

# ***DUKE V. PERU: STRETCHING LIMITED JURISDICTION TO INCLUDE ESTOPPEL WITHIN THE SCOPE OF A LEGAL STABILIZATION AGREEMENT***

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**ABSTRACT:** *In the recent arbitration of Duke Energy International Investments No. 1 Ltd v. Republic of Peru, the tribunal held that a foreign government was estopped from changing its interpretation of a law where a foreign investor had relied on a prior interpretation to its detriment. In the dispute, an American investor, Duke Energy, challenged the government of Peru over the interpretation of a Legal Stability Agreement. The novelty of this decision involves the scope of the arbitral tribunal’s jurisdiction and the application of general principles of law (namely estoppel) where no treaty or specific international agreement applied. Jurisdiction was based on a provision for international arbitration within the Legal Stability Agreement. With no applicable Bilateral Investment Treaty present, the tribunal had to determine the scope of its own jurisdiction according to the specific agreement between the parties. This short case note will focus on the scope of jurisdiction, the tax stabilization provisions in the Legal Stability Agreement, and the tribunal’s analysis of estoppel in international law.*

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## **List of Abbreviations**

BIT.....	Bilateral Investment Treaty
DEI.....	Duke Energy International
ICJ.....	International Court of Justice
ICSID.....	International Centre for the Settlement of Investment Disputes
LSA.....	Legal Stabilization Agreement
MRL.....	Merger Revaluation Law
SUNAT.....	Peruvian National Tax Administration Superintendency

## I. Introduction

On July 25, 2008, an arbitral tribunal sitting in Washington D.C.<sup>1</sup> delivered an important decision in the matter of *Duke Energy International Investments No. 1, Ltd v. Republic of Peru (Duke v. Peru)*.<sup>2</sup> The decision was the result of a drawn out legal battle spanning almost five years whereby an American investor, Duke Energy, challenged the government of the Republic of Peru (Peru) over the interpretation of a Legal Stability Agreement (LSA): a contract that had been signed by both parties. Central to the dispute was a claim concerning the Peruvian tax authority's inconsistent interpretation of a corporate merger law. The novelty of this decision involves the scope of the arbitral tribunal's jurisdiction and the application of general principles of law (namely estoppel) where no treaty or specific international agreement applied. Jurisdiction was based on a provision for International Centre for the Settlement of Investment Disputes (ICSID) arbitration in the LSA.<sup>3</sup> With increasing frequency, the jurisdiction of ICSID tribunals are based on provisions in Bilateral Investment Treaties (BITs). These are treaties that have been signed between a foreign investor's home-state and the host-state of the investment; generally giving tribunals sweeping jurisdiction over matters relating to international investment.<sup>4</sup> However, no applicable BIT was present in this dispute. Therefore, the arbitral tribunal had to determine the scope of its own jurisdiction according to the specific agreement between the parties. Furthermore, the dispute involved a claim that lacked specific substantive provisions in the LSA; forcing the tribunal to access, *inter alia*, whether an inconsistent interpretation of the so-called Merger Revaluation Law (MRL) was part of the tax stabilization guarantees in the LSA. This short case note will focus on the scope of jurisdiction, the tax stabilization provisions in the LSA, and the tribunal's analysis of estoppel in international law.

## II. The Background

The *Duke v. Peru* dispute addresses some new issues in international investment law; and yet, the political and economic background to the case poses one of the most commonly

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<sup>1</sup> The merits phase of the dispute was conducted in Washington D.C. between May 8 and May 16, 2007 under the authority of arbitrators Mr. L. Yves Fortier, president, Dr. Guido Santiago Tawil, and Dr. Pedro Nikken.

<sup>2</sup> *Duke Energy International Peru Investments No. 1, Ltd v. Republic of Peru (Duke v. Peru)*, Award and Partial Dissenting Opinions, ICSID Case No ARB/03/28, IIC 334 (2008), signed 25 July 2008, dispatched 18 August 2008, [available at](http://www.investmentclaims.com/ViewPdf/ic/Awards/law-iic-334-2008.pdf): <http://www.investmentclaims.com/ViewPdf/ic/Awards/law-iic-334-2008.pdf>.

<sup>3</sup> *Id.* at para. 63.

<sup>4</sup> See J. Yackee, *Bilateral Investment Treaties, Credible Commitment, and the Rule of (International) Law: Do Bits Promote Foreign Direct Investment?* 42 *Law & Soc'y Rev.* 805 (2008).

asked questions in foreign direct investment disputes: how can the legitimate expectations of foreign investors be protected amidst political upheaval? In 1990, Alberto Fujimori ascended to the presidency of Peru amid great internal conflict that had left the country in economic and political chaos.<sup>5</sup> During his first term in office, he enacted wide-ranging neoliberal reforms, known as ‘Fujishock,’ which called for, *inter alia*, vast privatizations of the nation’s state-owned enterprises.<sup>6</sup> Along with these privatizations were laws enacted to encourage the flow of foreign investment capital into the country. Fujimori’s economic plan restored macroeconomic stability to the country and triggered considerable economic growth in the 1990s.<sup>7</sup> However, by 2000, Fujimori had become embroiled in scandal and was eventually forced into exile.<sup>8</sup> Following a short period of rule by an interim president, the leader of Fujimori’s political opposition won the presidency.<sup>9</sup> President Alejandro Toledo and his government worked quickly to dismantle much of the pro-investor legal framework: a legal framework that had come to be associated with the Fujimori administration and was now clouded by accusations of collusion with foreign investors.<sup>10</sup> Therefore, almost overnight, foreign investors were transformed from economic miracle-workers to pariahs.

This shift in political attitudes towards foreign investors exemplifies one of the primary goals of transnational investment law: stabilizing the legal environment in politically unstable countries.<sup>11</sup> The dispute in *Duke v. Peru* can be traced back to the early days of the Fujimori presidency. Reversing the policies of the prior administration, Fujimori rose to power on a platform that would encourage private investment in recently privatized, but formerly state-owned, enterprises.<sup>12</sup> To meet this objective, the legislature passed a number of legal decrees giving legal protections to foreign investors wishing to invest in Peru.<sup>13</sup> One of the specific protections permitted the Peruvian Government to sign binding contracts with foreign investors called Legal Stability Agreements (LSAs), which provided a series of

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<sup>5</sup> When Fujimori came to power, much of Peru was dominated by the Maoist insurgent group Sendero Luminoso (‘Shining Path’), and the Marxist-Leninist group Túpac Amaru Revolutionary Movement (MRTA).

<sup>6</sup> L. Manzetti, *Privatization South American Style*, Oxford University Press, Oxford, England (1999), 325.

<sup>7</sup> *Id.*

<sup>8</sup> R. Atwood, *Democratic Dictators: Authoritarian Politics in Peru from Leguía to Fujimori*, *SAIS Review*, Vol. 21, No. 2 (2001), 167.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.* at 169.

<sup>11</sup> M. Sornarajah, *The International Law on Foreign Investment, Second Edition*, Cambridge University Press, Cambridge, England (2004), 77-78.

<sup>12</sup> C. Kenney, *Fujimori’s Coup and the Breakdown of Democracy in Latin America*, University of Notre Dame Press, South Bend, Indiana (2004), 135.

<sup>13</sup> *Id.* at 140.

guarantees to the foreign investor.<sup>14</sup> The provisions of the LSAs included: (1) the right to equal treatment and non-discrimination, (2) the right to free convertibility of foreign currency, (3) the right to free repatriation of invested capital, profits, and royalties, (4) the right to income tax stabilization, and (5) the right to resolve disputes arising out of or in connection with agreement by arbitration or other agreed methods of dispute resolution.<sup>15</sup> These LSAs represent an interesting approach to investment protection. Since they included the provision of ICSID jurisdiction, the LSA provided the foreign investor with standards of protection afforded to the foreign investor under international law. However, since LSAs were not treaties signed between states, the scope of the ICSID tribunals' jurisdiction was limited to the specific provisions stated in the LSA (discussed below).

### **III. The Privatization of Egenor**

Seeing opportunity in Peru, Duke Energy – through its subsidiaries – began purchasing shares in Peruvian electricity enterprises in the late 1990s. By the end of 1999, Duke Energy, through Duke Energy International Bermuda (DEI Bermuda) and Duke Energy International Peru (DEI Peru), had acquired a 90 percent interest in Egenor: an investment valued at approximately US\$ 288 million.<sup>16</sup> Egenor, later renamed Duke Energy International Egenor (DEI Egenor), was one of the electricity producers that emerged when the Peruvian Government authorized the breakup of the enormous state-owned electricity producer, Electroperú.<sup>17</sup> A 60 percent part of Egenor was offered for sale in 1996 and the winning bidder was Dominion Energy, another American investor.<sup>18</sup> Later in 1996, the owners of Egenor approved a merger between Egenor and Power North (a company wholly owned by a local Peruvian subsidiary of Dominion Energy).<sup>19</sup> Duke Energy would eventually purchase all of Dominion's resulting stake in Egenor. Additionally, Duke Energy was able to acquire, through a series of transactions with other stakeholders, all but ten percent of the shares in Egenor.<sup>20</sup>

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<sup>14</sup> *Duke v. Peru*, para. 40.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.* at paras. 45-73.

<sup>17</sup> *Id.* at para. 46.

<sup>18</sup> *Id.* at para 49.

<sup>19</sup> This merger, tacitly authorized by the Peruvian Government, would become central to the dispute. The tribunal had to determine if this merger was sufficiently approved by the government so as to reasonable induce reliance on the part of the foreign investor.

<sup>20</sup> *Duke v. Peru*, para. 49.

As part of this investment, the Peruvian Government signed a number of LSAs with the various private investors involved in the purchase of Egenor: most notably the Egenor LSA and the Dominion Energy LSA. Furthermore, as part of the transaction that resulted in Duke Energy's purchase of its 90 percent stake in Egenor, Duke Energy signed a Guarantee Agreement with Dominion Energy and Peru: this Agreement guaranteed that all of the "original obligations assumed, representations, and warranties made" by Peru would remain effective and enforceable against Peru.<sup>21</sup> In October 1999, shortly after Duke Energy's acquisition of Egenor, the original Egenor LSA was assigned to DEI Egenor. However, the Dominion Energy LSA, which would have provided coverage for Duke Energy's investment not covered by the Egenor LSA, was not assigned.<sup>22</sup> In 2000, Duke Energy petitioned the Peruvian Government for a new LSA that would fully cover its investment in Peru.<sup>23</sup> However, this LSA, which was called the DEI Bermuda LSA by the tribunal, was not signed until July 24, 2001.<sup>24</sup> By this time, the Fujimori Government had been ousted, and the legal environment was undergoing significant changes.

#### **IV. The Tax Assessments**

At the center of the dispute between Duke Energy and the Government of Peru was a new assessment of DEI Egenor's tax liability, which was made by the Peruvian tax authority (SUNAT)<sup>25</sup> shortly after the new Peruvian Government of Alejandro Toledo came to power. On November 22, 2001 (after a year-long investigation), SUNAT assessed a tax liability of approximately US\$ 12.4 million (plus US\$ 35.9 million in interest and penalties) against DEI Egenor for what SUNAT determined were tax underpayments in the years 1996 through 1999.<sup>26</sup> Duke Energy's tax liability was based on two assessments by SUNAT: (1) the Depreciation Assessment and (2) the Merger Revaluation Assessment.<sup>27</sup> The assessments turned on shifts in interpretation of the taxation regime in Peru; both of which were given legal authority under Rule VIII of the Peruvian Tax Code (Rule VIII).<sup>28</sup> Rule VIII is a general tax-avoidance provision, and provides SUNAT with the authority to scrutinize the actions of tax debtors in order to identify the true business intentions of the tax debtor, and

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<sup>21</sup> *Id.* at para. 55.

<sup>22</sup> It is unclear from the text of the tribunal's decision as to the reasons why this LSA was deemed assignable.

<sup>23</sup> *Duke v. Peru*, para. 72.

<sup>24</sup> *Id.*

<sup>25</sup> *Superintendencia Nacional de Administracion Tributaria*.

<sup>26</sup> *Duke v. Peru*, para. 128.

<sup>27</sup> *Id.* at para. 141.

<sup>28</sup> *Id.* at para. 126.

to waive the adopted legal forms and structures if the intention of the tax debtor is to avoid tax liability in a manner inconsistent with the law.<sup>29</sup>

In terms of both assessments, the question for the tribunal turned on the issue of whether Rule VIII was used by SUNAT in a manner that violated the tax stabilization provisions of the LSA between the Peruvian Government and Duke Energy. In answering this question, the tribunal needed to evaluate whether the scope of the tax stabilization provisions in the LSA included a stable interpretation of both the MRL and the depreciation rules of the Peruvian National Commission on Rates,<sup>30</sup> and if it did, was the new interpretation of these laws a violation of the tax stabilization guarantee? Since the tribunal did not have jurisdiction to scrutinize the competence or validity of SUNAT's decision-making (a matter of purely domestic law), the tribunal had to consider whether the new interpretations of the tax violated general principles of good faith in international law (discussed below).<sup>31</sup> In terms of the Depreciation Assessment, the tribunal found that a change in the method of depreciating assets in assessing tax liability was not a violation of the tax stabilization guarantee under the LSA.<sup>32</sup>

The Merger Revaluation Assessment, however, proved far more complicated. The Merger Revaluation assessment was based on the MRL. The MRIL was passed as part of the Peruvian Governments' efforts to remedy the era of hyperinflation that had plagued the country in the pre-Fujimori years.<sup>33</sup> The MRL encouraged companies to merge, and in the process, reevaluate their assets without fear of additional tax liability.<sup>34</sup> The MRL was passed in 1994 and repealed in 1998.<sup>35</sup> Therefore, only mergers that occurred within this period were covered by the law. The focus of the Merger Revaluation Assessment was the 1996 merger of Egenor and Power North.<sup>36</sup> The new tax assessment by SUNAT claimed,

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<sup>29</sup> *Id.* The text of Rule VIII as translated by the tribunal: “[w]hen 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.”

<sup>30</sup> 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 for the fixed assets of Public Utility Companies in Peru.

<sup>31</sup> *Duke v. Peru*, paras. 215-32.

<sup>32</sup> *Id.* at para. 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*.”

<sup>33</sup> *Id.* at para. 350.

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

<sup>36</sup> See *infra* note 19.

under authority of Rule VIII, that this merger was to be considered a ‘sham’ transaction and that the true purpose of the merger was to avoid tax liability as opposed to taking advantage of the true purpose of MRL (restructuring and revaluation of companies).<sup>37</sup> Essentially, the Merger Revaluation Assessment valued the tax liability of DEI Egenor absent the tax amnesty that was afforded under the MRL. As stated, the first issue for the tribunal was to determine if the MRL was included in the tax stabilization provisions of the LSA. The tribunal held that the MRL was included within the scope of the LSA. This determination was based primarily on prior arbitral decisions holding that the MRL was stabilized under Peru’s LSA regime.<sup>38</sup> SUNAT did not challenge these prior conclusions.

The tribunal then had to ask whether a change in the interpretation, as opposed to a change in the actual law, was included in the scope of the definition of tax stabilization under the LSA. The tribunal held that changes in the interpretation of the law, by government authorities (namely SUNAT), was included within the scope of the LSA guarantees.<sup>39</sup> The tribunal concluded 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 [DEI] Egenor.”<sup>40</sup>

The tribunal went on to hold that tax stabilization under the LSA regime in Peru includes:

“(a) laws or regulations that form a 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 place at the time the LSA is executed will not be changes to the detriment of the investor, and (c) even in the

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<sup>37</sup> *Duke v. Peru*, para 324.

<sup>38</sup> *Id.* at para. 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. Indeed, in the case of Egenor, SUNAT did not challenge this conclusion.”

<sup>39</sup> *Id.* at para. 345.

<sup>40</sup> *Id.*

absence of (a) and (b), stabilized laws will not be interpreted or applied in a patently unreasonable or arbitrary manner.”<sup>41</sup>

This determination that Peru was liable for changing the interpretation of the MRL in an arbitrary and unreasonable manner was not only based on the legal protections provided in the text of the applicable LSAs that had been signed with Duke Energy, but also the guarantees that may be implied from LSA under Peruvian law.<sup>42</sup> In its Decision on Jurisdiction of February 1, 2006 (discussed below),<sup>43</sup> the tribunal held that:

“[f]irst, Claimant is entitled to guarantees 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.”<sup>44</sup>

According to the tribunal,

“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.’”<sup>45</sup>

One of the fundamental facets of this obligation under Peruvian law is the so-called *doctrina de los actos propios*, which prohibits the Peruvian Government from contravening its own prior actions where one has relied upon the representation of such actions to her detriment.<sup>46</sup> This law, which is also considered a general principle of law<sup>47</sup> under the Latin phrase, *venire contra factum proprium non valet*,<sup>48</sup> would estop SUNAT from arbitrarily changing its

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<sup>41</sup> *Id.* at para. 227.

<sup>42</sup> *Id.* at para. 229.

<sup>43</sup> *Duke Energy International Peru Investments No. 1 Ltd v. Republic of Peru (Duke v. Peru, Jurisdiction), Decision on Jurisdiction*, ICSID Case No ARB/03/28, IIC 30 (2006), signed 01 February 2006, [available at: http://www.investmentclaims.com/ViewPdf/ic/Awards/law-iic-30-2006.pdf](http://www.investmentclaims.com/ViewPdf/ic/Awards/law-iic-30-2006.pdf).

<sup>44</sup> *Id.* at para. 134.

<sup>45</sup> *Duke v. Peru*, para. 230.

<sup>46</sup> *Id.*

<sup>47</sup> *See Statute of the International Court of Justice*, 3 *Bevans* 1179; 59 *Stat.* 1031; *T.S. No. 993*; 39 *AJIL Supp.* 215 (1945), Article 38, § 1(c) (defining one of the primary sources of international law as “the general principle of law recognized by civilized nations.”).

<sup>48</sup> *See Temple of Preah Vihear (Cambodia v. Thailand)*, [1962] *I.C.J. Rep.* 6, 65 (June 15) (separate opinion of Judge Alfaro) (“I have no hesitation in asserting that this principle [estoppel], known to the world since the days of the Romans, is one of the ‘general principles of law recognized by civilized nations’ applicable and in

interpretation of the tax laws for which Duke Energy had reasonable relied (this theory of Peruvian liability is discussed in detail below).

## V. The Scope of Jurisdiction

While the scope of jurisdiction has been laid out in previous sections, there are specific nuances to the issue of jurisdiction that need to be mentioned briefly. The ability of the arbitral tribunal to determine if the tax stabilization regime of the LSA had been violated was based on its grant of jurisdiction under the LSA itself.<sup>49</sup> All of the LSAs signed in association with the sale of Egenor's assets to private foreign investors included the following provision:

“10. 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 the 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 National of Other States.”<sup>50</sup>

Therefore, while the scope of jurisdiction was limited to disputes arising out of a particular LSA, the specific reference to ICSID obligated the tribunal to apply the choice of law rules found in Article 42(1) of the ICSID Convention.<sup>51</sup>

Since there was no provision in the LSA that provided for the substantive law that should be applied if a dispute were to arise, the tribunal had to answer questions relating to the applicable law of the dispute.<sup>52</sup> In its Decision on Jurisdiction, the tribunal held that Article 42(1) of the ICSID Convention, absent specific provisions on the applicable law,

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fact frequently applied by the International Court of Justice in conformity with Article 38, para. 1(c) of its Statute.”); J. Adcock, *Detrimental Reliance*, 45 La. L. Rev. 753, 764 (1985).

<sup>49</sup> *Duke v. Peru*, paras. 157-61.

<sup>50</sup> *Id.* at para. 63.

<sup>51</sup> *Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, art. 42(1), Aug. 27, 1965, 17 U.S.T. 1270, 515 U.N.T.S. 159. (Washington Convention).

<sup>52</sup> *Duke v. Peru, Jurisdiction*, para. 162.

“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.”<sup>53</sup>

The tribunal held that while the scope of its jurisdiction was limited to the LSA regime in Peru, the LSA regime is not a creature of purely domestic law and therefore principles of international law can be given effect under two scenarios: (1) where international law norms are consistent with the interpretation of Peruvian law, and most importantly (2) where Peruvian law and international law differ, international law has supervening authority.<sup>54</sup> This extension of jurisdiction that is granted by Article 42(1) of the ICSID convention essentially permits the tribunal to internationalize its jurisdiction. Such an interpretation of jurisdiction allows the tribunal to incorporate general principles of law and customary international law into its analysis.

While the tribunal in *Duke v. Peru* had to spend considerable time on questions of jurisdiction, it is the increasingly common practice of international tribunals to be granted ICSID jurisdiction through a relevant BIT.<sup>55</sup> The BIT normally includes both far-reaching protections for foreign investment, and ICSID jurisdiction without contractual privity; each giving foreign investors the opportunity to raise substantive claims that may have been outside the scope of the specific contractual agreements signed between the foreign investor and the host-state.<sup>56</sup> For example, had the *Duke v. Peru* dispute been based on jurisdiction in a relevant BIT, the tribunal would likely have determined that SUNAT’s inconsistent interpretation of the MRL was a violation of the ‘fair and equitable treatment’ standard in the BIT (a provision common to many BITs and prevents the host-state from taking arbitrary or unreasonable actions against the foreign investor in violation of her legitimate expectations).<sup>57</sup>

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<sup>53</sup> *Duke v Peru*, para. 181.

<sup>54</sup> *Id.* at para. 241.

<sup>55</sup> Yackee, *supra* note 4, at 807.

<sup>56</sup> *Id.*

<sup>57</sup> *See* C. Schreuer, *Fair and Equitable Treatment in Arbitral Practice*, 6 *Journal of World Investment & Trade* 357, 359 (2005).

However, since the jurisdiction in *Duke v. Peru* was limited to the scope of protections in the LSA, the tribunal had to take one of two paths: (1) either determine that

the inconsistent interpretation of the MRL was included in the scope of the LSA (which it did), or (2) determine that the inconsistent interpretation of the MRL was a violation of international law independent of the protections provided in the LSA (either as violation of the international minimum standard of treatment or general principles of law such as good faith and estoppel).<sup>58</sup> Since the tribunal determined that the inconsistent interpretation of the MRL was included in the scope of the LSA, it did not have to opine on any alternative theory of liability; and yet it did.<sup>59</sup>

After determining liability under the LSA, the tribunal embarked on an exhaustive analysis of an alternative theory of Peruvian liability: estoppel under international law (discussed below). The reason for this extensive analysis is only speculative, but could have been based on the arguably shaky ground that the tribunal assessed Peruvian liability under the LSA. The tribunal wanted to demonstrate that, even absent the tax stability provisions in the LSA, Peru had violated norms of international law and was therefore liable regardless of the specific interpretation of the LSA. The tribunal achieved this goal by steering clear of Duke Energy's claim that the inconsistent interpretation of the tax laws was a violation of the international minimum standard of treatment (calling it a "thorny issue"),<sup>60</sup> and finding it much easier to apply a more established principle of international law: estoppel.<sup>61</sup>

## VI. The Analysis of Estoppel

In an in-depth analysis, the tribunal in *Duke v. Peru* provided an alternative theory on Peru's liability that was based on the Peruvian doctrine of *actos propios*.<sup>62</sup> As stated, the doctrine of *actos propios* operates as a component of good faith whereby a state is prohibited

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<sup>58</sup> See *Duke v. Peru*, paras. 241-48 (discussion of international legal norms that would provide protections to the foreign investor against arbitrary action of the State).

<sup>59</sup> *Id.* at para 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."

<sup>60</sup> *Id.* at para. 280 (discussion avoiding the application of the minimum standard of treatment in international law likely because it has not yet crystallized as customary international law).

<sup>61</sup> *Id.* at para. 231.

<sup>62</sup> J. Brutau, "La Doctrina de los Actos Propios" in *Estudios de Derecho Comparado* (1951), 102.

from taking actions or making representations which are contrary or inconsistent with actions it had taken previously to the detriment of another.<sup>63</sup> While the tribunal lacked jurisdiction to rule on matters of Peruvian domestic law (repeatedly stating that the tribunal was not sitting as an appellate body to the tax court and that it lacked jurisdiction to evaluate the validity of SUNAT's interpretation of the domestic tax laws of Peru *per se*),<sup>64</sup> the tribunal did hold that it maintained jurisdiction over norms of international law applicable to the interpretation of the LSA.<sup>65</sup> In order to apply the doctrine of *actos propios* (a domestic legal doctrine), the tribunal had to access whether such a doctrine operated in the sphere of international law.<sup>66</sup> Finding that the doctrine of *actos propios* also operates as a general principle of law – known variously as *venire contra factum proprium non valet*, estoppel or the principle of consistency;<sup>67</sup> the tribunal held that it had jurisdiction under international law to determine if Peru was estopped from changing its interpretation of the tax laws where prior representations had reasonably induced Duke Energy's reliance.<sup>68</sup>

In its most basic terms, the doctrine of estoppel prevents a party from contravening its actions where prior representations gave the reasonable appearance that such actions could be relied upon by another.<sup>69</sup> That is,

“a man shall not be allowed blow hot and cold – to affirm at one time and deny at another . . . Such a principle has its basis in common sense and common justice, and whether it is called ‘estoppel,’ or by any other name, it is one which courts in modern times have most usefully adopted.”<sup>70</sup>

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<sup>63</sup> *Duke v. Peru*, para. 231; See also J. Brutau, “La Doctrina de los Actos Propios” in *Estudios de Derecho Comparado* (1951), 104.

<sup>64</sup> *Duke v. Peru*, para. 215.

<sup>65</sup> *Id.* at para. 241.

<sup>66</sup> *Id.* at paras. 231-32.

<sup>67</sup> See *Statute of the International Court of Justice*, 3 *Bevans* 1179; 59 *Stat.* 1031; T.S. No. 993; 39 *AJIL Supp.* 215 (1945), Article 38, § 1(c) (Article 38 lists “general principles of laws recognized by civilized nations” as a primary source of international law).

<sup>68</sup> *Duke v. Peru*, at para. 231.

<sup>69</sup> C. Brown, *A Comparative and Critical Assessment of Estoppel in International Law*, 50 *U. Miami L. Rev.* 369, 374 (1996).

<sup>70</sup> *Cave v. Mills*, 31 *L.J. Ex.* 265, 280 (1862).

In international law, estoppel has been invoked to prevent a state from changing course where its actions had the reasonable appearance that such actions would bind the state.<sup>71</sup> This principle has been repeatedly discussed in International Court of Justice (ICJ) cases.<sup>72</sup> Most succinctly, the international principle of estoppel was described in the *Temple of Preah Vihear* case, where the tribunal stated that:

“the principle operates to prevent a State contesting before that Court a situation contrary to a clear and unequivocal representation previously made by it to another state, either expressly or impliedly, on which representation that other State was, in the circumstances, entitled to rely and in fact did rely, and as a result that other State has been prejudiced or the State making it has secured some benefit or advantage for itself.”<sup>73</sup>

In *Duke Energy v. Peru*, the tribunal discussed the principle of estoppel as a general principle of law that could be applied to find Peru liable.<sup>74</sup> Through its approval of the Egenor and Power North merger under the authority of the MRL, Peru had given Duke Energy the reasonable appearance that such a representation would bind the state.<sup>75</sup> Estoppel in this context does not require illegal action by the state *per se*; it only prevents the state from changing its behavior after making prior representations that have induced reliance by third parties.<sup>76</sup>

While ultimately holding that Peru had violated its obligation under international law, the tribunal also had to sort out whether representations made by Peru had the effect

of binding SUNAT, and thus preventing SUNAT from making an independent assessment of Duke Energys’ use of the MRL.<sup>77</sup> This issue was somewhat controversial because, according

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<sup>71</sup> Brown, *supra* note 69, at 384.

<sup>72</sup> See *Legal Status of Eastern Greenland (Denmark v. Norway)* [1933] P.C.I.J. (ser. A/B) No. 53 (Apr. 5); *Fisheries (Norway v. United Kingdom)* [1951] I.C.J. Rep. 116 (Dec. 18); *Temple of Preah Vihear (Cambodia v. Thailand)* [1962] I.C.J. Rep. 6 (June 15); *North Sea Continental Shelf (Germany v. Denmark, Germany v. Netherlands)* [1969] I.C.J. Rep. 3 (Feb. 20); *Barcelona Traction Light & Power Co. (Belgium v. Spain)* [1964] I.C.J. Rep. 6 (July 24); *Delimitation of the Maritime Boundary in the Gulf of Maine Area (Canada v. U.S.)* [1984] I.C.J. Rep. 246 (Oct. 12); *Elettronica Sicula S.p.A. (U.S. v. Italy)* [1989] I.C.J. Rep. 15 (July 29); *Land and Maritime Boundary between Cameroon and Nigeria (Cameroon v. Nigeria) (Preliminary Objections)* [1998] I.C.J. Rep. 275 (June 11).

<sup>73</sup> *Temple of Preah Vihear (Cambodia v. Thailand)*, [1962] I.C.J. Rep. 6, 32-3 (June 15).

<sup>74</sup> *Duke v. Peru*, para. 231.

<sup>75</sup> *Id.* at paras. 247, 426.

<sup>76</sup> *Id.* at para. 245.

<sup>77</sup> *Id.* at paras. 428-30.

to Peruvian legal authorities, the domestic law doctrine of *actos propios* did not compel one state entity to oblige representations made by other state entities.<sup>78</sup> That is, under Peruvian law, the assurances given to Duke Energy by various Peruvian state entities did not bind SUNAT to that interpretation. However, under international doctrines on State Responsibility, valid assurances given to third parties by one state entity have the authority to bind other state entities, and even the state as a whole.<sup>79</sup> Therefore, the tribunal applied its rule permitting the “supervening application of international law” where inconsistent with domestic law, and held that the reasonable assurances given to Duke Energy regarding the tax implications of the MRL estopped SUNAT, a distinct state entity, from contravening those prior assurances.<sup>80</sup>

## VII. Conclusion

The decision in *Duke v. Peru* was eagerly awaited by the international investment arbitration community because it is the first arbitral award to analyze the scope and interpretation of legal stabilization since the ‘classic awards’ of the 1970s.<sup>81</sup> Those looking for guidance on legal stability in the context of investment arbitration will likely not be disappointed. However, the interpretation of the scope of the LSA in *Duke v. Peru* might be lacking. Due to the fact that the tribunal’s jurisdiction was limited to the LSA itself, it had to stretch (arguably too far) the scope of the LSA to include an inconsistent interpretation (not a change in the law) of the MRL (not a tax law, but a law having tax implications). With that said, the tribunal undoubtedly came to a correct and just conclusion. The Peruvian Government, in a period of traumatic internal political upheaval, treated the foreign investor, Duke Energy, in a unjustifiable manner. Caught in the middle of a domestic political fight, the foreign investor was arbitrarily and unreasonably stripped of the legitimate expectations of its investment. Protecting an investor by estopping a government from taking such arbitrary actions is exactly what the modern law of international investment strives to achieve.

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<sup>78</sup> *Id.* at para. 430.

<sup>79</sup> See J. Crawford, *The International Law Commission's Articles on State Responsibility: Introduction, Text and Commentaries*, Cambridge University Press, Cambridge, England (2008), 101.

<sup>80</sup> *Id.* at para. 432.

<sup>81</sup> The ‘classic awards’ refer to the series of arbitrations that resulted over disputes during the oil nationalizations of the 1970s in the Middle East. See e.g. *BP Exploration Co (Libya) Ltd v The Government of the Libyan Arab Republic*, 53 ILR 297 (1979); *Texaco Overseas Petroleum Co/California Asiatic Oil Co v The Government of the Libyan Arab Republic*, 53 ILR 389 (1979); *Libyan American Oil Co v The Government of the Libyan Arab Republic*, 20 62 ILR 140 (1981).

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