enloe, Ms. Dora Avendaño and Ms. Catherine Stempien, from Duke Energy; and

Attending on behalf of the Respondent:

Messrs. Manuel Talavera, Renzo Villa, Percy Velarde and Carlos Ramírez, from the Government of Peru; Judge Stephen M. Schwebel, counsel; Messrs. Daniel M. Price, Stanimir A. Alexandrov, Nicolás Lloreda, Patricio Grané and Michael J. Smart and Ms. Sharon H. Yuan, from Sidley Austin LLP; Mr. Jorge Santistevan, counsel from Santistevan de Noriega & Asociados; Ms. Vilma Belen-Pettorino,

¹ The hearing was conducted in English with simultaneous interpretation and transcription into Spanish. Some of the witnesses testified in Spanish, and their testimony was simultaneously interpreted and transcribed into English. Due to the practical limitations on the accuracy of simultaneous interpretation and transcription, in some cases there are minor discrepancies between the English and Spanish versions of the transcript. This explains the differences that can be discerned, in some cases, between the quotations to the transcript in the English and Spanish versions of this Award.

Ms. Janet Deane, Ms. Dara Levinson, Messrs. Ryan Brutger and Gus Kryder, from Sidley Austin LLP.

32. At the hearing, during his direct examination, Mr. Kaczmarek produced updated calculations for his damages assessment. Respondent sought leave to comment on this new evidence and, with the Tribunal's permission and by agreement with Claimant, submitted such comments on June 1, 2007.
33. During the hearing, it was agreed that the parties would submit Post-hearing Briefs by June 29, 2007, and that the Tribunal would provide the parties with a list of questions to address in those briefs by the end of May.
34. In accordance with the agreed schedule, the Tribunal submitted the following questions to the parties on May 31, 2007:
 1. What is the status of international law in the Peruvian legal system? Please specify if any distinction should be made as between treaties and other sources of international law.
 2. What is the substantive difference between, on the one hand, the concepts of good faith and *actos propios* under Peruvian law and, on the other hand, the concepts of good faith and estoppel under international law? If there is a difference, what is the significance of that difference applied to this case to the extent that those concepts apply?
 3. What should be the rule of attribution of conduct to the State in the context of estoppel?
 4. The Egenor LSA was effective from 24 July 1996 until 24 July 2006; the DEI Bermuda LSA is effective from 24 July 2001 until 24 July 2011. The intersection of the two LSAs creates three distinct five-year periods: (i) 24 July 1996 until 24 July 2001 (during which only the Egenor LSA was effective); (ii) 24 July 2001 until 24 July 2006 (during which both LSAs were

effective); and 24 July 2006 until 24 July 2011 (during which only the DEI Bermuda LSA is effective). How do the two LSAs interact in each of these three periods, and with what effect for purposes of the guarantees provided to Claimant in the DEI Bermuda LSA? How does the DEI Holdings USA 30 Percent Tranche LSA, dated 13 October 1999, and assigned to DEI Peru Holdings on 3 April 2003, fit into the analysis, if at all?

5. Does any change in the interpretation of the tax regime stabilized for an investor/company violate its LSA, or does the change need to be wholly or manifestly inconsistent with the prior interpretation? In other words, at what point does a change in interpretation become actionable under an LSA?
6. Also, what constitutes an “interpretation” of the tax regime? Is it sufficient to look to representations made by any state actors to the investor/taxpayer, or is it necessary to look to actual judicial or administrative pronouncements by the relevant tax authorities?
7. Even if the approval of various acts by Electroperu, as shareholder of Egenor, is considered a governmental act generally, can such approval bind SUNAT on tax matters? Is there a difference in how this question is answered under Peruvian law vs. applicable international law?
8. Did the Government of Peru take into account the general “statutory” depreciation rate and/or the benefits of the Merger Revaluation Law in establishing the minimum bid price for the 30 Percent Tranche?
9. If Egenor were an entirely private company, i.e. without any Electroperú representatives either on the board or at the shareholders’ meeting, owned by Dominion since 1996 to the present date, could a claim for breach of the Dominion LSA be

sustained in the same way as is argued in this case for the DEI Bermuda LSA, assuming the other facts remained the same?

35. Each of the parties submitted its Post-hearing Brief on June 29, 2007, including its answers to the Tribunal's questions. The parties each submitted their respective Submission on Costs on July 25, 2007. On August 30, 2007 the Claimant submitted a Supplement to its Submission on Costs.
36. Following the submission of Post-hearing Briefs, the members of the Tribunal deliberated by various means of communication, including meetings for deliberations in Montreal on July 23–24, 2007, in Washington, D.C. on December 10, 2007, in New York on February 3, 2008, and by conference call on February 22, 2008. On June 19, 2008, the proceeding was declared closed pursuant to Rule 38(1) of the Arbitration Rules.

II. FACTUAL BACKGROUND

A. PERU'S INVESTMENT PROTECTION SCHEME

37. The current scheme for the promotion and protection of foreign investment in Peru originated in the early 1990s. At that time, Peru began efforts to attract and promote investment in the country, reversing the policies pursued by previous administrations.
38. It was in this context that Law No. 25327 was adopted, authorizing the Executive Branch to legislate on matters of investment and investment protection. Pursuant to it, Legislative Decree No. 662 (Foreign Investment Law), Legislative Decree No. 674 (Privatization Law) and Legislative Decree No. 757 (Private Investment Law) were promulgated, as were the Regulations of the Regime to Guarantee Private Investment, approved by Supreme Decree No. 162-92-EF ("**Investment Regulations**").
39. These instruments provide various guarantees to foreign investors in Peru. In connection with a specific investment, the guarantees may be implemented through binding contracts referred to as "legal stability agreements" ("**LSAs**"), entered into by Peru and the foreign investor. The authorization to enter into LSAs is contained in the Foreign Investment

Law and the Private Investment Law. Relevant provisions of both laws are typically incorporated by reference into such agreements.

40. The standard text for all LSAs is incorporated as an annex to the Investment Regulations. The text refers in general terms to the stabilization of legal regimes applicable to various fundamental rights of foreign investors, including: (i) the right to equal treatment and non-discrimination; (ii) the right to free convertibility of foreign currency; (iii) the right to free repatriation of invested capital, profits and royalties; (iv) the right to income tax stabilization; and (v) the right to resolve disputes arising out of or in connection with the agreement by arbitration or other agreed method.
41. Under Peruvian law, the *Civil Code* provisions governing private contracts in general are also applicable to LSAs and, as such, these agreements are subject to the principle of *Contrato-Ley*, as set forth in Article 1357 of the 1984 *Civil Code*. That Article states as follows:

Garantía y seguridad del Estado. Por ley, sustentada en razones de interés social, nacional o público, pueden establecerse garantías y seguridades otorgadas por el Estado mediante contrato.²

42. Article 39 of the Private Investment Law confirms the foregoing:

Los convenios de estabilidad jurídica se celebran al amparo del artículo 1357 del Código Civil y tienen la calidad de contratos con fuerza de ley, de manera que no pueden ser modificados o dejados sin efecto unilateralmente por el Estado. Tales contratos tienen carácter civil y no administrativo, y solo podrán modificarse o dejarse sin efecto por acuerdo entre las partes.³

² Unofficial Translation: By law, supported by reasons of social, national or public interest, the State may establish guarantees and assurances by means of a contract.

³ Unofficial Translation: Legal stability investment agreements shall be concluded subject to Article 1357 of the Civil Code and shall have the [legal] effect of contracts enforceable as law, such that they may not be modified or terminated unilaterally by the State. Such contracts shall have a private rather than administrative character, and shall only be modified or terminated by agreement between the parties.

43. Furthermore, as set forth in the last paragraph of Article 62 of the Constitution of Peru, the investment protections provided for by LSAs are guaranteed by the Constitution:

La libertad de contratar garantiza que las partes pueden pactar válidamente según las normas vigentes al tiempo del contrato. Los términos contractuales no pueden ser modificados por leyes u otras disposiciones de cualquier clase. Los conflictos derivados de la relación contractual sólo se solucionan en la vía arbitral o en la judicial, según los mecanismos de protección previstos en el contrato o contemplados en la ley.

Mediante Contratos-ley, el Estado puede establecer garantías y otorgar seguridades. No pueden ser modificados legislativamente, sin perjuicio de la protección a que se refiere el párrafo precedente.⁴

44. Thus, pursuant to the investment laws of Peru, the main features of LSAs are that (i) the stabilized legal regimes cannot be changed unilaterally by the State, and (ii) the agreements are subject to private or civil law and not administrative law. As private-law contracts, the negotiation, execution, interpretation and enforcement of the provisions set forth in LSAs are subject to the general principles applicable to contracts between private parties under the Peruvian *Civil Code*. As such, the rights granted by Peru pursuant to an LSA are private contractual rights that are enforceable against the State as if it were a private party.

B. THE PRIVATIZATION OF EGENOR

45. In 1991, Peru began to pursue a far-reaching privatization program designed to attract the participation, in particular, of international investors. For this purpose, the Privatization Law established the *Comisión para la Promoción de la Inversión Privada* (“**COPRI**”), a

⁴ Unofficial Translation: Liberty to contract guarantees that parties may validly agree according to the legal norms in force at the time of the contract. Contract terms may not be modified by law or other dispositions of any type. Conflicts that arise from contractual relations may only be resolved by arbitration or judicial decree, according to the mechanisms of protection set forth in the contract or contemplated by law.

Through contracts-law [special investment-related private contracts of an obligatory character], the State may establish guarantees and grant securities. These may not be modified by legislation, without prejudice to the protection referred to in the preceding paragraph.

Peruvian inter-ministerial body charged with overall supervision of the privatization process.

46. In implementing its privatization mandate, COPRI selected the largest state-owned electricity generation company in the country, Electricidad del Perú S.A. or Electroperú S.A. (“**Electroperú**”), to be restructured into distinct, smaller electricity companies for privatization. In September 1994, as part of the privatization process, COPRI authorized the creation of a company named Empresa de Generación Eléctrica Nor Perú S.A. (“**Egenor**”), as a wholly-owned subsidiary of Electroperú. Thereafter, assets were transferred to Egenor from three state-owned companies, including Electroperú. Electroperú contributed fixed assets (in addition to cash and inventory) to Egenor consisting of six thermoelectric plants (Chiclayo, Piura, Paita, Sullana, Chimbote and Trujillo) and two hydroelectric plants (Carhuaquero and Cañón del Pato).
47. COPRI adopted the following privatization model for Egenor: a controlling 60 percent of the shares of Egenor, representing the company’s Class “A” shares, would be sold to a private investor through an international tender process (the “**60 Percent Tranche**”); 30 percent of the shares, these being Class “B” shares, would be retained by Electroperú for a subsequent public offering or share auction (the “**30 Percent Tranche**”); and the remaining 10 percent of the shares (also Class “B” shares) would be held for sale to Electroperú’s employees.
48. For each state-owned company being privatized, COPRI established a special committee, known as *Comité Especial de Privatización* (“**CEPRI**”), responsible for managing and implementing the privatization process, based on guidelines, objectives and policies approved by COPRI. The privatization program for Electroperú was administered by the *Comité Especial de Promoción de la Inversión Privada en Electroperú S.A.* (“**CEPRI-ELP**”). By February 1996, CEPRI-ELP had approved the *Bases del Concurso Público Internacional para la Venta de Egenor* (the “**Bidding Rules**”) for the privatization of Egenor, setting out the rules governing the relationship between Peru and the investor with regard to the tender bid. On February 28, 1996, CEPRI-ELP issued its privatization tender for Egenor.

49. The winning bidder for the 60 Percent Tranche was Dominion Energy, Inc. (“**Dominion**”) of the United States of America, which presented its bid through a locally incorporated wholly-owned subsidiary, Inversiones Dominion Perú S.A. (“**IDP**”). Between June 25 and August 9, 1996, a privatization agreement (itself dated June 20, 1996), governing the purchase of the 60 Percent Tranche, was executed between Electroperú and IDP, with Dominion and Egenor as intervening parties (the “**Privatization Agreement**”). Under the Privatization Agreement, Dominion (as “Operator” and “Holder of the Committed Interest”) was required to maintain control of Egenor with a minimum stake totalling 51 percent of IDP.
50. On November 27, 1996, the majority shareholders of Egenor, *i.e.*, IDP (60 percent) and Electroperú (39.98 percent), approved the merger of Egenor and Power North S.A. (“**Power North**”), a corporation established by IDP. Pursuant to the terms of the merger, Egenor S.A., the resulting corporation, assumed all of the assets and debts of Egenor and Power North. The merger of Egenor and Power North was consummated on December 31, 1996 by IDP (60 percent), Electroperú (39.98 percent), and Electrolima S.A. (0.02 percent).
51. In the context of the December 31, 1996 merger, particular assets of Egenor (namely Carhuaquero, Cañón del Pato, Chimbote and Trujillo) were revalued. Specifically, the book value of these assets was increased to reflect their higher market value, as determined in a September 1996 report prepared by PriceWaterhouseCoopers.
52. In 1997, Dominion sold 49 percent of IDP to Gener S.A., a Chilean company. On March 31, 1998, Dominion transferred its remaining 51 percent of IDP to Dominion Holdings Peru S.A. (“**DHP**”), a wholly-owned Peruvian subsidiary. Toward the end of 1998, Duke Energy learned of Dominion’s interest in selling its assets in Central and South America, including Peru. Duke Energy was focusing on a coordinated acquisition of a full 90 percent of Egenor (then named Egenor S.A.), representing its total outstanding or available stock (*i.e.*, the 60 Percent Tranche owned by IDP and the 30 Percent Tranche owned by Peru).

53. Duke Energy acquired Egenor through a series of transactions in late 1999. To comply with Peru's "two shareholders" rule, the acquisitions were completed through two Delaware-based Duke Energy subsidiaries: Duke Energy International Peru Holdings No. 1 LLC ("**DEI Holdings No. 1**") and Duke Energy International Peru Holdings No. 2 LLC ("**DEI Holdings No. 2**", and together with DEI Holdings No. 1, "**DEI Holdings USA**"). On October 7, 1999, DEI Holdings USA acquired the 30 Percent Tranche of Egenor S.A.A.⁵ On October 12, 1999, DEI Holdings USA also acquired 49 percent of IDP from Gener S.A. (and hence Gener S.A.'s indirect 29.4 percent ownership interest in Egenor S.A.A.). Finally, on November 11, 1999, DEI Holdings USA acquired the remaining 51 percent of IDP by purchasing 100 percent of DHP from Dominion.
54. As of the end of 1999, Duke Energy had become (through DEI Holdings USA) the 90 percent owner of Egenor S.A.A. for which it had paid approximately US\$288 million.⁶
55. Dominion's sale of DHP (*i.e.*, of its 51 percent interest in IDP) to DEI Holdings USA was subject to the approval of COPRI pursuant to the terms of the Privatization Agreement. Under the Privatization Agreement, Dominion (as Operator and Holder of the Committed Interest) was obligated to maintain its 51 percent interest in IDP for five years from the date of the Agreement (*i.e.*, until August 2001), unless another entity (to which the interest was being transferred) could meet the requirements specified in the Bidding Rules for the Operator and Holder of the Committed Interest. COPRI approved the sale of DHP, and thus Dominion's ownership interest in Egenor, to Duke Energy (through DEI Holdings USA) on September 22, 1999. On October 5, 1999, Dominion obtained and provided Duke Energy with a Guarantee Agreement between IDP and Peru ("**Guarantee Agreement**") pursuant to which Peru guaranteed, in connection with the 60 Percent Tranche, that all of the original obligations assumed, representations and

⁵ On April 16, 1999, Egenor S.A. amended its by-laws and changed its name to Egenor S.A.A. in accordance with the new General Law of Corporations (*Ley General de Sociedades*).

⁶ Duke Energy later increased its interest in Egenor S.A.A. (by that time named Duke Energy International Egenor S.A.A., which we have defined below as DEI Egenor) from 90 percent to 99.7 percent by a tender offer initiated in July 2001 by DEI Egenor.

warranties made, and liabilities of Electroperú remained effective and enforceable against Peru.

56. Duke Energy's acquisition of Dominion's Latin American assets had a number of international tax implications which Duke Energy intended to account for in a corporate reorganization. At the same time, Duke Energy needed to implement an ownership structure for Egenor S.A.A. generally mirroring the structure reflected in the Privatization Agreement. It was against this backdrop that DEI Bermuda was incorporated in August 1999. Subsequently, in May 2000, Duke Energy International Peru Holdings SRL ("**DEI Peru Holdings**") was established as a holding company wholly-owned by DEI Bermuda.
57. On July 26, 2000, Egenor S.A.A. changed its name to Duke Energy International Egenor S.A.A. ("**DEI Egenor**"). This entity changed its name to Duke Energy International Egenor S.A. in February 2001 and on June 26, 2003, to Duke Energy International Egenor S en C por A, evidencing a change in its corporate form.
58. On October 29, 2002, DEI Bermuda acquired 99 percent of DHP from DEI Holdings USA (and hence 51 percent of IDP), and the remaining 49 percent of IDP from DEI Holdings USA. On December 1, 2002, DHP and IDP merged to form Duke Energy International Peru Inversiones No. 1 SRL ("**DEI Investments SRL**"), as a result of which DEI Bermuda became the 99 percent owner of DEI Investments SRL, through which it owned 60 percent of DEI Egenor. The remaining 30 percent of DEI Egenor continued to be held by DEI Holdings USA.
59. On December 18, 2002, Duke Energy made a capital contribution of US\$200 million to DEI Peru Holdings, through DEI Bermuda. DEI Peru Holdings used these funds to acquire 90 percent of the capital stock of DEI Egenor from DEI Investments SRL and DEI Holdings USA.⁷

⁷ See Independent Auditors' Report dated April 3, 2003, Claimant's Exhibit 58 (from jurisdictional phase).

C. THE INVESTMENT PROTECTION GRANTED BY PERU

1. The Investment Protection Granted to Dominion

60. As an integral part of the Egenor privatization program and Dominion's investment in Peru, Peru approved LSAs for Dominion, IDP and Egenor.
61. Specifically, shortly after Electroperú executed the Privatization Agreement, Peru entered into two LSAs on July 24, 1996: one with IDP, as an investor in Egenor (the "**IDP Domestic Investor LSA**"); the other with Egenor, as a recipient of the investment from IDP (the "**Egenor LSA**"). Under the former, IDP undertook to pay US\$228.2 million for 60 percent of the capital stock of Egenor. Under the latter, Egenor agreed to issue shares representing 60 percent of its capital stock in favour of IDP.
62. On August 9, 1996, Peru entered into two additional LSAs: one with Dominion, as a US\$228.2 million foreign investor in IDP (the "**Dominion LSA**"); the other with IDP, as a US\$228.2 million investment recipient from Dominion (the "**IDP Recipient LSA**").
63. Peru agreed to guarantee legal stability, in accordance with the terms of these LSAs and the foreign investment laws of Peru, for a period of 10 years, from the effective date of the respective LSAs. The Dominion LSA provided for ICSID arbitration, in the following terms:

TEN.- It being the intention of both parties that problems arising in connection with the enforcement of this Agreement be resolved as expeditiously as possible, the parties agree hereinafter that any dispute, controversy or claim between them, relative to the interpretation, performance or validity of this Agreement, shall be submitted to the International Centre for Settlement of Investment Disputes to be resolved by de jure international arbitration, pursuant to the Conciliation and Arbitration Rules set forth in the Convention on the Settlement of Investment Disputes Between States and Nationals of Other States which was approved by Peru pursuant to Legislative Resolution N. 26210.

The costs incurred in connection with the application of this clause shall be shared by both parties in equal parts.

2. The Investment Protection Granted to Duke Energy

64. In connection with its investment in Peru, Duke Energy sought to obtain the same investment protection, through LSAs, as Dominion had obtained. Duke Energy and its outside counsel worked with Peru on different structures by which Duke Energy would obtain protection for its investment. The possibility of transferring or assigning to Duke Energy at least some of the LSAs that had been entered into by Dominion was seriously and actively considered. These discussions took place while Duke Energy was taking steps to acquire the various direct and indirect interests in Egenor S.A.A.
65. In the event, the Dominion LSA was not assigned because of concerns regarding its effectiveness due to a possible incurable default by Dominion under the LSA. As of the closing date for DEI Holdings USA's acquisition of the 30 Percent Tranche (*i.e.*, October 7, 1999), the first step in Duke Energy's indirect acquisition of Egenor S.A.A., no mutually acceptable solution had been identified to implement the investment protection regime for Duke Energy. It was thus agreed that DEI Holdings USA would be given an interim LSA, based on the express understanding that it would complete its acquisition of the 60 Percent Tranche of Egenor S.A.A. within 60 days of the date of this interim LSA. Peru and DEI Holdings USA thus executed a foreign investor LSA relating to the 30 Percent Tranche (the "**DEI Holdings USA 30 Percent Tranche LSA**") on October 13, 1999.
66. On October 14, 1999, the Egenor LSA was assigned to Egenor S.A.A. This assignment was performed in order "(...) to extend the rights granted by the Legal Stability Agreement dated July 24, 1996, signed by Empresa de Generación Eléctrica Nor Perú S.A. – E.G.E.N.O.R. to Egenor S.A.A (...)." ⁸ By the end of 1999, Duke Energy had

⁸ See *Resolución Ministerial* No. 566-99-EM/VME, dated October 6, 1999, Exhibit C-066.

become the owner of 90 percent of Egenor S.A.A. However, a solution regarding the assignment of the Dominion LSA had not yet been found.

67. As explained earlier, as part of Duke Energy's corporate reorganization, DEI Bermuda was incorporated in August 1999 and DEI Peru Holdings, wholly-owned by DEI Bermuda, was established in May 2000. With reference to the Privatization Agreement, DEI Bermuda was designated as the Operator and Holder of the Committed Interest and DEI Peru Holdings was designated as the bidder and owner of DEI Egenor. Thus, following an application by Duke Energy that was accepted by Peru, DEI Bermuda took the place of Dominion, and DEI Peru Holdings took the place of IDP, under the Privatization Agreement.
68. In February 2000, Duke Energy presented Peru with a proposal to obtain the same foreign investor protections that it would have obtained under the Dominion LSA, if the latter had been assignable. The proposal was premised on the requirements of the Privatization Agreement, Duke Energy's corporate and tax-related reorganization strategy as well as the need to maintain the effectiveness of the LSAs that were already in place (*i.e.*, the DEI Holdings USA 30 Percent Tranche LSA, the IDP Domestic Investor LSA, and the Egenor LSA).
69. The proposal presented by Duke Energy was implemented as follows:
 1. application for a foreign investor LSA by DEI Bermuda;
 2. application for a recipient company LSA by DEI Peru Holdings;
 3. the assignment of the DEI Holdings USA 30 Percent Tranche LSA, as modified, in favour of DEI Peru Holdings; and
 4. the assignment of the IDP Domestic Investor LSA in favor of DEI Peru Holdings.
70. On June 20, 2000, Duke Energy filed its request for a foreign investor LSA, through DEI Bermuda, with Peru (previously defined as the DEI Bermuda LSA). A second application

for a recipient company LSA was filed that same day through DEI Peru Holdings (the “**DEI Peru Holdings LSA**”).

71. On April 3, 2001, Peru provided drafts of the DEI Bermuda LSA and the DEI Peru Holdings LSA to Duke Energy’s outside counsel for review. With respect to the former, Duke Energy reverted to Peru to request that the draft LSA be modified to provide for ICSID arbitration.
72. Finally, on July 24, 2001, Peru executed the DEI Bermuda LSA and the DEI Peru Holdings LSA. By their terms, the LSAs were effective immediately. The final version of the DEI Bermuda LSA executed by the parties contained an ICSID arbitration clause, in precisely the same terms as the clause that had been included in the Dominion LSA.⁹
73. The DEI Holdings USA 30 Percent Tranche LSA and the IDP Domestic Investor LSA were assigned to DEI Peru Holdings on April 3 and March 14, 2003, respectively.

D. EGENOR’S TAX PRACTICES AND TAX RETURNS

1. Legislative and Regulatory Background

74. In the context of the re-orientation of Peru’s economy in the early 1990s, on January 1, 1994, the Government passed Legislative Decree No. 782, which granted State-owned entities the right to reorganize without tax consequences.
75. Soon after, on January 10, 1994, Congress granted tax-free reorganization benefits to all companies through the Merger Revaluation Law (Law No. 26283). The sole substantive article of the Merger Revaluation Law (“**MRL**”) provided as follows:

The formation, and other acts, contracts and transfer of equity, arising from merger or division agreements of any type of legal entity, whether mercantile, civil or cooperatives, shall be exempt from all taxes,

⁹ See above, para. 49.

including the Income Tax and fees for registration in the Public Registries until December 31, 1994.¹⁰

76. On September 19, 1994, the Government issued Supreme Decree 120-94-EF (Supreme Decree 120) to provide implementing regulations for the Merger Revaluation Law.
77. The tax benefits of the MRL were successively extended for annual periods until 1998.¹¹
78. On December 29, 1998, Congress passed Law No. 27034, which provided that companies that had revalued their assets and merged while the MRL was in force could not continue to claim the MRL's benefits beyond fiscal year 1998.
79. As described earlier, Electroperú contributed fixed assets, namely eight power plants, to Egenor. These contributions were made between April 1995 and May 1996. Chiclayo, Piura, Paita and Sullana power plants were transferred at revalued market rates, while the Carhauquero, Cañón del Pato and Chimbote-Trujillo power plants were contributed at values that equalled historical cost less accumulated depreciation, adjusted for inflation.
80. On April 30, 1987, the National Commission on Rates (*Comisión Nacional de Tarifas*) issued Resolution No. 013-87P/CTE, establishing the useful life and the depreciation percentage (the depreciation rate) for the fixed assets of the Electric Public Utility Companies. As of 1996, Electroperú started applying those depreciation rates to the fixed assets owned by Egenor.
81. On September 19, 1994, Supreme Decree No. 122-94-EF (the Income Tax Law Regulations) entered into force, setting forth in its Article 22 the provisions and percentages (rates) to be applied for the calculation of depreciation. Subparagraph (d) of Article 22 stipulates that SUNAT may authorize depreciation percentages different from the general ones provided the interested party demonstrates that, due to the nature and

¹⁰ *Artículo 1º - Exonérese de todo tributo, incluido el Impuesto a la Renta y los derechos de Inscripción en los Registros Públicos, la formación y otros actos, contratos y transferencias patrimoniales, derivados de acuerdos de fusión o división de toda clase de personas jurídicas, ya sean mercantiles, civiles o cooperativas, hasta el 31 de diciembre de 1994. (Exhibit C-14).*

¹¹ In 1994 (Law No. 26416), 1995 (Law No. 26561) and 1996 (Law No. 26733).

characteristics of the exploitation or use given to the good, its useful life is different to that assigned by subparagraph (b), which corresponds to annual depreciation percentages.

82. On April 4, 1995, Electroperú applied by letter to SUNAT for authorization to apply “the depreciation percentages for the items of the Fixed Assets listed in the table approved by Resolution No. 013-P/CTE issued by the *Comisión de Tarifas* (Commission on Rates), dated April 30, 1987.” The letter specified that Electroperú had already been applying such rates “for corporate operative and tax purposes.”
83. On December 28, 1995, Electroperú received SUNAT’s permission to continue to apply the special decelerated rate contained in Resolution No. 013-87P/CTE of April 30, 1987 of the Electricity Rate Commission to its assets, commencing in 1996.
84. A comparison of the general statutory rates and the special decelerated rates is set out in the following table:

General Useful Life	General Depreciation Rate	Special Useful Life	Special Depreciation Rate
5	20.00%	Various	Various
10	10.00%	10, 12, 16	6.25%, 8.33%, 10.00%
33	3.00%	33, 40, 60, 80	1.25%, 1.67%, 2.50%, 3.00%

2. Relevant Developments during the Privatization of Egenor

85. The Bidding Rules issued by CEPRI-ELP in February 1996 contained no specific information about what depreciation rate then applied to Egenor, or what depreciation rate would or should apply to Egenor after it was privatized.
86. On May 14, 1996, Dominion, through IDP, submitted an official query to CEPRI-ELP as to the applicable asset depreciation rates, as follows:

What is the depreciable value and useful life for tax purposes applicable to each plant? What is the annual depreciation rate for the plant, real property and equipment and in which year do they enter into service?

87. The next day, CEPRI-ELP issued Circular No. 15 (“**Circular 15**”) in response to a similar inquiry from another investor. Circular 15 reads as follows:

Question 21

According to section 1.5.1 of the Bidding Conditions, ELECTROPERÚ S.A. shall transfer to EGENOR, before the Closing Date, the assets that are part of the Thermoelectric Power Plants, power lines and hydroelectric plants.

Our question has to do with the valuation of those fixed assets to EGENOR and whether said value shall be treated as the accounting cost basis for depreciation purposes on the Income Tax Returns. Likewise, are those assets to be depreciated at the general rates or can they have a special accelerated treatment.

Answer 21

Pursuant to section 1.5.1 of the Bidding Conditions prior to the Closing Date, ELECTROPERÚ S.A. shall transfer to EGENOR the aforementioned assets; and it will be at the very moment of transfer that the value of those assets shall be determined.

The depreciation rate is the one that corresponds according to the Income Tax Legislation.

(Emphasis added)

88. On June 7, 1996, Electroperú’s accountants at Egenor contracted outside auditors to prepare financial statements for the company as of June 30, 1996.
89. On June 10, 1996, Dominion, through IDP, submitted another query to CEPRI-ELP, inquiring if Egenor itself had received a special depreciation rate from SUNAT (referring

to the December 31, 1995 financial statements of Electroperú). CEPRI-ELP never replied to IDP's inquiry.

90. As stated earlier, on June 20, 1996, IDP was declared the winning bidder of the 60 percent tranche of Egenor, prevailing over a consortium which included Duke Energy by US\$5 million.
91. Between June 25 and August 9, 1996, Electroperú, IDP, Dominion and Egenor signed the Privatization Agreement (itself dated June 20, 1996) governing the purchase of the 60 Percent Tranche.
92. On June 30, 1996, Villa Naranjo & Asociados sent Egenor the company's latest audited financials as of June 30, 1996.

3. Relevant Developments during Dominion's Management of Egenor

93. IDP officially became the 60 per cent shareholder of Egenor and commenced management of the company in conjunction with Electroperú in August 1996.
94. On September 9, 1996, Egenor sent a letter to both Deloitte & Touche and Luna Victoria-Vásquez, requesting information as to the correct depreciation rate for the company. Egenor received contradictory answers from the two firms:
 - On September 25, 1996, Luna Victoria-Vásquez responded to Egenor's question by concluding that, based on Article 105 of the Income Tax Law, Egenor must apply the special rate granted to Electroperú in 1995.
 - On October 1, 1996, Deloitte & Touche responded to Egenor's question by warning Egenor that it could not use the special rate granted to Electroperú because the rate was specific to the taxpayer that had requested it, namely Electroperú.
95. On October 24, 1996, IDP incorporated Power North at the Lima Commercial Registry and registered it with SUNAT. It had a stated capital of 100,000 shares of one Nuevo Sol

par value stock, and owned fixed assets valued at approximately US\$1.4 million. It was the legal and beneficial owner of valuable real estate which it leased to Egenor at fair market value for October, November and December 1996, prior to their merger.

96. In November 1996, Egenor retained Price Waterhouse to produce a valuation report to establish the market value of Carhauquero, Cañón del Pato and Chimbote-Trujillo. The Board of Egenor was interested in restating the value of these plants through a merger between Egenor and Power North.
97. Egenor's Board of Directors approved the merger of Egenor with Power North on November 25, 1996. Two days later, on November 27, 1996, the merger also received a favourable vote at the general meeting of Egenor's shareholders.
98. On December 10, 1996, Egenor's accountant sent the Luna Victoria-Vásquez opinion to Deloitte & Touche, asking it to review its analysis in light of that opinion. A week later, on December 17, Deloitte & Touche reconfirmed their original advice, stating that unless Egenor sought authorization from SUNAT for its own special rate, it had to apply the general statutory rate since Egenor would be a company "created by a simultaneous incorporation" and not as a consequence of Electroperú's split.
99. The merger between Egenor and Power North was completed by December 31, 1996, resulting in Egenor S.A.
100. On January 6, 1997, Deloitte & Touche issued its advice for the third time, reconfirming its two earlier opinions.
101. In the first quarter of 1997, Egenor filed its taxes with SUNAT, for the very first time as a partially privatized entity. Following the advice of Deloitte & Touche, Egenor recorded tax depreciation using the general statutory rate.
102. On April 8, 1997, Electroperú voted its shares in Egenor to approve the company's 1996 Financial Statements, dividend distributions and annual reports reflecting (a) application of the general statutory depreciation rate for tax purposes and (b) the asset revaluations

on account of the merger between Egenor and Power North. Similarly, Electroperú approved the 1997 Financial Statements of Egenor on March 23, 1998.

103. As mentioned earlier, on December 30, 1998, Congress repealed the Merger Revaluation Law via Law No. 27034.
104. In early 1999, SUNAT began to compile a registry of companies that had reorganized and taken advantage of tax benefits during the period the Merger Revaluation Law was in effect.
105. On January 25, 1999, SUNAT requested one of Peru's leading tax experts, Dr. Enrique Cárdenas, to provide a legal opinion regarding the effect of Law No. 27034 (which repealed the Merger Revaluation Law) on companies with LSAs.
106. On January 29, 1999, Dr. Cardenas sent SUNAT the requested legal opinion, in which he concluded that Law 27034 was not applicable to companies with LSAs that had availed themselves of the Merger Revaluation Law and its Regulations.
107. On February 25, 1999, Electroperú sent letters to the Minister of Economy and Finance and to SUNAT requesting their opinion on the effect of Law No. 27034 with respect to privatized companies in the electric sector that had LSAs. Electroperú's letter attached the legal opinion of major Lima law firms concluding that the repeal of the Merger Revaluation Law should not affect companies with valid LSAs.
108. On March 16, 1999, Electroperú voted its shares in Egenor to approve the company's 1998 Financial Statements, dividend distributions and annual reports reflecting (a) application of the general statutory depreciation rates for tax purposes, and (b) the asset revaluations on account of the merger between Egenor and Power North.

4. Relevant Developments during Duke's Acquisition of Egenor

109. As stated earlier, in 1999, Duke Energy embarked on a coordinated acquisition of 90 percent of Egenor, representing its total outstanding or available stock (*i.e.*, the 60 Percent Tranche owned by IDP and the 30 Percent Tranche owned by Perú).

110. The 30 Percent Tranche was sold through an auction process coordinated by CEPRI-*Participación Ciudadana* (“CEPRI-PC”). In July 1999, Banco de Crédito, which was hired by CEPRI-PC to oversee the sale of the 30 Percent Tranche, requested Estudio Grau Abogados – external counsel to Egenor – to provide a due diligence report on Egenor, including its tax compliance, as part of the data room to be provided for investors interested in purchasing the 30 Percent Tranche.
111. Estudio Grau had already prepared a legal opinion for Egenor on January 5, 1999, in which it stated that the benefits of the Merger Revaluation Law had been stabilized for Egenor. Estudio Grau reconfirmed its view in the due diligence report it prepared for the sale of the 30 Percent Tranche.
112. The auction of the 30 Percent Tranche was governed by *Bases de la Subasta de Egenor S.A.A.* (“Bidding Rules for the Egenor S.A.A. Auction”), dated August 17, 1999. According to Section 6.1 of these Bidding Rules, the date and time of the auction would be disclosed at least three working days in advance by notice published in the Bulletin of the Lima Stock Exchange. Following discussions with Duke Energy concerning its strategy for acquiring 90 percent of Egenor, CEPRI-PC agreed to postpone the auction for the 30 Percent Tranche until September 7, 1999. In late August 1999, following further discussions with Duke Energy, CEPRI-PC further postponed the auction until October 7, 1999.
113. On September 20, 1999, Miranda & Amado Abogados provided a legal opinion to Duke Energy, in which it was stated that the Merger Revaluation Law was stabilized for Egenor as part of the Egenor LSA.
114. At the end of September 1999, COPRI approved the transfer by Dominion of its ownership interest in Egenor to Duke Energy, and announced a base price of US\$60 million for the 30 Percent Tranche of Egenor (this being some 15–20% higher than the average price of Egenor’s shares listed on the Lima Stock Exchange).

115. As set out earlier, in October 1999, Duke Energy, as the sole bidder, won the auction for the sale of the 30 Percent Tranche. By mid-November 1999, it had also acquired the 60 Percent Tranche through DEI Holdings USA.
116. Within weeks of Duke Energy's acquisition of Egenor, SUNAT submitted its official opinion on the Merger Revaluation Law to the Ministry of Economy and Finance. In its opinion, SUNAT concluded that the Merger Revaluation Law was not part of the stabilized regime under the various outstanding LSAs. The Ministry took no action on the basis of that opinion.

5. Relevant Developments during Duke's Management of Egenor

117. In July 2000, President Fujimori began a controversial third term in office, following allegations that the third term was unconstitutional and the result of electoral rigging. His third term came to an end on November 18, 2000, amidst allegations of corruption.
118. An interim Government under Mr. Valentín Paniagua, acting as interim President of the country, was established immediately thereafter. Congress and the new interim Government launched investigations into Mr. Fujimori's policies, including foreign investments, privatization and LSAs.
119. It was in this context that, on November 24, 2000, SUNAT initiated a tax audit of DEI Egenor for tax year 1999 (*i.e.*, the tax compliance of Egenor S.A.A.). Upon being notified, DEI Egenor requested an extension of the term to initiate the audit, which was granted.
120. On January 22, 2001, Auditors Víctor García Quesada and Jorge Pinedo Zelaya made the first visit to the company. Two additional auditors were included during the tax inspection stage due to the complexity of the audit. SUNAT expanded the scope of the audit to include tax years 1996, 1997, and 1998 (*i.e.* the tax compliance of Egenor and Egenor S.A.) on May 9, 2001.
121. SUNAT's position that the benefits of the MRL were not stabilized by the LSAs, outlined since late 1999, was maintained and ratified on July 2001 by means of Memorandum No.

370-2001-K00000 from the National Legal Department (*Intendencia Nacional Juridica*) to the Department of Major Taxpayers, which enclosed an aide memoir from the same Department with the corresponding legal analysis.

122. On July 19, 2001, SUNAT assessed Edelnor and Luz del Sur (two other privatized companies in the electricity sector) for tax assessments on the basis that the Merger Revaluation Law was not stabilized under those companies' respective LSAs.
123. On July 28, 2001, Mr. Alejandro Toledo was inaugurated as President. On his first day in office, President Toledo replaced the head of SUNAT, Mr. Luis Alberto Arias, with Ms. Beatriz Merino.
124. Edelnor filed a local arbitration against the Ministry of Energy and Mines in relation to SUNAT's tax assessment on August 9, 2001. Luz del Sur filed a local arbitration against the *Comisión Nacional de Inversiones y Tecnologías Extranjeras* ("CONITE") – today PROINVERSION - in relation to SUNAT's tax assessment on September 25, 2001.
125. On August 17, 2001, CONITE issued its own official position on the Merger Revaluation Law. Contrary to SUNAT's position, CONITE took the view that the Merger Revaluation Law was a part of the stabilized tax regime for companies with LSAs.
126. On November 7, 2001, the report of a Congressional Commission on the Constitution issued two minority reports, concluding that, regardless of the outcome of the Edelnor and Luz del Sur arbitrations, SUNAT should apply Rule VIII of the Peruvian Tax Code in cases of companies with LSAs. Rule VIII, as amended on September 22, 1996, reads as follows:

When applying the tax norms, all interpretation methods admitted by Law may be used.

To determine the true nature of the taxable act, the National Tax Administration Superintendency (SUNAT) will deal with the business relations, situations and acts that are actually performed, pursued or established by tax debtors.

In the process of interpretation, no taxes may be created, no sanctions may be established, no exemptions may be granted and no tax provisions may be issued to be applied to entities or situations different from those specified in the law.

127. The awards in both the Edelnor local arbitration (issued on November 22, 2001) and the Luz del Sur local arbitration (issued on December 7, 2001) concluded that the Merger Revaluation Law was part of the stabilized tax regime for each company. The same conclusion was reached on April 22, 2002 in a local arbitration commenced by Edegel (another privatized electricity company).

E. THE TAX ASSESSMENT AND TAX AMNESTY

128. On November 26, 2001, SUNAT assessed a tax liability of approximately US\$12.4 million against DEI Egenor for what SUNAT determined were tax underpayments in 1996, 1997, 1998 and 1999, plus just over US\$35.9 million in interest and penalties (the “**Tax Assessment**”).
129. The Tax Assessment had two main components. The first component was based on SUNAT’s view, under its interpretation of Rule VIII of the Peruvian Tax Code, that the 1996 merger between Egenor and Power North, resulting in the creation of Egenor S.A., was a sham transaction concluded solely to take improper advantage of tax benefits provided for under the Merger Revaluation Law (the “**Merger Revaluation Assessment**”). Under its interpretation of Rule VIII, SUNAT determined that it had the authority to disregard the merger on the grounds that it was concluded to circumvent the payment of taxes.
130. The second component was based on SUNAT’s view that Egenor should have depreciated the assets that Electroperú had transferred to it during the privatization process using the special decelerated rate that had been provided to Electroperú by SUNAT in December 1995, rather than the general statutory rate set forth in the income tax regulations (the “**Depreciation Assessment**”).

131. On December 24, 2001, DEI Egenor applied for tax amnesty in connection with the Merger Revaluation Assessment under reservation of rights to seek compensation for the losses incurred.¹² On March 21, 2002, SUNAT accepted DEI Egenor's amnesty application. The amnesty payment, totalling approximately US\$6 million, was made through the relinquishment of various tax loss carry-overs and the use of advance income tax overpayment credits.
132. With respect to the Depreciation Assessment, DEI Egenor initiated an administrative complaint with SUNAT on December 21, 2001. In September 2002, SUNAT notified DEI Egenor that its complaint had been rejected. SUNAT restated its demand for collection of the Depreciation Assessment, with additional interest and penalties for non-payment. On September 23, 2002, DEI Egenor appealed SUNAT's denial of its claim to the Tax Court.
133. On December 27, 2002, SUNAT used Rule VIII to assess Barrick Misquichilca, a company that was also continuing to avail itself of the Merger Revaluation Benefits under its LSA. On July 9, 2003, SUNAT reassessed Edelnor, Luz del Sur and Edegel, this time also under Rule VIII.
134. As the Tribunal noted earlier, on October 6, 2003, Claimant filed for ICSID arbitration under the DEI Bermuda LSA.
135. The Tax Court issued its decision on DEI Egenor's appeal of SUNAT's decision on April 23, 2004. The Court found mainly in favour of SUNAT and against DEI Egenor. On July 27, 2004, SUNAT issued a revised tax assessment against DEI Egenor, in accordance with the Tax Court's decision, for approximately US\$27.6 million.
136. On August 27, 2004, DEI Egenor applied for amnesty in connection with the Depreciation Assessment stating that, nonetheless, its application was filed "under protest" and that it did not imply in any way an acknowledgement by DEI Egenor of the

¹² See Exhibit C-116, "Third Accessory Petition."

validity of the legal arguments on which SUNAT based its assessment.¹³ On August 27, 2004, SUNAT accepted DEI Egenor's amnesty application. On the same date, DEI Egenor paid the amnesty amount, in cash, in the sum of approximately US\$15.9 million.

137. On September 8, 2004, the Tax Court issued Resolution No. 06686/4/2004, holding that SUNAT exceeded its jurisdiction against Edegel in levying tax assessments based on alleged fraudulent mergers under Rule VIII of the Tax Code.

III. OVERVIEW OF THE AWARD

138. In its Request for Arbitration, Claimant asserted the following claims against Respondent arising from the Tax Assessment:

1. breach of the guarantee of tax stabilization in the DEI Bermuda LSA;
2. breach of the guarantee of non-discrimination in the DEI Bermuda LSA;
3. breach of the guarantee of free remittance of capital in the DEI Bermuda LSA; and
4. breach of the implied duty of good faith and the Peruvian doctrine of *actos propios*.

139. Following the Tribunal's Decision on Jurisdiction, in which the Tribunal stated that "Claimant is entitled to the guarantees provided by such rules of international law as may be held by the Tribunal to be applicable to the merits of the dispute by virtue of Article 42(1) of the ICSID Convention" (at para. 134), Claimant added a fifth claim:

5. breach of the minimum standard under customary international law.

140. In Part IV of the present Award, the Tribunal addresses, as preliminary issues, (a) the applicable law, (b) the effect of Duke/DEI Egenor's decision to take advantage of Peru's

¹³ See Exhibit C-121.

amnesty programme, and (c) the scope of protection provided to Claimant by the DEI Bermuda LSA.

141. In Part V, based on the framework provided in Part IV, the Tribunal addresses the issue of Respondent's liability for each component of the Tax Assessment. For the Depreciation Assessment, the principal guarantees at issue are tax stabilization and the doctrine of *actos propios* (good faith/estoppel). For the Merger Revaluation Assessment, the principal guarantees at issue are tax stabilization, the doctrine of *actos propios* and the guarantee against discrimination.
142. For the reasons set out below, the Tribunal has concluded, by majority, that Respondent is not liable for the Depreciation Assessment under any of the theories advanced by Claimant.¹⁴ With respect to the Merger Revaluation Assessment, the Tribunal finds Respondent liable for breach of the guarantee of tax stabilization under the DEI Bermuda LSA. The Tribunal, by majority, also considers the Merger Revaluation Assessment to be a violation of the implied duty of good faith.¹⁵ Having concluded that the stabilization guarantee was breached, the Tribunal has found it unnecessary to decide whether the guarantee of non-discrimination was breached by the Merger Revaluation Assessment.
143. The Tribunal's decision on damages is set out in Part VI, and its decision on costs in Part VII.

IV. PRELIMINARY ISSUES

A. APPLICABLE LAW

144. The issue of applicable law was raised during the jurisdictional phase of these proceedings, in the context of the debate over the admissibility of the claims. In that context, the Tribunal decided as follows in its Decision on Jurisdiction (at para. 162):

¹⁴ On this point, Dr. Guido S. Tawil has written a dissenting opinion.

¹⁵ On this point, Dr. Pedro Nikken has written a dissenting opinion.

Respondent argues that the Tribunal must apply Peruvian law to resolve this dispute. In fact, the question of the applicable law to the merits of this case is somewhat more complicated. The DEI Bermuda LSA contains no specific provision regarding the applicable substantive law. In such circumstances, Article 42(1) of the ICSID Convention requires the Tribunal to apply “the law of the Contracting State party to the dispute (including its rules on conflicts of laws) and such rules of international law as may be applicable.” Furthermore, even if the law of Peru were held to apply to the interpretation of the DEI Bermuda LSA, this Tribunal has the authority and duty to subject Peruvian law to the supervening control of international law.

(Emphasis added)

145. In the merits phase, each party advanced its own interpretation of Article 42(1) of the ICSID Convention and its own views on the significance of the Tribunal’s observations about applicable law in its Decision on Jurisdiction.

1. Claimant’s Position

146. It is Claimant’s position that the Tribunal’s evaluation of the present dispute must ultimately be based on the “supervening control” of international law.
147. During his opening statement at the merits hearing, Claimant’s counsel explained that international law should play a “triple role” in this dispute: (1) superseding Peruvian law where the two systems of law are inconsistent; (2) filling gaps in Peruvian law; and (3) establishing certain independent and autonomous rights for Claimant, notably the right to a minimum standard of treatment under customary international law and general principles of law.
148. With respect to points (1) and (2), relating to the role of international law where inconsistencies or gaps may exist, Claimant has identified at least three areas in which, in its submission, international principles may well conflict with the local norms of Peruvian law: (i) unity of the State vs. separate existence and authority of State agencies;

(ii) effect of amnesty; and (iii) the application of the concept of estoppel to the Government. In each case, Claimant submits, it is international law that should take priority over any inconsistent principles of local law.

149. Finally, with respect to point (3), Claimant submits that Respondent's breaches are also actionable under independent and autonomous guarantees of international law, which are imported via Article 42(1) of the ICSID Convention.

2. Respondent's Position

150. According to Respondent, Article 42(1) of the ICSID Convention gives the law of the host State primacy in the absence of an agreement on governing law.

151. Inasmuch as the DEI Bermuda LSA does not have a choice of law clause, Respondent submits that, in accordance with Article 42(1) of the ICSID Convention, the law of the host State, *i.e.*, Peru, applies in the first instance.

152. Respondent has referred the Tribunal to other ICSID tribunals that have considered contracts without a choice of law clause and that have found them to be governed by domestic law, without any need to refer to international law. See *Société Ouest Africaine des Bétons Industriels (SOABI) v. Senegal*, ICSID Case No. ARB/82/1, Award, February 25, 1988, 6 ICSID Rev. – FILJ 125, 159-64 (1991) (Broches, President) (applying Senegalese law); *S.A.R.L. Benvenuti and Bonfant v. People's Republic of the Congo*, ICSID Case No. ARB/77/2, Award, August 8, 1980, 1 ICSID Reports 330, 349 (1993) (applying Congolese law).

153. Respondent notes, as was confirmed by the Tribunal in its Decision on Jurisdiction, that, under Peruvian law, LSAs are treated as private contracts and, thus, are subject to relevant Peruvian Civil Code provisions. Thus, the negotiation, execution, interpretation, and enforcement of the LSA are all governed by Peruvian civil law.

154. According to Respondent, a tribunal should refer to international law under Article 42(1) in these circumstances only if (i) a gap in the law of the host State prevents resolution of the dispute (*i.e.*, "the conduct at issue is not covered by Peruvian law"); or (ii) the

resolution reached by applying the law of the host State is inconsistent with international law.

155. Respondent submits that, in this case, Claimant has failed to demonstrate that either a lacuna exists in the applicable Peruvian law or that Peruvian law is inconsistent with or does not conform to international law.
156. Finally, Respondent submits that the Tribunal's finding in its Decision on Jurisdiction does not accord Claimant an open-ended expansive entitlement to submit claims based on any and all protections that may be attributed to the sources of international law set out in Article 38(1) of the Statute of the International Court of Justice, namely treaties, customary international law, and general principles of law.

3. Tribunal's Analysis

157. The issue of applicable law raises two distinct issues for the Tribunal.
158. First, are there any gaps in Peruvian law, or inconsistencies between Peruvian law and international law? To the extent that there are, Respondent does not dispute that international law should take priority. Respondent does, however, take issue with the premise of the existence of gaps or inconsistencies.
159. Second, does Article 42(1) of the ICSID Convention entitle Claimant, in the circumstances of this dispute, to bring independent and autonomous claims based on recognized sources of international law, namely customary international law and general principles of law?
160. On the first issue, and as explained in greater detail below, the Tribunal finds that there is no inconsistency between local law and international law in respect of the effect the Tribunal should give to the amnesty that was granted to Egenor for both components of the Tax Assessment (see Section IV.B). On the other hand, the Tribunal finds that principles of international law must be given effect in determining the extent to which the division of the State into separate entities and agencies can insulate the State from

liability for certain actions and representations (i.e., the analysis of good faith and the doctrine of *actos propios*) (see Section IV.C.2).

161. On the second issue, the Tribunal first notes that the second sentence of Article 42(1) of the ICSID Convention does not provide an *a priori* hierarchy or preference as between national and international law. However, as explained in greater detail below, the Tribunal has considered the independent international-law principles that Claimant has suggested should be implied from the LSA (namely good faith, and fair and equitable treatment), and has determined that they are redundant in light of the protections provided to Claimant under the DEI Bermuda LSA and Peruvian law. Therefore, inasmuch as those principles are contained in both the DEI Bermuda LSA and Peruvian Law, it is unnecessary for the Tribunal to enter into a separate analysis of Claimant’s claim on these grounds.

B. EFFECT OF AMNESTY

162. DEI Egenor voluntarily availed itself of Peru’s Tax Amnesty Law, *Sistema Especial de Actualización y Pago de Deudas Tributarias* (“SEAP”) under reservation of its rights. In the case of the Merger Revaluation Assessment, DEI Egenor applied for amnesty immediately after having been assessed by SUNAT. In the case of the Depreciation Assessment, DEI Egenor applied for amnesty only after it lost its challenge to SUNAT’s assessment before the Tax Court.
163. During the jurisdictional phase, Respondent argued that Claimant’s claims arising from the Tax Assessment were inadmissible because the matters had already been settled in accordance with the Amnesty Law. In the Decision on Jurisdiction (at para. 164), the Tribunal dismissed the admissibility objection and ruled that it would consider the effect of the amnesty during the merits phase of the proceedings.

1. Parties' Contentions

a) Scope of Renunciation

164. According to Respondent, a taxpayer's request to receive the benefits of the Tax Amnesty Law entails the recognition and acceptance of the tax obligations specified in the request, since payment made in accordance with the Tax Amnesty Law constitutes renunciation of any ongoing or future challenge of the tax obligation in question, whether through administrative or judicial proceedings.
165. Relying on Dr. Hernández, one of its experts, Respondent submits that when a taxpayer renounces its right to challenge a tax debt by applying for amnesty, this renunciation applies not only to proceedings before domestic tribunals but to proceedings in any jurisdiction whatsoever, provided that the taxpayer had the option to adhere to the SEAP. Therefore, according to Respondent, DEI Egenor's reliance on the Tax Amnesty Law constitutes DEI Egenor's categorical renunciation of any ongoing or future challenge of the tax obligation at issue in any forum, including international arbitration under an LSA.
166. In response, Claimant submits that the only effect of DEI Egenor's acceptance of amnesty was the waiver of its right to challenge the amnesty payments through the procedural mechanisms available under Peruvian tax law. In fact, as Prof. Jorge Avendaño, one of Claimant's experts, points out, SEAP does not even mandate that a taxpayer accept SUNAT's underlying reasons for imposing its assessment when availing itself of amnesty. Rather, the taxpayer merely has to: (a) acknowledge that it is paying a debt, whether validly established or not; and (b) renounce its ability to challenge that debt under tax law procedures.
167. According to Claimant, Dr. Hernández's argument that DEI Egenor's renunciation of rights should be viewed as broadly as precluding DEI Bermuda's ICSID arbitration claims conflicts with the assertion of Respondent's other expert, Prof. Alfredo Bullard, that "special system[s] . . . for tax matters . . . should be [interpreted] restrictive[ly]." Professor Bullard's view regarding the restrictive application of tax laws is consistent with that expressed by Claimant's expert, Professor Avendaño.

b) Effect on DEI Bermuda

168. According to Dr. Hernández, “once EGENOR accepts amnesty under SEAP, its parent company [DEI Bermuda] may not file a complaint relative to the debt subject to the amnesty.” Respondent submits that, contrary to the position Claimant took in the jurisdictional phase, Claimant is now seeking improperly to take advantage of a corporate shell game to avoid the effects of the amnesty.
169. In response, Claimant argues that Respondent’s accusation that Claimant is “attempting to ‘hide behind corporate forms to evade’ the legal consequence of DEI Egenor availing itself of the Tax Amnesty Law” is nothing more than a “straw man” argument.
170. According to Claimant, DEI Egenor’s amnesty payments had no effect whatsoever on *either* DEI Egenor’s rights under the Egenor LSA or DEI Bermuda’s rights under the DEI Bermuda LSA. Because Claimant has never taken the position that DEI Bermuda’s LSA rights persist despite relinquishment of DEI Egenor’s LSA rights, Respondent’s position that Claimant is “hiding behind corporate formalities” is based on an entirely false premise.

c) Reservation of Rights

171. Respondent submits that the reservation of rights that DEI Egenor included in its application for amnesty is ineffective under Peruvian law.
172. Claimant responds that DEI Bermuda is not arguing that it retained the right to assert its claims in this arbitration only because DEI Egenor reserved its rights when applying for SEAP. Rather, Claimant’s position is that the limited waiver of DEI Egenor’s procedural rights under SEAP’s own terms had absolutely no effect on the civil and international law relationships established by the Egenor and DEI Bermuda LSAs. The purpose of the reservation of rights was simply to clarify, beyond doubt, above and beyond what Peruvian law already provided, that DEI Egenor and DEI Bermuda were continuing to evaluate all other avenues for redress apart from the Peruvian tax law dispute resolution mechanisms foreseen in the SEAP itself.

173. Claimant adds that DEI Bermuda cannot be equitably estopped from bringing the claims in this arbitration because the Government did not rely, and would not have been justified in relying, upon DEI Egenor's SEAP payments in light of the reservation of rights that Claimant included with its amnesty applications.

d) Mitigation of Damages

174. Claimant argues that DEI Egenor sought amnesty in order to mitigate damages, because otherwise penalties and interest on the Tax Assessment would have continued to accrue.

175. Respondent submits that a claimant is not required to take action to mitigate where domestic law does not permit such action or where such action would foreclose claimant's other means of redress. Thus, in the present case, international law would not require Claimant to avail itself of the Tax Amnesty Law, given that the benefit of that law (*i.e.*, the damages to be mitigated) is expressly conditioned on Claimant's renunciation of any challenge to the tax debt in any proceeding and in any jurisdiction.

176. Further, Respondent submits that, under Peruvian law, Claimant had an alternative means of mitigating damages that would not have required Claimant to relinquish its right to challenge SUNAT's assessment. As Dr. Luna-Victoria explained in his expert report, a taxpayer in Peru may invoke the "payment under protest" procedure. This procedure—and only this procedure—permits a taxpayer to pay an assessment, without acknowledging the obligation, and to challenge that assessment through administrative or judicial proceedings. In addition, making payment under protest has the effect of mitigating damages by halting the accrual of interest on the underlying assessment.

177. Claimant answers that Respondent's argument presupposes as its underlying premise that mitigation of damages by virtue of DEI Egenor's SEAP payments did in fact foreclose DEI Bermuda's claims in this arbitration under the DEI Bermuda LSA, which Claimant denies.

178. As a result, says Claimant, Respondent's reference to other possible means of mitigation, such as a "payment under protest," are of little relevance in this arbitration. According to

Claimant, DEI Egenor’s mitigation of damages, through payment under the amnesty programme, was clearly the most efficient and effective way of “stopping the bleeding” in this case, while at the same time preserving all of DEI Bermuda’s rights to initiate arbitration for all its claims under its LSA (*see* Navigant Second Expert Report at paras. 64-68, calculating the amount that would have been required to pay under protest. Had the Claimant paid under protest the damages “would be approximately US\$43.1 million higher than the US\$37.5 million presently claimed.”).

2. Tribunal’s Analysis

179. The Tribunal finds that the LSA rights of both DEI Egenor and of DEI Bermuda are separate and distinct from the rights to which the SEAP renunciation applies, quite apart from the fact that DEI Egenor may have reserved certain rights in its amnesty applications.¹⁶ In order to benefit from the Tax Amnesty Law, the taxpayer must desist from challenges before “administrative or judicial authorities.”¹⁷ Under each LSA, it was agreed that disputes over the scope of protection provided by the LSA would be referred to arbitration (national or international arbitration, in the case of the Egenor LSA, and ICSID arbitration, in the case of the DEI Bermuda LSA) and not to administrative or judicial authorities.¹⁸
180. The Tribunal therefore concludes that, since neither administrative nor judicial authorities in Peru had jurisdiction to hear claims or challenges based on the LSAs, renunciation of all challenges to the tax obligation through “administrative or judicial authorities”, as provided under the Tax Amnesty Law, could not have resulted in the waiver of the rights of DEI Egenor or DEI Bermuda under the respective LSAs.

¹⁶ The Tribunal notes that, strictly speaking, there was no “reservation of rights” in the amnesty applications. DEI Egenor simply paid and underlined in its application that the payment “[did] not imply in any way an acknowledgement by DEI Egenor of the validity of the legal arguments on which SUNAT based the Resolutions” (Exhibit C-121).

¹⁷ Legislative Decree No. 914, Article 9.3 (Exhibit C-144).

¹⁸ In his Second Expert Report, Professor de Trazegnies comments on the situation where claims under an LSA are submitted exclusively to arbitration. He notes that “the Tax Court has made it clear that, in these situations, there is a tax proceeding and an arbitration proceeding, and it has indicated that these two proceedings have their respective functions, and must not be confused.” (Report dated February 22, 2005 at paragraph 11.) He cites as authority for this proposition the Edelgel case (Tax Court Resolution No. 06619-4-2002), the Edelnor case (Tax Court Resolution No. 06604-5-2002) and the Luz del Sur case (Tax Court Resolution No. 06628-1-2002). (*Ibid.* at paragraphs 12–18.) In this case, he writes, “DEI Bermuda has not attempted to challenge the SUNAT’s assessment resolutions, nor does it wish to invalidate the Tax Court’s resolutions.” (*Ibid.* at paragraph 5.)

181. In addition, the DEI Bermuda LSA contains no specific provision regarding the applicable substantive law. In such circumstances, Article 42(1) of the ICSID Convention requires the Tribunal to apply “the law of the Contracting State party to the dispute (including its rules on conflicts of laws) and such rules of international law as may be applicable.”
182. Consequently, even if payment under the Tax Amnesty Law did, as a matter of Peruvian law, result in the renunciation of rights under the LSAs (which in the Tribunal’s opinion it did not do), Peruvian law (“the law of the Contracting State party to the dispute”), and in particular the Tax Amnesty Law, would be inconsistent with applicable principles of international law. One such principle is that waiver of ICSID rights must be explicit (*see* Professor Dolzer Second Expert Report at paras. 28-29). As discussed in the previous Section, Respondent does not dispute that, in the case of such conflict, it is international law that must prevail over the local law.
183. Finally, the Tribunal also relies, subsidiarily, on the principle, supported by Respondent’s own expert, Prof. Alfredo Bullard, that “special system[s] ... for tax matters ... should be [interpreted] restrictive[ly].” This principle should apply to the interpretation of DEI Egenor’s waiver of its rights to challenge the Assessments.

C. SCOPE OF PROTECTION PROVIDED BY DEI BERMUDA LSA

184. Claimant’s case on liability must, as the Tribunal ruled in its Decision on Jurisdiction, be grounded in the DEI Bermuda LSA. The relevant paragraphs of its Decision on Jurisdiction are set out below:

131. The Tribunal has no hesitation in applying the unity-of-the-investment principle to refute Respondent’s argument that the narrow description of the transaction in Clause Two of the DEI Bermuda LSA necessarily determines the scope of the “investment” for purposes of the DEI Bermuda LSA. The reality of the overall investment, which is clear from the record, overcomes Respondent’s objection that it could never have

consented to arbitration of a dispute related to the broader investment by Duke Energy in DEI Egenor.

132. However, the Tribunal also acknowledges the corollary finding in the CSOB case, namely that Claimant will need to substantiate its claims, during the merits phase, by reference solely to the guarantees contained in the DEI Bermuda LSA, and not those contained in any of the other LSAs. This is a function of the specific wording of Clause Nine of the DEI Bermuda LSA, and of the legal basis of Claimant's claims as formulated in the Request for Arbitration, namely the alleged breach of the protections contained in the DEI Bermuda LSA, not in any of the other LSAs.
133. While the Tribunal's lack of jurisdiction over the other LSAs will not prevent it from taking them into consideration for the purposes of the interpretation and application of the DEI Bermuda LSA (indeed, that is "perfectly possible, normal and called for"), it will not be in a position to "give effect" to the protections in those LSAs. In other words, in the peculiar circumstances of this case (successive agreements *for the protection* of the investment), the unity of the investment does not necessarily imply the unity of the protection of the investment.
134. Finally, by focusing on the guarantees included in the DEI Bermuda LSA, and excluding the application of the guarantees included in the other LSAs, the Tribunal is not limiting Claimant strictly to the text of the DEI Bermuda LSA. First, Claimant is entitled to the guarantees that are implied in the DEI Bermuda LSA by Peruvian law. Second, Claimant is entitled to the guarantees provided by such rules of international law as may be held by the Tribunal to be applicable to the merits of the dispute by virtue of Article 42(1) of the ICSID Convention.

(Emphasis added)

185. In this Section, before addressing Respondent's liability under each component of the Tax Assessment, the Tribunal will examine the scope of the protections included or implied in the DEI Bermuda LSA.

1. Tax Stabilization

a) Relevant Provisions of the DEI Bermuda LSA

186. Tax Stabilization is guaranteed in Clause Three, Section 1 of the DEI Bermuda LSA, which reads as follows:

THREE - By virtue of this Agreement, the STATE, and as long as it remains in effect, in connection with the investment referred in CLAUSE TWO, the STATE guarantees legal stability for DUKE ENERGY INTERNATIONAL, according to the following terms:

1. Stability of the tax regime with respect to the Income Tax, as stipulated in subsection a) of Article 10° of Legislative Decree No. 662, in effect at the time this Agreement was executed, according to which dividends and any other form of distribution of profits, are not taxed, in accordance with the stipulations of subsection a) of article 25 of the Amendment Text of the Income Tax Law, approved by the Supreme Decree No. 054-99-EF in effect at the time this Agreement was executed. Neither the remittances sent abroad of amounts corresponding to DUKE ENERGY INTERNATIONAL for any of the items contemplated in this subsection are taxed pursuant to the aforementioned law.

187. Clause Five of the DEI Bermuda LSA provides as follows:

This Legal Stability Agreement shall have an effective term of ten (10) years as from the date of its execution. As a consequence, it may not be amended unilaterally by any of the parties during this period, even in the event that Peruvian law is amended, or if the amendments are more

beneficial or detrimental to any of the parties than those set forth in this Agreement.

[...]

b) Parties' Positions

i) Claimant's Position

188. In addition to the relevant provisions of the DEI Bermuda LSA, Claimant relies on the particular language of several other legal instruments.
189. Firstly, Claimant relies on Article 10(a) of the Foreign Investment Law, cited in the DEI Bermuda LSA, which provides as follows:

Article 10. The National Competent Authority, on behalf of the State, prior to making the investment and the appropriate registration, may enter into agreements with foreign investors in order to guarantee the following rights:

- a. Stability of the tax regime in force on the date of execution of the agreement.

By virtue of the guaranteed stability of the tax regime, the foreign investor shall not be subject to a rate higher than the one established in the appropriate agreement for the purposes of the income tax payable by the company receiving the investment, and the tax assessing the profits attributed thereto and/or the dividends distributed in favor thereof; therefore, if the income tax payable by the company is increased, the rate applied to the foreign investor shall be reduced by the required amount so that the company's profits freely available thereto are at least equal to the guaranteed profits.

(Emphasis added)

190. Claimant also relies on Article 23 of the Investment Regulations, which is cited below, in relevant part:

Article 23.- The stability of the tax regime implies the following:

- a) For investors: It guaranties [sic] that while the stability agreement is in force, the income tax which results in a greater tax burden than the one effective as from the date of execution of the agreement will not be imposed on the amounts they are entitled to, in such a manner that they will be entitled to receive effectively such amounts in the same proportion for the following concepts:
 - a.1. The dividends agreed upon in their favor;
 - a.2. The profits they are entitled to;
 - a.3. The profits available thereto; or
 - a.4. The remittance of sums pertaining thereto for any of the concepts regulated in the various items of this section.

The stability system granted to investors as provided for by section a of Article 10° of Legislative Decree N° 662 implies that in case the income tax were amended during the effective term of the Stability Agreement results in a variation of the tax base or the aliquots imposed on the profit generating company, or new taxes were created and imposed on the company's income, or in the percentage reduction of the investor's available profit or dividends with regard to the profit before income as compared to the one subject to allocation or available at the time of setting the guarantied tax system due to any other cause with equivalent effects, under the stability granted by the agreement, the tax aliquot (s) with regard to the profits or dividends the investor is entitled to will be reduced in order to allow that the

profits or dividends finally available or subject to allocation are equal to the ones guaranteed [*sic*] up to the possible limit as to the tax imposed on profits or dividends.

- b) For investment-receiving companies included in sections a and b of Article 17° hereof: it is hereby guaranteed that while the Stability Agreement is effective, the income tax applicable thereto will not be modified. The same terms, as well as the same aliquots [portions], deductions and scales for the calculation of the taxable income as the one effective at the time of the agreement's execution will be applicable.

The tax stability system granted to companies under the provisions of Article 40° of Legislative Decree N° 757 implies that in case the income tax were modified during the term of the Stability Agreement, such modifications will not affect the investment-receiving companies which tax stability is protected by the appropriate agreement whether the aliquots increase or decrease or the taxable base is modified by being extended or reduced, or by any other cause with equivalent effects.

(Emphasis added)

191. Claimant refers to the above provisions (among others) as the “Tax Stabilization Regime” that applies to foreign investments in Peru. Claimant submits that the Tax Stabilization Regime assures the foreign investor that neither the dividends agreed in its favour, nor the profits generated by the local company for its disposal, will be altered either by reason of modification of the tax system or the manner in which that tax system is applied.
192. As for the particular Tax Stabilization Regime that applied to DEI Bermuda's investments in Peru, Claimant submits that pursuant to the terms of the Egenor LSA, the DEI Bermuda LSA and the Tax Stabilization Regime, Duke Energy was essentially the beneficiary of the tax regime originally granted to Dominion by the Government of Peru.

This tax regime included the laws and regulations stabilized *at the time the Egenor LSA was executed in 1996*. At that time, the Merger Revaluation Law was effective, and thus became stabilized for Egenor (which later became DEI Egenor). The same is true, according to Claimant, regarding the depreciation rate that was applied by Egenor following the privatization of the 60 Percent Tranche, namely the general statutory rate.

193. Thus, according to Claimant, by virtue of the interlinked nature of the LSAs as set forth in the Foreign Investment Law and the Investment Regulations, Duke Energy was effectively the beneficiary of (a) an exemption of the tax on dividends, and (b) a stabilized tax regime on profits generated by DEI Egenor and made available to DEI Bermuda, which included the general statutory depreciation rate and the Merger Revaluation Benefits.
194. In order to link the DEI Bermuda LSA and the Egenor LSA, but remain within the confines established by the Tribunal in paras. 132 and 133 of its Decision on Jurisdiction (cited earlier), Claimant has relied in particular on Article 23 of the Investment Regulations. Its argument was set out succinctly in its Memorial (at para. 155):

Broken down into its constituent parts, Article 23(a) confirms that: (i) if, in fact, the tax regime that is applied to DEI Egenor (ii) during the effective term of the DEI Bermuda LSA (iii) is different from the tax regime that was stabilized for DEI Egenor under the DEI Egenor LSA, then (iv) reparation for such variation of the tax regime will be made to DEI Bermuda (v) under the DEI Bermuda LSA. In essence, therefore, whereas Article 23(b) confirms that the income tax regime for DEI Egenor will be frozen for the next ten years, Article 23(a) establishes that it is DEI Bermuda that may claim for damages caused by the State's breach of that tax regime. More specifically, Article 23(a) provides that: (i) the DEI Bermuda LSA guarantees DEI Bermuda that (ii) the profits available or dividends distributable to it (iii) will *equal* the amount resulting from the application of the stabilized tax regime to DEI Egenor's taxable earnings (iv) in effect during the effective term of the DEI Bermuda and DEI Egenor LSAs. In other words, DEI Bermuda is

accorded the right to claim back from the Government the difference between the amount it expected to receive under its stabilized regime and the amount it actually received (or could receive) as a result of the Government's breach of that regime.

195. Finally, according to Claimant, modification by Peru of the tax law itself was not the only manner in which the Tax Stabilization Regime could be breached. The specifics of this argument by Claimant have evolved over the course of the proceedings.
196. Claimant first argued, in its Memorial (at para. 169), that Respondent would impermissibly modify the regime that had been stabilized for DEI Bermuda by “(a) *applying* existing laws or regulations in a manner *wholly inconsistent* with previous applications of those law (sic) or regulations; or (b) *applying* an existing law *illegitimately*.” (Emphasis in original.) In support of Claimant's case, Professor de Trazegnies submitted in his Second Expert Report (at para. 54) that “legal stability can be thwarted if, without making changes to the text of the law itself, it is interpreted in a way that is radically different from the way it was understood and applied before.” (Emphasis added.)
197. In its Reply (at paras. 220-23), Claimant modified the emphasis of its argument on this point, and averred that the conduct which could constitute a breach of the guarantee of tax stabilization included “any changes to the interpretation or application” of existing tax laws and regulations. (Emphasis added.) Similarly, in its Post-hearing Brief, in response to one of the questions posed by the Tribunal, Claimant submitted that “any change by the State in the application (interpretation) of the tax regime stabilized for an investor or the investment-receiving company that results in a greater tax burden than the one in effect at the time of the execution of the LSA constitutes a breach of the LSA and therefore becomes actionable.”

ii) Respondent's Position

198. Respondent submits that Peru complied fully with its tax stabilization promise to Claimant under Clause Three, Paragraph 1, of the DEI Bermuda LSA.

199. According to Respondent, Claimant – DEI Bermuda – can only invoke the guarantees under its own LSA, and therefore Claimant’s attempt to fuse the DEI Bermuda LSA and the Egenor LSA (by way of Article 23 of the Investment Regulations or otherwise) is impermissible. Respondent submits that Claimant’s interpretation cannot succeed because it fails to give the segmentation of LSAs any meaning.
200. Furthermore, according to Respondent, LSAs stabilize tax legislation, but not a specific interpretation or application of that legislation. Respondent argues that under an LSA (including the DEI Bermuda LSA), the tax authorities are not bound to a specific application or interpretation of the tax legislation, but rather can interpret and apply the legislation freely, provided that they do so within the bounds of law and reason. Respondent argues that Claimant has failed to meet its own standard, articulated initially in its Memorial, to demonstrate that Peru’s application or interpretation of the tax laws or regulations was “wholly inconsistent,” “illegitimate,” or “radically different” compared to the prior application or interpretation.

c) The Tribunal’s Analysis

i) Interpretation of Article 23(a) of the Investment Regulations

201. The parties agree that the linkage between the Egenor LSA and the DEI Bermuda LSA is provided by Article 23(a) of the Investment Regulations. They disagree, however, on the effect of its “offset” provision in those cases where, as in the case for DEI Bermuda, the withholding tax rate on dividends happens to be zero percent for the investor. According to Respondent, the result is that DEI Bermuda has no claim under its LSA if the tax stability of Egenor is affected, because there is nothing against which to offset. Claimant replies that where there is a right, there must be a remedy, and that Peru must accordingly compensate Claimant with the payment of damages.
202. The offset provision in Article 23(a) is the mechanism by which the investor's interests are met by avoiding a decrease in its revenues as a result of tax increases imposed on the recipient company, while the State's interest is met by ensuring that LSAs do not

“subtract resources from the National Treasury”,¹⁹ as stated in the Preamble to the Regulation.

203. This mechanism is therefore used to balance increased taxes on the recipient company against lowered taxes on the dividends of the investor in order to “allow the profits and dividends finally available or subject to allocation [to be] equal to the ones that were guaranteed, up to the possible limit [of] the tax imposed on profits and dividends.” (Claimant’s translation; emphasis added).
204. The wording of Article 23(a), at first blush, appears to favour Respondent’s line of argument. According to the express terms of Article 23(a), where, as in the present case, the investor’s dividends are not taxed at all, it would appear that the “possible limit” of the offset available to cure increases in the tax burden on the recipient company is zero.
205. The Tribunal must determine, however, whether the literal meaning of Article 23(a) is a sufficient basis on which to establish a limitation of liability in cases where Respondent has violated the DEI Bermuda LSA by impermissibly modifying the tax regime stabilized for Egenor. The Tribunal considers that the case against the express language limitation was made compellingly by two of Claimant’s experts on Peruvian law, Professor de Trazegnies and Professor Talledo.
206. At the hearing, Professor de Trazegnies opined that the express limitation should not be given effect by the Tribunal because: (i) Article 1322 of the Civil Code provides that whoever breaches an obligation must pay damages; and (ii) giving effect to the limitation would undermine the very purpose of the LSA, which is to protect the investor against modifications to the tax regime (*see* Hearing Transcript, May 14, 2007, pp. 1148:13-1151:22).
207. For his part, Professor Talledo opined that the offset mechanism described in Article 23(a) was merely the “compensation mechanism” provided for in the stability regime

¹⁹ “...no resta recursos a la Caja Fiscal”.

(Hearing Transcript, May 14, 2007, at p. 1205:4-5). He submitted that since, in the case where the tax on dividends is already zero, such compensation mechanism “... is not operative, it is only logical to understand, in keeping with the purposes of the agreement, that [assuming] that same allegation [*i.e.*, a zero-rated tax on dividends] – then the State should indemnify the investor for the reduction in the amount of profit to be distributed and which results from the increase in the tax burden.” (Hearing Transcript May 14, 2007, at p. 1205:3-10).

208. The Tribunal concurs with the view that Article 23(a) operates as a particular means of compensation. In the case where it cannot actually be applied, the investor should still be able to resort to the subsidiary means of compensation – payment of damages – available under Peruvian law. In this regard, Article 1321 of the Peruvian Civil Code sets forth that the party who does not comply with its obligations must pay damages.²⁰ This provision is mirrored by Article 1428 of the Peruvian Civil Code, which provides that upon a party’s failure to comply with a bilateral agreement, the other party can request payment of damages.²¹
209. The Tribunal, having considered all of the evidence and the applicable legal principles, concludes, notwithstanding the limitation wording in Article 23(a), that Claimant has a claim, under the DEI Bermuda LSA, if the tax stabilization guaranteed to Egenor (later DEI Egenor) in the Egenor LSA in 1996 was violated after July 24, 2001, the date on which the DEI Bermuda LSA came into force.

²⁰ Article 1321: “*Queda sujeto a la indemnización de daños y perjuicios quien no ejecuta sus obligaciones por dolo, culpa inexcusable o culpa leve. El resarcimiento por la inejecución de la obligación por su cumplimiento parcial, tardío o defectuoso, comprende tanto el daño emergente como el lucro cesante, en cuanto sean consecuencia inmediata y directa de tal inejecución. Si la inejecución o el cumplimiento parcial, tardío o defectuoso de la obligación, obedecieran a culpa leve, el resarcimiento se limita al daño que podía preverse al tiempo en que ella fue contraída*”.

²¹ Article 1428: “*En los contratos con prestaciones recíprocas, cuando alguna de las partes falta al cumplimiento de su prestación, la otra parte puede solicitar el cumplimiento o la resolución del contrato y, en uno u otro caso, la indemnización de daños y perjuicios. A partir de la fecha de la citación con la demanda de resolución, la parte demandada queda impedida de cumplir su prestación*”.

ii) The Meaning of Tax Stabilization under the LSAs

210. Legal stability, as set out in the Preamble to the Foreign Investment Law, guarantees foreign investors the “continuity of the existing rules.”²² The Tribunal must now determine whether legal stability covers not only the formal text of the laws and regulations that were in place at the time the Egenor LSA was executed, but also their specific interpretation and application at that time.
211. Article 23, on which Claimant has relied in order to demonstrate the linkage between the Egenor LSA and the DEI Bermuda LSA, says, in terms, that the income tax may not be “amended” nor “modified” while the LSA is effective.
212. Similarly, the Preamble to the Investment Regulations provides that LSAs “only guarantee the investors and enterprises in which they participate, that the laws in force at the time of their subscription will not be modified, for a certain period...” [emphasis added]
213. In the same vein, Article 24 of the Investment Regulations provides as follows:

Article 24. Pursuant to the provisions of the regulations referred to in Article 1° of this Supreme Decree, legal stability agreements exceptionally granted stability to the legal system in force at the time of execution of the agreement, and as long as such is in effect, on matters to which the stability is granted.

The stability referred to in the foregoing paragraph implies that will continue to be applied the same legislation in force at the time of the agreement’s execution, without being affected by the amendments thereto on the matters and during the term foreseen in such agreements, including the derogation of legal rules, even in the case of more or less favourable provisions.

²² Foreign Investment Law – Preamble (Claimant’s Exhibit C-8).

214. Claimant argues that a guarantee of tax stability that protects the investor strictly only against amendments or modifications to legislation and regulations would weaken the ambit of the guarantee which, as the evidence demonstrated, the parties intended to include in the LSA. The Tribunal will inquire as to what additional changes to the tax regime, if any, are covered by the guarantee of stabilization in addition to amendment or modification of Peruvian laws or regulations.
215. The Tribunal begins its analysis of this difficult question with the principle that its jurisdiction does not include the power to review the correctness of SUNAT's decisions and assessments or of the Tax Court's decisions as a matter of Peruvian tax law. As the Tribunal ruled in its Decision on Jurisdiction, it does not sit as the appellate division of the Tax Court.
216. The Tribunal's jurisdiction, under this particular guarantee, is limited to determining whether the relevant decisions or interpretations of SUNAT and/or the Tax Court, be they right or wrong, are consistent with the tax regime stabilized for Claimant in the DEI Bermuda LSA. The Tribunal's standard is therefore comparative in nature, rather than absolute. In other words, the Tribunal does not opine on the correctness of the relevant decision or interpretation, but only determines whether such decision of SUNAT or of the Tax Court in the present case represents a change from their respective decisions prior to the entry into force of the DEI Bermuda LSA.
217. This comparative exercise is reasonably straightforward for legislation and regulations, where a change is objectively demonstrable. Claimant establishes an actionable change by proving (i) the existence of a pre-existing law or regulation (or absence thereof) at the time the tax stability guarantee was granted, and (ii) a law or regulation passed or issued after the LSA that changed the pre-existing regime.
218. The exercise is considerably more difficult where the Tribunal must analyze changes in the interpretation or application of a law or regulatory instrument, which could give rise to a finding of breach of the stability guaranteed by the Respondent. The Tribunal is satisfied that Claimant in this instance must prove (i) a *stable* interpretation or application

at the time the tax stability guarantee was granted, and (ii) a decision or assessment after the LSA that modified that stable interpretation or application.

219. Thus, if, at the time when the guarantee was granted, the application of the existing rules resulted in a consistent interpretation, such interpretation must be deemed to be incorporated into the guaranteed stability. In a broad sense, stability is the standard by which the legal order prevailing on the date on which the guarantee is granted is perpetuated, including the consistent and stable interpretation in force at the time the LSA is concluded. The Tribunal is convinced that the maintenance of such stable interpretations of the law, existing at the time the LSA was executed, is part of “the continuity of the existing rules.”
220. The issue for Claimant is one of proof. Adducing proof of laws and regulations in force on a given date is not a significant problem. What is required, however, to prove to the satisfaction of the Tribunal the prevalence of a particular, consistent and stable interpretation? In brief, the Tribunal requires compelling evidence. Clear case law and/or well-established practice constitute persuasive evidence on the issue of consistent meaning, as does generally accepted legal doctrine. The opinion of lawyers retained by a party does not.
221. Furthermore, the statements or actions of a State agency that merely *imply* a specific interpretation or application of the law do not, in the Tribunal’s opinion, provide a sufficiently sound basis upon which to conclude that a stable interpretation of the law existed. That is not to say, however, that such statements or actions could not provide a sufficient basis to engage the State’s liability under the theory of estoppel (*la doctrina de los actos propios*). This is a different issue, involving an inquiry into whether such statements or actions were sufficient to lead the investor to the reasonable conclusion that such an implied interpretation or application of the law would not be modified in the future. The Tribunal will address the concept of estoppel in the next Section of this Award.

222. Does the absence of proof of a change in legislation or regulations, or of a stable interpretation or application, put an end to the Tribunal's inquiry in respect of the guarantee of tax stabilization? No. This is particularly important where, as in this case, there was arguably insufficient time for the development of stable interpretations or applications of the relevant law and regulations, many of which were introduced as part of the overall privatization and liberalization programme at the beginning of the 1990s.
223. In such a case, the Tribunal may depart from a strictly comparative analysis, and of a strict adherence to the requirement that Claimant establish a stable pre-existing interpretation or application. Even here, however, the Tribunal's departure must be measured, and the Tribunal must avoid seeking to establish the "correct" interpretation or application of the relevant law or regulation. Rather, the Tribunal, in the absence of a stable pre-existing interpretation against which it can judge subsequent developments, can only evaluate the decision or assessment that is impugned by Claimant against a reasonableness standard.
224. In such a situation, by definition, there is no objective standard against which to compare the actions of SUNAT or the Tax Court, since the law has not been amended, and there is no stable interpretation that has not been taken into account. The sole standard is Peruvian law itself, with respect to which the Tribunal's jurisdiction is limited.
225. The Peruvian courts are the appropriate forum in which to make a claim in relation to incorrect application of the law by SUNAT or the Tax Court. As explained earlier, as a consequence of DEI Egenor's use of the tax amnesty system, this Tribunal cannot substitute its own jurisdiction for the jurisdiction of the Peruvian courts in matters concerning the interpretation of tax law.
226. Therefore, since this Tribunal is not a Peruvian court of appeal, more is required than a mere demonstration of an erroneous interpretation of the law. It is not for the Tribunal to simply determine if Peruvian law was properly applied, to formulate its own theory on Peruvian law, or to determine what it would consider to be the appropriate interpretation from the variety of interpretations that one might reasonably formulate. By their very

nature, laws often invite different interpretations based on fairly reasonable principles. For this reason, and in order to preserve the proper balance of fairness between the parties in this arbitration, it must be demonstrated, absent a demonstrable change of law or a change to a stable prior interpretation or application, that the application of the law to DEI Egenor was patently unreasonable or arbitrary.

227. The Tribunal therefore decides that tax stabilization guarantees that: (a) laws or regulations that form part of the tax regime at the time the LSA is executed will not be amended or modified to the detriment of the investor, (b) a stable interpretation or application that is in place at the time the LSA is executed will not be changed to the detriment of the investor, and (c) even in the absence of (a) and (b), stabilized laws will not be interpreted or applied in a patently unreasonable or arbitrary manner.
228. However, tax stabilization does not mean that the laws shall only be interpreted or applied based on the meaning that most favours the beneficiary, or the meaning that its legal advisors suggest would be the most appropriate. Tax stabilization does not provide a guarantee against the risk that the Government or the courts will interpret the law in a manner that is unfavourable to the investor, or that differs from the opinion of the investor's legal advisors. An interpretation adverse to the investor cannot *per se* be considered a modification or violation of legal stability unless it is so unreasonable that, in practice, it violates the very stability that was guaranteed.

2. Good Faith and the Doctrine of *Actos Propios*

a) Introduction

229. In its Decision on Jurisdiction (at para. 134), the Tribunal determined that Duke Energy is protected not only by the text of the DEI Bermuda LSA, but by any guarantees that may be implied from the DEI Bermuda LSA under Peruvian law:

[T]he Tribunal is not limiting Claimant strictly to the text of the DEI Bermuda LSA. First, Claimant is entitled to guarantees that are implied in the DEI Bermuda LSA by Peruvian law. Second, Claimant is entitled to the guarantees provided by such rules of international law as may be

held by the Tribunal to be applicable to the merits of the dispute by virtue of Article 42(1) of the ICSID Convention.

(Emphasis added)

230. The most important of the implied guarantees is the Government's obligation to act in good faith. This follows directly from Article 1362 of the Peruvian Civil Code, which states that "contracts [must] be negotiated, entered into and executed according to the rules of good faith and common intention of the parties."
231. One of the fundamental facets of good faith within Peruvian law is the *doctrina de los actos propios*. This key aspect of good faith – known in various legal systems as *venire contra factum proprio non valet*, *la doctrina de los actos propios*, *allegans contraria non est audiendus*, estoppel or the principle of consistency – has also been universally applied as a general legal principle, both in civil and international law, to prohibit a State from taking actions or making representations which are contrary to or inconsistent with actions or representations it has taken previously to the detriment of another.
232. The parties do not disagree on the general content of the principle of good faith, or that the doctrine of *actos propios* is implied from all contracts, including LSAs, under Peruvian law. They do differ, however, on the question of whether Respondent breached its obligation of good faith when SUNAT issued the Tax Assessment against DEI Egenor, and whether SUNAT's conduct could properly be evaluated against the prior conduct and/or representations of the Government's various organs and entities, such as COPRI, CEPRI-ELP, the Ministry of Energy and Mines, and the *Corporación Nacional de Desarrollo* ("CONADE" today known as *Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado* "FONAFE"). The latter question raises the issue of whether principles of international law need to be applied to supplement the doctrine of *actos propios* and, if so, how.

b) The Parties' Positions

i) Claimant's Position

233. Claimant submits that, while the departmentalization or division of the State might be acceptable as an internal matter of Peruvian law, such a principle is inconsistent with the principle of the unity of the State under international law. According to Claimant, it is accepted by both parties that the latter principle must take priority in the event of such inconsistency, pursuant to Article 42(1) of the ICSID Convention.
234. Claimant argues that SUNAT, COPRI, CONADE, CEPRI-ELP and the Ministry of Energy and Mines are all interrelated Government agencies. *Vis-à-vis* the investor, they are indistinguishable parts of a single State, whose actions and representations are binding on one another for purposes of the application of the doctrine of *actos propios*.
235. Claimant contends that SUNAT's alleged autonomy within the Peruvian legal system does not mean that it is distinct, for all purposes, from the rest of the Government. The International Law Commission (ILC) Articles on State Responsibility make it absolutely unambiguous that SUNAT is as much a part of the same Government as, for example, the Minister of Energy and Mines. Moreover, SUNAT is part of the same Government as COPRI and CEPRI-ELP, which engineered and implemented the privatization of Egenor from 1996 to 1999, and as is CONADE, which instructed Electroperú on how to vote at Egenor shareholders' meetings.
236. Put another way, Claimant asserts that when the conduct of Respondent's officials, entities and organs are observed as a whole, Respondent's arguments do not support its ultimate position that the conduct of its officials, entities and organs is not attributable to the Government of Peru. In other words, according to Claimant, Peru is not a passive party: the coherent action of one part of the Government dealing with taxation issues and another dealing with investment promotion is the responsibility of Respondent as a single unit. It is not the responsibility of Claimant, it argues, to bear the risk of Government ambiguity and inconsistency.

ii) Respondent's Position

237. According to Respondent, which relies in this respect on the opinion of its expert, Professor Bullard, establishing a violation of the *actos propios* doctrine requires the establishment of three elements:
- First, the entity must have engaged in "binding conduct;" that is, in actions that induced reasonable reliance by another.
 - Second, the entity must have engaged in subsequent conduct that contradicts or undermines its prior unequivocal message.
 - Third, the entity engaging in the subsequent, allegedly contradictory conduct must be the same party that engaged in the actions generating reasonable reliance.
238. In other words, asserts Respondent, entity A's conduct ordinarily cannot bind entity B. The actions of a state-owned entity acting in the limited capacity of corporate shareholder (*acta jure gestioni*), for example, cannot bind the subsequent actions of a different State agency acting in a sovereign capacity (*ius imperium*).
239. In reply to Claimant's reliance on international law, Respondent contends that international law applies to Claimant's claims in only two circumstances: (i) when there is a gap in Peruvian law; and (ii) when there is a serious inconsistency between Peruvian law and international law, such that application of Peruvian law would itself violate international law.
240. In the present case, argues Respondent, the parties both agree that the matter at issue is addressed by the Peruvian doctrine of *actos propios*; there is, therefore, no gap in the applicable domestic law. Moreover, asserts Respondent, Claimant has not even attempted to suggest how the *actos propios* doctrine, or indeed the Peruvian law on good faith, might conflict with international law. Accordingly, Claimant's passing reference to international law on good faith must be disregarded.

c) Tribunal's Analysis

241. The DEI Bermuda LSA, as a legal instrument, is not a creature purely of domestic Peruvian law. As established earlier, in its discussion of applicable law, the Tribunal is of the view that principles of international law must be given effect in determining the extent to which the division of the State into separate entities and agencies can insulate the State from liability for certain actions and representations. More specifically, in interpreting the meaning of the doctrine of *actos propios* (or estoppel)²³ for the LSA context, the Tribunal must take into account the perspective of a reasonable foreign investor, perceiving, observing and interacting with the Government of Peru, the host State.
242. To this extent, the Tribunal agrees with Claimant. Claimant goes too far, however, in asserting that principles of State responsibility should apply, for purposes of estoppel, in attributing conduct of various State bodies or agencies to the State as a whole. The Tribunal rejects this aspect of Claimant's argument because there is an important and material distinction between, on the one hand, estoppel *vis-à-vis* the State created by acts or statements of its organs and, on the other hand, State responsibility for internationally wrongful acts of its organs.
243. In the context of State responsibility, the analysis begins with a breach of international law, and the subsequent inquiry focuses on whether that breach – the internationally wrongful act – can be attributed to the State as a whole. In the context of estoppel, any determination of “wrongdoing” – if that is the correct concept – is the end point of the inquiry. The analysis begins with a review of the acts and statements of the State's various organs and officials, all of which may very well be independently lawful. The conclusion of wrongdoing depends on the intricate dynamic, over time, between the State actors and the third party.

²³ The Tribunal uses the term estoppel here as a shorthand for the general concept, which exists both in the doctrine of *actos propios* and under international law, that a party is prohibited from taking actions or making representations that contradict what it has done or said before.

244. Under international customary law on State responsibility, the conduct of an organ of a State or of a person or entity empowered to exercise elements of governmental authority are considered an act of the State if the organ, person or entity acts in that capacity, even if it exceeds its authority or contravenes instructions. In such a case, if the person or entity was vested with *any* form of public authority, the State is liable for its actions, irrespective of its rank within the State hierarchy, whether it acted within the scope of its competence, or whether it induced reliance by the victim of the act based on the capacity in which it was acting.
245. Estoppel is different. Estoppel does not necessarily involve, *a priori*, any wrongful behaviour that causes damage. Instead, estoppel involves conduct that induces reliance by a third party as to the State's position on a particular subject, irrespective of whether that conduct is legal or not.
246. In the case of State responsibility, the State assumes the risk for the wrongful acts committed by its organs and officials. In the context 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.
247. The decisive element for estoppel is the *reasonable appearance* that the representation binds the State. In this regard, 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.
248. Accordingly, for purposes of estoppel, the Tribunal does not find helpful the principles on State attribution in the ILC's Articles on State Responsibility. Rather, the Tribunal draws inspiration, by analogy, from the test that applies in international law to determine whether a treaty is binding even though it was signed in violation of a country's internal

law. For the Tribunal, this test is helpful in understanding the test that should apply to determine whether a representation should be binding on the State, even though it has been made in violation of the country's internal law. The relevant test is set out in Article 46 of the Vienna Convention on the Law of Treaties:

Article 46. Provisions of internal law regarding competence to conclude treaties

1. A State may not invoke the fact that its consent to be bound by a treaty has been expressed in violation of a provision of its internal law regarding competence to conclude treaties as invalidating its consent unless that violation was manifest and concerned a rule of its internal law of fundamental importance.
2. A violation is manifest if it would be objectively evident to any State conducting itself in the matter in accordance with normal practice and in good faith.

249. Following this line of reasoning, for the conduct or representation of a State entity to be invoked as grounds for estoppel, it must be *unequivocal*, that is to say, it must be the result of an action or conduct that, *in accordance with normal practice and good faith*, is perceived by third parties as an expression of the State's position, and as being incompatible with the possibility of being contradicted in the future.

250. The *competence* of the State entity or official is also significant in this context. It is logical that this aspect is irrelevant within the regime of State responsibility, because what is essential there is the wrongful act (the breach of international law) committed by an organ or person acting under the aegis of the State. By contrast, it is difficult for an organ or official who manifestly lacks competence to be able to induce reasonable reliance in a third party, such as the foreign investor.

251. This analysis only takes the matter so far. In the end, everything depends on the particular circumstances surrounding the actions or statements at the heart of the estoppel allegations. These are studied more carefully by the Tribunal, for each of the

Depreciation Assessment and Merger Revaluation Assessment, in the Liability Section, below.

3. Other Guarantees

a) Non-Discrimination

252. The Peruvian Government's commitment of non-discrimination is set forth in Clause Three, Section 5 of the DEI Bermuda LSA, which states as follows:

THREE- By virtue of this Agreement and as long as it remains in effect, in connection with the investment referred to in CLAUSE TWO, the STATE guarantees legal stability for DUKE ENERGY INTERNATIONAL, according to the following terms:

[...]

5. Stability of the right to non-discrimination as stipulated in subsection c) of article 10 of Legislative Decree No. 662, which implies that the State at none of its levels, whether entities or companies of the Central Government, or Regional or Local Governments, may apply to DUKE ENERGY INTERNATIONAL a different treatment by virtue of its nationality, the sectors or types of economic activity in which it engages, or the geographic location of the company in which it invests, or in the following matters:

a) Foreign exchange, such that with respect to the investment referred to in CLAUSE TWO, the STATE may not apply to DUKE ENERGY INTERNATIONAL a currency exchange regime that entails a less favorable treatment than the one applied to any individual or legal entity in the execution of any type of foreign exchange transaction.

- b) Prices, tariffs or non-customs duties, such that the STATE may not apply differential amounts or rates to DUKE INTERNATIONAL ENERGY with respect to the investment referred to in CLAUSE TWO.
- c) The form of corporate organization, such that the STATE may not require that DUKE ENERGY INTERNATIONAL organizes DUKE ENERGY INTERNATIONAL PERU HOLDINGS, S.R.L., in which it is going to invest, as a certain type of company;
- d) its status as an individual or legal entity, such that the STATE, may not apply differentiated treatment to DUKE ENERGY INTERNATIONAL because of this status; and,
- e) Any other cause with equivalent effects, such as may be arise from application of discriminatory treatment to DUKE ENERGY INTERNATIONAL resulting from any combination of the various paragraphs of this section.

(Emphasis added)

- 253. There is no parallel non-discrimination protection in the Egenor LSA.
- 254. Claimant relies on several additional provisions to define the scope of the non-discrimination guarantee, namely Articles 2 and 10(c) of the Foreign Investment Act.
- 255. Article 10(c) of the Foreign Investment Law, specifically referenced in the DEI Bermuda LSA, guarantees the foreign investor “stability of the non-discrimination rights contemplated in Article 2 hereof.” In turn, Article 2 of the Foreign Investment Law establishes the general principle of equal treatment between foreign and national investors, and clarifies, according to Claimant, that the non-discrimination protection

granted to the foreign investor includes actions taken against the local company in which a foreign investor participates:

Article 2.- Foreign investors and the companies in which these participate have the same rights and obligations as the local investors and companies. Such rights and obligations are only limited by the exceptions established in the Political Constitution of Peru and the provisions hereof.

In no case the domestic juridical regulations will discriminate among investors or the companies based on the local or foreign share in the investments.

(Emphasis added)

256. According to Claimant, Article 2 of the Foreign Investment Law makes it clear that both DEI Bermuda and DEI Egenor (*i.e.*, “the company in which DEI Bermuda participates”) have the right to equal treatment on the same terms as those granted to a national investor and recipient company. Equally clear, however, says Claimant, is the fact that only DEI Bermuda can assert a claim under the DEI Bermuda LSA for action that falls short of this standard, regardless of whether that discriminatory action is taken against the foreign investor or the company in which it invests.
257. Claimant submits that the prohibition on discrimination based upon “any other cause with equivalent effects” (Clause Three, Section 5(e) of the DEI Bermuda LSA) is effectively synonymous with the Peruvian Constitution’s prohibition on differential treatment based on any unjustified reason.
258. Finally, Claimant asserts that the principle of non-discrimination under Peruvian law, as under international law, implies that differential treatment be judged against the context of those entities or individuals who are in the same situation. Thus, without a valid justification, the Government of Peru was prohibited from treating DEI Egenor differently from other similarly situated companies.

259. There is no disagreement on the part of Respondent on the scope of the protection that these provisions afford Claimant, and the Tribunal accordingly endorses Claimant's description of its scope. Where the parties differ is on the question of whether the tax assessment – and the Merger Revaluation Assessment in particular – was discriminatory. The parties' respective arguments on this issue are presented in the Liability Section below, at Section V.B.4.

b) Free Remittance of Capital

i) Relevant Provisions of the DEI Bermuda LSA

260. In Clause Three, Section 3 of the DEI Bermuda LSA, the Peruvian Government guaranteed free remittance of capital in the following terms:

THREE – By virtue of this Agreement, the **STATE**, and as long as it remains in effect, in connection with the investment referred in **CLAUSE TWO**, the **STATE** guarantees legal stability for **DUKE ENERGY INTERNATIONAL** according to the following terms:

[. . .]

3. Stability of the right to freely remit its dividends and capitals pursuant to Article 10(b) of Legislative Decree No. 662, which implies that **DUKE ENERGY INTERNATIONAL** may transfer abroad in freely convertible currency, without requiring prior authorization from any entity of the Central, Regional or Local Government as long as the investment was registered before the Competent National Organism and all corresponding tax obligations have been complied with, and without the **STATE** being allowed any restriction or limitation to this right, the following:

a) All its capitals brought from abroad, including the capital from the transfer of its shares, interests or rights over companies, of the reduction of the capital equity

and partial or total liquidation, which come from the investment referred to in CLAUSE TWO;

- b) All the dividends and the actually obtained net profits obtained from the investment referred to in CLAUSE TWO, as well as the profits obtained as consideration for the use and enjoy of the assets physically located in the country used for such investment; and
- c) All the royalties and considerations for the use and transfer of technology; trademarks and patents; and any other industrial property element authorized by the Competent National Organism.

ii) Claimant's Position

261. According to Claimant, the protection contained in Clause Three, Section 3 of the DEI Bermuda LSA must be viewed as consisting of two distinct and yet related aspects: (i) the right to remit freely the total amount of the profits generated by DEI Egenor, or to repatriate freely the investment without any regulatory restrictions or approvals; and (ii) (a *sine qua non* of (i)) the underlying ownership interest in the distribution of profits available to the investor or repatriation of the investment itself.
262. Moreover, Claimant contends that the reference to Duke Energy's compliance with all corresponding tax obligations does not vitiate its right of free remittance or its underlying ownership right. To the contrary, Claimant submits that it underscores the Government's breach of these rights, because the right to free remittance is predicated on the requirement of the payment of *legitimate* taxes.
263. Claimant submits that SUNAT's multi-million dollar assessments were unlawful, discriminatory and confiscatory; thus, they impaired Duke Energy's right of free remittance of the *full* amount of its profits.

iii) Respondent's Position

264. Respondent submits that Claimant's "imaginative interpretation" of Article Three, Section 3 of the DEI Bermuda LSA is unsustainable. At paragraph 202 of its Counter-Memorial, Respondent writes:

according to Claimant, the right to free transfers includes not only the right to be free from impediments to transfers but the right to be free of any measure that would have the effect of "illegitimately" or "unreasonably" reducing the amount of capital available to transfer. Claimant's interpretation is without merit and, in the absence of any real evidence that Peru has restricted Claimant's right to transfer, must be rejected.

265. Moreover, Respondent notes that the right to remit dividends and capital is expressly conditional in the relevant provision of the LSA on compliance with the tax laws.

iv) Tribunal's Analysis

266. The Tribunal agrees with Respondent's interpretation of the guarantee of free remittance under the DEI Bermuda LSA. The guarantee of free remittance does not indirectly guarantee tax stabilization or non-discrimination to Claimant. Indeed, under the structure of the DEI Bermuda LSA, the free-remittance guarantee need not accomplish any more than it expressly sets out to do, as tax stabilization and non-discrimination are specifically provided for under separate guarantees.

c) Independent Guarantees under International Law

i) Claimant's Position

267. In the earlier section of this Award addressing applicable law, the Tribunal already described Claimant's argument that international law in this case establishes certain independent and autonomous rights for Claimant. More specifically, Claimant submits that the Tribunal should apply relevant guarantees and protections found in customary international law and general principles of law.

268. Claimant relies on the jurisprudence of investor-state arbitration tribunals, and the views of international law scholars such as Professor Dolzer (one of Claimant's experts), to argue that the requirement of fair and equitable treatment of an investment by a host State is widely recognized as forming part of the customary standard of treatment under international law. Claimant submits that the jurisprudence of investor-state arbitration tribunals confirms that bad faith is not a requirement of the standard. And even if it is, according to Claimant, the evidence demonstrates that the bad faith requirement is satisfied in the instant case.
269. Claimant submits that there is no distinction between the fair and equitable treatment standard and the minimum standard of treatment under customary international law with regard, in particular, to the legitimate expectations of predictability, stability and transparency.
270. The minimum standard of protection requires a host state to: (1) act in good faith, with transparency and protection of legitimate expectations; (2) provide a stable and predictable legal framework for foreign investment; and (3) refrain from arbitrary conduct.
271. Claimant submits that Respondent breached the minimum standard of treatment by (1) failing to meet Duke Energy's legitimate expectations of a stable and predictable legal framework for its investment and (2) failing to refrain from arbitrary conduct.
272. Claimant also relies on "general principles of law" and in particular on the principles of good faith and estoppel. In his expert written opinion, supported by his testimony before the Tribunal, Prof. Rudolf Dolzer wrote (at para. 66):

In case an investor relies upon such statements in making an investment in the host country, in case the host country subsequently acts inconsistently with its earlier position, and in case the investor turns out to be disadvantaged by its reliance on this earlier position, the principles of good faith and of estoppel will coalesce and form the basis of a rule according to which a host state incurs liability under the general rules of

international law under such circumstances of a broken promise of the host state.

273. According to Claimant, again relying on the opinion of Professor Dolzer, general principles of law are, in the first place, sources of international law addressing the relationship between States, but they also apply between host States and the foreign investor.

ii) Respondent's Position

274. Respondent submits that Claimant may not raise independent claims under international law in this case; here international law may only fill gaps or correct shortcomings in domestic law. Even if international law were applicable as the basis for a claim, the only relevant law that would apply would be customary international law, says Respondent, because there is no applicable investment treaty.

275. Respondent adds that the arbitral awards that Claimant and its experts have cited do not establish that fair and equitable treatment is part of customary international law. In fact, nearly all of the passages cited by Claimant explicitly involve interpretation of specific *treaty* provisions requiring “fair and equitable treatment,” rather than pronouncements on the content of *customary international law*.

276. Respondent submits that Claimant fails to acknowledge that the very existence and content of the minimum standard of treatment is highly disputed. Respondent notes that a number of arbitral tribunals have found that the international minimum standard can only be violated through a showing of “bad faith” or other “egregious conduct” by the host state.

277. Respondent notes that various countries, notably the United States and Canada, deny the existence of a customary international law rule protecting investors’ “settled” or “legitimate” expectations, or prohibiting “arbitrary” conduct.

278. Respondent submits that Claimant’s argument under international law is defeated solely by the existence of debate and disputes among key states on those very questions. That

Claimant's home State (the U.S.A.) — the predominant capital-exporting State of the past century — does not consider customary international law to include the component principles invoked by Claimant demonstrates, according to Respondent, that the consistent state practice and *opinio juris* needed for a customary international rule do not exist.

279. Furthermore, Respondent submits that, even if the Tribunal were to find that the fair and equitable treatment standard applied in this case, there could be no breach:

- the determination of a breach of the fair and equitable treatment must be made in the light of the high measure of deference international law generally extends to the right of domestic authorities to regulate matters within their own borders;
- the threshold for finding a violation is high; and
- the minimum standard of treatment is applied with particular restraint when the action challenged relates to a definitive interpretation of the law of the host State by an administrative or judicial tribunal.

iii) Tribunal's Analysis

280. The Tribunal is of the view that it does not need to address the thorny issue of the content of the minimum standard of treatment. Even if the Tribunal held that the minimum standard did contain the elements that Claimant has advocated it did, the Tribunal's conclusion would add little to the outcome of this arbitration. As explained by the Tribunal earlier, this is due to the fact that the elements that Claimant has argued are part of the international law principles that should be implied as independent guarantees into the DEI Bermuda LSA overlap entirely, in the Tribunal's view, with the protections provided to Claimant under the DEI Bermuda LSA as interpreted under Article 42(1) of the ICSID Convention.

V. LIABILITY

A. THE DEPRECIATION ASSESSMENT

1. Background

281. The Depreciation Assessment was based on SUNAT's view that Egenor should have depreciated the assets that Electroperú had transferred to it during the privatization process using the special decelerated rate that had been granted to Electroperú by SUNAT in December 1995, rather than the general statutory rate set forth in the Income Tax Regulations.
282. SUNAT based the Depreciation Assessment on Chapter XIII of Legislative Decree No. 774 (the Income Tax Law that came into effect on January 1, 1994). Article 105 thereof refers to the so-called continuity rule as follows: "The depreciable value and useful life of assets transferred due to corporate reorganization shall be those which would have corresponded to be applied by the transferor."
283. SUNAT maintained that Egenor was constituted as a result of Electroperú's reorganization (in the form of a "division") and, therefore, pursuant to Articles 103 and 105 of the Income Tax Law, should have applied the same depreciation rates granted to Electroperú.
284. On December 21, 2001, Egenor filed an administrative challenge against the Depreciation Assessment, which was rejected in September 2002. On September 23, 2002, Egenor submitted an appeal before the Tax Court.
285. The Tax Court found that Chapter XIII of Legislative Decree No. 774 was inapplicable as its entry into force was conditioned, pursuant to its Article 106, on the issuance of implementing regulations, which had not been passed. It held that the continuity rule was nonetheless applicable, as it had been embraced by legal doctrine, a source of Tax Law pursuant to Rule III of the Peruvian Tax Code. The Tax Court concluded that since Egenor had received a block of property that made up an economic unit, in order to allow it to continue with the activity for which it was used by the transferor (Electroperú), the

transferred assets should have been depreciated for the rest of the useful life that they had in the hands of the transferor.

286. In this regard, the Tax Court affirmed: “The assets received by EGENOR should have maintained the same useful life and, consequently, the same percentages that ELECTROPERÚ S.A. had before the reorganization, for purposes of calculating the depreciation. For that reason it befits to maintain in this case the assessment by [SUNAT] to the transfer of assets made by ELECTROPERÚ S.A. for tax year 1996.”
287. However, the Tax Court partially reversed SUNAT’s assessment by ruling that Egenor was obliged to apply the special depreciation rate granted to Electroperú only to those assets transferred to it after the special rate was issued –December 28, 1995. On July 27, 2004, SUNAT issued a revised tax assessment against Egenor, pursuant to the Tax Court’s finding. On August 27, 2004, Egenor applied for amnesty in respect of the Depreciation Assessment.

2. Breach of Tax Stabilization Guarantee?

a) Claimant’s Position

288. Claimant submits that the depreciation rate that was stabilized for Egenor under the Egenor LSA on July 24, 1996 was the general statutory rate and not the special rate. Claimant’s position is based on two fundamental points:
- at the time of the transfer of assets from Electroperú to Egenor, no enforceable legal provision established the so-called continuity rule, according to which Egenor would have been obliged to apply the same depreciation rate authorized for Electroperú; and
 - in any event, the transfer of assets to Egenor was a “capital contribution”, not a corporate reorganization in the form of a “division”.

i) The Continuity Rule

289. Claimant submits that while Article 105 of Chapter XIII of the Income Tax Law – prior to its 1998 amendment – provided for the application of the continuity rule to asset transfers resulting from corporate reorganizations, Article 106 limited the concept of “reorganization” to corporate mergers and divisions, whose precise meaning was to be provided by the implementing regulations.²⁴ However, those implementing regulations had not been issued at the time of the transfer of assets from Electroperú to Egenor and, hence, according to Claimant, Chapter XIII of the Income Tax Law was not enforceable.
290. The continuity rule not being in force at the relevant time, Claimant asserts that Egenor was legally compelled to apply the general depreciation rate specified in Article 22(b) of the Income Tax Regulations, as it effectively did. Thus, the stabilized depreciation rate under the Egenor LSA and, therefore, under the DEI Bermuda LSA, was the general rather than the special one. According to Claimant, by insisting that Egenor should have applied the special depreciation rate, Respondent breached the DEI Bermuda LSA.

ii) Capital Contribution vs. Corporate Reorganization

291. Claimant maintains that, even if the continuity rule were applicable, SUNAT could not apply it to Egenor because the assets were not transferred from Electroperú to Egenor as part of a “corporate reorganization” (as required by the continuity rule), but rather as a capital contribution.
292. At the time of the transfer of assets from Electroperú to Egenor, there was no particular definition of a corporate “division” for tax purposes. In that context, submits Claimant, the concept of “division” should be the one applied in corporate law.
293. According to Claimant, the defining elements of a “division” are reflected in Law No. 26887, the new General Law on Corporations which came into force as of January 1, 1998. Relying on Professor Avendaño, Claimant explains that Law No. 26887 reflected

²⁴ Article 106 of the Income Tax Law provided as follows: “*The reorganization of corporations or companies is configured only in cases of mergers and divisions of same, with the limitations and in accordance with the provisions set forth in the regulations*” (Emphasis added).

the general understanding on what constitutes a division existing in Perú before such statute entered into effect. According to Article 367 of Law No. 26887:

In a spin-off, a company divides its capital into two or more blocks to transfer them completely to other companies or to keep one of them, satisfying the requirements and formalities set forth by this law. It may take one of the following forms:

1. The division of the whole capital of a company into two or more patrimonial blocks, which are then transferred to new companies or are absorbed by preexisting companies or both at the same time. This kind of spin-off causes the termination of the original company, or
2. The separation of one or more patrimonial blocks of a company that is not terminated and that transfers them to one or more new companies, or that are absorbed by preexisting companies or both at the same time. The original company adjusts its capital to the corresponding amount.

In both cases, the partners or shareholders of the original company receive shares or quotas as shareholders or partners of the new companies or, should that be the case, of the absorbing companies.

(Emphasis added)

294. In short, Claimant submits that in a division, (i) once the assets are transferred to the new company, the original company reduces its capital in the amount of the value of the transferred assets and (ii) the shareholders in the original corporation receive shares in the new corporation.
295. According to Claimant, Electroperú's reorganization did not comply with either of these two elements. First, the transfer of assets from Electroperú to Egenor was not followed by a capital reduction by the former. Second, Electroperú, not its shareholders, received shares of Egenor.

296. Further elements, asserts Claimant, confirm that the incorporation of Egenor was not the result of Electroperú's division. For example, the transfer of assets to Egenor did not take place in a single act, as would normally happen in a division, but through a series of acts. Egenor received contributions from four different companies – Electroperú, Electronorte S.A, Electronoroeste S.A. and Electrolima – and returned some of those assets to Electroperú.
297. Thus, according to Claimant, Electroperú's reorganization cannot be qualified as a "division" to which the continuity rule would have been applicable under Articles 105 and 106 of Legislative Decree No. 774 – assuming such rule contained in Chapter XIII of the Income Tax Law was in full force and effect. Claimant submits that this confirms that it was the general statutory rate rather than the special rate authorized for Electroperú that was stabilized under the Egenor LSA and, therefore, under the DEI Bermuda LSA.

b) Respondent's Position

298. Respondent submits that the depreciation rate that had been stabilized for Egenor under the Egenor LSA was the special rate, not the general statutory rate. Respondent presents the following principal arguments to support its position:
- Even if the continuity rule was not codified in 1996, it was clearly established in legal doctrine, which is recognized as a source of tax law in Peru.
 - Prior to the issuance of Chapter XIII of the Income Tax Law, Legislative Decree No. 200 provided for the continuity rule.
 - The transfer of assets from Electroperú to Egenor constituted a transfer of economic units – not of independent units – under the so-called permanent regime established by Chapter XIII of the Income Tax Law. The depreciation rate established under Article 22(b) of the Income Tax Regulations can apply to the transfer of independent units only.
 - In order to carry out the privatization process, Electroperú reorganized its activities and assets into several companies. Even though, as Claimant argues, the

incorporation of Egenor was the result of several capital contributions, those capital contributions took place in the context of Electroperú's reorganization pursuant to Decree No. 674 and Legislative Decree No. 782.

- The General Law on Corporations in force at the time the Egenor LSA was executed (Supreme Decree No. 003-85-JUS) did not contain a definition of "division." In the Tax Court's decision on Egenor's challenge to the Depreciation Assessment, it held as follows regarding the concept of "division":

(...) during the effective term of the Single Uniform Text of the General Business Corporations Law, approved by Supreme Decree No. 003-85-JUS, which is applicable to this case, it was not possible to interpret the term "split-up" [división] or the verb "to split up" [dividir] just as synonyms of the term "spin-off" [escisión] and the verb "to spin off" [escindir], respectively, and rather a new, broader, meaning had to be adopted and extended both to the act of splitting up the activities of a company of enterprise, even if that could not be interpreted as a spin-off or split-up, strictly speaking, in corporate terms, but always in the context of the reorganization of a company or enterprise.²⁵

c) Tribunal's Analysis

299. The Tribunal begins by observing that both the general statutory rate and the special decelerated rate were part of the tax regime in place at the time the Egenor LSA was executed. The real question for the Tribunal is to determine which particular rate should have been applied by Egenor to the assets that Electroperú transferred to it, as a matter of Peruvian tax law.
300. The Tribunal has already decided that it does not have the jurisdiction to rule on the correctness of particular interpretations of Peruvian tax law. This is therefore an instance

²⁵ Exhibit C-119 (Tax Court Resolution No. 02538-1-2004).

in which the Tribunal must simply determine whether the Depreciation Assessment was based on a patently unreasonable or arbitrary interpretation of the tax rules. For the reasons explained below, the Tribunal concludes that it was not.

301. The Tribunal turns first to the issue of continuity. While it is true that the Tax Court decision of April 23, 2004 (Resolution No. 02538-1-2004) questioned the validity of Chapter XIII of the Tax Law prior to 1998, it nevertheless confirmed that the principle of continuity was part of the tax regime (as legal doctrine) at the time that Electroperú transferred assets to Egenor, and on the date of the Egenor LSA.
302. The Tribunal does not consider the Tax Court's decision unreasonable. It is reasonable that depreciation over the useful life of assets should not be changed by the mere fact that ownership thereof has been transferred, if the assets are used in the same way. Depreciation is linked to the depreciating asset and its economic use rather than to the identity of its owner. It is not illogical or arbitrary that the rate should be determined *intuitu rei* and not *intuitu personae*.
303. Nor does the Tribunal consider that the Tax Court's decision violates the principle of legality, given the particular circumstances in which it applied legal doctrine to fill the gap left by the assumed inapplicability of Chapter XIII of the Tax Law. Notably, it appears to the Tribunal that had the Tax Court not relied on legal doctrine in order to ground the existence of the continuity rule, it could have done so on the basis of other sources of Peruvian tax law. For example, the Tax Court cited in its decision, among other arguments supporting the validity of Chapter XIII, a decision of the Constitutional-Social Division of the Supreme Court which had upheld the validity of a law (Law Decree No. 25764) even though its implementing regulations had not been adopted.²⁶
304. Indeed, having carefully read Articles 105 and 106 of Chapter XIII, the Tribunal is not convinced that the conclusion that Chapter XIII was not in force or inapplicable due to

²⁶ Details about this decision, dated November 28, 2001, were provided in the Second Expert Report of Dr. Luis Hernández Berenguel dated March 21, 2007, at paragraph 73.

the absence of “implementing regulations” is sound. Articles 105 and 106 read as follows:

Article 105.- The depreciable value and useful life of assets transferred in a company reorganization will be those that would have applied when they were in the possession of the transferor.

Article 106.- The reorganization of companies or corporations occurs only in cases of merger and division, with limitations, and in accordance with the stipulations stated in the regulations.

Arguably, Article 106 affords the executive branch the opportunity to define limitations applicable to the concept of merger or division through regulation, but does not require such regulations for the general concepts to apply. In this respect, the Tribunal notes that the wording of Article 106 of Chapter XIII can be distinguished from more explicit language in other Peruvian legislation that makes it clear that a tax measure is necessarily contingent on the promulgation of regulations. For example, Article 2 of Decree Law No. 26009 provided that the applicability of a benefit in relation to the Consumption Selective Tax would be exclusively contingent upon its regulations.²⁷ In contrast, the text of Article 106 does not expressly condition the entry into force of that provision, or any other article of Chapter XIII, on the promulgation of regulations.

305. The Tribunal also notes that the evidence of Professor Talledo, one of Claimant’s experts on Peruvian tax law, to the effect that the continuity rule set out in Chapter XIII of the Income Tax Law could not have been in effect due to the absence of implementing regulations,²⁸ seems to contradict earlier opinions given by Professor Talledo himself concerning analogous provisions, namely Chapter XIV of the Decree Law No. 25751.²⁹
306. The Tribunal now turns to the issue of “corporate reorganization”. Prior to the Egenor case, in its Decision No. 594-2-2001 dated May 25, 2001, the Tax Court had held that the

²⁷ SUNAT Memorandum No. 370-2001-K00000, July 12, 2001 (emphasis added) (Exhibit R-079).

²⁸ See Report of Prof. César Talledo dated December 20, 2006 at para. 5.

²⁹ See Second Expert Report of Dr. Luis Hernández Berenguel dated March 21, 2007 at paras. 74–79.

concept of corporate reorganization in tax law is a matter of substance and not of form. In that case, the Tax Court found that the term “division” or “spin-off” under Supreme Decree No. 003-85-JUS of 1985,³⁰ the predecessor to the General Corporations Law, was understood as including the act of dividing the activity of a corporation, in the context of a corporate reorganization, even if a formal spin-off was not carried out.³¹ The Tax Court found that the assets transferred by a state-owned company to an acquiring company in the context of a privatization, pursuant to Legislative Decree No. 674, amounted to a “division” in the context of a corporate reorganization. Consequently, the acquiring company had to continue depreciating those assets in accordance with the useful life and cost basis that the state-owned company had applied to the assets prior to their transfer. The Tax Court in the *Egenor* case cited that earlier decision and noted that, in accordance with the interpretation of the term “division”, Egenor had to continue depreciating the assets using the same useful life that those assets had at the time Electroperú transferred them.³²

307. Of course, it is possible to interpret these provisions in a different way, concluding that the concept of corporate reorganization should be applied identically for tax purposes and for corporate purposes. That does not mean, however, that the decision of the Tax Court or the Depreciation Assessment itself were so unreasonable that they constitute a violation of the guarantee of tax stabilization. It is not unreasonable, in the Tribunal’s view, that depreciation over the useful life of assets should not be modified by the mere change of ownership, provided that the economic use and nature of the assets remain the same. That was the case with the assets transferred by Electroperú to Egenor.

3. Breach of Good Faith (Doctrine of *Actos Propios*)?

a) Claimant’s Position

308. Claimant alleges that the Government of Peru:

³⁰ See Supreme Decree No. 003-85-JUS, January 14, 1985 (Exhibit R-204).

³¹ Tax Court Resolution No. 594-2-2001, May 25, 2001, at 2 (Exhibit R-134).

³² Tax Court Resolution No. 2538-1-2004, April 23, 2004, at 5 (Exhibit R-146).

- mandated the application of the statutory depreciation rate to Egenor’s assets;
 - confirmed that the general statutory depreciation rate was stabilized for Egenor during negotiations with Duke Energy;
 - ratified Egenor’s application of the general statutory depreciation rate through Electroperú’s shareholder vote;
 - failed to mention any possibility of forthcoming or latent tax liability during negotiations with Duke Energy;
 - commanded a higher price from Duke Energy by representing Egenor as a company in which the statutory depreciation rate was stabilized; and
 - benefited financially from Egenor’s application of the statutory depreciation rate.
309. Claimant submits that, in light of these actions and statements, on which Duke Energy relied, the Depreciation Assessment constitutes a breach of good faith.
310. Claimant submits that the Government cannot avoid the consequences of its inconsistent conduct based on the principle of separation of powers, as Respondent suggests. SUNAT, COPRI, CONADE, CEPRI-ELP and the Ministry of Energy and Mines are all interrelated Government agencies. As such, *vis-à-vis* the investor, they are indivisible, and in the eyes of the foreign investor, their actions must be deemed synonymous.
311. With respect to CEPRI-ELP, Claimant argues that:
- CEPRI-ELP, the sole Governmental entity authorized to address potential bidders on behalf of the State, was fully capable of making binding pronouncements on tax matters, and furthermore, it had the right to seek advice from SUNAT.
 - Specifically in the context of the privatization of Egenor, CEPRI-ELP was the “sole voice” of the Government and its pronouncements, e.g., Circular 15, became a binding part of the Privatization Agreement pursuant to the mandates of the Bidding Rules.

312. According to Claimant, CEPRI-ELP confirmed in Circular 15 that the general statutory depreciation rates contained in the Income Tax Legislation were the ones that would be applicable to Egenor's assets, thus excluding application of the Special Rate.
313. At the time CEPRI-ELP issued Circular 15, according to Claimant, there is no evidence to suggest that any potential buyer interested in acquiring the 60 Percent Tranche of Egenor was even aware that a Special Rate for Electroperú's assets had been requested or issued, much less that CEPRI-ELP intended it to apply to the assets of Egenor.
314. Claimant notes that, in fact, the question asked of CEPRI-ELP in Circular 15 is whether the statutory depreciation rate or *an even more accelerated rate* would apply to Egenor's assets. In other words, (a) the investor submitting the questions did not even hint at a special decelerated rate; and (b) CEPRI-ELP's answer must be judged in response to two variables (the statutory rate or an even more accelerated rate), neither of which envisages a special decelerated rate.

b) Respondent's Position

315. Respondent submits that, under Peruvian law, Egenor was required to continue applying the same depreciation rate to the assets it received from Electroperú as Electroperú had applied to those assets before they were transferred, and that bidders were assumed to know the laws and regulations applicable in Peru.
316. According to Respondent, CEPRI-ELP's Circular 15 "refers the bidder to the Income Tax regulations in order for the bidder itself—based on its own analysis and knowledge of these regulations—to determine the corresponding rate, pursuant to those regulations." Respondent submits that CEPRI-ELP did not – and could not have specified – which depreciation rates applied to Egenor under the Income Tax Rules.
317. Respondent also points to the written opinion provided to Egenor on September 25, 1996 (within a few months of its privatization) by the law firm Luna Victoria – Vásquez & Asociados. The opinion advised Egenor that, pursuant to the Income Tax Law and Supreme Decree 122-94-EF, the special rate "can and must be applied by EGENOR."

318. Respondent has filed witness statements from the various Government officials who, according to Claimant, provided assurances to Duke Energy in late 1999 about the Depreciation Rate. These witnesses say that they never provided such assurances.
319. With respect to CEPRI-ELP, Respondent argues that CEPRI-ELP could not and did not instruct Electroperú to approve Egenor's financial statements. Article 9 of the Privatization Law did not grant CEPRI-ELP the authority to issue "directions and instructions" concerning Egenor outside the context of a privatization process. For CEPRI-ELP, the Egenor privatization process was limited to the sale of the 60 percent interest.

c) Tribunal's Analysis

320. As the Tribunal explained earlier, determining whether the Depreciation Assessment violated the implied duty of good faith or the doctrine of *actos propios* requires close scrutiny of the specific acts and statements that are alleged to have induced reasonable reliance on the part of Duke Energy. For the reasons explained below, the Tribunal concludes that Claimant has not met its burden of establishing that Respondent, through its agencies or officials, unequivocally committed to Egenor that it should apply the general statutory rate. In coming to this conclusion, the Tribunal pays particular attention to the contemporaneous signals that, at the very least, cautioned Dominion (and later Duke Energy) that the special decelerated rates should continue to apply.
321. The Tribunal bases its decision, in particular, on the following observations:
- the bidding rules for the 60 Percent Tranche were silent on the question of the applicable depreciation rate;
 - Circular 15 referred the bidder to the "Income Tax Legislation", but not to a particular depreciation rate;
 - the May 31, 1996 and June 30, 1996 Financial Statements of Egenor suggested that the decelerated rate was being used;

- by its letter dated June 10, 1996 to CEPRI-ELP, Dominion, through IDP, specifically inquired if Egenor had received a special depreciation rate from SUNAT. Although CEPRI-ELP never replied to IDP's inquiry, it is clear from this letter that Dominion, even after Circular 15 had been issued, was uncertain as to which depreciation rate should be applied;
- the letter Egenor sent to its advisors (Deloitte & Touche, and Luna Victoria-Vásquez) on September 9, 1996, acknowledged that Egenor was then applying the special depreciation rate, because it inquired whether Egenor could modify its depreciation rate to the general rate;
- although Egenor received conflicting advice from its advisors, the response Egenor received from Luna Victoria-Vásquez on September 25, 1996 stated that Egenor must apply the special rate granted to Electroperú in 1995 based on the continuity rule set out in Article 105 of the Income Tax Law;
- Egenor, instead, accepted the advice it received from Deloitte & Touche, to the effect that it should apply the general statutory rate, but never sent Deloitte & Touche's advice to Luna Victoria-Vásquez for their comments; and
- this record was available to Duke Energy in 1999 when it was carrying out its due diligence for the acquisition of the 60 Percent Tranche from Dominion, and the 30 Percent Tranche from the Government.

322. It was also demonstrated, during the cross-examination of Pastor Narron in particular, that – as a matter of fact – Circular 15 was not interpreted by Egenor as a clear direction from the Government as to what depreciation rate to apply. If anything, the wording of Circular 15, combined with Egenor's historical use of the special decelerated rate, created confusion. It did not induce comfort and reliance. If it had, such reliance would not have been reasonable.

323. The Tribunal therefore concludes that Claimant has failed to establish that it could reasonably rely on Circular 15 and the general approval of Egenor's Financial Statements

by Electroperú as a basis to challenge the Depreciation Assessment on the basis of good faith and the doctrine of *actos propios*.

B. THE MERGER REVALUATION ASSESSMENT

1. Background

324. In the Merger Revaluation Assessment, SUNAT determined that it was permitted, under Rule VIII, to assess companies it concluded had undertaken “simulated” (or “sham”) mergers in order to avail themselves of the Merger Revaluation Benefits. SUNAT concluded that the merger between Egenor and Power North did not constitute a “real economic transaction” and declared this transaction a “simulation”.³³
325. Useful background on Rule VIII was provided in the expert report of Prof. Shoschana Zusman dated September 29, 2006, submitted by Respondent. Professor Zusman notes, at paragraph 35, that “the requalification of acts of private parties by the tax administration and the application of the criterion of economic reality date back to the year 1968 when there was not yet a legal regulation on evasion.” She notes that provisions in successive Civil Codes of Peru “were considered sufficient to apply the criterion of reality and requalify evasive acts.” Professor Zusman then sets out the evolution of the actual text of Rule VIII in paragraphs 36 and 37:

36. After an evolution, the Tax Code approved through Decree-Law 816 dated April 21, 1996, included in Norm VIII a provision to fight evasion. Its text is as follows:

“When applying tax norms, all interpretation admitted
by Law may be used.

³³ The reference to the term “simulation” in this context should not be confused with the concept of simulation in civil law, where a transaction that is found to be simulated can be declared to be invalid and without legal effect. “Simulation” in the context of Rule VIII refers to the determination by SUNAT that a transaction – such as the merger – lacks economic reality. While such a determination by SUNAT deprives the transaction of its tax consequences, it does not affect the validity of the transaction for civil- or commercial law purposes. This was helpfully explained by Professor Talledo during Day 5 of the hearing (Hearing Transcript, May 14, 2007, at pp. 1286–87).

To determine the true nature of the taxable event, the National Tax Administration Superintendency (SUNAT) will deal with the business relations, situations and acts that are actually performed, pursued or established by tax debtors. When these submit those acts, situations or relations to legal forms or structures that are not expressly those offered or authorized by private law to configure properly the true actual business intention of the tax debtors, in considering the actual taxable event, we shall waive the adopted legal forms or structures and consider the actual business situation.

In the process of interpretation, no taxes may be created, no sanctions may be established, no exemptions may be granted and no tax provisions may be issued to be applied to entities or situations different from those specified in the law.”

37. Said text was valid until September 22, 1996, date when Law No. 26663 was issued, which eliminated the second section of the second paragraph of said law (hereinafter referred to as the Second Paragraph), in reference to the power of the Public Administration to do away with the practice of subjecting acts to forms that are not expressly provided by Private Law. The new text of Norm VIII was then worded as follows:

“When applying the tax norms, all interpretation methods admitted by Law may be used.

To determine the true nature of the taxable act, the National Tax Administration Superintendency (SUNAT) will deal with the business relations, situations and acts that are actually performed, pursued or established by tax debtors.

In the process of interpretation, no taxes may be created, no sanctions may be established, no exemptions may be granted and no tax provisions may be issued to be applied to entities or situations different from those specified in the law.”

326. In its decision in the Edegel case,³⁴ the Tax Court considered the amended text of Rule VIII. The Court concluded that the new text of Rule VIII preserved the requalification power of SUNAT, including the power to requalify simulated acts, even though the September 22, 1996 amendment (Law No. 26663) did away with requalification on the basis of legal fraud (*fraude a la ley*).

2. Breach of Tax Stabilization Guarantee?

a) Claimant’s Position

i) Rule VIII

327. Claimant argues that SUNAT gave Rule VIII a far broader reach than was legally permissible. The original text of Rule VIII allowed SUNAT to evaluate the purpose of a transaction in order to ascertain whether there was a fraudulent evasion of the tax laws (*fraude a la ley tributaria*). This original text, however, was explicitly repealed in 1996, long before the Merger Revaluation Assessment. Claimant contends that Rule VIII, as amended, does not authorize SUNAT to scrutinize the purpose of a merger.

328. Under the amended Rule VIII, according to Claimant, SUNAT is permitted to examine solely whether the economic substance of a business transaction (e.g., a merger) corresponds to that which is typical of the type of transaction at issue. SUNAT was allowed to make two inquiries regarding the merger in this case: (a) what are the typical economic features of a merger transaction; and (b) were those features present in this transaction. If SUNAT considered factors extraneous to those two inquiries, it arbitrarily exceeded its authority under Rule VIII, says Claimant.

³⁴ Case No. 4852/2003 dated September 8, 2004 (Exhibit C-115).

329. As such, according to Claimant, the Merger Revaluation Assessment constitutes an outright violation of the law and hence a breach of the tax stabilization guarantee under the DEI Bermuda LSA.

ii) The MRL

330. Claimant also argues that SUNAT deprived DEI Egenor of the benefits of the MRL, which was part of the Stabilized Tax Regime.

331. Claimant submits that both of Respondent's tax experts have concluded, albeit in writings outside of the context of this arbitration, that criteria identical to those considered by SUNAT (i.e., duration of existence of the companies, economic link between the companies, existence of previously carried out operations, magnitude of existing operations, etc.) were not required for a merger to be valid under the Merger Revaluation Law. In other words, the MRL did not prohibit the merger of "paper" companies. By invalidating the merger on the basis of the above-mentioned criteria, SUNAT breached the tax regime stabilized for Duke Energy's investment by: (a) effectively depriving DEI Egenor from being able to avail itself of the benefits of a stabilized law; and (b) changing the scope of a stabilized law by reading in additional requirements.

332. Claimant contends that the Merger Revaluation Law unconditionally provided tax exemptions for asset transfers "arising from merger or division agreements of any type of legal entity." On its face, there were no additional requirements or any specific directions relating to how companies should merge or divide. Similarly, Claimant argues, the regulations implementing the Merger Revaluation Law established no requirement or condition for applying the law that had to do with the objective of the companies that merged.

333. Consequently, Claimant asserts, all that was required in order for a merger to qualify for the benefits of the MRL was that the merger be a valid merger under Peruvian corporate law.

334. According to Claimant, at the time of the merger between Egenor and Power North in December 1996, the requirements for a valid merger were set forth in Articles 355, 356

and 358 of the General Law of Corporations. Under these provisions, a valid merger had to meet three substantive requirements: (i) the extinguishment of the legal status of the absorbed company; (ii) the transfer of capital in block and universally; and (iii) the delivery to the partners or shareholders of the absorbed company of shares or participations in the new company or in the absorber, as applicable.

335. These were the only requirements under Peruvian corporate law governing the validity of the merger between Egenor and Power North, and Claimant submits that each and every requirement was in fact satisfied.

iii) Motivations for Merger

336. Even if economic motivation were somehow relevant to the inquiry of whether the merger was simulated, Claimant contends that Peru has ignored numerous valid reasons underlying the merger, *inter alia*:

- To revalue the assets transferred by Electroperú to Egenor, which were not revalued by CEPRI-ELP pursuant to Legislative Decree 782.
- To maximize the value of Egenor, and hence the Government's shareholding, in order to comply with the Privatization Agreement. Clause 12.1 of the Privatization Agreement obligated Egenor, and hence Dominion, to take all necessary actions to assist the Government in the sale of its 30 percent shareholding in Egenor. The merger boosted the value of the company and thus the value of Electroperú's shares, thus fulfilling the objective of Clause 12.1 of the Privatization Agreement.
- To obtain the benefits of the Peruvian State's private investment laws. Tax incentives were key to investors' decisions to revalue their assets, and in fact, to invest in Peru in the first place.

b) Respondent's Position

i) Rule VIII

337. Respondent submits that SUNAT applied Rule VIII properly. According to Respondent, Rule VIII of the Preliminary Title of the Tax Code requires SUNAT to interpret and apply the tax laws in a manner that takes into account the economic substance of taxable events (including business transactions), and not merely their legal forms.
338. Although Rule VIII was not codified until 1996, Respondent asserts that its underlying principle had been a component of the Peruvian Civil Code for decades. Article 191 of the Civil Code, in particular, provides that the legal effects arising from a transaction lacking in economic substance (i.e., a “simulated” transaction) are to be disregarded if those effects harm the rights of third parties.
339. In response to Claimant’s description of Rule VIII as a “seldom-used provision” of the Peruvian Tax Law, Respondent states that SUNAT has applied, and the Tax Court has confirmed, the principle underlying Rule VIII in numerous cases spanning at least the last forty years. Moreover, Respondent notes, the Tax Court's recent decisions reviewing SUNAT’s application of Rule VIII likewise confirm that the underlying principle requiring transactions to have economic substance (as first reflected in Article 191 of the Civil Code and now set out in Rule VIII) continues to be applied.

ii) The MRL

340. Respondent argues that Claimant cannot shift the focus of its argument to the Merger Revaluation Law, because economic substance is required not only by Rule VIII but also by the Merger Revaluation Law itself. This is confirmed, Respondent submits, by (i) the structure and framework of the Merger Revaluation Law and (ii) the purposes for which the law was enacted:
- The structure and framework of the Merger Revaluation Law indicate that the State was willing to sacrifice tax revenues that it would otherwise receive in exchange for corporate mergers that would strengthen the companies undertaking such transactions.

- The purpose of the Merger Revaluation Law likewise confirms that the law was based on the underlying premise that companies would undertake a real merger in order to claim the tax benefits that it provided in exchange for reorganizing.

341. Respondent does not dispute that the Merger Revaluation Law had multiple objectives, including, as articulated by Claimant, to “improve the financial health of companies” through the revaluation of their assets. Respondent argues, however, that Claimant cannot escape the fact that “merger or division agreements” were the means through which the law's objectives – including those cited by Claimant – were to be achieved. Simply put, Respondent says, the 1996 merger did not satisfy the law's objective that the merger be a genuine reorganization involving real companies.

iii) Motivations for Merger

342. Respondent does not dispute Claimant's statement that Egenor wished to revalue its assets in order to “rectify the distortions in the balance sheets.” Respondent replies, however, that Claimant could have remedied this distortion in the value of its assets through a tax-free voluntary revaluation, as was permitted under Article 252 of Peru's General Law of Corporations (Ley General de Sociedades). Indeed, Respondent observes that this was the precise advice provided by both Luna Victoria-Vázquez and Deloitte & Touche to Egenor in September 1996 in response to its specific inquiry “[w]hether it is permissible to carry out the voluntary revaluation of the fixed assets.”

343. Respondent submits that Egenor, against the advice of its advisors, chose to avail itself of the Merger Revaluation Law through a simulated merger as a tax-driven alternative means to achieve its stated objective, doubtless because that option offered certain tax benefits that Article 252 did not.

c) Tribunal's Analysis

344. To determine whether the Merger Revaluation Assessment violated the guarantee of tax stabilization in the DEI Bermuda LSA, the Tribunal must determine the following issues: (1) was Rule VIII part of the tax regime stabilized for Egenor on July 24, 1996; and (2) if

so, was SUNAT's assessment under Rule VIII consistent with any stabilized interpretation and application of the Merger Revaluation Law in 1996?

345. For the reasons explained below, the Tribunal concludes that while Rule VIII could properly be invoked by SUNAT to evaluate the legitimacy of transactions for tax purposes, SUNAT violated the guarantee of tax stabilization by using Rule VIII to change the stable interpretation of the MRL that generally prevailed in 1996 and was thus part of the tax regime stabilized for Egenor.

i) Rule VIII

346. The Tribunal notes that Rule VIII was introduced in April 1996, several months before the date of the Egenor LSA. Arguably then, the tax regime that was stabilized for Egenor, and thus later for DEI Bermuda in respect of Egenor, included the original version of Rule VIII. This original version, by Claimant's own admission, permitted SUNAT to scrutinize the underlying purpose of a transaction, such as a merger, and to disregard it for tax purposes if it concluded that the transaction was fraudulent.

347. In light of this observation, a claim for breach of the guarantee of tax stabilization based on a misuse of the new version of Rule VIII would not be upheld since the new version of Rule VIII was not the one that was stabilized. It seems to the Tribunal that Claimant could only complain that SUNAT had misinterpreted the new version of Rule VIII, but not bring a claim based on such complaint under the tax stabilization guarantee of the DEI Bermuda LSA.

348. In any event, the Tribunal accepts that both versions of Rule VIII provided SUNAT with the authority to set aside for tax purposes transactions which it concluded were "simulated".

349. The Tribunal therefore concludes that SUNAT did not violate the DEI Bermuda LSA's guarantee of tax stabilization merely by invoking Rule VIII.

ii) The MRL

350. Part of the stabilized tax regime for Egenor was the MRL, which was passed by Congress in 1994 and extended for annual periods until the end of 1998. The fact that the MRL was stabilized under Peru's LSA Regime was confirmed, as a general matter, by the Edelnor and Luz del Sur arbitral decisions. As for Egenor's specific situation, it was agreed by all advisors who considered the matter that the MRL was stabilized under the Egenor LSA. The Tribunal refers here to the due diligence report prepared for the privatization of the 30 Percent Tranche by Estudio Grau, the legal opinion prepared for Egenor by the same law firm on January 5, 1999, and the legal opinion prepared by Miranda & Amado for Duke Energy on September 20, 1999. Indeed, in the case of Egenor, SUNAT did not challenge this conclusion.
351. Claimant argues that the MRL imposed no prerequisites on the type of companies that could take advantage of the tax benefits of the law. Respondent, on the other hand, contends that it was implicit in the structure, framework and purpose of the MRL that only "real" companies, which would be genuinely strengthened by a merger, could avail themselves of the Merger Revaluation Law.
352. The Tribunal finds that Claimant has discharged its burden of demonstrating that SUNAT's use of Rule VIII to invalidate the tax consequences of the Egenor merger with Power North violated the stable interpretation or application of the MRL at the time the Egenor LSA was executed.
353. The Tribunal comes to its conclusion concerning the stable interpretation and application of the MRL based on its assessment of the expert testimony presented by the parties. The Tribunal found the testimony of Professor de Trazegnies particularly compelling. Professor de Trazegnies testified that it was clear to everyone at the time the MRL was introduced by Congress that "the actual objective of that law, in keeping with the statements of those who at that time opined on the law, the objective was revaluation, reassessment." (Hearing Transcript, May 14, 2007, at p. 1139:15-18) Professor de Trazegnies noted that the law addressed the problems caused by the hyper-inflationary period that gripped Peru between 1985 and 1991.

354. The Tribunal also notes the following testimony of Professor de Trazegnies from his direct examination at the hearing:

Q. The Revaluation Merger Law was from January 1994, and it was renewed four times by the Peruvian Parliament.

What does this fact suggest to you?

A. Well, what this is, it makes it obvious that the government, the Congress, and the country was very happy, very pleased with that merger and revaluation law and the way it was being applied. There was no mystery whatsoever that these mergers were taking place with a view to the revaluation. This has been stated by many, Cesar Luna Victoria, Luis Hernandez, all of those who intervened at that point in time thus recognized. However, that law continued to be extended during four years, which means that its purpose had not yet been fully satisfied and that it was considered that it was a positive end, a good purpose. (Hearing Transcript, May 14, 2007, at p. 1144:4-20)

355. Further, the Tribunal refers to the article by Dr. César Luna Victoria published in *Semana Económica* on December 16, 2001 (Exhibit C-114), which confirms that the MRL did not impose restrictions or conditions on companies before they were able to avail themselves of the benefits of the law. Dr. Luna Victoria affirms in that article that: “[...] *the [MRL] never stabilized a period of pre-existence, a minimum capital or a specific number of transactions, as it has done in other cases. If the law did not do so, the company (a paper company or not) had legal pre-existence, and the merger has been legally valid. By way of interpretation, the SUNAT cannot make up the omissions of the law under the same Rule VIII that it invokes*”.³⁵

³⁵ The Tribunal cannot accept the evidence of Respondent’s expert, Dr. César Luna-Victoria, that the quotation in this article was taken out of context.

356. Respondent's position, that the MRL had certain implicit requirements that companies had to satisfy before being able to enjoy the benefits of the law, was supported by Prof. Shoschana Zusman. Professor Zusman was not called to testify at the merits hearing, but the Tribunal has considered her two expert reports that were submitted by Respondent. In her Second Report, dated March 2007, Professor Zusman concludes as follows in respect of the MRL:

- (ii) Even if Law No. 26283 did not establish requirements for the merger, it was not enough to undergo the formal merger process in order to consider that such merger was valid for tax purposes.
- (iii) The merger may not be considered valid if it is carried out with a company that does not have an actual economic reality and if the only purpose of the merger was tax-related, because Law No. 26283 was a promotional law which, precisely because it granted an incentive, required the merger to have economic substance.

357. The Tribunal notes that Professor Zusman bases her conclusions on an abstract analysis of what she considers to be the applicable legal principles under Peruvian law, such as the principle of "self-integration" and the need to interpret the MRL as a "promotional" law (see Professor Zusman Second Report at paras. 6–14). However, the Tribunal finds Professor Zusman's opinion to be inconsistent with the object and purpose of the MRL, with its wording (*i.e.*, no indication of any special requirements) and, in particular, with the actual interpretation of the MRL that was prevalent at the time when the guarantee of tax stability was granted to Egenor. The Tribunal finds Professor de Trazegnies' testimony much more compelling, as it refers directly to contemporaneous documents and opinions.

358. In any event, Professor Zusman's opinion was effectively rebutted by the testimony of Professor Talledo, concerning comparable legislation in other jurisdictions. The following is an extract from his direct examination at the hearing:

Q. Professor Shoshanna Zusman states that tax benefits provided for

in the Merger Revaluation Law are not to be applied to all sorts of mergers, just to mergers among active companies, and also mergers that help consolidate or increase the trade value or the trade volume of the merger companies.

Do you agree with this position?

- A. I don't agree with this. In the statement by Dr. Zusman, it is implicit that 26283 included pre-requirements or conditions for the exemption, but the requirement would be that they have to be companies operating with assets or that had something to integrate or strengthen, and corporations who could also achieve the goals provided for in this regime. In comparative legislation, the conditions and requirements, be they previous or not, for the merger and reorganization of companies, is clearly stated--clearly stated--and from the legal point of view, those conditions, whether they are legal conditions or conditions that are part of the fact generating tax income or whether they are legal resolutions for that benefit--that is to say, that those requirements as well as more efficiency, et cetera or greater market share were not achieved, none of those requirements--that is to say, pre-requirements or requirements were established in this law 26283, and we cannot say that the fulfillment of the requirements leads to the enjoyment of the benefits.

(Hearing Transcript, May 14, 2007, at pp. 1226:17–1228:1)

359. The Tribunal also draws support from the testimony of Dr. Javier Núñez Carvallo. Dr. Núñez, a partner at Estudio Grau, testified that his law firm was involved in completing some forty mergers under the MRL. He emphasized that the MRL was renewed in successive years until the end of 1998, and that none of the “implicit” requirements for which Respondent is now arguing was ever raised as a relevant issue in those other mergers. The Tribunal did not hear or read testimony from any other witnesses contradicting the testimony of Dr. Núñez.

360. The Tribunal is satisfied that it is not unusual, following a period of hyperinflation of the kind that plagued Peru between 1985 and 1991, that companies should be allowed to revalue their assets tax-free. The book value of the assets, expressed in nominal terms, no longer reflects their actual value in the new currency adopted in the post-hyperinflation era. The re-valued figures are, of course, nominally higher than the old book values, but they do not reflect either any actual increase of value of the assets or any actual income or increase of wealth of the owner of such assets, *i.e.*, the taxpayer. Therefore, in such circumstances, it is reasonable that such revaluations should be tax free.
361. The Tribunal is also satisfied that, as a matter of legal or economic policy, the Peruvian Government did not implement a general legal regime that would have permitted revaluations with no tax consequences. Instead, the Peruvian Government allowed such revaluations in the context of corporate reorganizations under the MRL. The Tribunal is convinced that this restricted legal framework of beneficial revaluations clearly gave rise to a general practice in the country of using mergers and spin-offs mainly to revalue assets rather than to actually reorganize companies or corporations.
362. The general practice of allowing the MRL to be used in this way was based on a very broad interpretation of the literal terms of Article 1 of the MRL, which required a “merger or division agreement of any type of legal entity, whether mercantile, civil or cooperative...” (emphasis added). What was essential was the existence of a merger of “any type of legal entity”, irrespective of whether the sole purpose of the merger was the revaluation of assets in order to claim the tax benefits associated with it. According to the normal and widespread practice at the time, “merger” meant a formal legal act through which two or more companies joined together to form a new one, without regard to the underlying economic reality of the transaction.
363. In other words, at the time of the Egenor LSA, the prevailing interpretation of the MRL was that a formal merger was sufficient to invoke the tax benefits offered by this law. It was this interpretation that was stabilized by the LSA.

364. When SUNAT concluded in November 2001 that the Egenor-PowerNorth merger lacked economic reality, and thus invalidated its tax benefits under the MRL, SUNAT implicitly gave the word “merger” a meaning that was different from the meaning that prevailed in 1996, and which was thus the stabilized meaning under the Egenor LSA.
365. Therefore, based on the totality of evidence, the Tribunal concludes that SUNAT’s use of Rule VIII in 2001 to disallow the tax benefits of the Egenor-PowerNorth merger constituted a change in the stable pre-existing interpretation of the MRL.
366. The Tribunal therefore concludes that the Merger Revaluation Assessment constitutes a violation of the guarantee of tax stabilization.

3. Breach of Good Faith (Doctrine of *Actos Propios*)?

a) Claimant’s Position

367. Claimant alleges that the Government of Peru:
- approved the 1996 merger and the manner in which it would be concluded;
 - acknowledged that a primary reason for the merger was for Egenor to avail itself of the Merger Revaluation Benefits;
 - ratified the merger through Electroperú’s shareholder vote;
 - ratified the merger through a series of resolutions issued by the Ministry of Energy and Mines;
 - failed to mention any possibility of forthcoming or latent tax liability during negotiations with Duke Energy;
 - confirmed the propriety of the merger in connection with the sale of its 30 Percent Tranche;
 - commanded a higher price from Duke Energy by representing Egenor as a company for which the Merger Revaluation Law was stabilized; and

- benefited financially from the merger.
368. Given these actions and representations, Claimant submits that Respondent is estopped from invalidating the merger for tax purposes.
369. Claimant submits that the Government cannot avoid the consequences of its inconsistent conduct based on the principle of separation of powers, as Respondent would suggest. SUNAT, COPRI, CONADE, CEPRI-ELP and the Ministry of Energy and Mines are all interrelated Government agencies. As such, *vis-à-vis* the investor, they are indivisible, and in the eyes of the foreign investor, their actions must be deemed the actions of the State.
370. Claimant notes that Egenor’s by-laws made it clear that asset transfers and interested party transactions required a “favourable vote” of 85 percent of the company’s Board of Directors, thus necessitating the approval of Electroperú’s representatives, and thereby of the government.
371. With respect to Electroperú, Claimant argues that:
- Electroperú’s actions as shareholder, such as whether it would vote for or against actions proposed by Egenor’s Board of Directors, were firmly preordained by the Government of Peru, pursuant to Articles 15 and 21 of Supreme Decree 027-90-MIPRE, the regulations generally applicable to state-owned companies;
 - Electroperú’s actions were not, as Respondent suggests, that of a “private company” operating under primarily commercial conditions in a predominantly commercial market, with state ownership being merely an insignificant and incidental attribute. Its actions were clearly defined by a distinctive and incontrovertible “governmental” purpose; and
 - Even assuming, *arguendo*, that Electroperú was not performing any “governmental” function *per se*, the Tribunal can *still* find that Electroperú’s actions were binding on the State based on the sole fact of Government *control*.

372. Claimant contends that, despite their proclamations to the contrary, Mr. Miranda and Mr. Sánchez clearly viewed Electroperú's 30 percent shareholding in Egenor as the Government's shares, as evidenced by numerous references to the State's shares, which are found in Egenor Board or Shareholders' Meeting Minutes. Moreover, pointing to their resignation letter, Claimant submits that both Mr. Manuel Suárez Mendoza and Mr. Víctor Guevara Pezo, who were appointed by Electroperú to succeed Mr. Gastón Miranda and Mr. Alfredo Montesinos as Egenor Directors, unquestionably understood that they served on Egenor's Board on behalf of the Peruvian Government.

b) Respondent's Position

373. Respondent submits that Claimant's claim that Peru breached its obligation of good faith under Peruvian law is entirely premised on unfounded factual assertions, from which meritless legal conclusions are drawn. Respondent specifically denies that Peru in fact made such statements or took such actions.

374. As a general matter, Respondent contends that:

- There cannot be a contradiction between Electroperú's conduct as a shareholder of Egenor and SUNAT's assessment of DEI Egenor for tax underpayment because they are separate entities.
- A sophisticated investor such as Claimant cannot claim to be unfamiliar with the well-recognized principle that a national tax service cannot be bound by the actions of a separate Governmental entity. In the United States, Duke Energy's home jurisdiction, this rule was settled over 6 years ago by the US Supreme Court. Other jurisdictions have taken a similar view (Canada, Mexico).

375. Furthermore, in reply to Claimant's arguments based on the approval of the Egenor merger by its shareholders, Respondent asserts that it was not the Peruvian State that was shareholder of Egenor, but Electroperú. With respect to Electroperú, Respondent argues that:

- Electroperú is a private law corporation with its own legal standing. Electroperú is

governed by the General Law of Corporations Law and by express provision of that law, Electroperú lacks power of *ius imperium*. This means that Claimant cannot succeed in labeling Electroperú's votes as sovereign acts of the Government of Peru.

- The act of a state-owned company, acting as a commercial actor (*acta jure gestionis*), and not as a sovereign authority (*acta jure imperii*), cannot be regarded as an organ of the tax administration and is thus not authorized to interpret or apply tax laws. Still less can it preclude their interpretation and application by authorized state organs.
- International law also draws a clear distinction between a state and a corporate entity owned by that state.
- The representative of Electroperú did not receive instructions from the Government of Peru. Under Peruvian law, Electroperú did not require such instructions to decide how it would vote its shares in Egenor.
- Egenor's amended by-laws provided that certain significant corporate actions required a vote of at least 85 percent of the members of the Board of Directors (and therefore the support of both Electroperú-appointed Directors). But that fact did not transform the commercial nature of the Electroperú-appointed Directors' actions on the board into governmental action attributable to the State, much less into a pronouncement on tax matters over which SUNAT had exclusive jurisdiction.
- Electroperú's approval of the merger between Egenor and Power North at the General Shareholders' Meeting was by no means an act of the State but rather an act decided by the directors of a State-owned company subject to private law. The law required that Electroperú, and not the State, provide written instructions on how to vote Electroperú's minority shareholding to Electroperú's representative at the Egenor General Shareholders' Meeting.

- Claimant mischaracterized a statement made by an Electroperú-appointed Director, Mr. Gastón Miranda, during a meeting of Egenor’s Board of Directors, to argue that the Directors “were well aware of their central role in the State’s ongoing privatization process.” According to the meeting minutes, Mr. Miranda stated that “the Republic of Peru, represented by Electroperú, wanted to have an attractive quotation of Egenor’s stock on the stock exchange...” Claimant’s assertion that Mr. Miranda “directly represented the State” – and purportedly bound the State in the latter’s exercise of sovereign authority – simply does not follow from the “fact that [Mr. Miranda] spoke about the State’s indirect interest in the good business performance of Nor Perú-Egenor.”

376. With respect to CONADE, Respondent argues that:

- CONADE did not vet or approve the 1996 merger;
- In any event, such an approval could not bind SUNAT and it therefore cannot be reasonably relied on by the taxpayer as a guarantee that the taxpayer will not be audited and assessed by the tax authority.
- Putative “approval” from CONADE does not constrain SUNAT’s authority to audit and assess. As a factual matter, several state-owned companies that, unlike Electroperú in relation to Egenor, do act pursuant to CONADE’s instructions have been regularly assessed by SUNAT.

377. With respect to CEPRI-ELP, Respondent argues that:

- CEPRI-ELP could not and did not instruct Electroperú to approve Egenor’s financial statements or the 1996 merger. Article 9 of the Privatization Law does not grant CEPRI-ELP the authority to issue “directions and instructions” to Egenor outside the context of a privatization process. For CEPRI-ELP the Egenor privatization process was limited to the sale of the 60 percent interest.

378. Finally, Respondent submits that under international law, which Claimant has asserted is applicable, Government actions are accorded a presumption of regularity. This is particularly true when, as here, a claimant has accused a state of acting in bad faith, an assertion which must be proven by “clear and convincing evidence.” [Respondent’s Rejoinder, para. 64]

c) Tribunal’s Analysis

379. In the previous section, the Tribunal determined that the Merger Revaluation Assessment constituted a breach of the guarantee of tax stabilization under the DEI Bermuda LSA. Having found Respondent liable on that basis, the Tribunal need not consider Claimant’s alternative grounds for liability, including breach of the doctrine of *actos propios* or good faith. The Tribunal nevertheless feels compelled, having heard a substantial amount of evidence and argument on this point, to set out its views on the issue.

380. By contrast to its conclusion concerning the actions and representations of various Government actors in respect of the depreciation rate applicable to the fixed assets transferred to Egenor by Electroperú, the Tribunal has come to the view that the actions and representations of the various State actors who participated in the process leading up to and including the merger of Egenor and PowerNorth in 1996, as well as the process of completing the privatization of Egenor to Duke in 1999, have legal effect. Indeed, the conduct of the various State actors 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.

381. For the Tribunal, the analysis of the *actos propios* issue comes down to four fundamental questions: (i) did the representatives of Electroperú and of the various State agencies involved in the privatization have full information about the nature of the merger and its tax implications?; (ii) did Electroperú’s representatives unequivocally support the merger and the manner in which it would be concluded, and was it reasonable for Dominion (and later Duke) to interpret that support as coming from the State itself?; (iii) did the representatives of the various State agencies involved in the privatization unequivocally

support the merger and the manner in which it would be concluded?; and (iv) assuming the answer to questions (i)-(iii) is, in each case, affirmative, is the Merger Revaluation Assessment nevertheless immunized from scrutiny under the doctrine of *actos propios* based on the Respondent's defense that only SUNAT has authority over tax matters within Peru, and therefore representations and support from any other State agencies or entities are irrelevant?.

382. The Tribunal takes each question in turn.

i) Information about the Merger and its Tax Implications

383. In this section, the Tribunal considers whether the representatives of Electroperú and of the various State agencies involved in the privatization had full information about the nature of the merger and its tax implications.

384. In the Tribunal's view, there is ample evidence to show that the Electroperú-appointed Directors who sat on Egenor's Board, as well as members of CEPRI-ELP (including Mr. Alfageme, CEPRI-ELP's legal advisor) received information regarding the merger in the form of draft meeting minutes, financial statements and the Price Waterhouse valuation report well before the merger took place.

385. The relevant minutes of the Egenor Board of Directors' meeting (November 13 and November 25, 1996) explicitly evidence that the Board, which included Electroperú's representatives, had full knowledge of the fact that a primary reason for the merger was for Egenor to avail itself of the Merger Revaluation Benefits. Indeed, it is pointed out in each set of minutes that the revaluation is based on the MRL.

386. Furthermore, Respondent has admitted that Mr. Pedro Sánchez, who was Chairman of Electroperú's Board of Directors and represented Electroperú's minority interest in Egenor at the shareholders' meetings, received the detailed technical, financial, and legal information and analyses provided by the company's professional management and legal advisor, who recommended the merger of the two companies. Respondent made the admission in arguing that Mr. Sánchez relied on that information without forming an independent view that Claimant could reasonably rely on.

387. Considering the evidence, the Tribunal concludes that the representatives of Electroperú and of the various State agencies involved in the privatization had full and complete information about the nature of the merger and its tax implications.

ii) The Merger and Electroperú

388. In this section, the Tribunal considers whether Electroperú's representatives on the Egenor Board unequivocally supported the merger and the manner in which it would be concluded, and whether it was reasonable for Dominion (and later Duke) to interpret that support as coming from the State itself.

389. As noted earlier in the factual background, Egenor's Board of Directors approved the merger of Egenor with Power North on November 25, 1996. Two days later, on November 27, 1996, the merger also received a favourable vote at the general meeting of Egenor's shareholders.

390. It is not contested by Respondent that, at the Board meeting, a vote in favour of the merger was cast by Mr. Gastón Miranda and Mr. Alfredo Montesinos, the two representatives of Electroperú. Nor is it contested that, at the shareholders' meeting, a vote in favour of the merger was cast by Mr. Pedro Sánchez, the representative of Electroperú.

391. What is contested by Respondent is that the respective votes of these individuals could reasonably be relied upon by Dominion (and now Claimant) for the proposition that the State itself (and not just Electroperú) approved the merger.

392. Respondent argues that the Peruvian State was not the shareholder in Egenor; rather, Electroperú, a company subject to the General Law of Corporations, was the shareholder. In support of Respondent's position, Mr. Sánchez explains in his witness statements that he was not acting as a Government representative, and that he based his decisions strictly on commercial considerations.

393. Considering all of the evidence presented to it, the Tribunal has no hesitation in concluding that the State – through the support demonstrated for the merger by Electroperú – did approve the merger, and the manner in which it was conducted.
394. First, the Tribunal notes that Electroperú’s representatives did not vote for the merger in a void, but rather in context of the by-laws of Egenor. Egenor’s by-laws, dated May 10, 1996, were purposely amended by CEPRI-ELP and provided to potential investors on May 22, 1996. The amended by-laws mandated that certain significant corporate actions undertaken by Egenor following the 60 percent privatization had to be approved by the Electroperú-appointed Directors of the company.
395. Specifically, Article Forty-Two of the amended by-laws provided that any decision made in relation to, *inter alia*, disposal of property worth more than US \$30 million, or transactions between Egenor and companies wholly or partially owned by the Class A Shareholders (both of which were corporate actions undertaken as part of the 1996 merger), “must be made at the decision of at least eighty-five percent (85%) of the Members of the Board of Directors....”
396. Given that in 1996 Electroperú held 40 percent of the seats on the Board, an opposing vote by either of its two appointed Directors, Mr. Gastón Miranda or Mr. Alfredo Montesinos, would have been enough to block the merger with Power North.
397. The preamble to the Egenor by-laws reflects that they were amended in order “to grant to the shares belonging to the State certain control powers through qualified majorities in order to make certain decisions at the General Shareholders meetings and on the Board of Directors....” On this basis, among others discussed below, it is reasonable for the Tribunal to conclude that CEPRI-ELP (presided by Mr. Sánchez) viewed Electroperú’s shareholding in Egenor as the Government’s shareholding.
398. The Egenor by-laws were drafted to reflect the requirements of the Privatization Law, as well as Law No. 29248 and its Regulations (approved by Supreme Decree No. 027-90 – MIPRE, dated April 2, 1990). Pursuant to these laws, the Peruvian Government was anything but a “private” shareholder; rather, it was under very specific obligations to

exercise control over the operation of all companies in which it had holdings, including Egenor.

399. Electroperú was required under Peruvian law to act in accordance with the directions and instructions of CEPRI-ELP. Article 9 of the Privatization Law required that “companies subject to the process of the promotion of private investments shall be obligated to the following, subject to the personal liability of their Directors: (a) to carry out the decisions of the Special Committee pertaining to such process in the company;” and “(b) to provide the representatives of the Special Committee any assistance necessary for carrying out their duties, in keeping with the principles of veracity, efficiency or celerity.” Moreover, Article 9 states clearly that, “in the event that the State is a minority shareholder in a company included in the process [in this case, Egenor], the obligations referred to in this article shall apply to the holders of the State’s shares in such Company.”
400. Despite Mr. Sánchez’s testimony that “my participation in CEPRI-ELP had no bearing whatsoever on how I cast my votes as the representative of... Electroperú,” the fact that he was appointed to the Boards of both Electroperú and CEPRI on the same day, and, some time later, appointed as Chairman of Electroperú and CEPRI on the same day, was not a mere coincidence. Rather, the Tribunal finds that it was consistent with the requirements of the Privatization Law for Mr. Sánchez to occupy those positions simultaneously: he was thereby able to make decisions with a unified objective, as he did with regard to the 1996 merger.
401. During the hearing, Mr. Fritz Du Bois testified on this point. The Tribunal accepts Mr. Du Bois’ evidence rather than the categorical denials of Mr. Sánchez, which the Tribunal does not find credible:

Q. Did you find Mr. [Sánchez] Gamarra's testimony credible?

A. Well, it's difficult to understand how somebody who had both roles, head of Electroperú and head of the CEPRI, could say that one had [no] relation with the other. One would have assumed that he was always acting together.

And as I already mentioned, that 30 percent continued to be shares of the State, continued to be within the privatization process, and will have been normal for somebody participating in a general shareholders' meeting to have had instructions either from the main holding company, the CONADE, FONAFE, in those days probably CONADE in 1996, or through the board of Electroperú. I think in this case the same person taking all those roles maybe was assumed that the instructions were basically posted.

I find it difficult to believe it could be completely separate from his overall main role within the electricity sector privatization process.

Q. Thank you.

Now, in addition to testifying that he never received instructions from CEPRI-ELP on how to act in Nor Peru-Egenor's general shareholder meetings--and I gave the previous paragraph reference which was to the first affidavit--he again testifies to that effect in his second affidavit at paragraph 15. Mr. Gamarra has testified that he never received any instructions regarding his voting of the State's shares from CONADE, and here I'm referring to his second affidavit which appears under Tab 6, so I would like you to turn to Tab 6.

A. Um-hmm.

Q. And I would like you to turn to paragraph 16.

A. Um-hmm.

Q. Now, in respect of Mr. Sánchez Gamarra's testimony in paragraph 16 that he never received instructions from CONADE, do you find his testimony credible?

A. Once again, the norm says that CONADE is the overall holder of all State shares, and from my experience certainly in the case of Petroperu, for example, which had a similar situation with a 30 percent holding in a

new company that was created out of the privatization process, we always coordinated with CONADE the position as not only with CONADE, but also with separate concern as the overall objective was that sooner or later those shares would be sold and those proceeds would go to the treasury.

So, I don't know if he did or didn't receive instructions, obviously, but he should have received some kind of guidance or at least have coordinated adequately the position.

I had participated in shareholders' meetings once again Banco Continental, where we were a 30 percent--had a 30 percent participation, and I got instructions as to how to vote, and those instructions were given to me by the holding company, you know, the holding entity, OIOE, the replacement of CONADE.

So, my experience was there had to be some kind of procedure. It couldn't be just left to the--well, free initiative of a person. It was clearly a procedure by which the State coordinated its position where the companies would have had a stake.

Q. You've testified that you have been on the boards of several companies that were in the process of being privatized.

Could you describe for the Tribunal's benefit what you viewed as your responsibilities with respect to the State's interests and whether you had to seek approval before taking a vote.

A. I was represented in the State in several companies. One was Petroperu, for example, a hundred percent owned company, but which was part of the privatization process and sold. An important operation was La Pampilla, included a new company where we had a 30 percent -- we kept the 30 percent minority shareholder, which is already now sold.

I also participated on behalf of the State in two companies where we had minority shareholding, which was Telefonica and Banco Continental,

where basically my role was to assist the privatization process until those shares were eventually sold.

In the case of shareholders' meetings, I always participated. At times I participated with reading instructions, and in the case of day-to-day business of the board, I had permanent contact with the people concerned, basically the people involved in the privatization process, the CEPRI, to make certain that we were going all in the same line, and were going to reach our objective of selling those shares as soon as possible and at the best possible price. That's how I--that's where I was instructed when I was designated in those boards, and I tried to fulfill that during the time I was in the boards.³⁶

402. Article 15 of Supreme Decree No. 027-90-MIPRE provides that, “In order to participate in a General Shareholders’ Meeting or the corresponding highest corporate organ, the State shall give to the company which holds the shares, the credentials of the authorized representative and clear and written instructions. Such representative may not alter such instructions or vote in a manner contrary to the mandate contained therein.”
403. Pursuant to Article 21 of this Decree, Mr. Sánchez, and later Mr. Jesús Beoutis, were the “authorized representative[s]” within the meaning of Article 15 by virtue of the fact that each was “the Chairman of the Board of Directors of the company [i.e., Electroperú] or Business Group that owns the shares” of Egenor. Indeed, both Mr. Sánchez and Mr. Beoutis attended Egenor Shareholders’ Meetings and voted Electroperú’s shares at those meetings pursuant to Article 21 of Supreme Decree 027-90-MIPRE, as evidenced by each and every set of minutes from those meetings in which they participated. Importantly, Article 21 expressly declares that “the provisions of Article 15 of these Regulations applies to the present article.” Consequently, it is clear that Mr. Sánchez’s participation in Egenor Shareholders’ Meetings was governed by Article 15 of the decree in question.

³⁶ Hearing Transcript, May 9, 2007, at pp. 337:5–341:14.

404. Nowhere in Mr. Sánchez's witness statement does he ever deny receiving such instructions.
405. As one of Claimant's counsel said in his opening statement, the evidence is convincing that Electroperú was "doing the State's work."³⁷ The Tribunal agrees.
406. Further evidence that Electroperú was "doing the State's work" relates to the period when Duke enters the picture.
407. Following the repeal of the Merger Revaluation Law at the end of 1998, four electricity companies (i.e., Egenor, Edegel, Edelnor and Luz del Sur) formed the view that the repeal could not apply to them because of their respective LSAs. In February 1999, Electroperú, while still a shareholder of certain of these companies, including Egenor, specifically requested instructions from the Ministry of Economy and Finance as to what position it should take on the issue. A letter from Mr. Jesús Beoutis Ledesma, Chairman of Electroperú, to the Minister of Economy and Finance, dated February 25, 1999, states that, "given the importance of the subject in question, we request your interpretation of the problem in order to define a position to take as representatives of the State's shares in the privatized companies of the electric sector." (Emphasis added).
408. In addition, shortly after Duke Energy's acquisition of Egenor in 1999, Messrs. Manuel Suárez and Víctor Guevara, the Electroperú-appointed Directors at that time, sent Egenor's President, Mr. Mark T. Cox, a formal letter of resignation from the Egenor Board. In the letter, they expressly confirmed that they were appointed to Egenor's Board for the purpose of representing the Government's interests; they said: "we hereby advise you that we were appointed as directors of EGENOR S.A.A. as representatives of the State's shares."³⁸ (Emphasis added).
409. Electroperú's actions were not, as Respondent suggests, that of a "private company" operating under primarily commercial conditions in a predominantly commercial market,

³⁷ Hearing Transcript, May 8, 2007, at p. 79:19.

³⁸ Letter from Mr. Manuel Suárez Mendoza and Mr. Victor Guevara Pezo to Mr. Mark T. Cox IV, dated November 12, 1999, Exhibit C-165.

with State ownership being merely an insignificant and incidental attribute. Its actions were clearly defined by a distinctive and incontrovertible “governmental” purpose.

410. Everything that Electroperú did within the context of the privatization of Egenor was at the direction and on behalf of the Government. Indeed, Egenor’s by-laws, the Privatization Agreement, and the Privatization Law all clearly indicate that Electroperú was one of the Government’s agents in the privatization of Egenor.
411. Specifically, as already noted, the Egenor by-laws contained “qualified majority” provisions to ensure that the Government, through Electroperú, retained a certain level of control. Additionally, the Privatization Agreement mandated that Dominion cooperate with Electroperú and any other Governmental entities necessary to effectuate the Government’s 30 percent privatization. Most importantly, the Privatization Law mandated that Electroperú implement CEPRI-ELP’s privatization initiatives vis-à-vis Egenor and other privatized companies.
412. In this context, it is clear why the Government supported the merger. As Mr. Miranda himself said during a meeting of Egenor’s Board of Directors: “the Republic of Peru, represented by Electroperú, wanted to have an attractive quotation of Egenor’s stock on the stock exchange...”³⁹ The Electroperú-appointed Directors understood that their role was to safeguard and foster the State’s 30 percent shares for later privatization, thus supporting a merger that increased the value of those shares on the stock exchange.
413. In conclusion, the Tribunal finds that it was reasonable for Dominion (and later Duke) to interpret the support for the merger from Electroperú’s representatives as coming from the State itself.

³⁹ Board of Directors’ Meeting Minutes, dated March 13, 1997 at p. 1, Exhibit C-048.

iii) The Merger and Various State Agencies

414. In this Section, the Tribunal considers whether, apart from Electroperú, representatives of the various State agencies involved in the privatization unequivocally supported the merger and the manner in which it was to be concluded.
415. Claimant asserts that the approval for Electroperú to vote its shares in favour of the 1996 merger was provided by the CONADE, a separate Peruvian Government agency established to serve as a holding company for all companies in which the Government holds a stake. CONADE appointed certain directors to sit on Egenor's Board.
416. Claimant also submits that Electroperú's approval of the merger was "blessed" by CEPRI-ELP. Claimant points to the minutes of the Shareholders' Meeting, which state that the merger "had been discussed with our shareholder ELECTROPERÚ S.A. and coordinated with CEPRI, and had earned their backing."
417. Respondent argues that Claimant fails to show how the simple fact that Egenor forwarded information regarding the 1996 merger to CEPRI-ELP could possibly constitute CEPRI's approval of the merger. Moreover, Respondent says, even if one were to assume that Messrs. Alfageme and Delboy had received such documents, it would not prove that CEPRI-ELP approved the merger. Finally, Respondent argues that even if the 1996 merger could be said to fall within the scope of the privatization of Egenor, Article 8 of Decree 874 states that all CEPRI approvals and decisions must be "adopted by a Resolution of the Committee," and no such Resolution exists.
418. Furthermore, Respondent notes that the quoted language from the meeting minutes does not describe a statement made at Egenor's General Shareholders' Meeting. Rather, it is a reference to a statement made by Mr. Cox to Egenor's Board of Directors. Respondent points out that while Mr. Pedro Sánchez, President of CEPRI-ELP, participated in the Shareholders' Meeting, no member of the Board of Directors was a member of CEPRI-ELP. Therefore, Respondent concludes, there was no one from CEPRI-ELP at Egenor's Board of Directors Meeting who could have stood up and contradicted Mr. Cox when he made his statement.

419. At first blush, Respondent's arguments appear to have some merit. They have been carefully considered by the Tribunal. The Tribunal concludes, however, that they are plainly rebutted by the evidence. On the issue of support for the merger by CEPRI-ELP and other State agencies, the Tribunal finds the testimony of several of Claimant's witnesses, namely Pastor Narron, Mr. Cox and Dr. Núñez, most compelling.

420. During his cross-examination, Pastor Narron described what he perceived as the State's approval for the merger. From his perspective, the various Government agencies (CEPRI, COPRI, the Ministry of Energy) and Electroperú unequivocally supported the merger and the manner in which the merger was implemented. He said:

They [government officials] endorsed it through their directors, they were quite happy to endorse it, and as shareholders, Pedro Sánchez and those others that worked with him in certain capacities, Alfageme and Jean Delboy, they were all ecstatic, as I said earlier, about this.⁴⁰

421. During the hearing, the Tribunal also heard from Mr. Cox, who became Chairman of the Board of Egenor after Dominion's acquisition, and who therefore led the Board at the time of the merger. The Tribunal found Mr. Cox to be a very credible witness. Mr. Cox testified as follows:

Q. How did the idea of merging Nor Peru-Egenor with Power North come about?

A. Well, it emerged, I guess, in part, with the work of the staff and people working in Nor Peru-Egenor as well as amongst directors and in consultations with the government. Clearly, we had the examples before us of similar transactions that had been done with Electrolima and two other electric distribution companies, and as we began to study on the one hand the issues of the revaluation and on the other the office problems and how to finance that and put it all together, people began to say, well, gee, maybe this is what we should do that would make the

⁴⁰ Hearing Transcript, May 11, 2007, at p. 960:14-19.

most sense of all, so I think staff began to look at it. The lawyers began to look at it. The accountants began to look at it. We had already hired some experts to go out and make studies of the assets of Egenor that were subject to revaluation, and they, you know, were working on that part of the puzzle, and then, of course, there was a great deal of consultation with the government and amongst the directors.

We included the government for a variety of different reasons. One, they owned, still, 30 percent of the company and were, of course, on the Board of Directors, but we were appreciative of the fact that although Egenor, our acquisition of 60 percent of Egenor, for us, was primarily an economic event, in the context of government of Peru, the privatization of Egenor was not just an economic event, it was a political event, and it was something that, you know, in whatever we did, you know, there was a lot of focus on us. This was part of a major privatization program, and so we wanted to make sure ministers or other government officials, Mr. Pedro Sánchez, others, would be in a position to respond, should a newspaper start talking about, well, this privatized company getting a new office space or this or that or the other.

And upon an ongoing basis we consulted with them as well, so we went forward together and ultimately designed a process which ended in the approval at the Board of Nor Peru-Egenor and ultimately the shareholders of Nor Peru-Egenor and the merger.

Q. Mr. Cox, could you take a look at Claimant's Exhibit 146, C-146, which is key exhibits volume C7. Hopefully you will see there a memo of November 22, 1996. In particular, if you take a look at points one and two there.

What materials were circulated to the government in advance of the merger?

A. Well, this letter, this note is November 22, so this is--this is toward the end of the process, but as you can see from this particular memo,

given the complexities of the transactions, the lawyers had done some draft minutes of an Egenor board of directors' meeting which outlined all the details of the transaction. I think somewhere in these documents there are probably copies of those.

And they were rather complex, and then there were draft minutes of special shareholders' meetings as well that included financial statements and the revaluation by PriceWaterhouse--all sorts of details.

And it was very important that we get these out early to all parties, and particularly to the government so that they would have time to carefully analyze them and then guidance could be provided or information could be synthesized and provided to the appropriate parties.

So, you can see, for example, that the copies of this went to Dr. Alfageme who, in addition to his position as a legal advisor at CEPRI, was also an alternate director for Mr. Montesinos and Nor Peru-Egenor. And Mr. Delboy also.

Allow these folks and their people to study these issues, make any final comments as to deal, structure and the like so that those could all be put in final order before the Board of Directors and the government as well as our directors at the level of the board of Egenor approves them, and when we looked at the shareholders' meeting where the shareholders of Nor Peru-Egenor approved them, and in that particular instance the government was represented by Mr. Pedro Sánchez. He would want to have his people make absolutely certain that all the documents were in order.

So, it was a comprehensive set of documents that were prepared. They were prepared in draft to permit changes, corrections and the like that might come in from either the technicians at CEPRI or Electroperú or, for that matter, from Dominion and the like to make sure that everything was in order before we finalized the transactions and give the technicians in the ministries as well as Electroperú and Dominion time to brief the

people who were going to have to make the final decisions so we could intelligently know what we were approving and approve it appropriately.

Q. Mr. Cox, I would like you to take a look at C-46, Claimant's Exhibit C-046, which is a copy of Board minutes of Nor Peru-Egenor. I think the page should be open to November 25th, 1996, minutes.

A. Yes, I have them here.

Q. And there in paragraph one is a statement at the end of the first paragraph under point 1, "The above-mentioned plan, meaning revaluation of assets and merger, had been discussed with our shareholder ELECTROPERÚ S.A. and coordinated with CEPRI and had earned their backing."

Now, in this arbitration, Peru's witnesses, in particular Mr. Alfageme, have criticized that statement. What's your reaction to that?

A. Well, the statement was made to the Board by me, and it was meant to, in summary, really reflect the series of consultations that had taken place at various levels, exchanges of documents and ideas with members of the government, with Mr. Pedro Sánchez, with a lot of his advisors, with people in Electroperú, with people at CEPRI, as well as within Dominion, so that we could reach an appropriate and correct structure for the transaction.

And in every instance, we had the full support of the people involved at CEPRI and Electroperú. And ultimately this was demonstrated quite clearly by the fact that directors from the government as well as Dominion on the Board of Nor Peru-Egenor unanimously approved this proposal, and then we put it to the shareholders, and the shareholders unanimously approved it, and the shareholders in the case of the Government of Peru shares were represented by Mr. Pedro Sánchez, who was a very senior official, and by me on behalf of Dominion.

So, the ultimate facts speak to the correctness of this statement.⁴¹

(Emphasis added)

422. Dr. Núñez also testified in a convincing manner about the perception that he, as Secretary of the Board of Egenor, had formed concerning the State's support for the merger and the manner in which it was being undertaken:

Q. You also say in paragraph six of your first witness statement that Mr. Sánchez, Chairman of Electroperú and Chairman of CEPRI-ELP, told you personally about why the State was agreeing to the merger. Please, can you tell us where that exchange took place and exactly what he told you.

A. I recall clearly that Mr. Sánchez was, indeed, invited to participate, was convened to the general meeting of stockholders of Egenor which was held, the meetings at the offices of Estudio Grau on that very day in 1996.

Before the meeting, when I came out to greet Mr. Pedro Sánchez and later after the meeting and throughout the meeting itself, I had a chance to converse with him and to exchange ideas as to how this process was actually taking place, and he was extremely enthusiastic in his comments about the adequacy of this revaluation merger because it enormously facilitated the success of the Participacion Ciudadana project within which the State would be selling off the balance of the stock that it had in its hand of privatized industry. Not just Egenor, but other companies of the electric sector and even of other sectors as well.

So, the position by Mr. Sánchez in this case was one of enthusiastic support toward the project.

⁴¹ Hearing Transcript, May 10, 2007, at pp. 822:6–828:9.

[...]

Q. Did he tell you this statement in his capacity as head of CEPRI-ELP, or in his capacity as head of Electroperú?

A. I would say that in his--twofold, in his double capacity as President for CEPRI, the Special Committee for privatization of Electroperú, as well as in his capacity as President of Electroperú. In the first case, as a high-level official in charge of the success of the privatization program; and, in the second case, as President of the stock holding company of Egenor, which was the beneficiary of the issuance of the new liberated stock that the company produced as a consequence of the revaluation of its assets and the merger.⁴²

423. The Tribunal also finds the testimony of Dr. José Daniel Amado on this point helpful:

Q. Thank you.

Now, let's turn back to the due diligence that was done in connection with the '99 acquisition of Egenor.

In the context of that due diligence, what significance did you draw from the votes of Mr. Sánchez Gamarra, who was at the time the Chairman of CEPRI-ELP and of Electroperú, approving the merger between Nor Peru-Egenor and Power North that had taken place in 1996?

A. Well, in fact, this was what was in order in keeping with the law. Mr. Sánchez was the President of Electroperú, and it was up to him to, indeed, take the vote regarding this type of a situation. But, indeed, Mr. Sánchez, a person who was one of the actual architects of the privatization process in Peru, particularly in the

⁴² Hearing Transcript, May 11, 2007, at pp.1042:10–1043:13 and p. 1044:4–17.

energy sector, and considering further his official position as President of CEPRI Electroperú, so he was part of the COPRI structure. Obviously, there was an additional assurance for everyone.⁴³

424. The Tribunal also observes that public notification of the merger was published in *El Comercio*, *El Peruano*, and *El Tiempo* and a 30-day protest period was provided in accordance with the requirements set forth in the General Law of Corporations. No Governmental entity complained about the merger.
425. Finally, it is noteworthy that various rights, concessions and permits that were previously granted by the Government were assigned, with no protest whatsoever, in favour of the new company, Egenor S.A., as part of the merger process. Moreover, at Duke Energy's request, the Ministry of Energy and Mines approved the assignment of the Egenor LSA in favour of Egenor S.A. in 1999, making explicit reference to the merger.
426. On the basis of the totality of the evidence on this issue, the Tribunal concludes that, apart from Electroperú, representatives of various State agencies involved in the privatization unequivocally supported the merger and the manner in which it was concluded.
427. The Tribunal emphasizes that, in coming to the conclusion that the various State actors named herein supported the merger of Egenor with Power North, it is not suggesting that these individuals did anything wrong *per se*. To the contrary, it appears to the Tribunal that these individuals were properly and effectively implementing the policy of the Peruvian Government at that time. Indeed, it bears repeating that the Tribunal's primary finding in respect of the Merger Revaluation Assessment is that SUNAT breached the Egenor LSA by straying from the widely-accepted and stable interpretation of the MRL at the time of the foreign investment into Egenor. The Tribunal's findings concerning the

⁴³ Hearing Transcript, May 10, 2007, at pp. 618:14–619:12.

conduct of the various individuals that are described under the Tribunal's analysis of the *actos propios* issue are secondary in nature and support its primary finding on liability.

iv) The Defense Based on SUNAT's Authority over Tax Matters

428. The Tribunal has answered questions (i)-(iii) in the affirmative. It is therefore necessary to turn now to question (iv): is the Merger Revaluation Assessment immunized from scrutiny under the doctrine of *actos propios* based on the Respondent's defense that only SUNAT has authority over tax matters within Peru, and therefore representations and support from any other State agencies or entities are irrelevant?
429. Respondent argues that any approvals by Electroperú or various Government entities and officials of the 1996 merger could not immunize Egenor's tax practices from review by SUNAT. Respondent rests its argument on the principle that a national tax service cannot be bound by the actions of a separate Governmental entity. Respondent points to case law that supports this principle in various jurisdictions in addition to Peru, including the United States, Canada and Mexico.
430. In short, Respondent asserts that, for purposes of Claimant's claim of breach of good faith, there is no contradiction between Electroperú's conduct as a shareholder of Egenor and SUNAT's assessment of DEI Egenor for tax underpayment because they are separate entities. The same conclusion is urged by Respondent in connection with the putative approvals for the merger by the other relevant Governmental agencies (CONADE, COPRI, CEPRI-ELP).
431. Earlier in the present Award, the Tribunal developed its reasoning on estoppel.
432. The Tribunal determined that this was one of the areas in which there was an inconsistency between international law and Peruvian law. In 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.

433. The Tribunal also determined that, in the context 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.
434. The decisive element for estoppel is the *reasonable appearance* that the representation binds the State. In this regard, 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.
435. The Tribunal now applies its earlier determinations to the evidence before it, and to the factual conclusions reached in the first three sections of this part of the Award.
436. The Tribunal concludes that, from the point of view of the reasonable investor, the actions and representations of the representatives of Electroperú and of the various State agencies involved in the privatization of Egenor created confidence in the investor that the State would not reverse course after the merger was approved and consummated. Having considered the evidence put forward by both parties, the Tribunal concludes that the actions and representations surrounding the merger were of such a nature as to create such a climate of confidence.
437. This is particularly true given the basis for SUNAT's assessment. SUNAT did not assess the merger on the basis that the Merger Revaluation Law was outside the scope of the stabilization guarantee of the LSA. If that were the basis for the assessment, Claimant could not invoke the representations and conduct of the other entities, as it was clearly on notice that SUNAT could challenge the merger on that basis.
438. Indeed, in the Due Diligence Report prepared by Estudio Grau for Banco de Crédito in 1999, in preparation for the auction of the Government's remaining interest in Egenor, the sole tax contingency mentioned pertained to whether Egenor could continue applying

the benefits granted by the Merger Revaluation Law or whether, pursuant to Law 27034, it had to cease applying those benefits. Although the report mentioned that SUNAT could be expected to take the view that the Merger Revaluation Law was not capable of stabilization under a legal stability agreement, it specifically concluded that Egenor had a reasonably strong legal basis to continue claiming the benefits of that law under its LSA.

439. However, SUNAT's conclusion that the merger was a sham, and that it did not fulfil the objectives of the Peruvian legislation, flies in the face of all of the evidence concerning the unequivocal support that the State showed for the merger.
440. Not surprisingly, nothing in the Grau report in 1999 indicated to Claimant that there may have been questions raised by SUNAT regarding the validity of the merger itself. Furthermore, throughout negotiations with Duke Energy, the Government made absolutely no mention of any tax contingencies stemming from the merger. To the contrary, the Government actively encouraged Duke Energy's acquisition.
441. The Tribunal therefore concludes that the defence based on SUNAT's authority over tax matters is unavailing to Respondent.
442. In conclusion, having considered the evidence and arguments presented by the parties, the Tribunal is of the opinion that the Merger Revaluation Assessment constitutes a breach by Peru of the implied duty of good faith owed to Claimant under the DEI Bermuda LSA.

4. Breach of Non Discrimination Guarantee?

a) Claimant's Position

443. Claimant submits that SUNAT's own data reveals the contours of four distinct groups of companies that were "in the same situation" as DEI Egenor for purposes of their selection for audit and ultimate assessment, and against which the Tribunal can measure SUNAT's treatment of DEI Egenor:

- With regard to the first group, the 1,558 other companies that reorganized under the Merger Revaluation Law were clearly similarly situated to DEI Egenor for purposes of their selection for audit, given that they all undertook the same type of transaction that served as the alleged basis for DEI Egenor’s assessment. All of these companies reorganized, and all were entitled to enjoy the tax benefits of the resulting asset revaluation. It thus stretches the bounds of imagination to believe that none of them – aside from the five that continued those benefits – engaged in any “questionable” conduct in connection with the reorganizations.
- With regard to the second group, comprised of the 101 Major Taxpayers that were actually selected for audit in 2000, each of these Major Taxpayers was clearly similarly situated to DEI Egenor for purposes of their ultimate assessment, given that each and every one of them must have satisfied essentially the same “objective criteria” that allegedly led SUNAT to select DEI Egenor for audit. Again, given that all 101 of these companies displayed what SUNAT admittedly considered to be the tell-tale signs of tax evasion, it is astonishing that not a single one was ultimately assessed for any wrongdoing, apart from those that continued benefits under their LSAs. Furthermore, all the companies that did claim those LSA benefits were ultimately assessed, in some cases under multiple theories.
- With regard to the third category of comparators, namely the companies that SUNAT was allegedly “investigating” in connection with revaluations done between 1994 and 1998, it is clear that each of those companies were in a similar situation as DEI Egenor, but, to the best of Claimant’s knowledge, were never assessed.
- Finally, with regard to the fourth category of comparators, namely the companies that merged, revalued, but relinquished their LSA rights, it is unquestionable that the (at least) three companies in this group were similarly situated to DEI Egenor, but were treated more favourably. The only distinguishing factor between these companies and DEI Egenor was that they decided not to continue applying the Merger Revaluation Law’s depreciation benefits, while DEI Egenor chose to

continue doing so. Tellingly, the four other companies that also continued to insist on their LSA rights – Edelnor, Luz del Sur, Edegel and Barrick – were also assessed by SUNAT under Rule VIII.

444. On the basis of the above, Claimant submits that SUNAT’s assessment of DEI Egenor (*i.e.*, Duke Energy’s investment) was discriminatory on the basis of nationality.
445. Indeed, Claimant asserts that SUNAT’s assessments were discriminatory in intention, character and effect. Claimant submits that the evidence it has put forward demonstrates that the Government of Peru, facing an immense political storm after the fall of the Fujimori administration, singled out foreign investors that were continuing to avail themselves of the Merger Revaluation Benefits under their LSAs.
446. Claimant highlights in particular that SUNAT resorted to Rule VIII (to disallow the Egenor and Power North merger as a “sham” transaction) only after its initial strategy (*i.e.*, taking the position that the benefits of the Merger Revaluation Law were not stabilized under LSAs) seemed destined to fail.

b) Respondent’s Position

447. Respondent denies that SUNAT’s audit of DEI Egenor was politically motivated, and has put forward several witnesses from SUNAT who attest to the objectivity of the agency and the audit process that was undertaken against Egenor.
448. Respondent submits that the companies in Claimant’s “four groups” are not similarly situated to DEI Egenor and, in any event, their treatment does not support Claimant’s assertion that SUNAT discriminated against DEI Egenor for having continued to claim benefits under the MRL:
 - First, Claimant’s assertions are based on the incorrect premise that SUNAT’s selection criteria included whether a taxpayer had conducted a reorganization and that consequently each of the 1,558 companies should have been selected for audit because they had reorganized. Instead, SUNAT employed objective criteria. Those criteria included whether the taxpayer had not yet been audited in the past

two years, whether the taxpayer had a permanent credit balance, and whether the taxpayer had significant distortions in its sales tax ratios. During the audit period 1999-2004, 587 of the 1,558 companies were considered major taxpayers. Of those 587, 329 reorganized under the MRL, and approximately half (143 of 329) of these companies revalued their assets in combination with their reorganization. Of those 143 large taxpayers that revalued and reorganized under the MRL, 71 were selected for audit and 34 were ultimately assessed. Thus, even if SUNAT's selection criteria had included reorganizations, the numbers demonstrate that SUNAT was exercising its authority to audit and assess taxpayers on a reasonable, even-handed, and non-discriminatory basis.

- Second, of the 101 major taxpayers selected for audit in 2000, 68 were ultimately assessed on various grounds, including underpayments of income tax. If one accepts Claimant's premise that these 101 companies were similarly situated to DEI Egenor, the fact that 70% of them were assessed nullifies Egenor's complaint.
- Third, the 129 taxpayers referred to by Ms. Merino were selected for audit two years after DEI Egenor. Forty-three of them were major taxpayers and 12 were ultimately assessed. In any event, it is unclear how Claimant would make the case that these 129 companies are similarly situated to DEI Egenor, given that Egenor was selected by SUNAT two years earlier.
- Fourth, Claimant fails to demonstrate how DEI Egenor was discriminated against when it was not assessed because it had continued to avail itself of the MRL benefits after the law expired.

449. Finally, Respondent submits that Claimant's argument that SUNAT changed its strategy in a politically motivated campaign to go after Egenor, based on a comparison of the way other companies (Edelnor and Luz del Sur) were treated, is not valid. Respondent submits that:

The specific facts in the case of Egenor justified the approach SUNAT took in that case. Specifically, in the case of Egenor, the issue was whether it was eligible to receive the tax benefits under Law No. 26283 in the first place because its merger in 1996 with Power North S.A. had been a sham. In the other cases (*Edelnor* and *Luz del Sur*), by contrast, the issue was whether the companies had continued claiming the tax benefits beyond the expiration of Law No. 26283, by virtue of their respective LSAs.

c) Tribunal's Analysis

450. The claim for the guarantee against discrimination under the DEI Bermuda LSA is another one of Claimant's alternative bases for liability in respect of the Merger Revaluation Assessment. Given its earlier findings of liability under the guarantee of tax stabilization, and its conclusions under the doctrine of *actos propios*, the Tribunal has decided that it is not necessary for it to develop its conclusions under this alternative theory.

VI. DAMAGES

A. APPLICABLE STANDARD OF DAMAGES

451. In its Memorial, Claimant submits the following arguments for the applicable standard of damages:

- It is a generally accepted principle of international law that a State's violation of an investor's rights, guarantees and protections requires that the offending Government pay prompt, full and adequate compensation.
- The provisions of the Peruvian Civil Code clearly state that there is liability for damages whether the breach is partial or total, and whether it arises from *dolo*, *culpa inexcusable* or *culpa leve*.
- Peruvian Law follows the *restitutio in integrum* principle, which means that the reparation of damages is integral, covering all consequences arising from the

breach. In this respect, Peruvian law is supported by long-standing international jurisprudence.

452. In sum, Claimant submits that whatever measure of damages the Tribunal adopts, it should: (1) make Claimant whole, and (2) result in a fair outcome.
453. Respondent does not contest Claimant's submissions on the applicable standard of damages. Respondent does, however, question whether Claimant has sustained any damages at all, and therefore whether there is any loss to be made whole.
454. Respondent asserts that Claimant has failed to present any evidence that Claimant itself (i.e., DEI Bermuda) sustained damages as a result of Respondent's breach of the DEI Bermuda LSA, given the dependence of Claimant's liability theory on the breach of the Egenor LSA. Respondent notes that Claimant has not provided a single financial statement, balance sheet, or tax return for DEI Bermuda that shows that that company suffered economic harm because of SUNAT's assessments of DEI Egenor. Rather, argues Respondent, Claimant's allegations relate solely to the harm suffered by DEI Egenor, a company which is not, and could not be, a party to this proceeding. As such, Respondent concludes, Claimant has failed to meet its burden of proof. By providing evidence only for damages allegedly sustained by DEI Egenor, Claimant is asking the Tribunal to assume that one hundred percent of those damages are transferable to, and thus recoverable by, DEI Bemuda.
455. In response, Claimant argues that the losses suffered by DEI Egenor are the losses suffered by DEI Bermuda in proportion to DEI Bermuda's percentage ownership of DEI Egenor through DEI Peru Holdings SRL (i.e., 99.7 percent). Claimant contends that DEI Bermuda's claim to lost dividend payments is fully supported in two respects. First, utility companies are generally purchased for their dividend-paying capacity, given the regulated environment in which they operate. The same is true of DEI Egenor. Second, the Navigant Expert Reply Report demonstrates how DEI Egenor has actually declared and paid dividends, as expected, in nearly every year since its privatization. Indeed, Claimant points to the fact that more than 95 percent of DEI Egenor's entire retained

earnings has been used consistently for the purpose of distributing dividends to its shareholders. Claimant submits that to the extent the earnings of DEI Egenor have been impaired by SUNAT's tax assessments, then the amount by which those earnings have been impaired is the amount unavailable for distribution to DEI Egenor's shareholders.

456. Respondent replies that even assuming that "utility companies are generally purchased for their dividend paying capacity," this general assertion does not begin to meet Claimant's burden of proof to evidence its damages in this specific case. Respondent notes that DEI Egenor's dividend payment ratio has fluctuated wildly during the time period in question, from a positive 173 percent in one year to a negative 238 percent in the next.
457. The Tribunal has concluded that Claimant has indeed sustained a loss as a result of SUNAT's assessment against Egenor. Although it is true that the dividend payment ratio fluctuated significantly between 1996 and 2000, the evidence reveals that a dividend was declared in each of those years, and that a total of approximately 95% of Egenor's profit was paid out as dividends during that period.
458. The Tribunal concludes that DEI Bermuda is entitled to be made whole for the damages suffered by DEI Egenor, but that DEI Bermuda's damages are not identical to DEI Egenor's damages. The Tribunal will award to Claimant the proportion of the losses sustained by DEI Egenor that reflects the product of the historical level of dividends paid by DEI Egenor to its shareholders (95 percent) multiplied by DEI Bermuda's percentage ownership of DEI Egenor through DEI Peru Holdings SRL (99.7 percent), which results in a factor of 94.715 percent.
459. The Tribunal now turns to the actual quantification of damages.

B. QUANTUM OF DAMAGES

1. Navigant's Analysis (for Claimant)

460. In support of its position on the quantification of damages, Claimant submitted the following expert reports from Mr. Brent C. Kaczmarek, C.F.A., of Navigant Consulting, Inc.:

- Expert Report dated June 15, 2006; and
- Expert Reply Report dated December 20, 2006.

461. In addition, Mr. Kaczmarek submitted a document entitled "Revised Damages Support" at the hearing on May 14, 2007, at the end of his examination-in-chief.

462. Navigant's approach to quantifying damages in this case was explained as follows at paragraph 116 of its Expert Report:

To determine the harm caused by SUNAT's revaluation and depreciation rate assessments, we have calculated the difference between 1) the corporate income tax and employee profit sharing payments Egenor has paid since 1996 and will pay in the future ("Actual Scenario") and 2) the corporate tax and employee profit sharing payments Egenor would have paid if SUNAT's audits did not result in the revaluation and depreciation rate assessments ("But-for Scenario"). We have calculated the net present value of the difference between the two scenarios as of 15 June 2006 using the interest rates SUNAT credits to taxpayer, on tax refund requests. For periods prior to 15 June 2006, we have utilized the actual interest rate as stipulated by SUNAT. For periods after 15 June 2006, we have utilized SUNAT's currently quoted interest rate of 7.2 percent.

463. In order to be able to forecast depreciation and employee profit-sharing expenses under the various scenarios, Navigant constructed a financial model containing the 6,000 plus assets on Egenor's balance sheet.

464. Appendix 1 to Navigant’s Expert Report contains a schematic diagram that explains the information flow in the damages model. There are 23 steps in the model that Navigant developed in order to produce the annual cash flow impact of SUNAT’s assessment from 1996 to 2074. Navigant produced with its model various exhibits that contained the information produced at each step of the modelling exercise, as described in the following table:

Exhibit	Information
A2	Annual Cash Flow Impact of SUNAT’s Assessment from 1996 to 2005
B1A	Actual and BUT-FOR Cash Payments to Settle Tax Returns 1996 to 2005
B1B	Actual and BUT-FOR Cash Payments to Employee Profit Sharing Plan 1996 to 2005
B2	Summary of Egenor’s Actual Tax Returns and But-for Tax Filings 1996 to 2005
B3	Actual & BUT-FOR Monthly Payment Calculation 2001 to 2005
B4	Actual & BUT-FOR Monthly Payment Factor Calculation 2001 to 2005
C1	Cash Payments to Settle Audits of 1996 to 2000 Tax Returns
D2A	General v. Special Depreciation Expense on Non-Revalued Asset Portion 2006 to 2074
D2B	General Depreciation Expense on Revalued Asset Portion 2006 to 2030
E2	Navigant Estimate of 2002-2003 SUNAT Assessment
E3A	Navigant “Non-Revaluation Asset” General Depreciation Rate Expense Calculation 2004 to 2005
E3B	Navigant Depreciation Expense Recalculation Under Tax Court Method 2002 to 2003
E3C	Navigant “Revaluation Asset” General Depreciation Rate Expense Calculation Method 2001 to 2005

Exhibit	Information
E4	Detailed Accounting Data by Asset (Egenor v SUNAT)
E5-A	Egenor Partial Write-off / Improvement Asset Accounting
E5-B	Annual Inflation Factors 1996 to 2005

465. As of June 15, 2006, the date of its initial report, Navigant calculated Claimant’s total damages from both components of the Tax Assessment to be US\$37,533,190, plus pre- and post-award interest.
466. In the Revised Damages Support submitted by Mr. Kaczmarek during the hearing, Navigant calculated Claimant’s damages resulting separately from each of the Merger Revaluation Assessment and Depreciation Assessment.
467. In order to make the separate calculations, Navigant used its financial model to determine the effect on Egenor’s cash flow of only the Merger Revaluation Assessment, and then of only the Depreciation Assessment. This required Navigant to re-run the model through its 23 steps for each of the two scenarios. The information generated by that exercise was submitted as part of Navigant’s Revised Damages Support as Exhibits G1 through H4 (for the Depreciation Assessment damages) and as Exhibits I1 through K1 (for the Merger Revaluation Assessment damages).
468. The results of Navigant’s calculations were set out in a document entitled “Damages Summary” submitted with Navigant’s Revised Damages Support. The Damages Summary is reproduced in the table below:

Navigator's Damages Summary
(Amounts in Soles unless otherwise noted)

	[A] As of 15 June 2006	[B] Interest to 15 June 2007	[C=A+B] Total as of 15 June 2007	[=C / 3.1754] Total (in USD) as of 15 June 2007
Depreciation Rate and Merger Assessment Damages	S/. 122,358,198	S/. 10,528,077	S/. 132,886,275	\$ 41,848,673
If Interest is Added to 2002/2003 Tax Credit, Adjust by:	(S/. 1,151,143)	(S/. 99,048)	(S/. 1,250,191)	\$ (393,711)
If Damages Beyond 2011 are not Recoverable, Adjust by:	(S/. 16,686,025)	(S/. 1,435,717)	(S/. 18,121,742)	\$ (5,706,916)
Merger Assessment Damages Only	S/. 71,412,243	S/. 6,144,530	S/. 77,556,773	\$ 24,424,253
If Interest is Added to 2002/2003 Tax Credit, Adjust by:	S/. 0	S/. 0	S/. 0	\$ --
If Damages Beyond 2011 are not Recoverable, Adjust by:	(S/. 14,486,184)	(S/. 1,246,436)	(S/. 15,732,620)	\$ (4,954,532)
Depreciation Rate Assessment Damages Only	S/. 21,487,624	S/. 1,848,862	S/. 23,336,486	\$ 7,349,148
If Interest is Added to 2002/2003 Tax Credit, Adjust by:	(S/. 1,151,143)	(S/. 99,048)	(S/. 1,250,191)	\$ (393,711)
If Damages Beyond 2011 are not Recoverable, Adjust by:	(S/. 2,199,841)	(S/. 189,281)	(S/. 2,389,122)	\$ (752,385)

469. Navigator has therefore calculated the damages from the Merger Revaluation Assessment alone to be US\$24,424,253, and the damages from the Depreciation Assessment alone to be US\$7,349,148. These figures are, in each case, calculated as of June 15, 2007, and subject to adjustment if the Tribunal finds that damages beyond 2011 (the date the DEI Bermuda LSA expires) are not recoverable.

2. Macroconsult's Analysis (for Respondent)

470. In response to Claimant's position on the quantification of damages, Respondent submitted the following expert reports from Mr. Pablo Bustamante of Macroconsult S.A.C.:

- Expert Report dated October 2, 2006; and
- Expert Reply Report dated March 26, 2007.

471. In addition, with the Tribunal's permission, Respondent submitted a letter on June 1, 2007 commenting on the Revised Damages Support submitted by Claimant on May 14, 2007.

472. Mr. Bustamante’s criticism of Navigant’s analysis was summarized as follows in paragraph 2 of his Expert Reply Report:

(i) Navigant’s allegation that Peru received a “double payment” for the tax benefits associated with the Merger Revaluation Law (“MRL”) and the use of the general depreciation rate is not supported by evidence and, in any event, does not affect its estimate of damages; (ii) Navigant’s methodology for calculating damages is conceptually flawed and unnecessarily complex; (iii) Navigant has failed to justify its inconsistent treatment of tax credits earned by DEI Egenor, which inflates Claimant’s damages; and (iv) Navigant has confirmed the accuracy of my calculation of the amount that Claimant’s damages would be reduced if those damages are not calculated after the expiration of the DEI Bermuda LSA in 2011.

473. Mr. Bustamante was the first of the parties’ experts to seek to isolate the damages of each of the two separate assessments. In his Expert Reply Report, he presented the relevant figures. These are summarized by the Tribunal in the following table:

Macroconsult’s Damages Summary

(in US Dollars, and applying adjusted tax credits)

	Depreciation Assessment	Merger Revaluation Assessment
Cash Damages (1996–2074)	15,000,538	15,385,392
Non-Cash Damages	639,002	(1,373,620)
	15,639,540	14,011,772
Total	15,639,540	14,011,772
Adjustment if post-2011 damages excluded	(644,798)	(4,443,614)
	14,964,742	9,568,158
Total (1996–2011)	14,964,742	9,568,158

3. Tribunal's Analysis

474. In the present award, the Tribunal has found Peru liable to the Claimant for breach of the LSA in relation to the Merger Revaluation Assessment only. In this respect, the Tribunal finds that damages beyond 2011 cannot be recovered, given that the benefits of the MRL (which itself was repealed at the end of 1998) could only be expected to extend until the expiry of the LSA.
475. As for the actual amount of damages sustained by Claimant by reason of the Merger Revaluation Assessment alone, the Tribunal must choose between Navigant's and Macroconsult's calculations. Navigant's calculation, excluding damages beyond 2011, results in damages of US\$19,469,721. Macroconsult's calculation, on the same basis, results in damages of US\$9,568,158. This is not an insignificant difference.
476. In reviewing the two calculations, the Tribunal, of course, is mindful of the criticism levied against the Navigant assessment by Respondent and its expert.
477. First, and most fundamentally, Respondent argues that Claimant has simply not proven that Navigant's calculation is correct, and that Macroconsult's calculation is incorrect. Respondent made this point most directly in its comments on Claimant's revised damages, which Respondent submitted by letter on June 1, 2007. In that letter, Respondent wrote:
- Mr. Kaczmarek's Revised Damages Support does not meet Claimant's burden to establish that its calculation of the damages from the Merger Revaluation and Depreciation Rate Assessments is correct and Respondent's is wrong.
478. Respondent implies that Navigant's calculations are incorrect because they are based on what Respondent suggests is a flawed and unnecessarily complex methodology that creates two scenarios for the time period (1996-2000) before SUNAT's 2001 assessment. In particular, Respondent submits that Navigant calculated the difference between what Egenor actually paid based on its understanding of the rules and what it owed under SUNAT's rules during those five years prior to the assessment. According to Respondent,

however, no such difference existed during that period: Egenor paid what it thought it was entitled to pay and not what SUNAT ordered it to pay. Thus, argues Respondent, Claimant's experts calculate a difference between the actual payment and the "but-for-the-breach" payment where none existed.

479. According to Respondent, a simpler way to calculate Egenor's damages would have been to add together (i) the amount of the Tax Assessment in 2001, and (ii) from 2001 onward, the difference between the taxes paid under SUNAT's rules and the taxes paid under the company's understanding of the rules.

480. Claimant responds that:

- Its damages do not somehow predate the issuance of SUNAT's assessment. Navigant, argues Claimant, simply "redid" the accounting for Egenor starting in 1996, as this was necessary to determine the exact amount of the losses DEI Egenor and DEI Bermuda would suffer in prospective years.
- Navigant simply followed the very same procedures that SUNAT followed in order to quantify the impact SUNAT's assessments would have on Claimant's investment in prospective years. If the calculations appear to be complex, contends Claimant, it is not because they were made so unnecessarily by Navigant.
- Importantly, Claimant submits that Respondent's criticism does not conclude that Navigant has erred in its quantification.

481. In order to resolve the disagreement between the parties on the issue of quantum, the Tribunal has studied closely the calculations submitted by their respective experts. Although the Tribunal was not supplied with an electronic version of either of the experts' models, it sought to follow the calculations through the information contained in the exhibits and appendices of each report.

482. Reviewing the data contained in the exhibits and appendices of the various Navigant reports, the Tribunal was able to follow the logic of its model, and understand the flow of

data. Macroconsult's model was not as transparent, and thus less helpful to the Tribunal. Although Mr. Bustamante's expert reply report was accompanied by 20 exhibits, the Tribunal was unable to verify its calculations because the supporting data was insufficient for these purposes. In this connection, the Tribunal's assessment of Macroconsult's Report is identical to the observations made by Mr. Kaczmarek when he was asked by Claimant's counsel to comment on Mr. Bustamante's calculations. Mr. Kaczmarek testified that he "looked at the calculations to see if he could replicate them. We did find some errors in the analysis, but we were unable to fully reconcile it because a lot of the supporting detail was not included with it."⁴⁴ The Tribunal agrees.

483. The Tribunal therefore concludes that it can and does rely on the calculations submitted to it by Mr. Kaczmarek. On this basis, the Tribunal finds that DEI Egenor suffered damages of US\$19,469,721. Applying its earlier finding concerning the proportion of DEI Egenor's loss suffered by Claimant (94.715 percent), the Tribunal awards Claimant damages in the amount of US\$18,440,746 (plus pre- and post-award interest).
484. Finally, the Tribunal must determine where and in what currency the award is payable.
485. Respondent submits that even if damages to DEI Bermuda were established, any damages should be payable in Soles in Peru as the DEI Bermuda LSA is an instrument of Peruvian law, and the alleged harm occurred in Peru.
486. In response, Claimant submits that, in light of the fact that Claimant has demonstrated harm not only to DEI Egenor, but also to DEI Bermuda, damages should be payable in U.S. Dollars in Bermuda.
487. Considering that (i) the Tribunal has found that DEI Bermuda suffered a loss, (ii) such loss was suffered in Bermuda, (iii) there is evidence before the Tribunal that dividends paid by Egenor to DEI Peru Holdings SRL are not subject to additional taxes under Peruvian tax laws, and (iv) the tax rate on dividends paid by DEI Peru Holdings SRL to DEI Bermuda have been stabilized at zero percent in the DEI Bermuda LSA (*i.e.*, until

⁴⁴ Hearing Transcript, May 14, 2007, at p. 1346: 4-8.

2011, which is the same period for which the Tribunal has assessed the underlying damages), the Tribunal orders Respondent to pay the award of damages in Bermuda in U.S. Dollars.

488. In conclusion, the Tribunal awards Claimant damages in the amount of US\$18,440,746 plus simple interest from June 15, 2007, calculated using the actual interest rate(s) stipulated for that period by SUNAT (*i.e.*, the interest rate(s) SUNAT credits to taxpayers on tax refunds).⁴⁵

VII. COSTS

A. PARTIES' SUBMISSIONS

489. The parties submitted their respective submission on costs, as directed by the Tribunal, on July 25, 2007. Claimant filed a supplementary submission on costs on August 30, 2007. The parties very helpfully agreed on a template that both sides used in their submissions, which indeed has made the Tribunal's analysis simpler, and has avoided the need for the Tribunal to review voluminous quantities of supporting law firm, expert and vendor invoices spanning a period of four years.
490. The parties agreed on the categories of costs incurred by each side in this arbitration. They are: (1) fees and expenses of legal counsel; (2) fees and expenses of experts; (3) expenses incurred by fact witnesses; and (4) out-of-pocket expenses incurred by each party (including advance payments to ICSID).
491. In their submissions, each party submitted the reasonably incurred costs on a month-by-month basis from the inception of this dispute to the date of the submission, followed by the presentation of the total of all of these categories added together.

⁴⁵ The parties' damages experts each used the interest rate stipulated by SUNAT to adjust calculations in their analysis. See Navigant Expert Report dated June 15, 2006, at paragraph 116, and MacroConsult's Expert Reply Report dated March 26, 2007 at paragraph 21.

492. Claimant's overall total costs amount to US\$9,715,837.25⁴⁶, broken down as follows:

<u>Category</u>	<u>Amount (US\$)</u>
Legal Fees and Expenses	
Fulbright & Jaworski LLP	
Fees	4,350,836.29
Expenses	517,786.46
Crowell & Moring LLP	
Fees	300,000.00
Expenses	27,137.07
Miranda & Amado, Abogados	
Fees	1,300,121.50
Expenses	184,869.68
Expert Fees and Expenses	1,979,563.54
Witness and Client Out-of-Pocket Costs and Expenses (including, but not limited to witnesses' and client representatives' travel expenses)	228,522.71
ICSID Payments	<u>827,000.00</u>
OVERALL TOTAL	<u>9,715,837.25</u>

493. Respondent's overall total costs amount to US\$5,248,930.23⁴⁷, broken down as follows:

<u>Category</u>	<u>Amount (US\$)</u>
Legal Fees and Expenses	
Sidley Austin LLP	
Fees	3,696,091.56
Expenses	244,323.76
Judge Stephen M. Schwebel	

⁴⁶ This amount includes an advance payment of US\$175,000 requested by ICSID on November 15, 2007 and an advance payment of US\$225,000 requested by ICSID on March 20, 2008, both of which made after the Claimant's Submission on Costs of July 25, 2007 and the Supplement to Claimant's Submission on Costs of August 30, 2007.

⁴⁷ This amount also includes the advance payment of US\$175,000 requested by ICSID on November 15, 2007 and the advance payment of US\$225,000 requested by ICSID on March 20, 2008, both of which made after the Respondent's Submission on Costs of July 25, 2007.

Fees	80,637.50
Expenses	0.00
Santistevan de Noriega & Asociados	
Fees	169,119.31
Expenses	2,907.97
Expert Fees and Expenses	231,039.48
Witness and Client Out-of-Pocket Costs and Expenses (including, but not limited to witnesses' and client representatives' travel expenses)	4,810.65
ICSID Payments	<u>820,000.00</u>
OVERALL TOTAL	<u>5,248,930.23</u>

B. ANALYSIS

494. Article 61(2) of the ICSID Convention reads as follows:

In the case of arbitration proceedings the Tribunal shall, except as the parties otherwise agree, assess the expenses incurred by the parties in connection with the proceedings, and shall decide how and by whom those expenses, the fees and expenses of the members of the Tribunal and the charges for the use of the facilities of the Centre shall be paid. Such decision shall form part of the award.

495. In this case, the parties have agreed on the allocation of certain costs. In Article 9 of the DEI Bermuda LSA, which contains the ICSID arbitration clause, the parties agreed that “the costs incurred in connection with the application of this [arbitration] clause shall be shared by both parties in equal parts.”

496. By letter from the Secretariat dated March 20, 2008, the Tribunal invited the parties to make simultaneous submissions on the interpretation of their agreement on costs within ten days. By letter dated March 31, 2008, the parties jointly stipulated that they understood the agreement on costs in Article 9 to refer only to the payments requested by ICSID and made by the parties. In the same letter, they jointly wrote:

Both parties respectfully request that the fees and costs incurred by the parties in this arbitration, other than the payments requested by ICSID and made by the parties, be assessed by the arbitral tribunal pursuant to Article 61(2) of the 1965 Convention on the Settlement of Investment Disputes between States and Nationals of Other States, after taking into account the submissions on costs made by the parties on July 25, 2007 and August 30, 2007.

497. The parties have therefore agreed that, in connection with Article 61(2) of the ICSID Convention, “the fees and expenses of the members of the Tribunal and the charges for the use of the facilities of the Centre” shall be shared equally by them. In fact, as is standard, the parties have paid equal shares of the advances requested by ICSID.⁴⁸ The Tribunal therefore need not make any assessment in order to give effect to the parties’ agreement to share equally these costs. The decision that remains for the Tribunal on the issue of costs, under Article 61(2) of the ICSID Convention, is therefore how to attribute “the expenses incurred by the parties in connection with the proceedings.”
498. The amounts in question are set out in the parties’ respective submissions on costs. Excluding the payments to ICSID, Claimant has incurred expenses in the total amount of US\$8,888,837.25. Respondent has incurred expenses in the total amount of US\$4,428,930.23.
499. Although Claimant was successful during the jurisdictional phase of this arbitration, Respondent raised serious arguments against jurisdiction, many of which raised novel and difficult issues related to the unique investment protection regime at issue here. As for the merits phase, Claimant has succeeded only in part: it has prevailed in one of its two claims; in relation to that claim, it has succeeded on two of the five alleged breaches of the LSA; and it has been awarded damages representing roughly half of the overall damages that were being sought. Finally, the Tribunal has found that there was no

⁴⁸ Each party has paid \$820,000 by way of advances to ICSID against the costs of the arbitration. Claimant has, in addition, paid a registration fee of \$7,000. The Tribunal has decided that this amount is excluded from the parties’ agreement in relation to “payments requested by ICSID and made by the parties,” and is in any event *de minimis*.

individual bad-faith conduct in relation to the estoppel claim against Respondent for the Merger Revaluation Assessment.

500. Having considered the matter carefully, the Tribunal has decided that it is just and equitable, in the circumstances of this case, to order that each party bear its own legal costs and expenses.

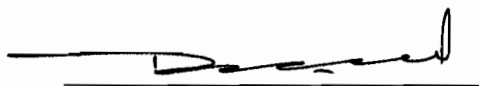
VIII. DECISION

501. Having heard and read all the submissions and evidence in this arbitration, for the reasons set out above, the Tribunal awards and orders as follows:

1. Within thirty (30) days of the date of this Award, Respondent shall pay to Claimant the sum of US\$18,440,746, plus simple interest calculated thereon from June 15, 2007 using the actual interest rate(s) stipulated for that period by SUNAT for refunds to taxpayers; and
2. Each of Claimant and Respondent shall bear its own legal costs and expenses, and share equally the payments requested by ICSID and made by the parties.

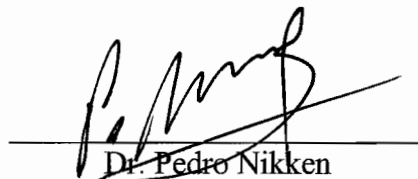
Date: *July 25, 2008*

Date: *July 22, 2008*



Dr. Guido Santiago Tawil
Co-arbitrator

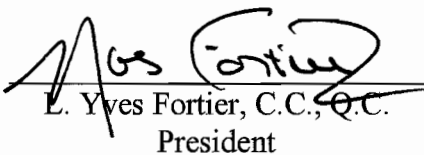
Subject to the attached dissenting opinion



Dr. Pedro Nikken
Co-arbitrator

Subject to the attached dissenting opinion

Date: *11 July 2008*



L. Yves Fortier, C.C., Q.C.
President

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. GUIDO SANTIAGO TAWIL**
—

I

1. I have concurred with my distinguished colleagues and fellow arbitrators in most of the issues discussed in the Award. Unfortunately, I am unable to join in their conclusions on two issues: (i) the scope of the Tribunal's jurisdiction to construe Peruvian law and to review the correctness of SUNAT's decisions and assessments or of the Tax Court's decisions; and (ii) whether the Depreciation Assessment (as defined in paragraph 130 of the Award) constitutes a breach of the DEI Bermuda LSA. I feel obliged to briefly set down my opinion in relation to these two issues.

II

2. The Award takes the position that the Tribunal's jurisdiction does not include the power to review the correctness of SUNAT's decisions and assessments or of the Tax Court's decisions.¹
3. While I have agreed that the Tribunal does not sit as the appellate division of the Tax Court, I respectfully dissent on the issue of the scope of the Tribunal's jurisdiction.
4. As the Tribunal stated in its Decision on Jurisdiction,² it is not for the Tribunal to determine whether any particular decision of the Tax Court is right or wrong as a matter of Peruvian tax law, but whether such interpretation is consistent with the rights stabilized for DEI Bermuda under its LSA. While the Tribunal does not exercise any authority over SUNAT's or the Tax Court's powers, it has been constituted to determine whether SUNAT's or the Tax Court's decisions in the present case represent a change from the stabilized regime under the DEI Bermuda LSA.
5. While a comparative exercise is reasonably straightforward for legislation and regulations and could suffice where a change is objectively demonstrable, the Award reflects the view that in the absence of proof of a stable pre-existing application or interpretation against

¹ Award, at para. 216.

² At para. 159, *in fine*.

which the Tribunal can judge subsequent developments, the Tribunal can only evaluate the decision or assessment that is challenged by Claimant against a reasonableness standard.³

6. I am unable to agree with this conclusion. In my opinion, in such cases the Tribunal is entitled to depart from a strictly comparative analysis and determine the precise scope of the stabilized regime.
7. While Peruvian courts are the only forum empowered to interpret domestic law and to review administrative decisions in order to reverse or annul them, the Tribunal constitutes the proper contractually-agreed forum to construe Peruvian law in order to determine the scope of the stabilized regime under the DEI Bermuda LSA. In performing such function, the Tribunal's powers to interpret Peruvian law must be construed broadly and, in doing so, it is empowered to depart from the Peruvian courts' view if, in the Tribunal's opinion, such view does not reflect adequately the status of domestic law.
8. The parties have voluntarily decided to entrust that task to the Tribunal, not to Peruvian courts. Thus, in order to determine if the DEI Bermuda LSA has been breached, the actions of SUNAT and the Tax Court subsequent to the entry into force of the DEI Bermuda LSA must be evaluated against the Tribunal's own determination of the meaning and scope of the stabilized regime at the relevant time. The Tribunal's powers in such respect do not differ from those that would have been held by a local court called upon to decide whether the LSA has been breached if such court and not this ICSID Tribunal had been the forum contractually designated to settle the present dispute.
9. Therefore, in my opinion, in applying Peruvian domestic law pursuant to Article 42 of the ICSID Convention, the Tribunal is not limited to an analysis merely of the reasonability of the interpretation or application made by Peru of its own laws and regulations. Much less can the determination of the stabilized regime be made by reference to the reasonability of the interpretation of laws and regulations adopted by Respondent's local

³ Award, at para. 223.

courts after execution of the Egenor LSA –i.e. the Tax Court’s decision of May 25, 2001– or to constructions elaborated subsequent to SUNAT’s tax assessments, such as the Tax Court’s decision of April 23, 2004.

10. As stated above, this does not mean that the Tribunal’s jurisdiction to decide this dispute includes the authority to reverse the decisions of the Peruvian courts or administrative agencies. Whatever finding the Tribunal reaches, it cannot exceed the boundaries of its jurisdiction, which is limited to determining whether a violation of the DEI Bermuda LSA has occurred.
11. The jurisdiction of local courts is, thus, distinct from the specific jurisdiction attributed to this Tribunal by the parties’ agreement. Each is a distinct venue that serves a particular object and purpose.
12. As it happens in other fields of law, such interaction can give place to some particular but not totally unusual situations. It could well happen (as it has been increasingly recognized in the domain of Administrative Law in certain cases of State liability)⁴, for example, that while an administrative decision remains extant in a legal system,⁵ it still generates State responsibility and the duty to compensate.

III

13. I must also respectfully disagree with my distinguished colleagues on the decision adopted concerning the Depreciation Assessment.
14. The continuity rule was not in force at the time of the transfer of assets from Electroperú to Egenor and of the execution of both the Egenor LSA and the DEI Bermuda LSA.
15. While Article 105 of Chapter XIII of the Income Tax Law – prior to its 1998 amendment – provided for the application of the continuity rule to asset transfers resulting from

⁴ See G. S. Tawil, “La Responsabilidad del Estado y de los Magistrados y Funcionarios Judiciales por el Mal Funcionamiento de la Administración de Justicia”, Buenos Aires, 1993 (2nd. ed.) at pp. 137/146 concerning State responsibility for judicial errors in cases of decisions that have acquired the status of *res judicata*.

⁵ Due, as an example, to the impossibility of reversing it based on the lack of remedies available, standing or other limitations. This situation only arises in cases in which, as in the DEI Bermuda LSA, Claimant has an autonomous remedy available to claim State liability.

corporate reorganizations, Article 106 limited the concept of “reorganization” to corporate mergers and divisions, whose precise meaning was to be defined in the implementing regulations. As those implementing regulations had not been issued at the time of the transfer of assets from Electroperú to Egenor, Chapter XIII of the Income Tax Law was not enforceable.⁶

16. In the absence of a legal provision – i.e. the continuity rule or some other provision with similar effect – establishing a specific rate that Egenor was obliged to apply, Egenor was required to apply – as it did – the general depreciation rate provided for in the tax regime. By establishing that Egenor should have applied the special depreciation rate, Peru breached the DEI Bermuda LSA.
17. Even applying the reasonability test referred to at paragraph 302 of the Award –the application of which I do not agree with for the reasons stated in Section II above– I come to the conclusion that the Depreciation Assessment was based on an arbitrary interpretation of Peruvian tax laws.
18. It is an established principle in tax law –to which Peruvian tax law is not foreign- that governmental powers can only be exercised pursuant to certain conditions and limitations. One such limitation is given by the principle *nullum tributum sine lege*. A tax obligation can only arise from a legal provision. Taxpayers cannot be deemed to be responsible for any tax obligation not stated in the law.
19. This legality principle is at the core of the Peruvian legal system. Article 74 of the Peruvian Constitution establishes such principle as follows: “Taxes are created, modified and abrogated, or exoneration is established, exclusively by law or legislative decree in case of delegation of powers, except for fees and rates that are regulated by supreme decree (...)”.

⁶ The parties to the present dispute agree that the Tax Court considered that Chapter XIII was not in force at the time the transfer of assets from Electroperú to Egenor took place. *See* Respondent’s Rejoinder, para. 194.

20. The constitutional principle of legality has also been codified in the Peruvian Tax Code and in the Private Investment Law.
21. Rule IV of the Peruvian Tax Code provides that “Only by law or legislative decree in case of delegation it is possible to a) create, modify and suppress taxes; indicate the fact giving rise to the tax obligation, its calculation base and percentage; the tax creditor; the tax debtor (...)”.⁷
22. The Private Investment Law confirms the principle by stating in its Article 14 that “The constitutional principle of legality in relation to tax issues implies that the creation, modification or elimination of taxes, as well as the granting of exemptions and other tax benefits, determination of taxable matter, persons subject to taxation, tax collectors and tax withholding agents, the applicable rates and the taxable base, should be made by means of a law voted by the Congress of the Republic, in accordance with the provisions set forth herein.”⁸
23. The depreciation rate applicable to a company’s assets is an essential component of the taxable income, i.e. the tax calculation base under the Income Tax Law. Determination of the tax base depends on the applicable depreciation rate. The lower the depreciation rate is, the higher is the tax base, and *vice versa*. Therefore, the way to determine the depreciation rate cannot be legitimately established by any means other than by the law and its implementing regulations.
24. If the continuity rule was not applicable due to the lack of specific tax legislation (the implementing regulations), it cannot be inferred from principles or legal doctrine. Otherwise, Chapter XIII of the Income Tax Law and the condition therein established in order for such Chapter to enter into force (the issuance of the absent implementing regulations) would be meaningless.⁹

⁷ See Respondent’s Exhibit R-256.

⁸ See Claimant’s Exhibit C-9.

⁹ In its majority opinion, the Tribunal has acknowledged that the Tax Court found that Chapter XIII of the Income Tax Law was not enforceable due to the absence of implementing regulations. However, it finds that conclusion not sound since its Article 106 “affords the

25. Due to the constitutional limitation imposed by the legality principle, legal doctrine cannot be held as an autonomous source of tax obligations nor can it step into the shoes of the body in charge of issuing the implementing regulations required under Chapter XIII of the Income Tax Law.¹⁰ As established by Rule VIII, third paragraph, of the Peruvian Tax Code: “In the process of interpretation, no taxes may be created, no sanctions may be established, no exemptions may be granted and no tax provisions may be issued to be applied to entities or situations different from those specified in the law”.
26. Based on the foregoing, the Tax Court decision of April 23, 2004, which confirmed that the continuity rule was part of the tax regime at the time that Electroperú transferred assets to Egenor, and on the date of the Egenor LSA (on the basis that it was recognized by legal doctrine –, a source of tax law according to Rule III of the Peruvian Tax Code) violates the constitutional principle of legality stabilized under the DEI Bermuda LSA and does not meet the threshold established by the reasonability test applied by the Tribunal in the Award.
27. Having decided that the continuity rule was neither in force at the relevant time nor stabilized under the Egenor and the DEI Bermuda LSA, it is unnecessary to decide whether the constitution of Egenor qualified as a corporate division for tax purposes.¹¹

executive branch the opportunity to define limitations applicable to the concept of merger and division through regulations, but does not require such regulations for the general concepts to apply.” For the majority opinion, a more explicit language would have been required in order to make the enforcement of the rule contingent on the promulgation of regulations (Award, at para. 304). I respectfully disagree with such conclusion. First, article 106 provides: “*The reorganization of companies or corporations occurs only in cases of merger and division, with limitations, and in accordance with the stipulations stated in the regulations*”. While it is true that the implementing regulations could have established limitations, the use of “and” following “limitations” indicates that those regulations were not restricted to such purpose. Second, even assuming that the implementing regulations could have just provided for limitations to the general concept, it seems unreasonable to deem a tax rule enforceable without having its precise limits established. Third, following the reasoning explained in para. 24 above, when a certain rule subjects its application “*in accordance with the stipulations stated in its regulations,*” its actual application should be considered contingent on those regulations without need of an express qualification exclusively conditioning its enforcement to their issuance.

¹⁰ As a tax law source, legal doctrine may serve as a source of interpretation, but never to enforce a regime that shall be established by law or to define a concept that shall be defined by the implementing regulations. I share the view expressed in the Award that it would be reasonable that depreciation over the useful life of assets should not be changed by the mere fact that ownership thereof has been transferred (Award, para. 302). However, in my view, the issue is not whether the continuity rule is reasonable, but whether such rule existed and was enforceable at the relevant time. If such rule was not established and enforceable when the transfer of assets from Electroperú to Egenor took place it could never have been applied by SUNAT, irrespective of how reasonable or logical such a rule would have been if legally enacted.

¹¹ Notwithstanding so, it should be noted that, pursuant to Article 106 of the Income Tax Law, the Executive was the one empowered to establish the meaning of “division” through the implementing regulations and not the Tax Court. In its April 23, 2004 decision, the Tax Court first held that Chapter XIII of the Income Tax Law was not in force (*see* p. 5 of the Tax Court decision, Spanish original). However, it then filled that gap by applying its own criteria. Through this reasoning, the Tax Court actually enforced the very same Chapter XIII that it had held before was not in force.

28. Due to the majority's finding on liability concerning the Depreciation Rate Assessment claim, it is also unnecessary to enter into further damages considerations in connection with such claim.

Date: July 25, 2008



Dr. Guido Santiago Tawil
Arbitrator

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).

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*".

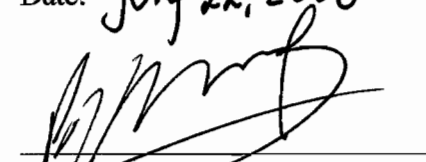
13. Every foreign investor knows or must be deemed to know that the approval by the State shareholders, or the agencies in charge of privatization, of the tax accounts of a company that is privatized does not extinguish contingent tax liabilities nor precludes audit and/or assessment by the tax authority. 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, ***only verbally***, 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