



# Peru's oil & gas investment guide

2017 / 2018



Ministry of Foreign Affairs  
Peru



**ProInversión**

Private Investment Promotion Agency - Peru



Building a better  
working world



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# About this oil & gas investment guide

The Oil & gas industry in Peru has evolved from an industry in decline to a major contributor to the economic growth in Peru. From 1995 to 2014, investment in the sector increased from \$147 million to \$1,190 million, which means an increase of 800%. For years 2017-2018, it is expected that US\$2,898 million will be invested in around 15 oil and gas projects, which represents 14.2% of all the investments to be made in 2017-2018, exceeding investments obtained in the sector in 2016 by 5%.

Among other key factors in the success of this industry is its enormous potential. Currently, Peru has a hydrocarbon potential of 10,000 million barrels of oil across the country (including both on-shore and offshore blocks). Camisea project and other



new industrial opportunities around this source, such as biofuels or petrochemical industry, have also contributed to increase this potential.

This oil & gas investment guide has been structured to help investors broadly evaluate Peru's oil and gas sector investment conditions and provide them a general updated landscape of the industry. In that sense, we have included various aspects usually taken into consideration by investors from around the world before making critical decisions on the development of new oil & gas operations.

Within this guide, we have examined a wide-range of information from a macroeconomic perspective (overview of Peru's political

structure, business environment and favorable investment promotion conditions) to the specific key indicators, regulatory requirements, growing potential and also some information regarding some topics currently discussed by experts in this field.

We have also included a description of the hydrocarbon terms and fiscal regime applicable to oil and gas companies, considering major government taxes, royalties and similar levies, as well as an overview of the customs, labor and accounting aspects that should also be taken into account when starting a business and developing oil and gas activities in Peru.

## Why Peru?

What oil &  
gas investors  
should know

“The difference  
between good  
investment decisions  
and bad investment  
decisions is the right  
information at the  
right time”



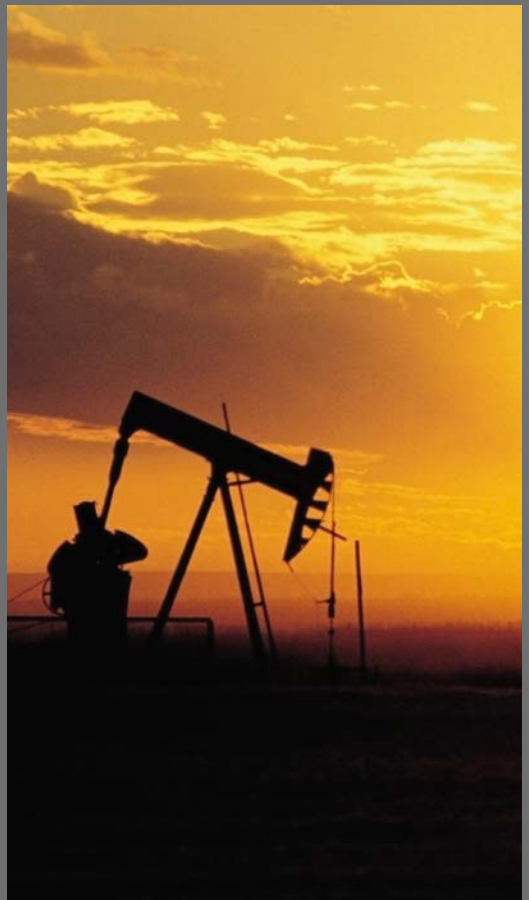
**Paulo Pantigoso**  
Country Managing Partner



This oil & gas guide is the first, and still the first, handbook of its kind. Since its first edition (2014), the objective of this document has been its use as guide and tool in the process of evaluating the oil & gas landscape in Peru to ensure that foreign investors have the most recent and accurate information to start and develop their operation in Peru on a long-term basis.

With this guide, EY demonstrates its commitment to contribute to Peru's progress, through our support for business ventures, growth and success. We provide readers with the most recent information on the country's shining economic performance, as well as important technical information on how to establish businesses in Peru. At EY we are committed to contributing towards attracting investment that can increase the prosperity of our economy, and we are sure that the Oil & Gas industry has the potential to provide such growth.

We invite you to contact us with your questions and we wish you all the best with your Oil & Gas investment opportunities in Peru.





**Beatriz De La Vega**  
Oil & Gas Leader and Editor



Peru has a longstanding tradition as an oil producing country, which dates back to the end of the 19th century. Indeed, it hosted the very first oil well drilling in South America, located at the northern region of Peru, which is still producing hydrocarbons. More recently, Camisea, a major project regarding one of the most important natural gas reservoirs in the region, started production in 2004. This project boosted the Peruvian economy in every aspect by providing a reliable source of cheap and eco-friendly energy, diversifying the energy matrix and making of Peru an exporter of liquefied natural gas since 2010.

The exploitation of oil basins and the Camisea project have been developed in a political and macroeconomic stability provided by and improved upon by the government. As a result, Peru's economy has been growing at annual rates above other countries in the region, largely supported by the prices of commodities.

Despite the downfall of international prices and high volatility, Peru still has much more to offer. Indeed, the oil & gas sector has real potential for growth and further expansion. For example, from the eighteen basins along Peru, fifteen of them are still under-explored. This holds golden opportunities for investors as much of



the country is still open to vast exploration. To optimize proven reserves of natural gas, efforts to develop midstream projects are underway by the Peruvian government in order to spread the use of hydrocarbons throughout all Peruvian territory. This also could bring opportunities in the development of distribution concessions, thermoelectric plants and petrochemical projects.

Peru has been compliant with the EITI standard (Extractive Industries Transparency Initiative) since 2007, consolidating during the last ten years its proven leadership in fiscal transparency in extractive industries in Latin America.

International investors are a crucial part of the growth and success of Peru's oil & gas exploration and production. Peru welcomes foreign investment with an open and stable regulatory environment. A foreign investment law guarantees the security of foreign and domestic investments. Furthermore, Peru is consistently undertaking measures to improve its business climate to attract more investment.

We invite you to contact us with your questions and we wish you all the best with your oil & gas investment opportunities in Peru.





**Silvia Alfaro Espinoza**

General Director of Economic Promotion  
Ministry of Foreign Affairs



**Ministry of Foreign Affairs  
Peru**

In the last several years, Peru has shown itself as a strong economy due to the sustained growth of its GDP, its exchange rate stability and its low levels of inflation. Because of this, Peru has held its place as the regional leader country in terms of economic growth, despite the changing global environment. Likewise, Peruvian credibility before the international community has increased thanks to its accurate macro economical management, the continuity of its private investment promotion policies and all the efforts it has been making to elevate its standards on public policies and good practices, in accordance with its ambition to become part of the OECD.

Peru is a rich country in cultural and historical terms, and its privileged geographical location on the southeastern Pacific coast and its wide diversity of flora, fauna, climate and natural resource abundance, makes it an attractive destiny for productive investments. In that sense, our oil and gas resources, two of the main power sources around the world, are very important factors for economic and social development.

Peru's hydrocarbons sector has great potential in exploration, exploitation, distribution and commercialization activities. According to the last Hydrocarbons Reserves Annual Book, published by the Ministry of Energy and Mines

(2015), proven reserves are estimated at 473 million barrels of oil, 714 million barrels of liquefied natural gas and 14.09 trillion cubic feet of natural gas. Despite the potential of the sector, we consider it a main issue to drive its growth by means of the strengthening of its competitiveness, respect for the environment and by giving investors the best opportunities to develop this high-demand market. Likewise, promoting the sustainable development of this industry and enhancing the access network of resources to generate more inclusion and welfare to the population is of special interest to the government.

In this regard, it is a pleasure to present the Peru's oil and gas investment guide 2017 / 2018. With this publication, investors and businessmen will have a specialized tool which details one of the economic sectors with the greatest potential in the Peruvian economy. Within this guide, you will have access to very useful information, ranging from regulatory and tax issues to the latest developing trends of the oil and gas sector.

As General Director of Economic Promotion and on behalf of the Ministry of Foreign Affairs, I invite you all to invest in the Peruvian oil and gas sector, in which I am sure you will find great opportunities to make your businesses grow, and make Peru grow, too. Welcome!







## Rafael Zoeger Nuñez

Chairman of the Board of  
Directors of Perupetro S.A.



Peru has a hydrocarbon potential of 10,000 million barrels of oil throughout its territory, including marine waters resources. According to this, on average, the country may produce one million barrels of oil per day.

With this in mind, Perupetro has begun a reform towards the sustainable recovery of the upstream hydrocarbons sector that goes beyond the current oil market conditions or royalties reduction.

This new reform is based on three pillars: (i) a new Regulatory Framework, (ii) strengthening and redefinition of Perupetro's role and (iii) a National Plan of Hydrocarbons Exploration and Exploitation which will set up production and investment goals and medium and long term reserves.

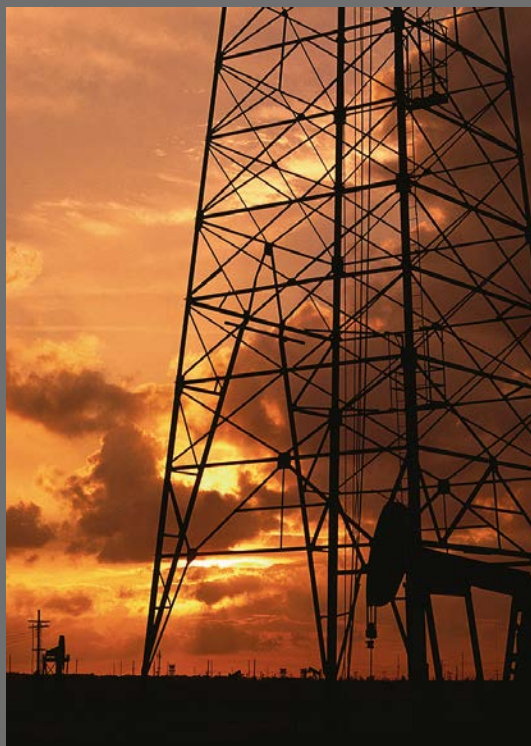
Perupetro is working on a more competitive Exploration & Exploitation (E&E) framework according to global tendencies which is aimed to attract new sustainable investments with broad business, technological, social and environmental support.

As part of this reform, Perupetro has redefined its investment portfolio, identifying nine (9) Potential Products according to the hydrocarbon affiliation of the different Peruvian basins and establishing 54 areas for Contracts and/or Technical Evaluation Agreements.

This will be part of the Action Plan 2017-2018 for contracting areas, which is deemed to be announced during the second semester of 2017.

The Peruvian upstream sustainable reform is urgent and shall be integral in order to achieve the energetic objectives that our country requires and demands.

This is a great opportunity to focus on a new perspective, to offer different and better alternatives to attract investors, and with Peru being a multiracial and multicultural country, Perupetro will make every effort to harmonize the interests of all the stakeholders involved in the hydrocarbon industry.





**Alvaro Quijandria**

Executive Director  
ProInversión



**ProInversión**

Private Investment Promotion Agency - Peru

In the last three decades, Peru has maintained an economic policy framework that has allowed it to promote private investment and boost growth in the domestic market, while at the same time developing a clear policy of commercial integration and foreign investment. As a result, Peru's economy has achieved some of the best growth in the world in the last 10 years. The macroeconomic strengths and excellent economic results have led the risk rating agencies to grant Peru investment grade, confirmed in December 2016 with the forecast of "stable."

For 2017, the Revised Multiannual Macroeconomic Framework 2017-2019 issued by the Ministry of Economy and Finance estimates a growth rate of 4.8% for Peru, again the highest in the region. At those rates, future prospects are set for stable growth. This positive view of the Peruvian economy is based largely upon the beginning of the construction of infrastructure concession megaprojects, signed in recent years, and on a recovery in the mining industry, as well as the measures implemented to ease up investments, which will encourage a diversification in the production industries. Regarding the oil and gas sector, the Ministry of Economy and Finance estimates that its contribution to GDP will rise in 5.9%.

Likewise, a particular characteristic of the oil and gas sector is that its steady growth in the last year is closely related to the economic development of the country and its necessity to generate energy for its use in economic and productive activities. It is important to mention that according to



the National Energy Programme 2014-2025 prepared by the Peruvian Ministry of Energy and Mines, liquid and gaseous hydrocarbons will cover 76% of the energy matrix. Due to this, it is necessary to stimulate and promote the development of appropriate infrastructure for the transport and distribution of hydrocarbons, guaranteeing the supply of energy to consumers, with emphasis in regional markets and in sectors that contribute the most to the economy growth.

It is important to highlight the Peruvian government's decision to work towards closing the infrastructure gap and promoting the participation of the private sector in infrastructure through the mechanism of public-private associations. Peru's Agency for the Promotion of Private Investment, ProInversion, provides assistance for investors in the stages of research, establishment and post-establishment. In order to help close the infrastructure gap, ProInversion carries out a series of processes to promote private investment in infrastructure and public service projects through a mechanism of Public Private Associations. Over the next five years, the Peruvian government's objective is to reduce the infrastructure gap by half. A large part of the projects that are required to reach that objective will be promoted by ProInversion through these Public Private Associations.

Thus, according to estimations made by the Central Reserve Bank of Peru, the hydrocarbons sector is the second sector with more planned investment for 2017-2018 period. In a way,

this investment interest is underpinned by the issuance of legal measures aiming towards the promotion of investment and the strengthening of energetic security.

Peru is also developing a plan focused on being accepted as a member of the OECD and, since 2008, has been promoting the OECD Guidelines for Multinational Businesses, as well as the guidelines on corporate responsibility in the supply chain, contributing towards the appropriate climate to develop sustainable mining projects.

Foreign investment can be made in Peru under conditions that are equal to domestic investment and is not subject to compliance with any performance requirements. Additionally, Peruvian regulations include special rules that guarantee that critical aspects for development investments remain permanent, such as: the free movement of capital, free competition, and the protection of private property. The framework of investment policies is based on the conviction that private investment should be the driving force behind growth. The fundamental plan for the country's growth and development is for domestic and foreign investments to be the advantage that develops the country's huge opportunities.

We welcome investors to explore the range of investment possibilities given in the Peruvian hydrocarbons sector and to contribute and participate in the development of energetic resources in a sustainable way.



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# Background information

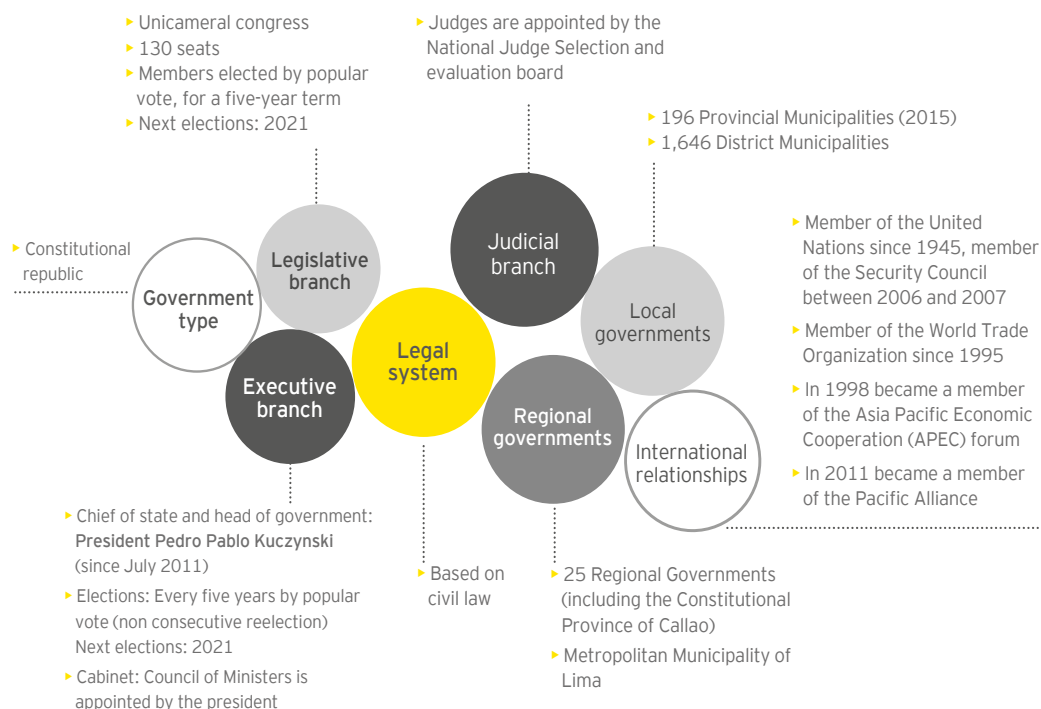
# 01 | Form of government

Peru is a democratic constitutional republic with a multiparty system. Under the Constitution of 1993, the President is the Chief of State and Head of Government. The president is elected every five years and cannot run for re-election immediately. The President appoints the Prime Minister and the members of the Cabinet. There is a unicameral Congress of 130 members elected for a five-year period. The legislative proposals can be submitted by both, the executive and legislative branch, and will become law once they are approved by the Congress and

promulgated by the President. The judicial and electoral bodies are independent.

The Peruvian Government is elected directly through a mandatory vote, applicable to all citizens between the age of 18 and 70. In the last democratic election (2016), President Pedro Pablo Kuczynski was elected as President. Peru has some of the best macroeconomic indicators of the Americas and expects to grow in terms of the Gross Domestic Product (GDP), at a rate well above the average rate of the region.

## Country overview



Sources: Peruvian Constitution / CIA - The World Factbook / Ministry of Foreign Affairs / United Nations

## 02 | Geography

Peru, located on the west central coast of South America, is bordered by the Pacific Ocean to the west, Chile to the south, Bolivia and Brazil to the east, and Colombia and Ecuador to the north. With a total land area of 1,285,215.60 km<sup>2</sup>, Peru is the third largest country in South America after Brazil and Argentina. It may be divided geographically in three regions:

- ▶ The Coast (Costa), which is a narrow desert strip 3,080 km long that accounts for only 11.7% of Peru's territory even though it contains approximately 19.3 million inhabitants. Lima, the political and economic capital of the country, is located in this region.
- ▶ The Highlands (Sierra), which consists of the Andean Mountain Range, covers 27.9% of Peru's territory and contains almost 9.5 million inhabitants.
- ▶ The Amazon Jungle (Selva) is the largest region occupying 60.4% of Peru's territory, in which 3.0 million inhabitants reside. This region is rich in petroleum and forestry resources.



### Peru's geographic information



**Population**  
31.8 million  
Urban 76.7%  
Rural 23.3%



**Principal languages**  
Spanish / Quechua /  
Aymara



**Natural Resources**  
Gold, copper, silver,  
zinc, lead, hydrocarbons,  
fish, phosphates, and  
agricultural products



**Area**  
1,285,215.60 km<sup>2</sup>



**Currency\***  
Sol (S/)  
S/1 = US\$0.303  
US\$1 = S/3.296



**Timezone**  
GMT -5 (five hours behind  
Greenwich Mean Time). There  
is no daylight savings time,  
and there is only one time  
zone throughout the entire  
country.



**Religion**  
Freedom of religion  
mostly Roman Catholic



**Climate**  
Varies from tropical in the  
Amazon region to dry on the  
Coast to temperate, to very  
cold in the Highlands

\*Exchange rate as of January 25, 2017  
Sources: BCRP / INEI / SBS



## 03 | People

The estimated population of Peru for the year 2017 is 31.8 million, of which 10.1 million (approximately 31.9%) reside in Lima, the capital of the country. The labor force is about 23 million (2015).

The predominant religion is Roman Catholicism and the main official languages are Spanish and Quechua. Aymara is also spoken in some parts of the southern Highlands region of the country. With respect to the literacy rate, 94.0% of the population aged 15 and over can read and write.

### People overview

<b>Population</b>	31.8 million people 76.7% resides in urban areas
<b>Age structure</b>	0 - 14 years 27.5% (2016) 15 - 64 years 65.7% (2016) 65 years and over 6.8% (2016)
<b>Growth rate</b>	1.1% (2013 - 2016)
<b>Birth rate</b>	18.3 births/1,000 population (2016)
<b>Death rate</b>	5.7 deaths/1,000 population (2016)
<b>Sex ratio</b>	At birth 1.03 male/female
<b>Life expectancy at birth</b>	74.8 years (2016)

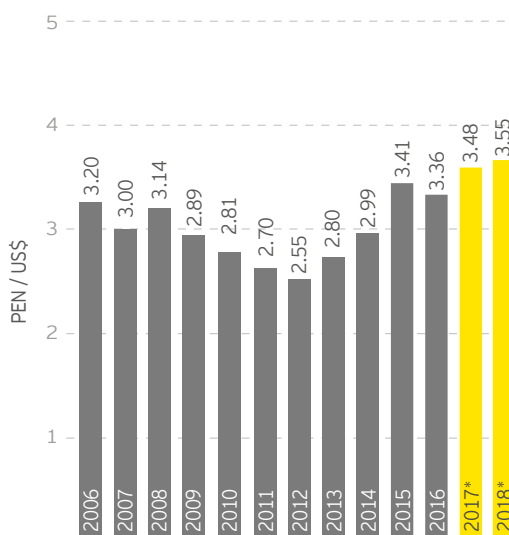
Sources: INEI / CIA Factbook

## 04 | Currency

The Peruvian currency is the Sol (former "Nuevo Sol") (S/ or PEN). Peru has a free-floating managed exchange rate regime. Banks are currently (January 25, 2017) buying US dollars at S/3.294: US\$1.00 and selling at US\$1.00: S/3.296. Parallel market rates are slightly different.

There are no restrictions or limitations on holding bank accounts in foreign currency or to remit funds abroad.

### Exchange rate



\*Estimated

Sources: BCRP / Ministry of Economy and Finance

## 05 | Economic overview

With an estimated population of 31.8 million for 2017, and rich deposits of copper, gold, silver, lead, zinc, natural gas, petroleum and urea, Peru is a very diverse country due to the climatic, natural and cultural variation of its regions.

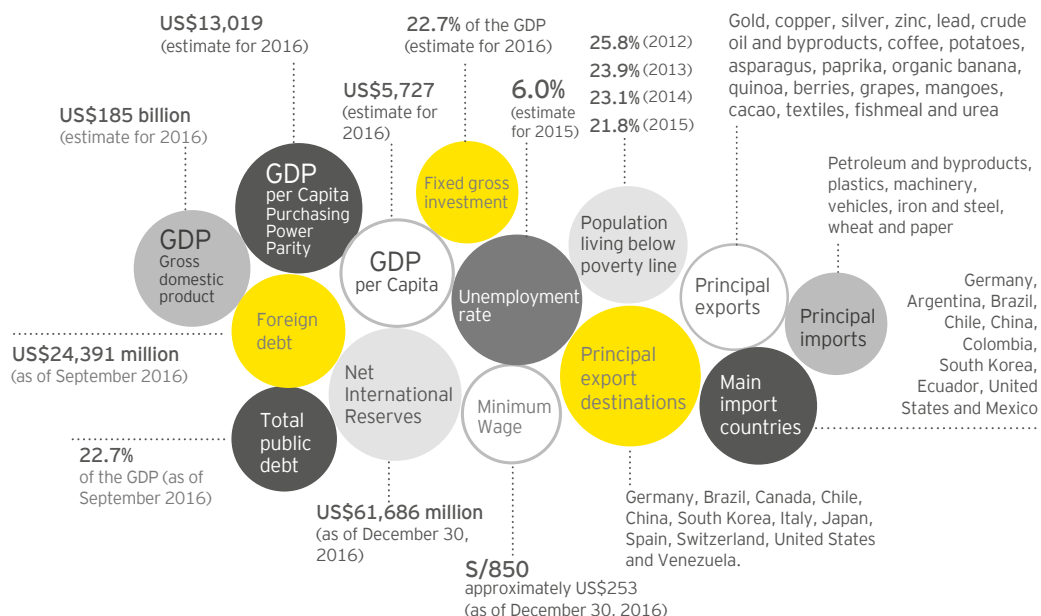
Peru's economy reflects its varied geography, an arid coastal region, the Andes further inland, and tropical lands bordering Colombia and Brazil. Abundant petroleum resources are found mainly in the Amazon Jungle area.

In recent years, Peru has achieved significant advances in social and development indicators as well as in macroeconomic performance, with very dynamic GDP growth rates, reduction of external debt, a stable exchange rate, and low inflation

which in 2016 was 3.2%, a little bit above the upper limit of the Central Bank's annual target range of 1% to 3%.

The country has had continuous economic and political stability since the early 1990's. The Peruvian economy is expected to have grown 124.6% between 2000 and 2016. This growth was largely driven by prudent macroeconomic policies, investor- friendly market policies and the government's aggressive trade liberalization strategies. Growth is now slowing within a context of lower prices for Peru's largest commodity exports, although the country's economy has remained strong in the last years, growing at an expected rate of 4.0% in 2016 and with an estimated growth of 4.3% for 2017.

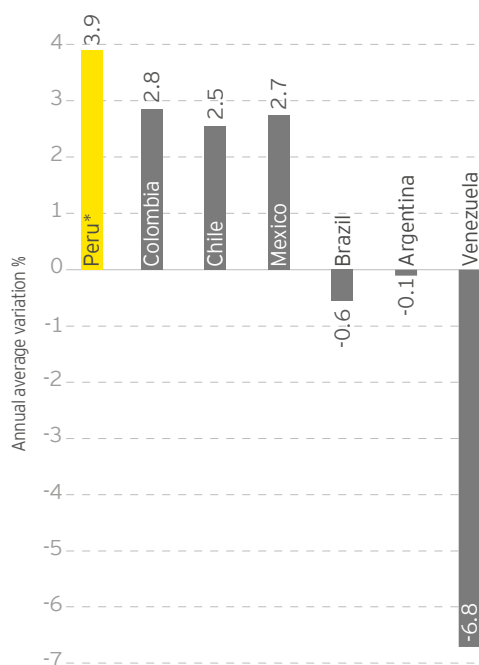
### Peru's economic overview



Sources: BCRP / Ministry of Economy and Finance (MEF) / Apoyo consultoría / International Labor Organization (ILO) / INEI / International Monetary Fund (IMF)

Despite the mentioned slowdown, Peru's economic growth will continue to be one of the strongest among its peers, as the central bank now expects growth of around 4.3% in 2017. It is expected that the increase in mineral production will support Peru's economic growth over the next few years. Peru's rapid expansion has helped to reduce the national poverty rate by almost 27 percentage points in the last 10 years, to 21.8% of its total population in 2015.

### Economic Growth Rates Latin America projections: 2016-2018 (Annual average variation %)



\*As of January 2017

Sources: International Monetary Fund (IMF) / For Peru, BCRP

The country's recent boost in economic growth has much to do with the monetary and fiscal policies applied over the past two decades, reducing the debt level (from 32.3% of the GDP in 2006 to 22.7% in the third quarter of 2016) and ensuring consistent fiscal government: -0.3% in 2014, -2.1% and -2.7% for 2015 and 2016, respectively. All of this has gone hand-in-hand with the liberalization of the goods and labor markets, opening up trade through multiple recent international trade agreements, direct foreign investment, and the maximization of the revenues resulting from its rich natural resources. Peru is also reaping the benefits of the increasing size of its market and domestic consumption, and the development of its financial sector, which can be seen, for example, in the growth of private consumption by an estimated 3.5% in 2016 (estimated at 3.5% for 2017). Likewise, as of December 29, 2016, net international reserves stood at approximately 32% of the estimated GDP as of the same date.

Peru is one of the fastest growing economies in the region. Since 2000, it achieved an impressive accumulated growth rate of 126% GDP

The Peruvian economy for 2017 is expected to be the first fastest growing in South America. This is driven principally by public investment (7.4% for 2017), private consumption (3.5% for 2017) and improved employment indicators. At the same time, the growth of fixed private investment in 2017 is expected to be situated at 5.0.

### **GDP and GDP per Capita (Purchasing Power Parity-PPP) of the Principal Economies of Latin America (2016 and 2021)**

Country	2016		2021
	GDP in US\$ Billions (PPP)	GDP per Capita in US\$ (PPP)	GDP per Capita in US\$ (PPP)
Brazil	3,135	15,211	17,725
Mexico	2,307	18,865	22,970
Argentina	880	20,171	24,233
Colombia	690	14,162	17,991
Venezuela	469	15,103	14,536
Chile	436	23,969	29,221
Peru	410	13,019	16,459

Source: International Monetary Fund (IMF), October 2016



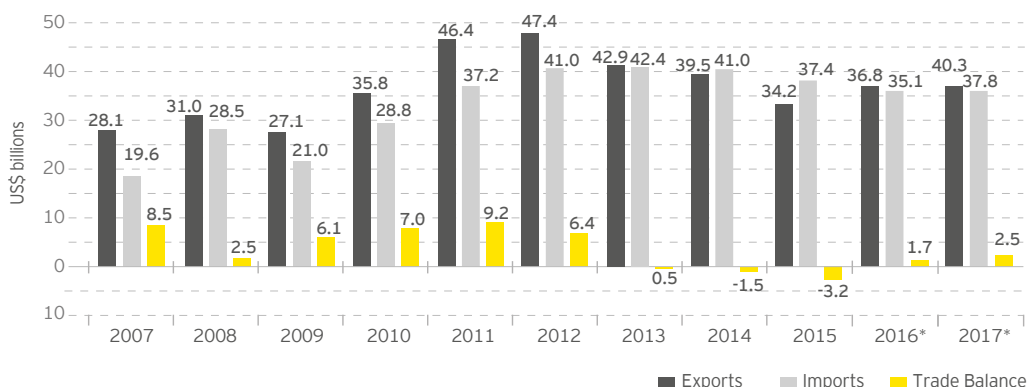
Peru has signed a number of Free Trade Agreements (FTAs). These FTAs have been entered into with the United States, China, Thailand, the European Union, South Korea, Canada, Costa Rica, Chile, Honduras, Mexico, Venezuela, Panama, Singapore, Cuba, Japan and EFTA States (European Free of the Trade Association) which includes Iceland, Kingdom of Norway, Swiss Confederation and the Principality of Liechtenstein. It also has 33 (see page 41) Bilateral Reciprocal Investment Promotion and Protection Agreements (BRIPPAs). Also, Peru maintains trade negotiations corresponding to the Trans Pacific Partnership Agreement (which includes Australia, Canada, Chile, Japan, New Zealand, and Singapore among others), and with El Salvador and Turkey.

The Free Trade Agreement (FTA) with the United States entered into force on February 1, 2009, opening the way to greater trade and investment between both countries. Likewise, the Free Trade Agreement (FTA) with China and Japan became effective in 2010 and 2012, respectively. Additionally, Peru entered into the Framework Agreement for the Pacific Alliance in April 2011, a trading bloc that it forms part of together with Chile, Colombia, and Mexico, aimed at encouraging regional integration and the greater growth, development, and competitiveness of their economies, as well as achieving the free circulation of goods, services, capital, and people.

Peru's traditional main exports are gold, copper, petroleum oil, natural gas, zinc, lead, iron, fishmeal, quinoa, grapes, asparagus, mangoes, cacao, berries and coffee, and its principal trading partners are Argentina, Brazil, Canada, Chile, China, Ecuador, Germany, Italy, Japan, Mexico, South Korea, Spain, Switzerland, and the United States.



## Trade balance



\*Estimated  
Sources: BCRP

## Peru's main economic activities ]

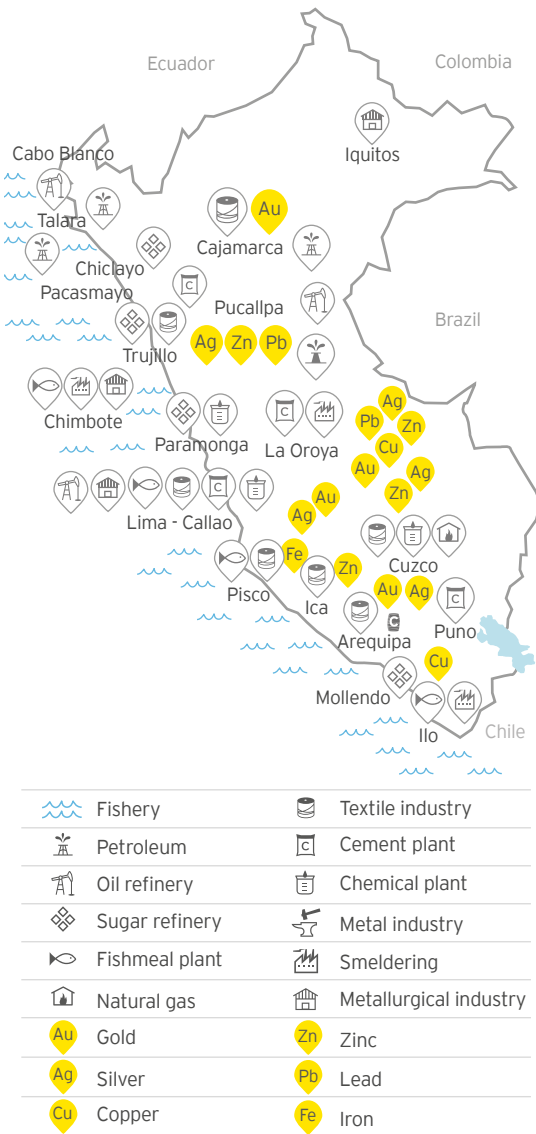
Peru's main economic activities include agriculture, fishery, mining, the exploitation of petroleum and gas, and the manufacturing of goods, most notably textiles. The sharply contrasting geographical areas of Peru make it a particularly diverse country, with a wide variety of ecosystems, and thus, flora and fauna.

In 2015, Peru ranked as the world's top producer of fishmeal (US\$1.158 billion exported); and it is the second-largest exporter of avocado (US\$306 million were exported in 2015). It is also an important producer and exporter of fresh asparagus (US\$316 million as of October, 2016), fresh grapes (US\$236 million as of October 2016) and natural calcium phosphates (US\$249 million as of October 2016).

In mining, according to the U.S. geological survey, Peru ranked third in the world in 2015 in the production of silver, copper and zinc, fourth in tin lead, and molybdenum, fifth in mercury, and sixth in gold besides having large deposits of iron ore, phosphates, manganese, petroleum, and gas. The principal destinations for Peruvian copper are China and Japan, gold to Switzerland, United States and Canada, zinc to South Korea and silver to the United States.

One of the economic activities that is only recently being exploited and which shows great potential is that of forestry resources (cedar, oak, and mahogany, mainly).

## Main economic activities by region



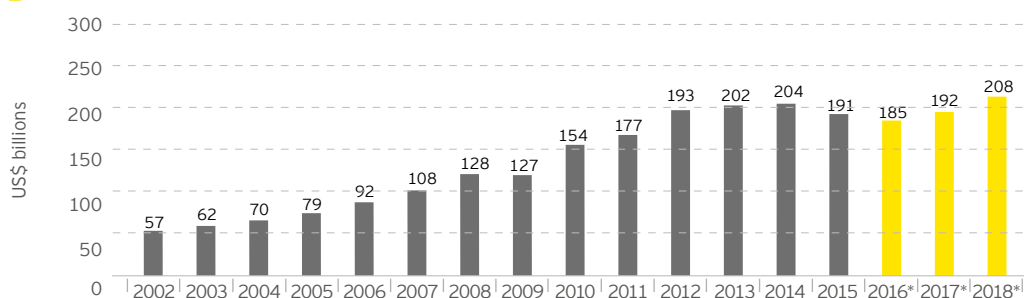
Source: University of Texas - Perry Castaneda Library Map Collection



## [ Gross Domestic Product (GDP) / Trade Balance ]

The Gross Domestic Product (GDP) estimate for 2016 is US\$185 billion. It is estimated that at the end of 2016, total FOB exports came to US\$36.8 billion, while imports totaled US\$35.1 billion. The principal exports came from the mining, hydrocarbons, and agricultural and livestock industries.

### Peru's real GDP



\* Estimated

Sources: BCRP / Ministry of Economy and Finance / International Monetary Fund (IMF) / EY / Apoyo Consultoría

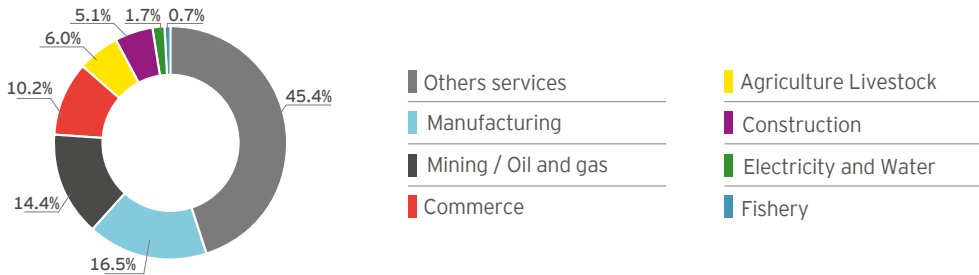
### Gross Domestic Product (GDP) by Industry - Annual % Change

	2008	2009	2010	2011	2012	2013	2014	2015	2016*	2017*	2018*
Agriculture and Livestock	8.0	1.3	4.3	4.1	5.9	1.6	1.4	3.4	1.3	2.8	5.0
Fishery	3.0	-3.4	-19.6	52.9	-32.2	18.1	-25.3	15.9	-12.8	34.7	5.7
Mining	7.3	-1.4	-0.7	-1.1	2.2	4.3	-2.2	15.5	21.7	7.5	5.0
Hydrocarbons	10.3	16.1	28.4	19.7	2.3	7.2	3.9	-11.5	-5.5	7.1	6.6
Manufacturing	8.6	-6.7	10.8	8.6	1.5	5.1	-2.9	-1.5	-2.2	3.5	4.0
Electricity and Water	8.1	1.1	8.1	7.6	5.8	5.5	4.9	5.9	7.6	5.5	5.0
Construction	11.0	-0.5	12.5	8.9	7.2	8.9	2.1	-5.8	-2.7	3.6	5.5
Commerce	16.8	6.8	17.8	3.6	15.8	5.9	4.4	3.9	2.0	3.3	3.8
Other Services	8.7	3.6	8.8	7.0	7.3	6.2	4.8	4.2	4.0	3.9	3.8
<b>GDP</b>	<b>9.1</b>	<b>1.0</b>	<b>8.5</b>	<b>6.5</b>	<b>6.0</b>	<b>5.8</b>	<b>2.4</b>	<b>3.3</b>	<b>4.0</b>	<b>4.3</b>	<b>4.2</b>

\*Estimated

Sources: BCRP

## Peru's GDP by productive sector



Sources: BCRP

## GDP variations



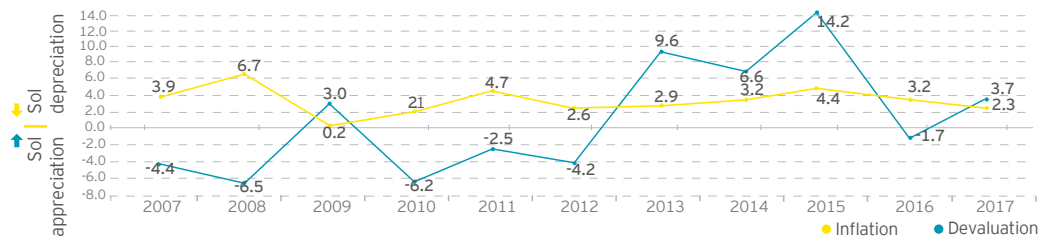
\*Estimated

Source: BCRP

## [ Devaluation and inflation ]

Exchange rate appreciation: the market value of the Sol rose fell 1.7% against the US Dollar in 2016. The annual inflation rate was 3.2% as of December, 2016. Peru's central bank aims to keep the annual inflation rate within a target range of 1% to 3%.

## Devaluation and inflation



\* Exchange rate estimated at 3.48 according to the Multiannual Macroeconomic framework (MMM) of August 2016

Sources: BCRP / Ministry of Economy and Finance



## 06 | Infrastructure and services

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It is expected that Peru will only realize its full economic potential after reducing its infrastructure bottlenecks. Estimates vary, but the investment required runs into billions of dollars (160 billion in accordance with last estimation performed by Universidad del Pacifico). In recent years, Peru has begun to take the necessary measures to improve its underprivileged infrastructure (transport facilities, electricity, water and communications) in order to promote new investments which will contribute to the development of the productive sectors of the country. Recently the Government has approved a new regulation for PPP projects with the intention to reduce dramatically the calendar of the whole process.

The hydrocarbon is one of the sectors affected by this constraint since oil and gas companies need to have access to transportation facilities to deliver their products to national and international markets. Well-developed infrastructure reduces the effect of distance between regions, with the result of truly integrating the national market and connecting it at low cost to markets of other countries and regions.

The government has been evaluating different alternatives to reduce such problems. One of those alternatives is the construction of pipelines, i.e. to transport natural gas extracted from Camisea's gas fields to the north and south region of Peru (called Southern and Northern Peruvian Gas Pipeline project). Another important alternative implemented by the Government is the Northern Peruvian Pipeline, constructed to transport oil from the north region of Peru to the coast.

### [ Public-Private partnerships ]

Peruvian laws have incorporated Public-Private Partnerships (PPPs), a modality of private investment participation. PPPs are executed under the form of concession, operation, management, joint venture and any other modality admitted by Peruvian laws. The main characteristic of PPPs is the distribution of risks between the Peruvian Government and the privates.

PPPs provide the opportunity to invest by means of the use of expertise, equipment, technology, among other tools in order to create, develop, improve, operate or maintain public infrastructure or provide public services. This modality of investment can be requested as of a private initiative or through a public tender.

In this regard, the following projects in the sector are in the short term pipeline of the Government:

- 950 Kms of new highways to facilitate transport.
- 650 Kms of energy transmission lines.

#### **Transmission line Aguaytia-Pucallpa**

The project consists in the design, construction, operation maintenance and financing of an energy transmission line of 132 Kms with a power of 80MVA. The purpose is to reinforce the Pucallpa energy center to cover the current demand of energy. The investment will be US\$37 million.

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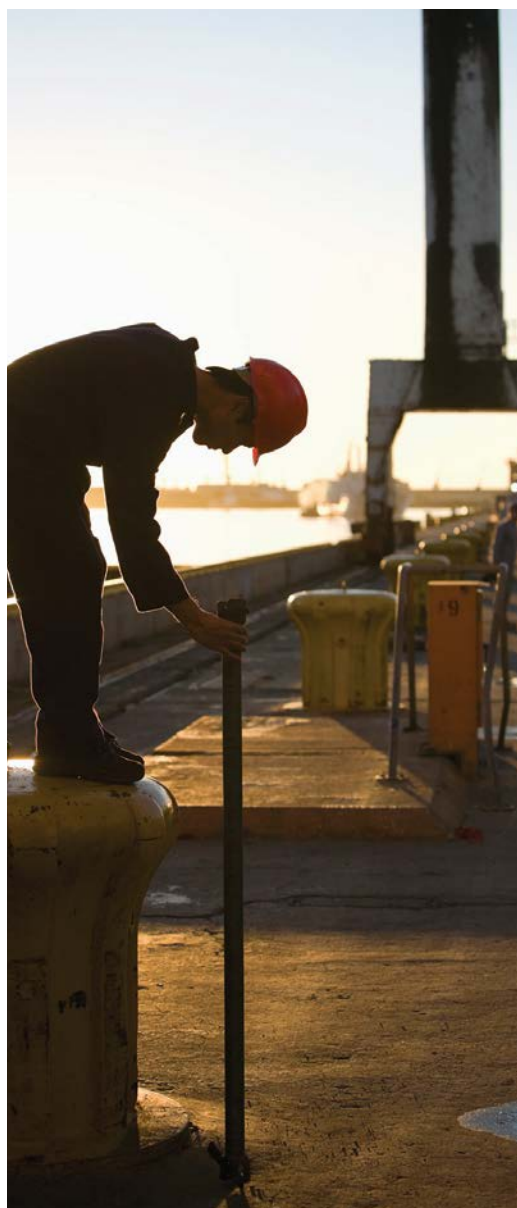
### **Transmission lines in Huancavelica, Junin and Lima**

This project comprises the design, construction, operation maintenance and financing of 2 lines of energy transmission of 390 and 300 Kms approximately, with a power of 1,400 and 600 MVA. The investment will be US\$570 million.

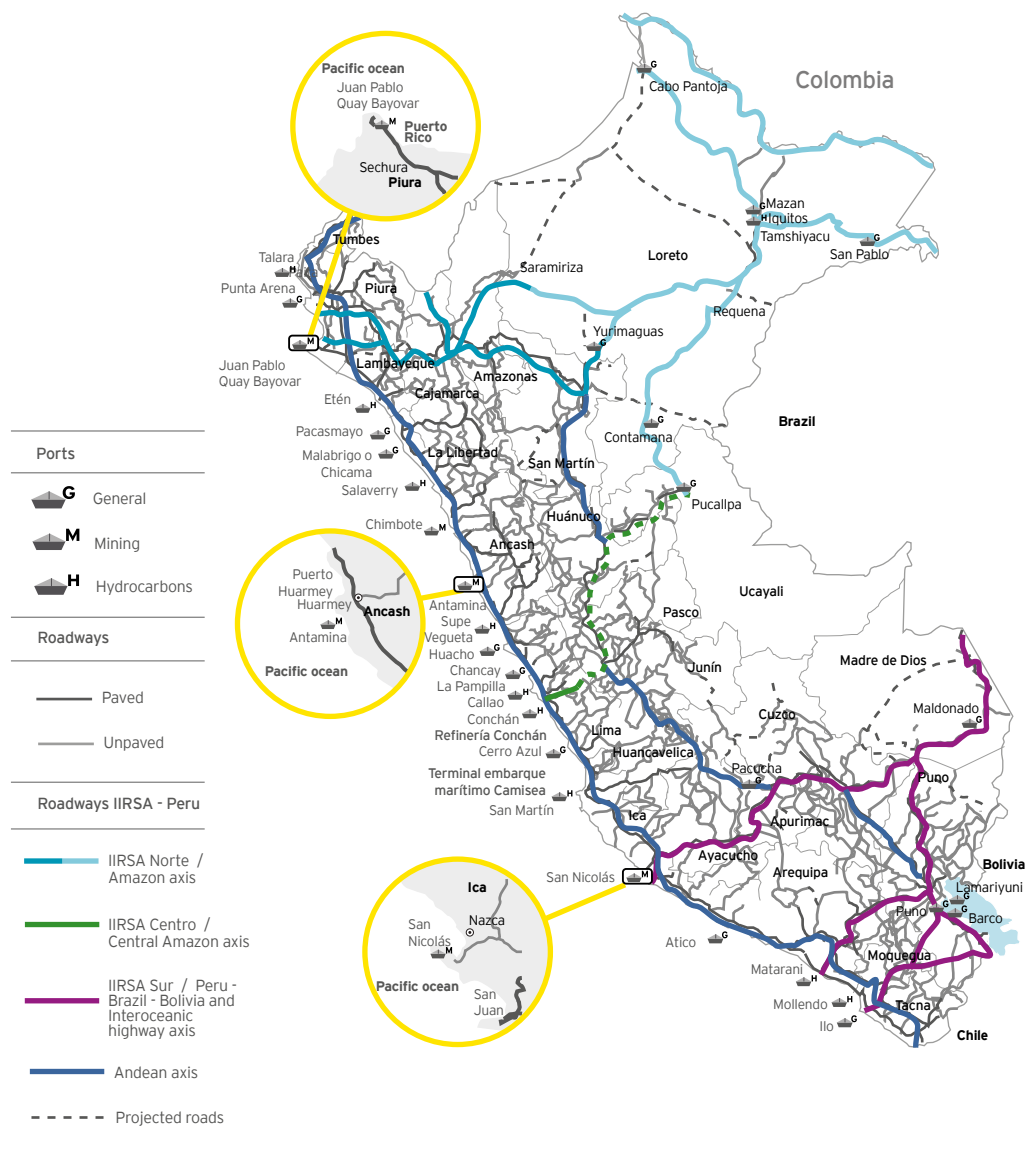
#### **[ Works for taxes ]**

Works for taxes is a regime that consists of the joint participation between a private company and a public entity to develop and execute a public investment project. Upon the signature of an agreement, the private company commits to carry out a project in exchange of the recognition of the investment and disbursements made as a credit against income tax, through the issuance of a Regional and Local public Investment Certificate.

This regime has become an efficient tool of Corporate Social Responsibility, allowing an efficient and direct application of public funds on behalf of regional governments, local governments, public universities and national government's entities in sectors such education, health, security, tourism, agriculture and irrigation, culture, sanitation, sports, and the environment, among others.



## Infrastructure access map



Source: Ministry of Transport and Communications

## 07 | Peru's investment-grade rating

Peru has maintained its investment-grade credit rating since Moody's Investors Services raised it to that level in December, 2009 matching moves made by Standard & Poor's and Fitch Ratings the previous year. Sound economic prospects, with GDP growth rates estimated at 4% over the medium term, are a key supporting factor for the investment-grade rating. Peru's robust growth prospects are supported by important investments levels. The upgrade is also supported by the significant decline in Peru's fiscal and external vulnerabilities within a context of high and diversifying sources of growth with low inflation and strengthening macroeconomic fundamentals. It is

expected that these trends will remain in place over the medium term despite an increasingly riskier international environment. The strong support for sound trade and macroeconomic policies from the current administration of President Kuczynski remains a precondition for Peru to maintain its investment-grade rating.

It is well known that countries with investment grade ratings gain a higher level of confidence that generates more foreign and domestic investment. The risk premium demanded by multinationals and foreign investors is slashed after the upgrade. At the same time, the investment horizon is elongated.

### Peru's investment grade rating (long term debt in foreign currency)

Country	S&P	Fitch	Moody's
Chile	AA-	A+	Aa3
Peru	BBB+	BBB+	A3
Mexico	BBB+	BBB+	A3
Colombia	BBB	BBB	Baa2
Uruguay	BBB	BBB-	Baa2
Paraguay	BB	BB	Ba1
Brazil	BB	BB	Ba2
Bolivia	BB	BB-	Ba3
Ecuador	B	B	B3
Argentina	B-	B	B3
Venezuela	CCC	CCC	Caa3

S&P / Fitch	Moody's	Feature
AAA	Aaa	Risk Free
AA+, AA, AA-	Aa1, Aa2, Aa3	High Grade
A, A+, A-	A1, A2, A3	High Repayment Capacity
BBB+, BBB, BBB-	Baa1, Baa2, Baa3	Moderate Repayment Capacity
BB+, BB, BB-	Ba1, Ba2, Ba3	Some Repayment Capacity
B+, B, B-	B1, B2, B3	Highly Uncertain Repayment Capacity
CCC+, CCC, CCC-, CC	Caa1, Caa2, Caa3	Extremely Vulnerable to Default
SD/D	Ca	Default

● Investment grade

As of december 2016

Source: Standard & Poor's/Fitch Ratings/Moody's



The same occurs with domestic investment. Local investors gain more self-confidence, thus allowing themselves to consider opportunities with lower rates of return. The impact is immediate, as consumers gain access to credit with more favorable terms.

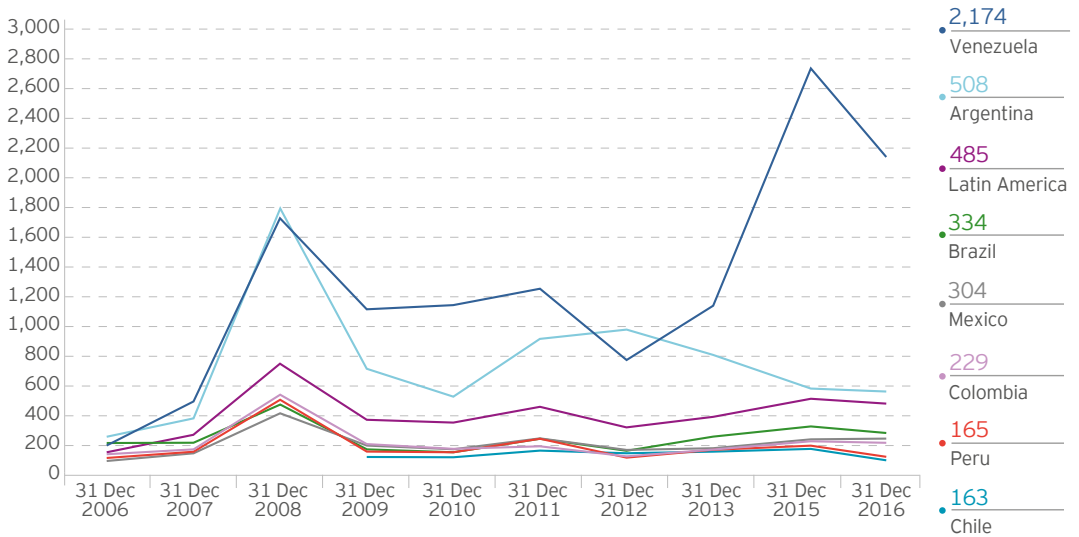
The upgrade to investment grade has brought Peru a lot of positive attention worldwide. More importantly, it has had a positive impact on the local economy and should help to boost the stock market and the appreciation of the Peruvian currency, the sol, in the short term. For this reason,

nowadays, many multinational corporations look at the country more seriously, as higher private investment is flowing into the country. This should contribute to alleviating a still complex social situation in Peru, by achieving improvements in employment and decreases in poverty.

### [ Northern peruvian oil pipeline ]

As of December 2016, Peru had a country risk of 165 base points, ranking as the second-lowest in Latin America. This score is nearly one-third of the regional average (485 points).

### Country risk indicator (2006-2016)



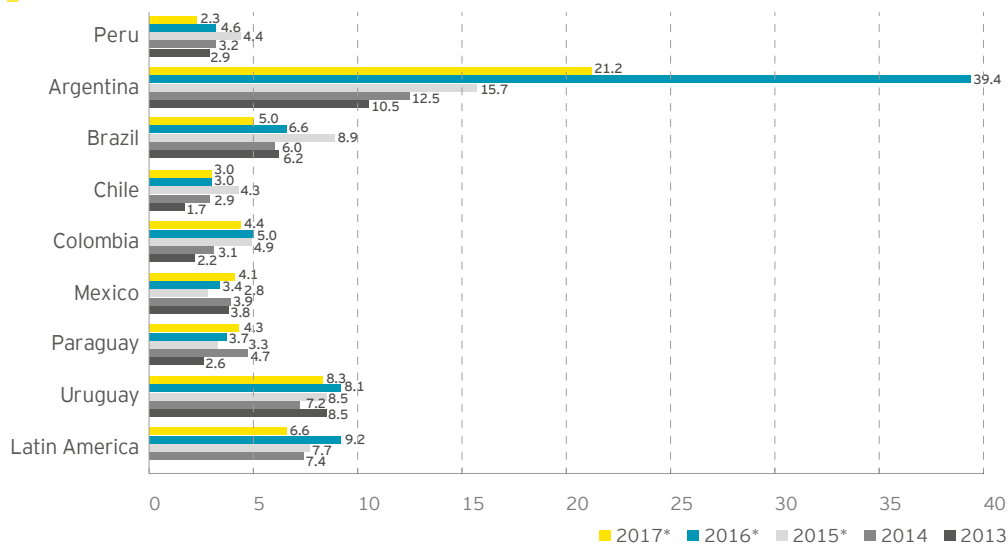
Source: BCRP

Peru has achieved the position of the third most globalized country in Latin America, according to the Globalization Index established by EY. Five elements are considered within this index: openness to foreign trade, capital flows, exchange of technology and ideas, international movement of workers, and cultural integration. Additionally, in early 2015 Bloomberg Markets positioned Peru as the eighth emerging market with the greatest international projection, based on the country's

advantages, such as low share prices and their possible increase in the future.

As may be seen in the following charts, Peru's level of inflation is one of the lowest in Latin America, with a rate of 3.2% in 2016, and an estimated range of 2.3-4.6% for 2017. In addition, over the past decade (2006-2015), the Peruvian economy had the lowest average annual inflation rate in Latin America, at 3.2%, below that of Ecuador (4.2%), Colombia (4.0%) and Brazil (5.7%).

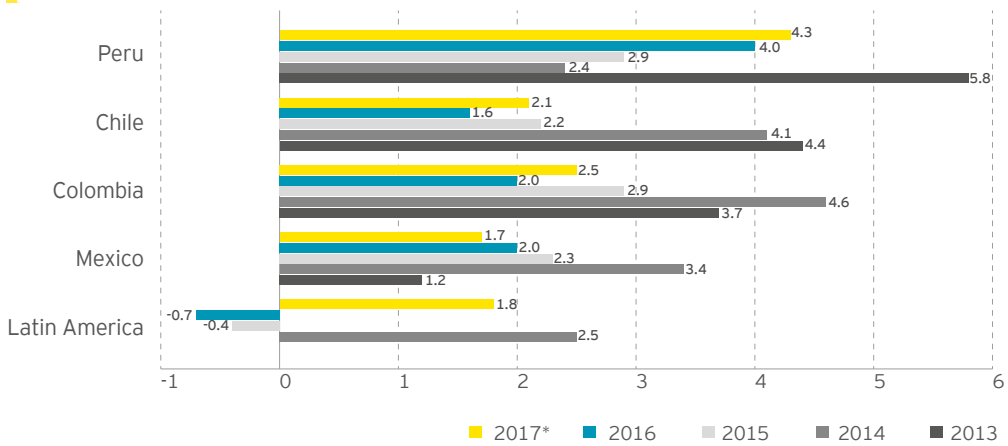
### Estimated inflation rates in Latin America



\*Estimated

Sources: Latin America Consensus Forecast (December 2016)/BCRP

**Estimated Gross Domestic Product (GDP) growth percentage rates  
(Pacific Alliance and Latin America)**



\*Estimated

Sources: Latin American Consensus Forecast (December 2016) / BCRP



## 08 | Investment promotion conditions

### [ Foreign investment legislation and trends in Peru ]

The Peruvian government is committed to the pursuit of an investor-friendly policy climate. It actively seeks to attract both foreign and domestic investment in all sectors of the economy. It has therefore taken the necessary steps to establish a consistent investment policy, which eliminates all obstacles for foreign investors; with the result that now Peru is considered to have one of the most open investment regimes in the world.

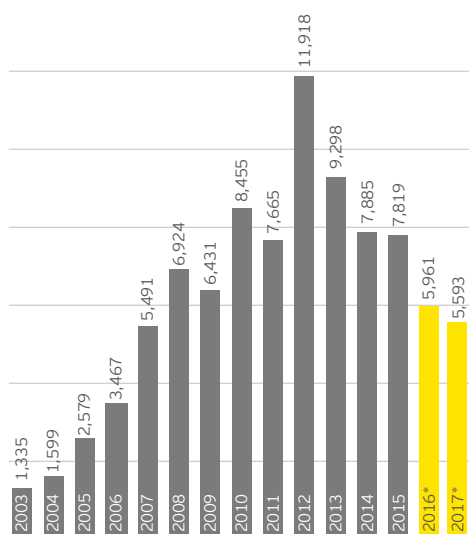
In an attempt to reduce the political risk perception of the country, Peru has adopted a

legal framework for investments which offers automatic investment authorization and establishes the necessary economic stability rules to protect private investors from arbitrary changes in the legal terms and conditions of their ventures and reduces government interference with economic activities.

Peru's Central Bank reported that the stock of foreign direct investment (FDI) inflow is expected to be US\$5,593 million in 2017.

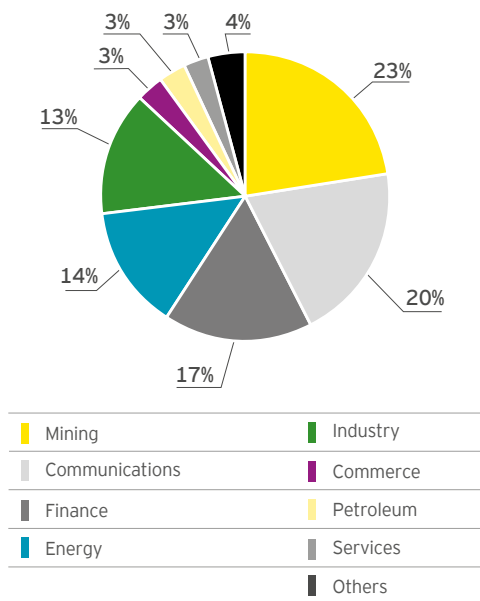
FDI is concentrated in mining, communications, finance, industry and energy.

**Foreign direct investment inflows (millions of US\$)**



\*Estimated  
Source: BCRP

**Foreign investment by industry (2016)**



Source: Proinversion

The Peruvian government guarantees foreign investors legal stability on income tax regulations and dividend distributions. Foreign investors entitled to obtain tax and legal stability are those willing to invest in Peru, in a two-year term, at least US\$10 million in the hydrocarbon and/or mining sectors; US\$5 million in any other economic activity or to acquire more than 50% of the shares of a privatized state-owned company. Peruvian laws, regulations, and practices do not discriminate between national and foreign companies. Accordingly, national treatment is offered to foreign investors. There are no restrictions on repatriation of earnings, international transfers of capital, or currency exchange practices. The remittance of dividends, interests and royalties has no restrictions either.

Foreign currency may be used to acquire goods abroad or cover financial obligations as long as the operator is in compliance with the relevant Peruvian tax legislation.

### **[ Elimination of bureaucratic barriers ]**

Due to the last tax reform, many modifications were introduced regarding the regulation of the activities carried out by public administration entities. Because of this, Legislative Decree No. 1256 declared the elimination of illegal and unreasonable bureaucratic barriers that may have been hindering the access or permanence of economic agents into the Peruvian market or that may have contravened laws or principles related to the bureaucratic simplification process.

The aforementioned Legislative Decree aims at public administration entities and all public employees and encourages them to its compliance to improve the use of public resources and to promote the efficiency in the functioning of public administration entities.

### **[ Real estate investment promotion rules ]**

On August, 2015, by means of Legislative Decree No. 1188, Peru enacted special rules with tax incentives to promote Real State Investment Trusts (REITs) in Peru, called in spanish as Fondos de Inversión en Bienes Inmobiliarios (FIRBI's).

Under these rules, companies who provide real state to the said funds from January 1st, 2016 until December 31st, 2019, shall consider that such alienation took place in the date in which the FIRBI transfers real state to a third party or to another participant; or when the company transfers its participation certificates issued by the FIRBI as a consequence of its contribution. The mentioned Legislative Decree also includes certain provisions with tax incentives on municipal taxes (Property Transfer Tax).

This regulation has been effective since January 1st, 2016.

### **[ Recognition of favorable investment climate ]**

According to the World Economic Forum 2016-2017, Peru is among the top countries in Latin America in terms of macroeconomic environment, market size, financial market development, labor market efficiency, and goods market efficiency, and technological preparation, among others.





## Global competitiveness index

	2014 - 2015		2015 - 2016		2016 - 2017	
	Ranking	Score	Ranking	Score	Ranking	Score
<b>Peru Total</b>	<b>65/144</b>	<b>4.20</b>	<b>65/148</b>	<b>4.24</b>	<b>67/138</b>	<b>4.23</b>
SUB-INDEX:						
<b>Basic requirements</b>	<b>74</b>	<b>4.59</b>	<b>74</b>	<b>4.52</b>	<b>77</b>	<b>4.43</b>
Institutions	118	3.40	118	3.26	106	3.3
Infrastructure	88	4.19	88	3.54	89	3.57
Macroeconomic environment	21	5.04	21	5.89	33	5.44
Health and primary education	94	5.73	94	5.39	98	5.33
<b>Efficiency enhancers</b>	<b>62</b>	<b>4.20</b>	<b>62</b>	<b>4.19</b>	<b>57</b>	<b>4.26</b>
Higher education	83	3.99	83	4.08	80	4.13
Goods market efficiency	53	4.19	53	4.47	65	4.37
Labor market efficiency	51	3.71	51	4.33	61	4.34
Financial market development	40	4.14	40	4.49	26	4.75
Technological readiness	92	3.55	92	3.30	88	3.56
Market size	43	5.61	43	4.47	48	4.40
<b>Innovation and sophistication factors</b>	<b>99</b>	<b>3.73</b>	<b>99</b>	<b>3.34</b>	<b>108</b>	<b>3.30</b>
Business sophistication	72	4.14	72	3.93	78	3.78
Innovation	117	3.31	117	2.76	119	2.82

Source: World Economic Forum 2016-2017

## [ Ease of Doing Business in Peru ]

According to Doing Business 2017, Peru ranks 54th out of 190 countries in terms of ease of starting a company and doing business, and 3rd third in Latin America.

### Doing Business (presenting Latin America countries)

Position	Country
47	Mexico
53	Colombia
<b>54</b>	<b>Peru</b>
55	Puerto Rico (United States)
57	Chile
62	Costa Rica
70	Panama
88	Guatemala
90	Uruguay
103	Dominican Republic
106	Paraguay

Source: World Bank (WB) - Doing Business 2017

### Forbes (presenting Latin America countries)

Position	Country
36	Chile
49	Costa Rica
55	Uruguay
56	Colombia
<b>57</b>	<b>Peru</b>
59	Panama
65	Mexico
91	Brazil
93	El Salvador
95	Guatemala
116	Paraguay

Source: Forbes 2016

## Summary of doing business indicators

	Indicators	Peru	Latin America and the Caribbean
Starting a business	▸ Number of procedures	6.0	8.3
	▸ Time (days)	26.0	31.6
	▸ Cost (% of income capita income)	9.9	31.5
	▸ Minimum capital (% of per capita income)	0.0	2.3
Construction permits	▸ Number of procedures	14.0	14.4
	▸ Time (days)	174.0	181.3
	▸ Cost (% of warehouse valvue)	0.5	2.5
Property registration	▸ Number of procedures	4.0	7.1
	▸ Time (days)	6.5	68.6
	▸ Cost (% of property value)	3.3	5.8
Getting electricity	▸ Number of procedures	5.0	5.5
	▸ Time (days)	67.0	66.0
	▸ Cost (% of income capita income)	335.5	999.0
Access to credit	▸ Strength of legal rights index (0-12)	8.0	5.3
	▸ Depth of credit information index (0-8)	8.0	4.8
	▸ Credit bureau coverage (% of adults)	37.4	13.0
	▸ Credit registry coverage (% of adults)	100.0	41.2
Protecting minority investors	▸ Extent of conflict of interest regulation (0-10)	7.0	5.3
	▸ Extent of shareholder governance index (0-10)	5.0	4.4
	▸ Strength of minority investor protection index (0-a0)	6.0	4.8
Paying taxes	▸ Number of payments per year	9.0	28.9
	▸ Time (hours per year)	260.0	342.6
	▸ Total tax rate (% of profit)	35.6	46.3
Trading across borders	▸ Time to export - Documentary compliance (hours)	48.0	56.0
	▸ Cost to export - Documentary compliance (US\$)	50.0	111.0
	▸ Time to export - Border compliance (hours)	48.0	63
	▸ Cost to export - Border compliance (US\$)	460.0	527.0
Enforcing contracts	▸ Time (days)	426.0	749.1
	▸ Cost (% of claim)	35.7	31.3
	▸ Quality of judicial processes (0-18)	8.5	8.4
Resolving bankruptcy	▸ Time (years)	3.1	2.9
	▸ Cost (% of estate)	7.0	16.7
	▸ Recovery rate (cents on the dollar)	30.3	31.0

Source: World Bank (WB) - Doing Business 2017



## [ Settlement of investment disputes ]

Foreign investors are protected against inconvertibility, expropriation, political violence and other non-commercial risks through access to the corresponding multilateral and bilateral conventions such as the Overseas Private Investment Corporation (OPIC) and the Multilateral Investment Guaranty Agency (MIGA).

Also, Peru has joined the International Convention for Settlement of International Disputes (ICSID) as an alternative to settle disputes arising between investors and the government. In addition, Peru has signed 33 Bilateral Reciprocal Investment Promotion and Protection Agreements (BRIPPAs) and 11 Free Trade Agreements (FTAs).

## Bilateral Reciprocal Investment Promotion and Protection Agreements (BRIPPAs)



Source: Proinversion

## [ Pacific Alliance ]

The Pacific Alliance is a mechanism for in-depth integration, established by the Declaration of Lima, signed by Peru, Chile, Colombia and Mexico on April 28, 2011. Its founding instrument is the Pacific Alliance Framework Agreement, signed on June 6, 2012 in Antofagasta Chile. Its profile is predominantly economic and commercial, and its fundamental purpose is to become an area that fosters greater growth, development and competitiveness of its economies with a view to improving its projection to the world and contributing to an economic rise with social inclusion.

The Pacific Alliance's Framework Agreement determines that, as a fundamental part of the plan to achieve its objectives, efforts should be directed towards the free trade of goods and services, the free movement of people and capitals, and the development of cooperation mechanisms to encourage investment, as well as the sustainable quality of life for its populations.

As part of this, the Pacific Alliance member countries are completing their legal framework in order to promote the achievement of their objectives, basing their actions on four main issues:

### **Trade and integration**

The Alliance has focused on the fostering of negotiations that translate into measures that will facilitate trade and customs cooperation between members. Efforts are focused towards eliminating tariff barriers, the cumulation of origin with regard to products that contain materials originating in one of the member countries, provided that the customs tariff is 0% everywhere, the reduction of technical obstacles to trade and the alignment with health and phytosanitary measures.

### **Capitals and services**

Within the scope of capitals and services, the Pacific Alliance's actions are directed towards cooperation in investment, cross-border trade of services, financial services, telecommunications, air transport and maritime transport. It also seeks to strengthen the integration of the stock exchanges of the member countries.

### **Integrated Latin American Market -MILA**

The Lima Stock Exchange - BVL (Peru), the Santiago Stock Exchange - BCS (Chile), the Colombia Stock Exchange - BVC (Colombia) and, since, 2014, the Mexican Stock Exchange - BMV (Mexico) together with the central securities registers of each country have integrated their variable income market (shares) by establishing the Integrated Latin American Market (MILA) with which it intends to diversify, expand and make more attractive the negotiation of this type of securities in the four country members, as much for local as for foreign investors.

This integration seeks to develop the capitals market of the member countries, in order to provide investors with a greater offer of securities and issuers with wider sources of financing. It is hoped that the unified market of these countries will become the leader in the region in a number of issuers.

### **Movement of people**

The free movement of people is one of the central pillars of the Pacific Alliance. This workgroup is focused on developing issues such as facilitating migratory transit, free movement of people, consular cooperation, student and labor cooperation, and the exchange of information on migration flows.

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## Cooperation

The Pacific Alliance seeks to encourage cooperation on aspects that significantly impact the comprehensive development of the population of member countries and the strengthening of technology of their industries. To achieve this, the main purposes of the cooperation work group are to consolidate a platform of student and academic movement, the structure of a scientific research network on climate change, the identification and use of synergies to increase competitiveness of medium, small and micro business, the execution of physical interconnection projects, and the creation of a cooperation fund.

You can easily find more information in the EY's Pacific Alliance Business Guide at [ey.com/pe/EYPeruLibrary](http://ey.com/pe/EYPeruLibrary).

### [ Stabilization fund for prices of oil's fuel derivatives ]

The Stabilization Fund for Prices of Oil's Fuel Derivatives is an intangible fund created in 2004. It aims to soothe the high volatility of international oil prices, taking into consideration that Peru is a net oil importer. In so doing, the fund establishes maximum and minimum limits (price bands), in order not to let high volatility affect its consumers. It is important to mention that there are price bands for fuels such as:

1. Fuel oil
2. Liquefied Petroleum Gas
3. Gasoline 84 and 90 RON
4. Gasohol 84 and 90 RON
5. Diesel BX (mix of Diesel N° 2 and Biodiesel B100, wherein X is the percentage of B100 in the mix)

The fund enables the government to compensate producers and importers, so that they do not charge consumers above of the maximum limit whenever oil prices surpass it. The payments made by the government ("compensation factor") are the result of comparing import parity pricing with the maximum limit. Therefore:

$$\text{CompF} = \text{IPP} - \text{MaxLim}$$

Likewise, when oil prices fall below the minimum limit, producers and importers charge consumers with the minimum limit, and make payments to the fund ("contribution factor"), which are equal to the difference between the minimum limit and import parity pricing. Thus:

$$\text{ContF} = \text{MinLim} - \text{IPP}$$

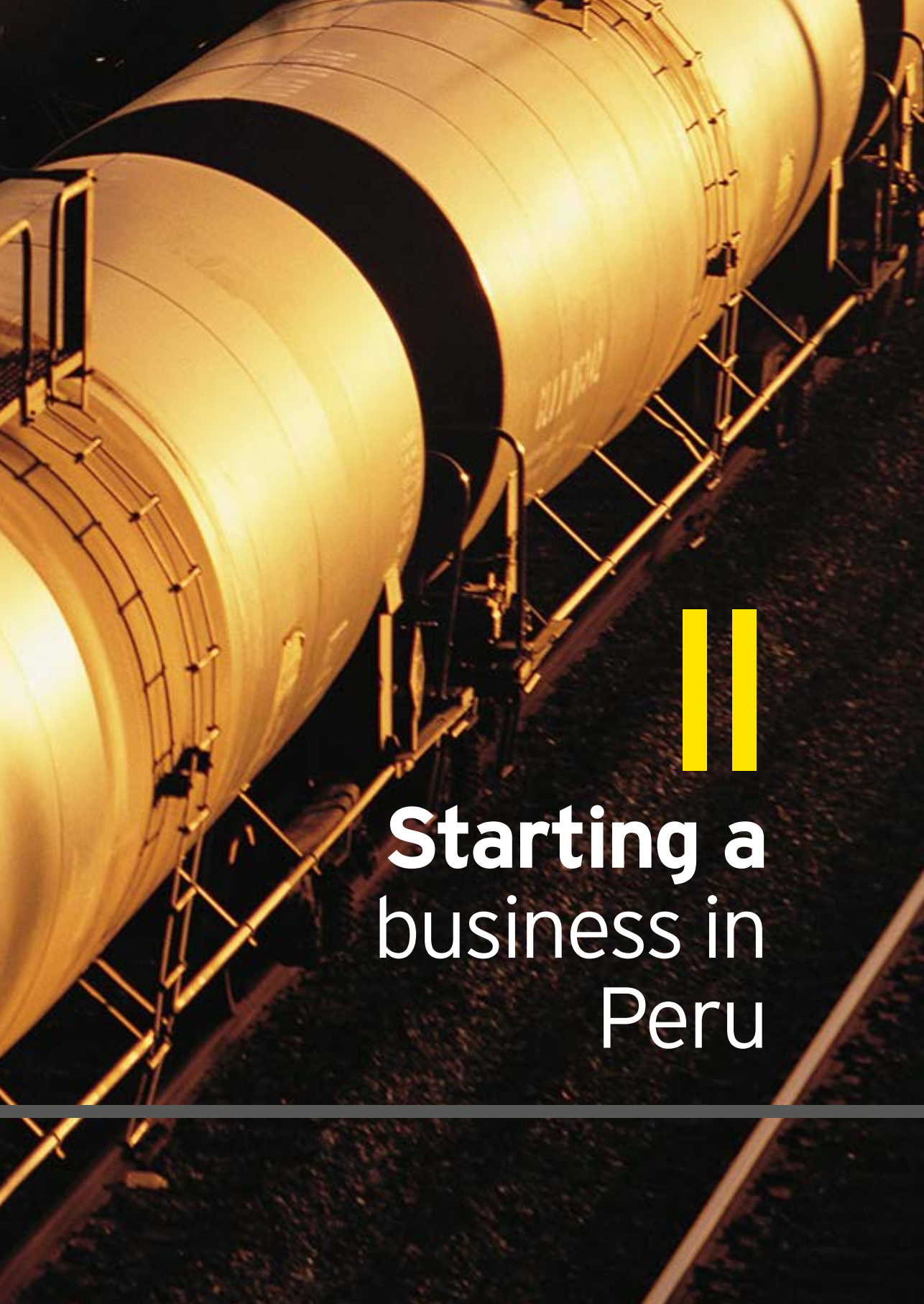
The General Bureau of Hydrocarbons (DGH, in Spanish) manages the fund, whilst the Supervisory Body of Private Investment in Energy and Mines (OSINERGMIN, in Spanish) updates the price bands from time to time. The last update is dated as of December 31, 2015.

Peru is improving  
its infrastructure  
to promote new  
investment and  
increase its  
economic potential

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# Starting a business in Peru

## 01 | Requirements for foreign investors

Foreign investors shall be able to sign licenses and service contracts and therefore, carry out oil and gas exploration and production activities if they establish a corporation (subsidiary or affiliate) or a branch in Peru. Furthermore, the investors shall appoint a representative, in the case of foreigners with an alien registration card.

The most common types of legal organizations used by foreign investors for doing business in Peru are a corporation (Sociedad Anónima - S.A.) and a limited-liability company (Sociedad Comercial de Responsabilidad Limitada - S.R.L.). However, the Peruvian Corporation Act also provides other forms of legal entities, including two special forms of corporations: the closely held corporation (Sociedad Anónima Cerrada) and the open stock company (Sociedad Anónima Abierta).

In these cases, the legal, technical, economic and financial capacity for carrying out oil and gas exploration and production activities, evaluated by Perupetro, will lay in the parent company, who will be jointly and severally responsible for the capacity of their Peruvian branches and/or corporations. If there is no parent company, the qualification process must be followed by the applicant company.

Associative agreements, such as joint ventures, are also allowed.

## 02 | Establishing a Peruvian corporation

### [ Corporation ]

A corporation (Sociedad Anónima - S.A.) is composed of shareholders whose liability is limited to the value of their shares. The board of directors and one or more managers manage the S.A. To incorporate an S.A., investors (i.e. the shareholders) shall sign a public deed of incorporation before a notary public and file it before the Public Registry of Legal Entities. Also, investors shall request the to Tax Authority (SUNAT) the registration of the company as a taxpayer in order to obtain from the tax identification number (Registro Único de Contribuyente - RUC). The bureaucratic and legal steps that an investor must complete to incorporate and register a standard S.A. normally take between 15-30 days.

The incorporation documents must include, at least, (a) the company's name; (b) business purpose and duration; (c) the company's domicile; (d) the name, nationality, marital status and residence of any individual shareholder and name, place of incorporation and address of any corporate shareholder (a minimum of two shareholders are required to set up an S.A.); and (e) the capital structure (the shares of nominal value and the total number of shares), classes of shares and details of individual initial capital contributions (whether in cash or kind).

Sufficient proof that a minimum of 25% of capital stock has been paid into a Peruvian Financial Entity before the execution of the public deed of incorporations must also be shown.

## ► Capital

Capital is divided into shares which may be freely transferred with just a private agreement, unless such transfers are restricted by the corporate bylaws. There are no minimum or maximum capital requirements, although issued capital must be fully subscribed and at least 25% thereof paid in upon incorporation. Nonetheless, Peruvian Financial Entities request a minimum deposit of approximately \$300.00 for the account opening (the amount may change depending on the Financial Entity). Capital may be supplied in cash or in kind. Value of non-monetary contributions must be reviewed and approved by a majority of the board of directors within 60 days of incorporation and may be challenged in court during the following 30 days.

## ► Control

An annual general meeting is required. Bylaws may specify a higher quorum and larger majorities than those laid down by law. The minimum quorum for a general meeting is 50% of capital on the first call and any number of shareholders on the second call. Most decisions are taken by a simple majority of the paid-up voting shares represented.

For major decisions, such as capital increases or decreases or corporate bylaw changes, the minimum quorum is two-thirds of total voting shares represented on the first call and 60% on the second call, and the decision requires in absolute majority of total voting shares represented.

## ► Founders, shareholders

An S.A. must have a minimum of two individual or corporate shareholders, with no requirements as to their nationality or residence. The shareholders' general meeting is the supreme body of the S.A. and has power of decision on any subject and the exclusive power of decision with respect to dissolution, amendments to the bylaws and a capital increase or reduction, among other key corporate decisions.

## ► Types of shares

Shares must be nominative and they represent the unit into which the proprietary interests in a corporation are divided. As a general rule, each share gives the right to one vote, but non-voting shares may be issued. Shares shall be recorded in the stock ledger. Different classes or series of shares may be issued, with different rights and/or obligations. All shares of the same class shall have the same par value but may be issued at a premium or at discount from par. Corporations may purchase their own shares subject to certain limitations. Bylaws restrictions on transfer of shares are permitted.

## ► Management

One or more managers are appointed (and removed) by the board of directors, unless bylaws stipulate appointment by a general shareholders meeting. Managers could be a natural person or a legal entity. When only one manager is appointed, he/she will be the general manager. There are no nationality requirements.

## ► Board of directors

An S.A. must have a minimum of three directors, with no maximum number provided by the law. There are no requirements as to their nationality or residence. Directors may not be shareholders, and they serve one to three-year renewable terms. Directors may be elected by cumulative voting, in which each share has as many votes as there are directors to be elected, and shareholders either accumulate their votes in favor of one candidate or distribute them among several. Elected directors must accept the position expressly and in writing the position. A quorum is half the board membership plus one. The board of directors has all the powers vested in it by law and the corporate by-laws.

# Requirements of a Corporation (S.A.) in Peru\*

\*The obligation to submit audited financial statements to the securities commission, stated for legal entities with annual sales or total assets equal or above 5,000 tax units (not listed in the Stock Exchange), was declared as unconstitutional by the Constitutional Court on April 4th, 2016. Such obligation was in force as from June 2011.

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## [ Limited Liability Company ]

The Limited Liability Company or S.R.L. (Peruvian acronym for Sociedad de Responsabilidad Limitada) is subject to registration procedures, reporting and accounting requirements similar to those for the S.A. The minimum number of partners is two and the maximum 20, whose liability is limited to their capital contributions. At least 25% of each participant's contribution to capital must be paid-in upon founding.

Although to incorporate a S.R.L. no minimum capital is specified, entities of the national financial system request a minimum deposit of approximately US\$300.00 for the account opening.

The S.R.L.'s capital is divided into and represented by participating interests which cannot be denominated shares and which are not freely negotiable certificates. Capital holdings may be transferred outside the company only after they have been offered through the management to other partners or the company itself and they have declined to purchase the offered interests. Further restrictions on transfers may be set out in the bylaws.

The partner's general meeting shall entrust the company's management to one or more managers who are not required to be partners in the S.R.L. or Peruvian citizens. Decisions are determined by the majority of capital contributions.

The main characteristics of the S.R.L. are:

- ▶ Limited liability. Partners are not personally liable for the corporation's liabilities.
- ▶ Centralized management. Partners general meeting and one or more managers (no board of directors is required).

- ▶ Transfer of interest. Transfer of partners interest to third parties is subject to approval by the existing partners and must be registered in the public register.
- ▶ Continuity. Death, illness, bankruptcy, retirement or resignation of any partner does not cause the dissolution of the entity.

## [ Closely Held Corporation ]

Provisions applicable to the S.A are applicable to the closely held corporation subject to certain specific provisions. A corporation can be classified as closely held if it does not have more than 20 shareholders and its shares are not listed in the Stock Exchange. The closely held corporation has certain features found in a limited-liability company (for example, limited liability of equity owners, absence of freely transferable equity shares and no requirement for a board of directors).

## [ Public Corporation ]

A corporation will be considered "open stock" when either (i) it has undertaken an initial public offering (OPP) or stock market launch to sell its stock to the public; (ii) it has more than 750 shareholders; (iii) at least 35% of its shares are held by at least 175 shareholders; (iv) it is incorporated as an open stock corporation; or (v) all the shareholders with voting rights agree unanimously to subject the company to the legal regime applicable to open stock corporations. This form of corporation is subject to the Securities Market Act as well as to certain specific regulation on minority shareholders protection, public disclosure, among others.

## 03 | Establishing a branch

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Branches are another type of investment vehicle that foreign investors can establish for carrying out oil and gas exploration and production activities. The branch does not have legal independence or legal personality distinct from its parent company, except for tax purposes. Therefore, the branch will be regulated by the parent company's bylaws and its activities must be within the parent company's corporate purpose.

In the case of branches, the capital assigned by the parent company does not have any limitation, but it shall be deposited or wire transferred in a peruvian financial institution. However there is no obligation to credit the transfer for registry purposes. The parent company remains fully liable for the obligations assumed by the branch.

The branch operates through its legal permanent representatives with sufficient powers.

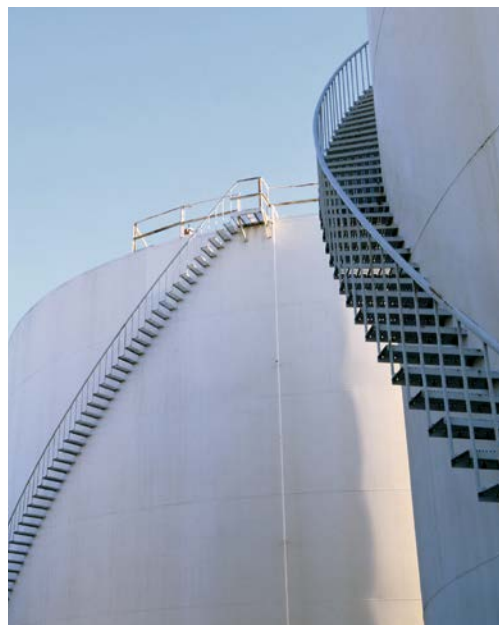
Procedures for organizing a branch in Peru are similar to the procedures applicable for organizing corporations or limited liability companies. It takes between two to three weeks to register a branch once the necessary documents, such as the certificate of existence of the parent company and the apostille documents, among others, have been submitted to the Peruvian notary public.

These documents include copies of the parent firm's corporate charter and bylaws, minutes of the shareholders agreement to set up a branch in Peru, certification of the branch's address, assigned capital and line of business, notifications of the appointment and powers of a legal representative in Peru and a Peruvian consul's certification that the parent company

is duly constituted in the country of origin and entitled to set up a branch in a foreign country.

Procedures for organizing a branch in Peru are similar to the procedures applicable to organizing corporations or limited liability companies

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## 04 | Associative agreements

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Associative agreements are another type of investment vehicle that allow different companies (and individuals) to jointly participate and integrate into certain businesses or enterprises for reaching a common purpose. This type of investment vehicle is very common in the hydrocarbon sector because of the great risk involved in carrying out this type of activity. This makes sense due to the large amount of investment normally incurred in the exploration and production phase.

Unlike the other types of investment vehicles, an associative agreement does not create a corporation or legal entity different from its associates. Indeed, even though they have a common purpose in developing a business activity together; associative agreements do not create legal entities, therefore, each of the parties keep their legal personality and patrimonial independence.

There are three basic types of associative agreements that could be applied in Peru: a) partnership contracts, b) consortiums; and c) joint ventures; the latter not being regulated in the Peruvian Corporations Act. Resources assigned to the aforementioned contracts will be considered as foreign investment provided these contracts grant foreign investors a participation in the production capacity, which does not qualify as a capital contribution. Also, these investment vehicles should correspond to contractual commercial transactions through which a foreign investor provides goods or services, obtaining a participation in the physical production, the global sales amount or the net profits of the company that receives the investment.

To carry out hydrocarbon activities, each of the parties should be qualified as a contractor by Perupetro. To have such qualification, they should

be legally, technically, economically and financially qualified to engage in obligations, regulations and investments required for developing the hydrocarbon activity. One of the parties must be assigned as the operator responsible for conducting the activities; however, all of the parties will be jointly and severally liable before Perupetro for the assumed contractual obligation.









# Hydrocarbons in Peru

# 01 | Importance of Peru's oil and gas sector

The oil and gas sector in Peru has gone through a transformation, from an industry in decline to a major contributor to the economic growth in Peru.

Historically, Peru became an importer in the late 1980s and early 1990s. The combination of a state-dominated turn in Peru's energy sector in the 1960s (political interference such as policies that changed from government to government, refusal by various governments to grant new contracts, and fixed petroleum prices) and a lack of significant discoveries over the years, set Peru on a path of dwindling reserves. The implementation of such policies caused a decline in private investment.

Under these circumstances, the military regime decided to expropriate the International Petroleum Company and created a state-owned oil company named Petroperu, which controlled the sector for approximately 25 years. Nevertheless, their management did not result in an improvement of the sector as revenues, reserves and production started declining. For this reason, the government in force through the 90's decided to restructure the company implementing a privatization process, ceasing Petroperu's downstream operations, and assigning Perupetro (newly created governmental agency) the commercial faculties to negotiate and subscribe license and service contracts with investors (see more detail about Petroperu in page 72).

As a result, Peru's oil and gas sector became more competitive. From 1990 to 1997, investment in the sector increased from \$20 million to \$4.3 billion. Areas under operation hiked from 1 million to 23 million hectares in the same period. Prices were set by the market, not the State.

This growth increased significantly in 2004- 2005, when the major reserve of natural gas reserves near the Camisea River in the Amazon began producing (which now is known as the "Camisea Project")\*. From that moment on, Peru has entered into a takeoff stage, explained not only by the Camisea discovery and the geological potential, but also by the economic and political stability that it has achieved during the last years. This situation boosted the oil and gas sector, as well as the oil and gas discoveries in several locations of the country. The rising investment in Peru during the last years reflects such growth.

Due to smarter energy management, Peru began to diversify its energy use, reduce its dependence on imports, and position itself as an exporter of liquefied natural gas (LNG). Still, challenges remain, particularly as exploration and development activities show resilience in a context of low prices.

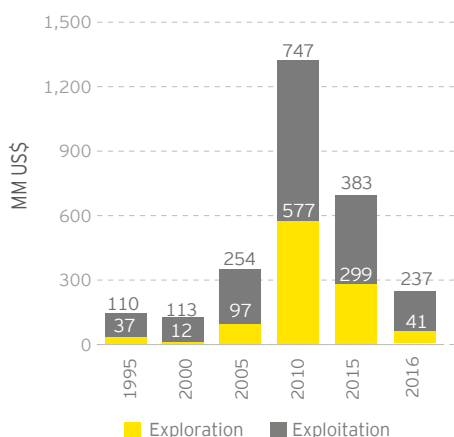
(\*) The Camisea Project was discovered in 1989

## Hydrocarbon Investment (2005-2016 exploration and exploitation phase in millions of US\$)

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016*
Exploration	96.40	136.30	251.00	539.10	539.10	747.06	476.90	785.080	438.04	501.70	299.40	46.95
Exploitation	254.90	551.90	855.00	610.80	610.80	576.50	884.00	731.102	812.49	688.01	382.87	287.65
<b>Total</b>	<b>351.30</b>	<b>688.20</b>	<b>1,106.00</b>	<b>1,149.90</b>	<b>1,149.90</b>	<b>1,323.90</b>	<b>1,360.90</b>	<b>1,516.18</b>	<b>1,250.53</b>	<b>1,189.77</b>	<b>682.28</b>	<b>334.60</b>

\*The numbers shown for year 2016 only include the investments performed from January to December 2016.  
Source: Perupetro

## Oil exploration and exploitation investments evolution (1995-2016)



Sources: Ministry of Energy and Mines / OSINERGMIN

## Estimated investment by sector percentage (2017-2018)

Sector	2017 - 2018
Mining	29.3%
Infrastructure	16.8%
Oil & Gas	14.2%
Electricity	9.8%
Industry	8.0%
Other sectors	21.9%
<b>Total:</b>	<b>100.00%</b>

Source: BCRP / OSINERGMIN

According to Peru's Central Bank, 14.2% of the investments to be made in 2017-2018 will be related to oil and gas activities. These new investments are expected to exceed those achieved in 2016 by 5%.

Some of the investments that are going to take place in 2017 correspond to ongoing projects that may lead to new opportunities.

In relation to upstream projects, the most important investments are focused in the northern and southeastern regions. The first ones show promising results in off-shore blocks, while the latter ones are taking advantage of the infrastructure developed for the Camisea Project (gathering systems, infrastructure, among other facilities).

Midstream projects are, without a doubt, the most promising projects nowadays. While TGP has just finished the third expansion of the Camisea's pipeline, the Southern Peruvian Pipeline concession will enter into a new international bidding. This last project is expected to raise particular interest due to raising natural gas demand in the southern regions of the country.

Downstream activities have also renewed the interests of investors and the government. Indeed, the Talara and La Pampilla Refineries' Modernization Projects aim towards complying with the need to supply cleaner fuels to consumers, as well as refining heavy oil more efficiently. And that is just a glimpse of how much downstream projects have drawn attention lately: there are two distribution concessions of natural gas by virtual pipelines scheduled to begin operations in April 2017, which could also lead to the development of other industries such as vehicle natural gas.

In 2012, Peru ranked 98th out of 147 countries in a survey done by Fraser Institute, which focused on the attractiveness for global oil and gas investment. In 2014, it ranked 79th out of 156 countries; in 2015, 89th out of 126; and in 2016 it ranked 64th out of 96 countries.

The government is still working on making the appropriate improvements, especially in social, environmental, and infrastructure matters to promote investment in the sector.

## Resource governance Index 2013

Rank	Country	Resource Measured	Composite Score	Institutional and Legal Setting	Reporting Practices	Safeguards and Quality Controls	Enabling Environment
1	Norway	Hydrocarbons	98	100	97	98	98
2	United States (Gulf of Mexico)	Hydrocarbons	92	88	97	89	90
3	United States	Hydrocarbons	88	79	91	83	93
4	Australia (Western Australia)	Minerals	85	88	87	65	96
5	Brazil	Hydrocarbons	80	31	78	96	66
6	Mexico	Hydrocarbons	77	84	82	31	53
7	Canada (Alberta)	Hydrocarbons	76	67	72	74	96
8	Chile	Minerals	75	77	74	65	37
9	Colombia	Hydrocarbons	74	75	73	91	58
10	Trinidad and Tobago	Hydrocarbons	74	64	83	86	52
11	Peru	Minerals	73	88	85	56	55
12	India	Hydrocarbons	70	60	72	83	61

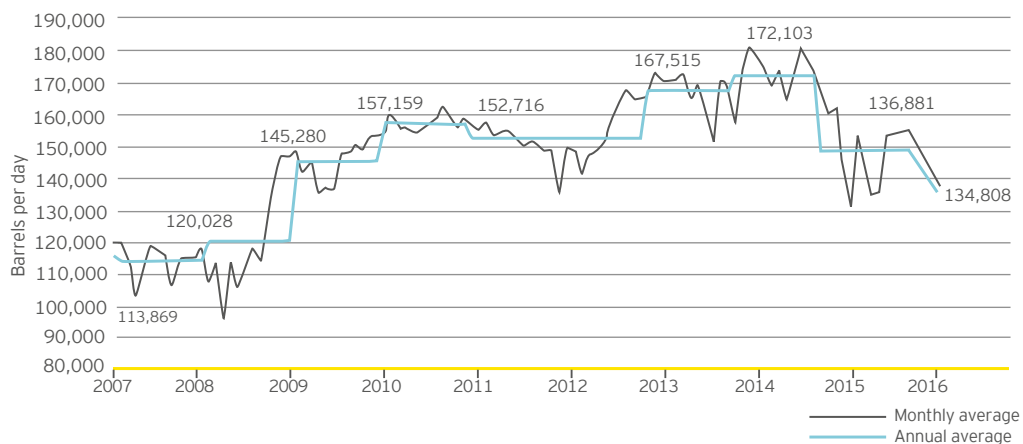
## Ranking by Fraser institute

Ranking of countries made according to the scope of investment barriers (based on the composite index score of Fraser Institute).

	2015	2014	2013	2012	2017
Countries	Ranking (Sample of 126)	Ranking (Sample of 126)	Ranking (Sample of 156)	Ranking (Sample of 157)	Ranking (Sample of 147)
Argentina-Chubut	83	97	136	140	107
Argentina-Colombia	53	60	59	31	57
Argentina-Mendoza	74	103	108	150	124
Argentina-Neuquen	59	91	99	142	110
Argentina-Salta	55	99	96	122	125
Argentina- Santa Cruz	86	107	140	143	135
Bolivia	93	117	153	145	146
Brazil - Onshore CC	82	66	87	154	88
Brazil - Offshore CC	65	47	69	114	72
Brazil - Offshore presalt área PSC	81	68	102	113	70
Chile	34	n.d.	24	116	90
Ecuador	89	121	155	74	143
México	68	82	126	87	n.d.
Peru	64	89	79	115	98
Venezuela	96	125	156	157	147
Notes: ▶ n.d: not determined ▶ CC: Concession Contract ▶ PSC: Profit Sharing Contracts					



### Oil (liquid hydrocarbon) average audited production\* (2007-2017)

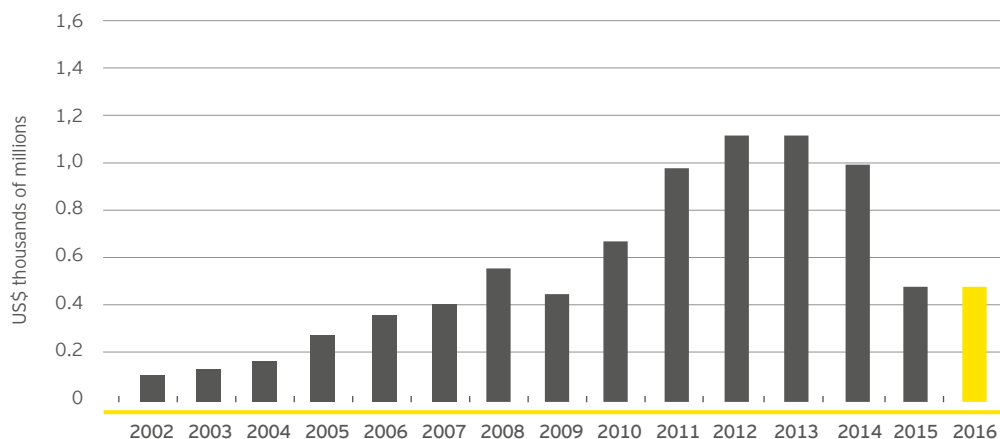


\*Includes petroleum and natural gas liquids.

Source: Ministry of Energy and Mines

### Oil & Gas canon revenues

The oil and gas canon is a portion of the generated income obtained by the Government for the oil and gas exploitation. The beneficiaries of such revenues are the Local and Regional Governments, among other public entities located in the area exploited. The following chart shows the amount of revenues obtained and destined to Oil & Gas canon since 2001.



Source: Perupetro

## Fiscal revenues (2005-2016 in millions of US\$)

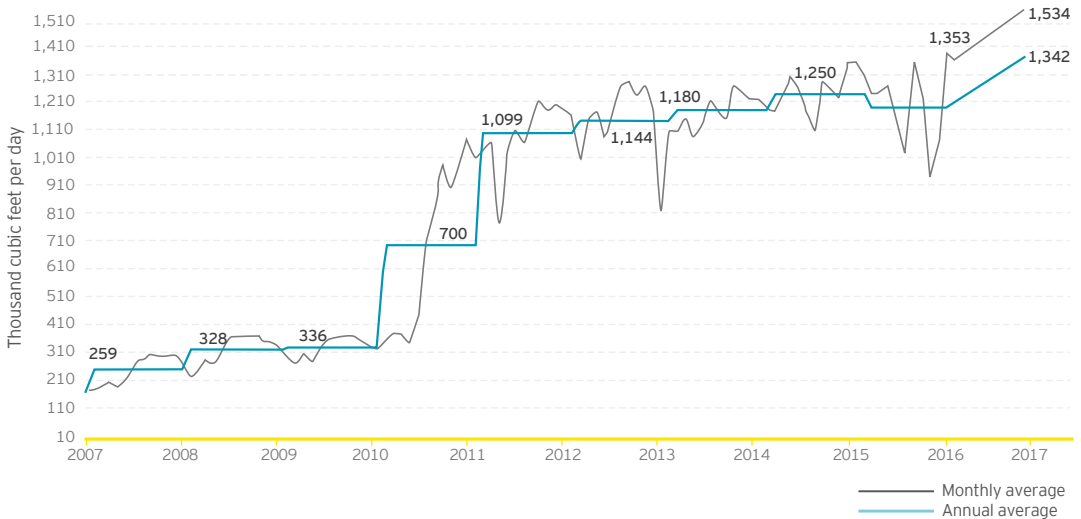
The oil and gas industry represents one of the main sources of fiscal revenues, and comes not only from the activities carried out in the Camisea Project (Blocks 56 and 88), but also from the activities executed in other blocks.

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016*
License contract	672.07	791.03	1,132.01	859.12	1,319.57	1,998.33	1,894.75	1,932.66	1,608.19	728.98	627.39
Service contract	60.71	65.03	85.30	54.10	73.89	1.00	105.03	88.27	85.01	39.96	32.86
<b>Total</b>	<b>732.78</b>	<b>856.03</b>	<b>1,217.31</b>	<b>913.22</b>	<b>1,393.46</b>	<b>1,999.33</b>	<b>1,999.78</b>	<b>2,020.93</b>	<b>1,693.21</b>	<b>768.94</b>	<b>660.25</b>

\*Estimated as of December 31, 2016

Source: Perupetro

## Average natural gas audited production (2007-2017)



Source: Ministry of Energy and Mines

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### [ Transparency in oil & gas activities ]

EITI (Extractive Industries Transparency Initiative), a global coalition of governments, companies and civil society, is an international organization that is working together to improve openness and accountable management of revenues from natural resources.

By joining EITI, countries implement the EITI Standard to ensure full disclosure of taxes and other payments made by oil, gas and mining companies to governments, which are disclosed annually in the EITI report, so that citizens can

be aware and informed of how much their governments receive from the exploitation of natural resources and also where such funds are destined.

Peru joined EITI in 2005, given the importance of oil and gas and mining activities in the national income, and its meaningfulness in the Latin American and global production. Thus, Peru became the first Latin American country to join the initiative, ensuring transparency and stability of the rules related to the incomes from extractive industries.



## 02 | Hydrocarbon production and exports

The investment and work involved in the sector contributed to the recovery and the positive evolution of the hydrocarbon national production. An emblematic example of this growth is the Camisea project. This project was not only significant to the country, but it also contributed to putting Peru on the map of natural gas producers.

The hydrocarbon investment for years 2017-2018 is estimated at approximately US\$2.9 billion and the growth of the sector is estimated to be 4.6% for 2017. This growth will rely on the investment portfolio and Peru's geological potential.

**Estimated GDP Hydrocarbon growth until 2017**



\*Estimated as of December 31, 2016  
Source: BCRP

### Hydrocarbons audited production (2006-2016)

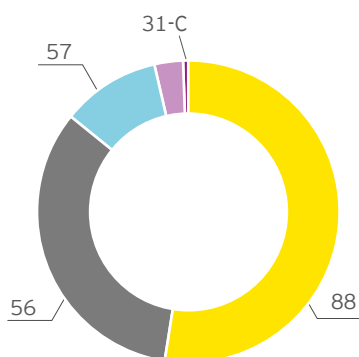
	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016*
Petroleum (MBLS)	28,314	28,146	28,027	25,927	26,531	25,387	23,984	22,956	25,296	21,173	14,773
NGL (MBLS)	18,873	13,416	15,903	27,100	30,832	20,354	31,596	38,187	37,751	33,360	34,671
Natural Gas (MMCF)	63,556	96,206	122,230	125,300	255,609	401,169	418,795	430,559	456,407	441,244	494,930

\* There was no production on December, 2016 due to issues on the Northern Peruvian Pipeline.

NGL: Natural Gas Liquids  
Source: Perupetro

### Natural gas audited production by oil well (2015)

	Block	Accumulated (MCF)*	%
▶ Northern area	-	48.81	3.18
▶ Aguaytía	31-C	6.05	0.40
▶ Pluspetrol	88	808.61	52.70
▶ Pluspetrol	56	509.28	33.19
▶ Repsol	57	161.53	10.53
<b>Total</b>			<b>100.00</b>



52.7%  
88

10.53%  
57

0.40%  
31-C

33.19%  
56

3.18%  
-

\*MFC: Thousands Cubic Feet  
Source: Perupetro



The scenario for Peru for the following years is neither daunting nor uncertain. The growth for the Oil & Gas industry for 2017 is estimated at 4.6%.

## Infrastructure and refineries

Despite the downfall of international oil prices during 2014 and 2015, Peru has been able to attract investment in every segment of the hydrocarbons sector. Perhaps, the stabilization of oil prices around US\$50, and the upcoming changes in legislation will boost projects in the mid and long-term.

Nonetheless, hereby we provide an outlook of investments related to upstream, midstream, and downstream phases, to be carried out in the mid and long-term.

### Upstream

The following upstream projects are estimated to take place within years 2017-2018:

#### Upstream projects (estimated for years 2016-2018)

Project (Company)	Estimated investment*
Block Z-38 exploration and development (Karooon)	US\$3,000 million
Block 58 exploration (CNPC)	US\$1,300 million
Block 57 seismic and drilling (CNPC, Repsol)	US\$1,000 million
Block 108 exploration (Pluspetrol)	US\$400 million
Block 64 production (Geopark)	US\$150 million

\* Investment reflects the grand total of the projects, regardless of their beginning and/or ending date

As can be seen, the most important of the projects stated above will take place in Peru's most significant oil and gas producing areas.



Block Z-38 is currently the most important off-shore project of the country, and is located in the northern region of Talara. Talara's production of hydrocarbons dates back to the early 20th century, but off-shore activities have renewed interest on its potential since the 1970's.

Karooon estimates that around 2,500 million oil barrels and 3.5 TCF of natural gas could be recovered in this project, which will mark one of Peru's deepest drilling efforts, at almost 1 Km beneath surface.

Blocks 57 and 58 are located next to Camisea Project's blocks, in La Convención province, region of Cusco. A couple of months ago, CPNC confirmed that around 3.9 TCF of natural gas is present in Block 58, which represents almost 40% of Camisea's proven reserves; while it will continue efforts along Repsol to develop discoveries made in Block 57.



The main advantage of these projects is that they can benefit from the already existing infrastructure of the Camisea Project, such as gathering systems and the Malvinas' gas separation plant, in order to deliver gas and liquids to the coast through TGP's pipelines.

Finally, we should mention that Geopark's project will also mark the return of Petroperu (National Oil Company) to upstream projects in more than two decades.

## Midstream

### Midstream projects (estimated for years 2016-2018)

Project (Company)	Estimated investment*
Southern Peruvian Pipeline (**)	-
Northern and Central Pipeline	US\$3,300 million
Northern Peruvian Oil Pipeline over-haul	US\$1,900 million
Third expansion of pipeline capacity (Transportadora de Gas del Peru)	US\$400 million

\* Investment reflects the grand total of the projects, regardless of their beginning and/or ending date

\*\*To be determined.

Without a doubt, this segment channels the most important investments in the oil and gas industry. Hereunder we provide a detail of the ongoing and upcoming midstream projects:

#### *The Southern Peruvian Pipeline*

In June 2014, ProlInversion awarded a 34-year concession of the Southern Peruvian Pipeline, which is expected to cover a length of more than 1,000 Km. with a total investment of

approximately US\$7,330 million, out of which an estimated of US\$3,600 to US\$4,000 million correspond to the investment in infrastructure.

It will run from the Camisea gas fields to the most southern regions of the country. It is aimed towards providing those regions with a clean and low-cost energy source, and being a reliable source of gas to the upcoming petrochemical and energy projects involved in the southern power node.

As of January of 2017, the pipeline already shows 37.6% of advanced work. It must be said that 62.76% of the pipelines are located in Peru.

However, recently the concession has returned to the Peruvian Government, along with all the assets involved in the project. In that sense, the contract to build and operate the pipeline will be subject to an international bidding in the following months.

This upcoming bidding is of high importance, and it is estimated that all efforts will be aimed to make the project attractive to foreign investors.

#### *Northern and Central Pipeline*

The Government is studying the possibility of connecting the Camisea gas reservoirs with central and northern regions of the country (probably through Cusco), in order to satisfy the increasing demand for natural gas in the northern region of the country.

#### *Northern Peruvian Oil Pipeline over-haul*

The Northern Peruvian Oil Pipeline is an old infrastructure, which dates back to the 1970's. In the last couple of years, problems regarding its safety began to arise, and the news concerned not only the population, but also the Government and investors.

Certainly, this oil pipeline is the main infrastructure used by producing Blocks from the northeastern jungle, among them Block 192, which used to be the highest producing block before problems affected the pipeline's operations.

Recently, the Government has issued a Legislative Decree in which it has declared the public necessity and national interest in the operation of this pipeline (Legislative Decree No. 1292). To that extent, it has allowed Petroperu to authorize the necessary investments and expenses to the adequate performance of the operation to

Northern Peruvian Oil Pipeline over-haul to ensure its maintenance, sustainability and its infrastructure enhance.

Due to its paramount importance to oil production in the country, the Government might start a bid regarding a complete over-haul project of the pipeline.

### *Third expansion of pipeline capacity*

Transportadora de Gas del Perú, the operator of the pipeline that connects the Camisea Blocks to the coast, just finished the third expansion of the pipeline's capacity. Due to this, the pipeline's capacity is now of 1.540 thousand cubic feet daily in total.

### *Virtual pipelines to central regions*

Notwithstanding recent problems with the development of the Southern Peruvian Pipeline, many companies will start providing natural gas not only to southern regions, but also to others around the country.

In order to do this, virtual natural gas pipelines will begin to operate in April 2017, and will obtain their liquefied natural gas from the LNG plant located in Planta Melchorita. It is important to recall that this plant receives Camisea's natural gas for export purposes, but now it will also provide natural gas for internal consumption purposes.

Under this context, new liquefied natural gas distribution projects through virtual pipelines could arise for interested investors. According to the energy regulator entity, there are more than 200,000 demanding users, the ones that range from residential, to vehicular, and even industrial customers. Not to mention, other connected activities can be performed in order to provide better services to users.



## Downstream

Downstream projects are also significant, since the Government is looking forward supplying the population with natural gas in their home. Hereunder, we provide details of downstream projects:

### Downstream projects (estimated for years 2016-2018)

Project (Company)	Estimated investment*
Talara Refinery Modernization (Técnicas Reunidas)	US\$3,545 million
La Pampilla Refinery Modernization (Repsol)	US\$1,000 million
Natural Gas Massification in Lima and Callao (Cálidda)	US\$538 million
Natural Gas Massification in Ica (Contugas)	US\$325 million
Natural Gas Massification in northern and southern regions (Fenosa and Gases del Pacífico)	US\$220 million
Natural Gas Massification in central regions (**)	US\$350 million
Natural Gas liquefaction and regasification plant (Clean Energy)	US\$75 million

\* Investment reflects the grand total of the projects, regardless of their beginning and/or ending date

\*\*To be determined

## Refinery projects

### Talara Refinery

The Talara refinery is located in the northern region of Piura, an area in which hydrocarbons have been exploited since the early twentieth

century, and it is operated by Petroperu. It is the second most important refinery in the country, next to La Pampilla refinery, located in Lima and owned by Repsol.

In order to make its refining activities more competitive, Petroperu signed a deal with a Spanish contractor ("Técnicas Reunidas") by means of which the aforementioned refinery will undergo a complete optimization process, including an upgrade in the refining capacity from 65,000 bpd to more than 95,000 bpd, and a desulfurization tower in order to comply with current environmental standards.

This project will implicate an investment of an amount up to US\$3,500 million, creating around 14,000 direct and indirect jobs. Likewise, it will provide support to refine the increasing hydrocarbon's production in the northern and northeastern blocks.

### La Pampilla Refinery

La Pampilla refinery is owned by Repsol and is the most important refinery in the country by refining capacity and strategic location near Lima, the capital of Peru.

This project contemplates the construction of six new processing units that will produce low-sulfur diesel in order to comply with environmental standards set forth in Law No. 28694, which forbids commercialization of diesel with a content of sulfur above 50ppm.

The optimization process is estimated to last about 47 months and includes the construction of fuel storage tanks, for a total investment of US\$800 million. This year (2017) Repsol expects to invest US\$140 million (approximately) and US\$97 million in 2018.

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### *Other refineries*

There are also other refineries located in the country, like in Conchán (Lima), El Milagro (Amazonas), Iquitos (Loreto), Pucallpa (Ucayali), and Shiviayacu (Loreto).

Conchán is the most important of the aforementioned, and Petroperu (National Oil Company) operates it. The other refineries are relatively small, and operate locally.

### *Gas distribution trends*

#### ► Natural Gas Massification in Lima and Callao

Calidda continues its efforts to connect more residential consumers to the natural gas distribution network. As of 2016, more than 339,632 consumers were effectively connected.

It is expected that during the coming years more consumers will have access to the network.

#### ► Natural Gas Massification in Ica

Contugas was granted with the natural gas distribution concession in 2008, and began operations in 2011. Since then, more than 1,000 km of pipelines have been added to the natural gas distribution network in the Ica region. According to the Minimum Coverage Plan, almost 50 thousand connections to the network should be completed by 2020.

#### ► Natural Gas Massification in northern and southern regions

Two concessions to distribute natural gas in the northern and southern regions of the country were awarded in 2013. Fenosa was awarded the

southern concession, while Gases del Pacífico obtained the northern concession.

Fenosa is looking forward to beginning operations in the coming April, starting the road to connect more than 50,000 natural gas users by 2023. On the other hand, Gases del Pacífico is expected to grant access to natural gas to almost 150,000 users by 2021.

It must be added that natural gas will be available to these concession by virtual pipelines.

#### ► Natural Gas Massification in central regions

This project is in the process of being awarded by Proinversión, and it will cover supply to 7 regions: Ucayali, Junín, Huancavelica, Ayacucho, Apurímac, Cusco, and Puno.

It is estimated that the total investment will be of US\$350 million, and it will be supported by the new legislation of FISE (see page 115), since funds from this mechanism could be available to help low-income population to benefit from natural gas supply.

#### ► Natural Gas liquefaction and regasification plant

Clean Energy invested around US\$ 75 million to build a natural gas liquefaction and regasification plant in Tumbes, seizing the opportunity that interesting volumes of natural gas on the northern coast offer.

This plant will be able to process around 24 million cubic feet daily, and will help Gases del Pacífico in its goal to grant access to natural gas to the northern population.

# Southern Peruvian Gas Pipeline Project - Reference map

## Pipeline Reference Map

Construction will be made in three stretches

- Benefited regions
- Future connections

## Where will natural gas be used?

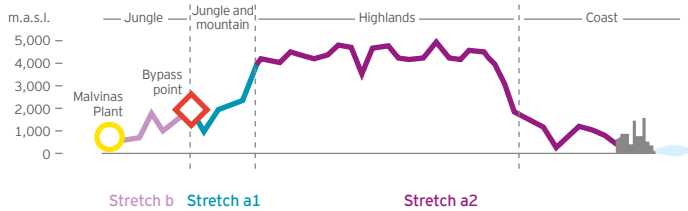
- Mollendo's, Ilo's and Quillabamba's thermal plants and other thermal plant that may choose to use natural gas
- Vehicles working with vehicle natural gas (VNG)
- Industry (factories)
- Residences

### Influence Area

The pipeline will benefit Apurimac, Puno, Arequipa, Cuzco, Moquegua and Tacna regions. Several branches and other infrastructure will be built in order to supply those regions with gas.

These two plants are part of the Power Node awarded by Prolinversion in November, 2013

## Elevation path



Source: Ministry of Transport and Communications

## 03 | Diversifying the energy matrix: Natural gas

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The development of natural gas and condensates from the Camisea project have created a new strategic option for the energy sector in Peru. The development has contributed to increase the reserves and hydrocarbon production and, therefore, the supply and demand patterns of such an energetic matrix.

Before the arrival of natural gas, the energy matrix of Peru depended on liquid fuels – primarily imported diesel, coal, wood, and other traditional energetics. Nowadays, the consumption of liquid fuels has been reduced, in order to introduce different energy sources, such as LPG (Liquefied Petroleum Gas) and VNG (Vehicle Natural Gas). In the future, Peru intends to generate a matrix based not only on petroleum, but equally on renewable energy and natural gas.

The global trend, in terms of fuel oil is to replace oil with other sources that are cleaner and cheaper. So by the time Camisea is completed (Blocks 57, 58, among others), Peru will be energetically integrated into all corners. The development of this industry will trigger the possibility of progressing in the domestic and foreign markets, which will contribute to a future advance on petrochemical, fertilizer and other projects.

### [ Camisea Project ]

Camisea's estimated hydrocarbon reserves are around 13 million cubic feet of natural gas and 660 million liquid barrels. It is estimated that these reserves will reduce the cost of electricity and national fuel by the time they commercialize.

### **Natural gas: the fuel of the future**

Camisea has contributed greatly to Peru's development by providing a steady and increasing flow of a clean energy source. However, Camisea's gas is far from just being a hydrocarbon used directly in the industrial and housing sectors, as well as for exports: arguably, its biggest contribution is the provision of the necessary raw material to generate electricity.

Camisea's gas impact on savings in power generation are estimated to be around USD22,400 million during its first 10 years (the project began operating in 2014). Without a doubt, it has dramatically changed Peru's energy matrix, and because of this, it has paved the way for some of the most ambitious energy and infrastructure projects for the mid-term.

### **Thermoelectric plants projects**

Due to the development of the Camisea project, and the increasing availability of natural gas through the pipeline that connects such fields to the coast, many projects regarding thermoelectric power plants have started operating in the recent years.



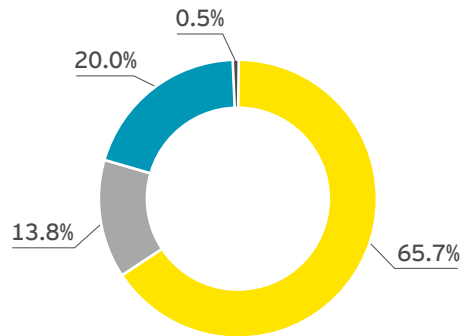


Certainly, the gas pipeline has allowed thermoelectric power plants to be constructed and operated some kilometers to the south of Lima, in Chilca. Fenix Power, Engie, Kallpa, and Termochilca operate thermoelectric power plants in Chilca, generating around 16,000,000 MWh of a great total of 48,587,388 MWh generated in the country during 2016. Some of the aforementioned companies have currently developed extensions of their power plants in Chilca.

Nonetheless, the southern power node has already received investments to develop thermoelectric power plants. Engie is running some of those plants, and some other investors might find it attractive for new projects in the node and its surroundings, especially when the southern Peruvian pipeline starts operating.

Indeed, currently 10% of the power plants under construction are thermoelectric, and, the government is interested in exporting to nearby countries, such as, Chile. It is expected that many other investments in thermoelectric power plants will arrive in the following years.

#### Energy mix objective (%) 2025



● Natural Gas and NGL

● Renewable Energy (Hydroelectric, biofuels, wind, solar, geothermal, biomass, etc.)

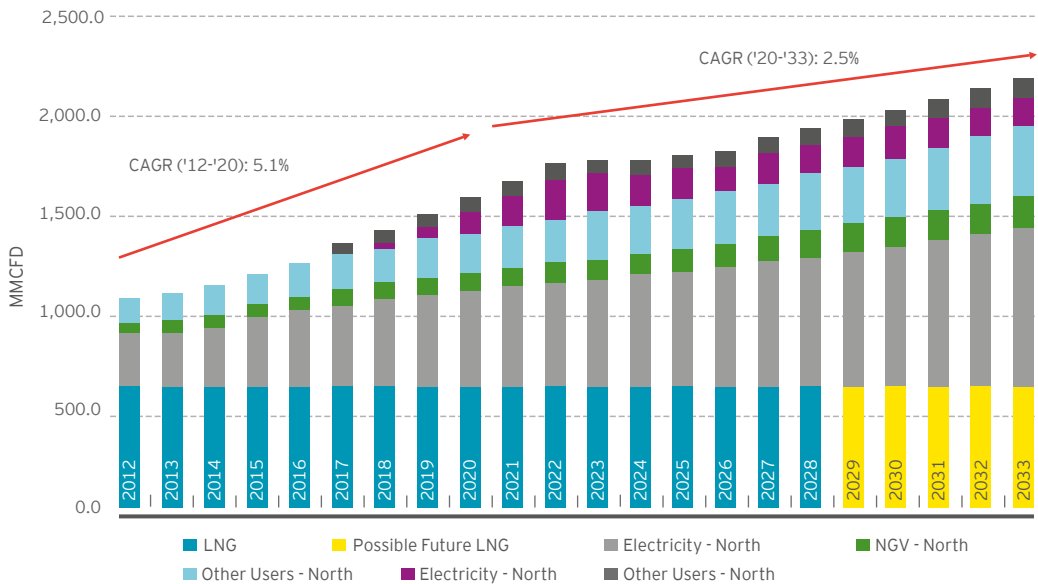
● Petroleum

● Carbon

Source: Ministry of Energy and Mines



## Natural gas demand forecast (2013-2033)



Sources: Wood Mackenzie's analysis / COES

These deposits are large enough to satisfy the actual energy needs of the country for more than a decade. This is why Camisea is one of the most important energy sources of the country.

The Camisea zone is located approximately 500 kilometers to the southeast of the city of Lima, the capital of Peru, on the eastern slopes of the Andes in the region of Cusco. It is located in the Bajo Urubamba valley, one of the areas with the most natural biological diversity in the world.

The major part of the reserves are located in two main gas fields, San Martín and Cashiriari, located in opposite banks of the Camisea River. Blocks 88 and 56 are known as the blocks of the Camisea project.

Three main actors are involved in the management of the natural gas industry in the Camisea project, at different stages. The production stage has been granted by the government to The Consortium integrated by Pluspetrol (operator) - Hunt Oil - SK Innovation - Repsol Exploración Perú - Sonatrach Peru Corporation - Tecpetrol. The transportation and distribution stages have been granted to Transportadora de Gas del Perú S.A and to Gas Natural de Lima y Callao S.A (Calidda), respectively.

Camisea's gas is also currently available in Ica, a region to the south of Lima, by the distribution concession awarded to Contugas, and it will be available April to the northern and southern regions through the recently awarded distribution concessions to Gases del Pacífico and Fenosa.

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## **[ National Energy Programme 2014-2025 ]**

In November 2014, the Ministry of Energy and Mines presented the National Energy Programme 2014-2025. This document forecasts the energy demand of the country until 2025. It also sets down how this demand could be satisfied through the offer of alternative and traditional energy sources.

The provision set forth in the energy planning for the country through 2025 expect an increase in the consumption of liquid hydrocarbons from 209,000 bpd to 285,000 bpd or, another scenario, from 212,000 bpd to 339,000 bpd, stressing the necessity of new infrastructure. Therefore, the optimization projects of the Talara and La Pampilla refineries will gain special importance in order to reach those expectations.

Another relevant topic regarding demand of hydrocarbons is that of the massification of natural gas, which is moving towards consolidation with the on-going and upcoming projects of gas pipelines in the southern and northern regions of the country, respectively. It is expected that the national demand for natural gas will rise from 1900MMscfd to 2400MMscfd by 2025, making it necessary to develop a national pipeline system for its supply.

On the other hand, taking into consideration that Peru had a negative balance of trade rounding US\$3 billion as of 2014, exploration and refining activities become indispensable so that the demand is satisfied in the mid and long term.

Looking forward to achieving this goal, minimum annual goals will be established, so that oil production can be increased from 62 Mbpd to

153 Mbpd by 2025. It is worth mentioning that the optimization of the Talara and La Pampilla refineries and the biddings of new blocks will be crucial to complete this task.

### **Main investment projects**

The total private capital investment projects that are expected for year 2017 are calculated to be worth approximately US\$37,000 million. Almost 14.2% of that amount will be focused directly in the hydrocarbons sector, considering the development of the following projects:

- ▶ Activities regarding Block 57 - Kinteroni, headed by China National Petroleum Corporation and Repsol YPF S.A.
- ▶ Exploration activities on block 58, carried out by China National Petroleum Corporation.
- ▶ Gas distribution improvement developed by Calidda Gas Natural del Peru.
- ▶ Exploration activities on Block Z-38, headed by Karoon Gas Natural.

It is also important to mention in progress that are directly related to renewable resources such as biofuels, and wind and solar power. Given the importance of supporting investment in these areas, the government has already issued some legal instruments (such as Legislative Decree No. 1002).

Regarding wind power projects, Marcona and Tres Hermanas Wind Farms, located in Nazca (Ica), are the first wind farms ever built in Peru. The energy produced there will be sold to the National Electric Network and the National Interconnected Electrical System, for electricity supply purposes, according to the agreements signed with the Peruvian Government.

## 04 | Growing potential

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Peru has 18 sedimentary basins with hydrocarbon exploration potential. However, only three of them have been exploited, which shows that an important part of the national territory with hydrocarbon potential has not been explored yet, especially in the jungle and in the coast. According to Perupetro, Peru is one of the few countries in the world whose territory is relatively underdeveloped, which means that it has an almost intact hydrocarbon potential.

Ten basins are located in the continental zone of Peru (in the coast and in the south and north jungle), and the rest are located offshore.

The basins located in Talara, Marañon and Ucayali are the best known. Further studies have been conducted at these basins, especially in the Talara basin, that has been explored and has had production fields since the 19th century. On the other hand, the Marañon basin (northern jungle) already has production oil wells and new structures have been discovered, but still this basin is only partially exploited.

In the same sense, even though the Ucayali basin (northern and central) has not been explored yet, in the south zone are the Camisea fields, which are the principal natural gas deposits of Peru.

Regarding the other 15 basins whose potential have not been explored in detail, we have the Santiago and Huallaga basins, where abundant crude samples have been found, inferring the existence of active oil systems. We also have the Madre de Dios basin, where preliminary studies confirm the presence of gas deposits.

A case that may bring attention is the Titicaca basin, which produced light oil in very antique fields at the beginning of the 20th century.

In the case of natural gas, in 2014 the Chinese company CNPC acquired Petrobras' assets in the country, therefore comprising an investment of US\$1.4 billion in exploration activities in block 58, near Camisea fields. It was estimated at up to 8 trillion cubic feet of natural gas. Recently, they announced that Block 58 exploratory efforts were successful, granting almost 4 TCF in reserves.

### [ Petroperu (National Oil Company) ]

Even though Petroperu, a state-owned company of private law, initially was not actively involved in exploration and exploitation of hydrocarbon activities, which occurred as a consequence of the privatization process during the 90's; nowadays it is re-assuming its participation in the hydrocarbon production scenario.

In 2006, Peruvian Congress passed Law No. 28840, which allowed Petroperu to return to participate in all stages of hydrocarbon activities, especially in exploration and production. Thus, it could be a competitor in every activity of the industry.

The first step into reinserting Petroperu into upstream activities was taken in October 2014, when Petroperu associated with a private company planning on exploring and producing hydrocarbons in Block 64. This operation meant a step further into the modernization plan for Petroperu, which is aimed towards channeling private equity for further projects, or associating with oil companies in order to boost exploration.

Later in January 2016, Petroperu was authorized to participate in Talara Refinery Modernization Project and in the exploitation of Block 192 develop upstream activities.

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The authorization on the modernization of Talara Refinery will allow them to adopt all the necessary measures to assure the correct engineering, procurement and construction of the new assets that will let it be able to produce LPG, oils and 50 ppm sulfur diesel, making the Peruvian northern region dynamic, and assuring the total nationwide supply through the Petroperu fuel distribution grid.

#### **Petroperu's reorganization and its participation in social projects**

On December 31, 2016, by means of Legislative Decree No. 1292, the government declared the necessity to modernize and reorganize Petroperu.

For this purpose, it authorized Petroperu to modify totally or partially its internal structure in order to improve the efficiency of its operation, increase its operational capacity and to modify its services to reach an adequate standard of performance, considering the necessity to protect the environment and the nearby communities.

Also, Petroperu has been authorized to contract third parties by means of joint venture, services contracts, among other forms, regarding the management and operation of its current projects and the future ones. By this, the government has noted that despite the authorizations given to Petroperu, it is still a public entity.

In the same Legislative Decree, Petroperu has been authorized to participate as a partner and also as an operator (if agreed) in the exploration and the exploitation of hydrocarbon activities according to the terms and conditions included in the correspondent contract. For these purposes, the only condition that it must fulfill is not making any disbursement while developing exploration activities.

It is worth mentioning that due to the said Legislative Decree No. 1292, Petroperu is now authorized to organize and carry social responsibility activities through the Regime called Construction work for Taxes, according to Law No. 29230.

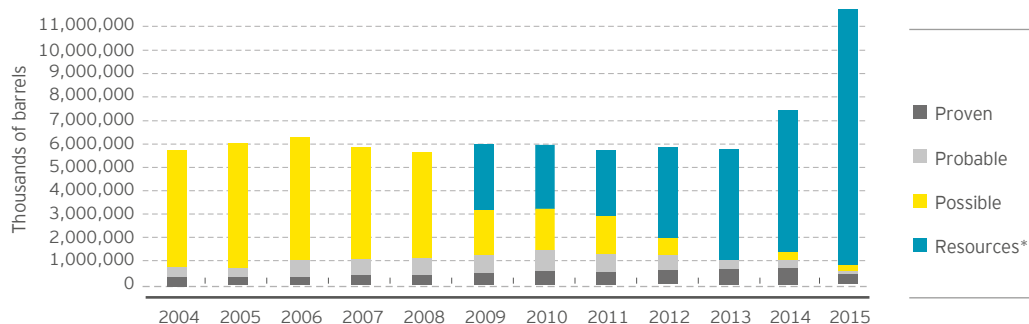
## Oil and gas companies must fulfill all the requirements needed to develop exploration and production activities under a license or service contract

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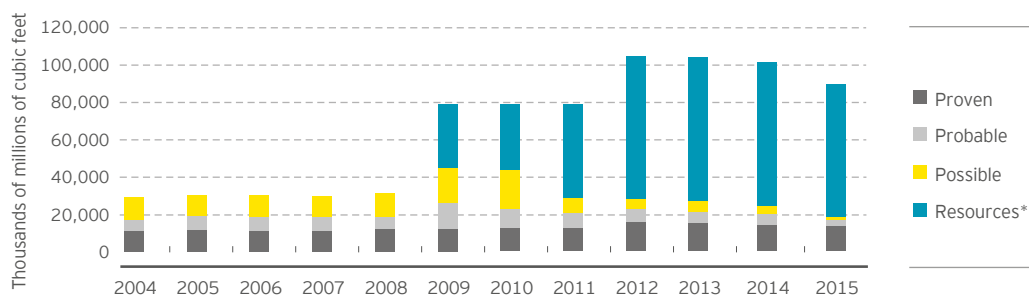


## Oil reserves (2004-2015)



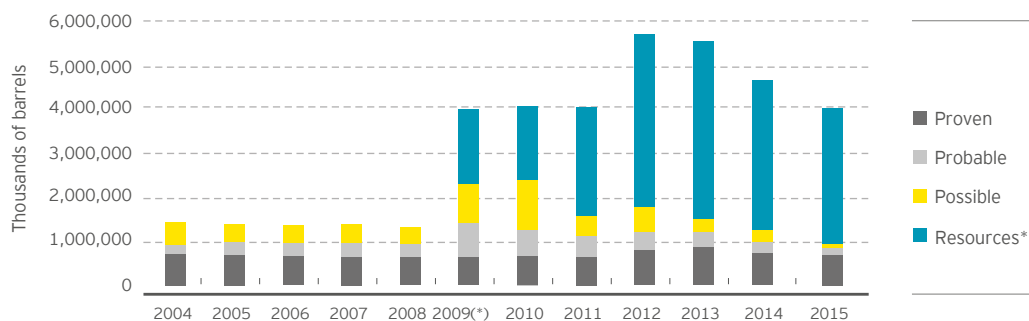
\* Includes contingent and prospective resources. Data updated up to December, 2015.  
The resources come principally from a reclassification of possible reserves to resources as of 2009  
Source: Ministry of Energy and Mines

## Natural gas reserves (2004-2015)

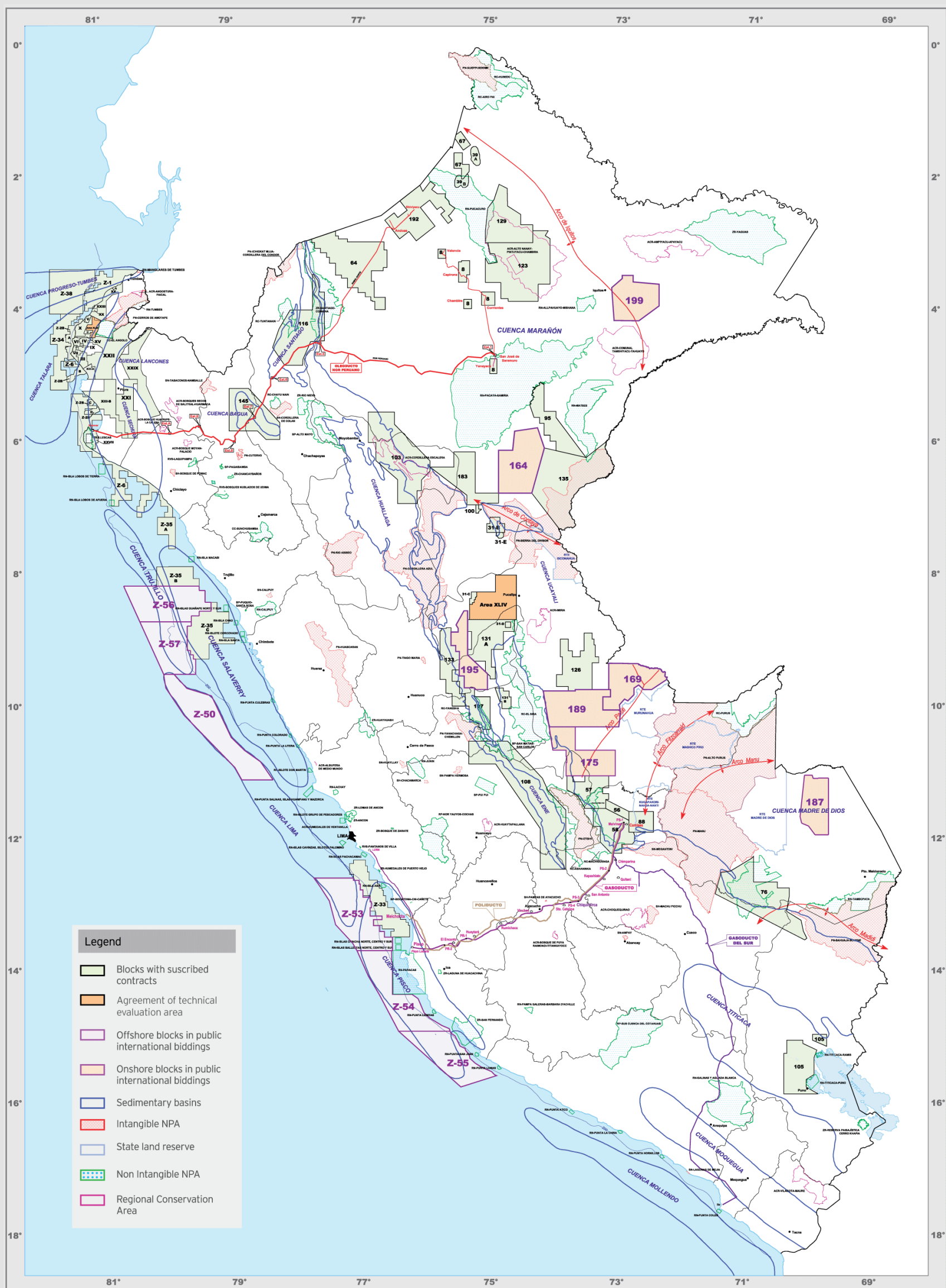


\* Includes contingent and prospective resources. Data updated up to December, 2015.  
The resources come principally from a reclassification of possible reserves to resources as of 2009  
Source: Ministry of Energy and Mine

## Natural gas liquids reserves (2004-2015)

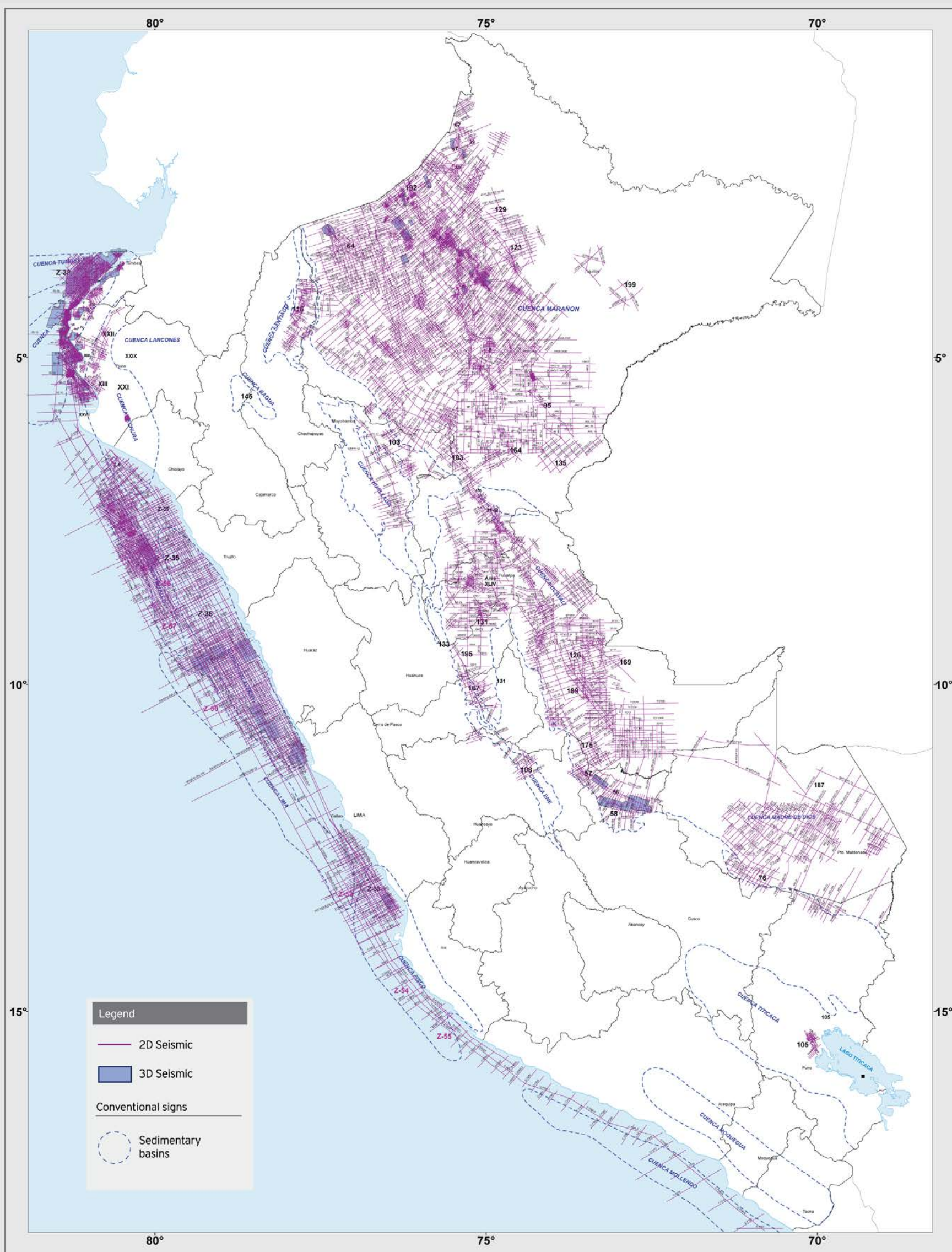


\* Includes contingent and prospective resources. Data updated up to December, 2015.  
The resources come principally from a reclassification of possible reserves to resources as of 2009  
Source: Ministry of Energy and Mines













## Exploitation and exploration contracts (January to December 2016)

	Suscribed	Inforce	Investment (US\$ millions)*
► Exploitation	0	25	287,65
► Exploration	-	26	46,95
<b>Total</b>	<b>0</b>	<b>51</b>	<b>334,60</b>

\* Investment made up to December, 2016

► Exploitation contracts						
Zone	Operator	Block	Basin	suscription date	Lot area / ha	Effective work area / ha
North Rainforest	Pacific Stratus Energy	192	Marañon	30-ago-15	512,347.24	2,037.00
	Pluspetrol Norte	8	Marañon	20-may-94	182,348.21	541
	Petroperu	64	Marañon	07-dic-95	761,501.00	66.00
	Perenco	67	Marañon	13-dic-95	101,931.69	378.00
Central Rainforest	Maple	31B y 31D	Ucayali	30-mar-94	71,050.00	154.00
	Aguaytia	31C	Ucayali	31-mar-94	16,630.00	18.00
	Maple	31-E	Ucayali	6-mar-01	10,418.93	9.00
	Cepsa	131	Ucayali	21-nov-07	778,403.37	90.00
South Rainforest	Pluspetrol Peru Corp.	56	Ucayali	7-sep-04	58,500.00	64.00
	Pluspetrol Peru Corp.	88	Ucayali	09-dic-00	143,500.00	129.00
	Repsol	57	Ucayali	27-ene-04	287,102.80	12.00
North-West	GMP	I	Talara	27-dic-91	6,943.25	339.00
	Petrolera Monterrico	II	Talara	05-ene-96	7,707.42	136.00
	GMP	III	Talara	31-mar-15	35,799.31	227.00
		IV	Talara	31-mar-15	29,521.99	181.00
		V	Talara	8-oct-93	9,026.03	42.00
	Sapet(*)	VI/VII	Talara	22-oct-93	34,444.83	2,513.00
	Unipetro ABC	IX	Talara	16-jun-15	2,754.13	52.00
	CNPC	X	Talara	20-may-94	46,952.34	2,252.00
	Olympic Peru Inc	XIII	Sechura	30-may-96	263,357.85	29.00
		XV	Talara	26-may-98	9,999.77	10.00
Continental Shelf	Petrolera Monterrico	XX	Talara	19-ene-06	6,124.21	131.00
	Savia	Z-2B	Talara	16-nov-93	199,865.22	318.00
	BPZ	Z-1	Tumbes, Talara	30-nov-01	224,375.85	30,077.00
	Savia	Z-6	Talara, Sechura	20-mar-02	528,116.61	15,552.00

► Exploration contracts (continues)						
Zone	Operator	Block	Basin	suscription date	Lot area / ha	Effective work area / ha
North Rainforest	Perenco Peru Limited	39	Marañon	9-sep-99	745,141.20	119.00
	Gran Tierra Energy Peru S.R.L.	95	Marañon	7-apr-05	345,281.67	7,509.00
	Pacific Stratus Energy S.A., Sucursal Del Peru	116	Santiago	12-dec-06	658,879.68	128.00
	Gran Tierra Energy Peru S.R.L.	123	Marañon	29-sep-05	940,421.09	171.00
	Gran Tierra Energy Peru S.R.L.	129	Marañon	11-apr-05	472,433.68	90.00
	Pacific Stratus Energy	135	Marañon	21-nov-07	1,020,390.63	117.00
	Andean Exploration Peru S.A.C.	145	Bagua	16-apr-09	500,000.00	80.00
	Hydrocarbon Exploration Plc., Sucursal del Peru	183	Marañon	28-sep-11	396,825.66	0.00
Central Rainforest	Compañía Consultora de Petroleo	100	Ucayali	26-mar-04	7,700.00	40.00
	Talisman	103	Marañon, Huallaga	9-aug-04	870,896.17	120.00
	Petrolifera Petroleum del Peru	107	Ucayali	1-sep-05	252,232.33	114.00
	Petrominerales Peru	126	Ucayali	23-oct-07	424,419.24	12.00
	Petrolifera Petroleum del Peru	133	Huallaga, Ucayali	16-apr-09	309,309.20	47.00
South Rainforest	Hunt Oil	76	Madre de Dios	2-may-06	837,237.78	235.00
	Pluspetrol E&P	108	ENE	13-dec-05	1,241,675.95	36.00
	CNPC	58	Ucayali	12-jul-05	340,133.72	65.00

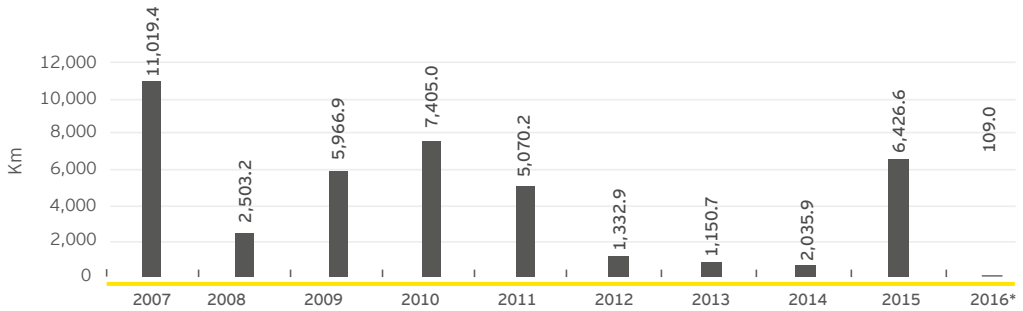
► Exploration contracts (continues)

Zone	Operator	Block	Basin	suscription date	Lot area / ha	Effective work area / ha
Highlands	Siboil del Peru Sierra	105	Titicaca	13-dec-05	443,213.17	9.00
North-West	Gold Oil	XXI	Sechura	4-may-06	303,331.20	44.00
	BPZ	XXII	Talara, Sechura	21-nov-07	369,043.82	66.00
	BPZ	XXIII	Talara	21-nov-07	93,198.96	543.00
	Petro Bayovar Inc., Sucursal del Peru	XXVII	Sechura	16-apr-09	49,821.14	144.00
	Ricoil S.A.	XXIX (*)	Lancones	18-sep-15	303,802.34	0.00
Continental Shelf	Savia	Z-33	Lima, Pisco	1-sep-04	424,783.28	15,414.00
	Gold Oil	Z-34	Talara	8-mar-07	296,799.27	32,549.00
	Savia	Z-35	Salaverry, Trujillo	20-sep-05	765,635.90	20,549.00
	Kei Peru	Z-38	Tumbes, Talara	12-apr-07	487,545.51	112,555.00



## 2D and 3D seismic

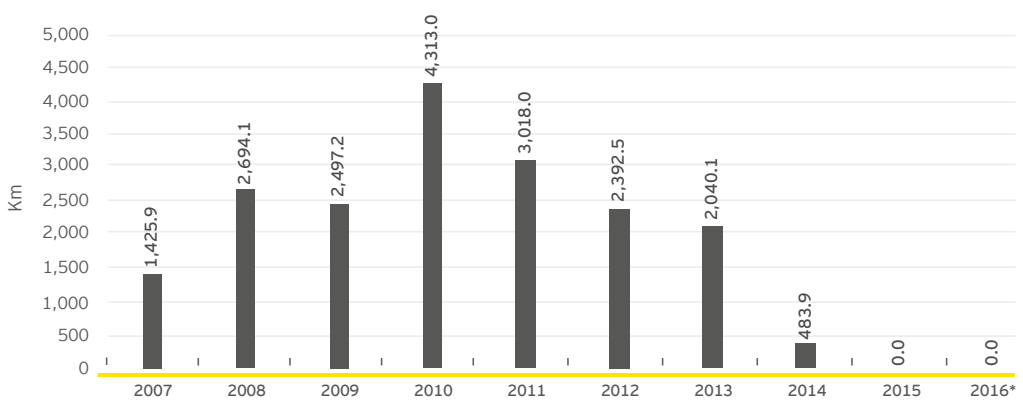
Registered 2D seismic, (2008-2016)



\*As of December, 2016

Source: Perupetro

Registered 3D seismic, (2008-2016)

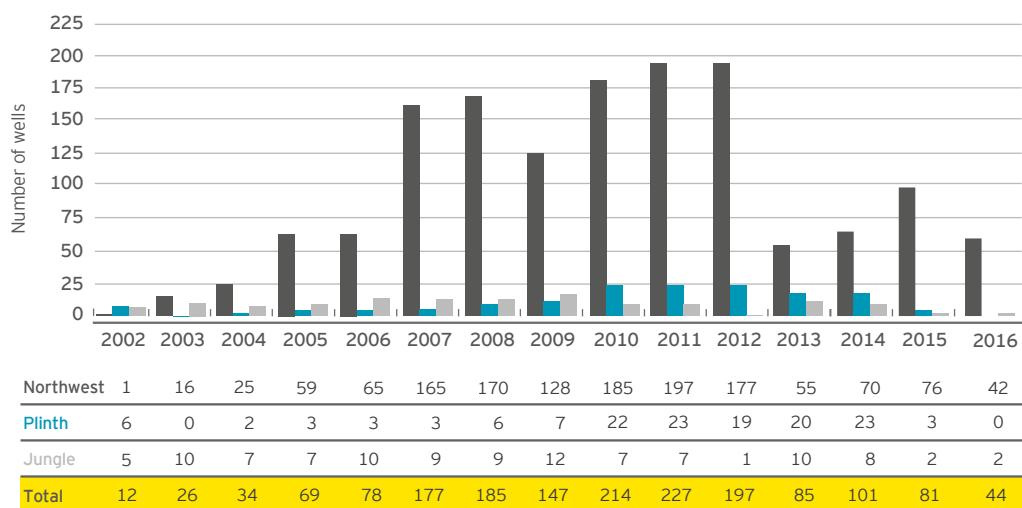


\*As of December, 2016

Source: Perupetro

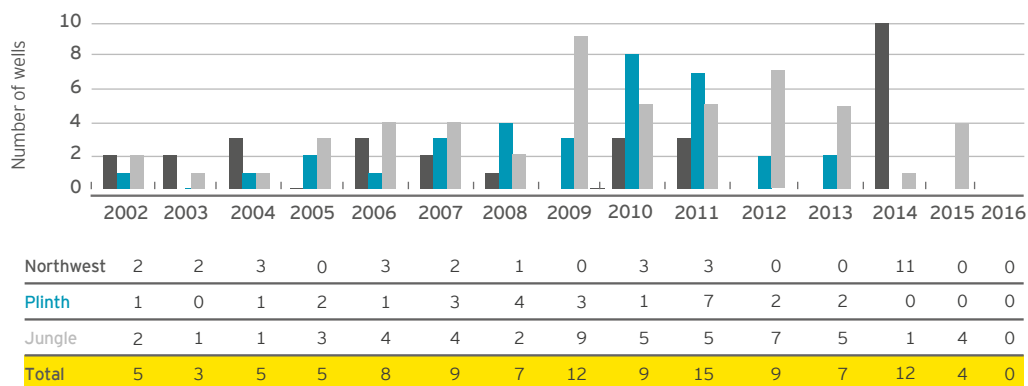
## Development and exploratory drilling

### Development drilling (2002-2016)



Source: Perupetro

### Exploratory drilling (2002-2016)



Source: Perupetro



## 05 | Prior consultation

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In order to start an investment project which may require the exploration and/or exploitation of natural resources, the government and/or the community may require following a process of consultation with the indigenous peoples who might be directly affected by it.

Indeed, such process has to be done taking into consideration that Peru has endorsed Convention No. 169 of the International Labour Organization, Law No. 29785, Law of the Indigenous and Native Peoples Right to Prior Consultation, which was passed by Peruvian Congress in August 2011, while its Regulations were approved by Supreme Decree No. 001-2012-2012-MC, in force since April 4th, 2012.

The aforementioned Law and its Regulations set the beginning of a new approach to be observed between the Government and indigenous peoples in the context of natural resources' exploitation projects, such as those in the hydrocarbons industry.

The prior consultation process is triggered every time indigenous or native peoples which could be directly affected in their collective rights by legislative or administrative means are identified by the Government.

This process is meant not only to protect the rights of the indigenous or native peoples', but also to prevent eventual social conflicts in the investment projects that may affect them directly. Hence, this legal instrument's goal is aimed towards achieving consensus between the promoting entities, such as the Presidency of the Cabinet, Ministries or Administrative Organisms, and the indigenous or native peoples' representatives.

The General Bureau of Energetic Environmental Affairs of the Ministry of Energy and Mines has been chosen as the authority in charge of some of the Administrative Proceedings that are part of the Prior Consultation regarding oil and gas activities.



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As the process' Regulations state, it has seven stages, which are:

- i. Identification of the legislative or administrative mean matter of consultation.
- ii. Identification of the indigenous peoples and their representative organizations.
- iii. Publicity of the legislative or administrative mean matter of consultation.
- iv. Information.
- v. Internal evaluation by the indigenous peoples.
- vi. Dialogue between the Government and indigenous peoples.
- vii. Decision.

It must be noted that if a consensus is not met in the last stage of the process, the promoting entities will do their best effort in order to adapt the legislative or administrative means so that it guarantees the indigenous peoples' rights and the improvement of their living conditions. Thus, the lack of consensus does not imply a veto right in favor of the latter.

The decision must take into consideration the following aspects: (i) Be in accordance to the promoting entity's competences; (ii) respect the Constitutional and legal frame; (iii) comply with the environmental legislation; (iv) preserve the survival of the indigenous peoples and their collective rights; (v) guarantee communal property and land rights of the indigenous peoples.

Once a decision is achieved, a report of all the process is submitted to the Interculture Viceministry, which is the public entity in charge of supervising all the process.

As of December 31, 2016, 34 prior consultation processes have taken place. More than ten of them are directly related to the hydrocarbons industry and have already been completed successfully.



## 06 | Trends in the oil and gas industry in Peru

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### [ Trends in the hydrocarbons industry ]

The actual international context, in which oil prices have still slumped more than 60% of their value compared to 2014, truly puts companies a stage in which it will be necessary to produce more efficiently. But it also brings an opportunity to discuss new policies that may help to develop new projects.

In particular, this means that governments will have to step up in order to prevent negative consequences in economies which rely heavily on oil. Certainly, countries like Mexico and Colombia have taken decisions towards reducing the tax burden of oil companies. Meanwhile, Peru is looking forward following those steps, especially regarding the reduction of royalties.

In this regard, during the last months, Perupetro has began revising hydrocarbon regulations and identifying topics that could be changed in the short-term. The main goal of this reform is to provide energy security, sustainable economic growth and to improve the quality of life of the population. In this sense, the reform has been focused on redesigning and reinforcing the institutional framework in order to articulate more efficient and timely plans.

In particular, Perupetro's reform will focus on three pillars or main topics, which are:

- 1) Regulatory framework
- 2) Reinforcement and redefinition of Perupetro's role
- 3) National Plan

The first pillar aims toward elaborating a more competitive framework with worldwide tendencies that allows it to attract new sustainable investments, with a wide entrepreneurial, technological, social, and environmental support. This means, among other aspects, a revision of contractual terms, a regulatory update of norms and regulations, and socio-environmental license achievement.

The second pillar is focused on making or Perupetro into an active investment promoter, leading the interaction and development of sector policies, with full capacity and autonomy. This will include the institutional and organizational strengthening of Perupetro, a redefinition of the promotion process carried on by it, contractor's support, hydrocarbons production and reservoir management.

The third pillar will aim towards the elaboration of a National Hydrocarbons E&P Plan, by establishing medium and long term production, reserves and goals.

As part of these reforms, Perupetro is also revising the current royalty framework, the contract model and the requirements related to legal, technical and financial capacity of oil and gas companies. Results of these activities are expected to be approved on the first, second and third quarter of this year (2017).

Perupetro is also planning to carry out oil bidding rounds on several on-shore and off-shore blocks during the coming years and thereby promoting investment in the Peruvian Oil & Gas sector.

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The opportunity opening for Peru is important, even more so if we consider that the majority of the oil sedimentary basins have not been explored yet. Also, there are large natural gas reserves not only in the area surrounding the Camisea project, but also in other locations, such as Piura and Tumbes.

### **[ Biofuels ]**

The development of the natural gas industry in Peru is contributing to the creation of new industrial opportunities around this resource, such as in biofuels and the petrochemical industry. This will contribute to reaching the energy matrix diversification objective, so that by 2025 Peru will have reached a diversified and equilibrated matrix (13.8% oil; 65.7% natural gas and natural gas liquids; and 20.0% renewable resources).

In this context, biofuels are a clean and renewable alternative against the contaminating oil industry, especially for its contribution to the diversification of the availability of liquid fuels for transport.

In Peru, there is no significant production of biodiesel and ethanol, but some processing plants have been installed during recent years.

Some of the companies that have made investments in this industry are: Pure Biofuels, Biodiesel Peru International, Herco Combustibles, among others.

Peru has some advantages related to biofuel production, due to the existence of great potential for the development of several oil crops, for obtaining fats and oils from animal origin. The existing potential crops show high production yields.



## Petrochemical Industry in Perú

Petrochemical Industry is an important economical segment in many countries, especially in the ones that own available raw material in competitive quantities such as Peru.

Petrochemical Industry is divided into three:

- First generation basic industry (for example: gas of synthesis, ethylene)
- Second generation industry (for example: ammonia, urea, polyethylene, and polypropylene)
- Transformation industry or third generation (for example: fertilizers NPK, MAP, plastics)

### Competitive integration

#### Extraction / Raw material



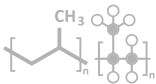
Nafta  
Gas  
Ethanol  
Salt

#### 1st Generation / Basic Petrochemical



Ethylene  
Propylene  
Cloro/Soda

#### 2nd Generation



Polyethylene  
Polypropylene  
PVC  
Ammonia  
Urea

#### 3rd Generation



Plastics  
Fertilizers

In the case of Peru, the vision that needs to be realized is the case of Peru, is to have a planned petrochemical development for the southern part of the country that will not only supply the country but also create earning an export market for its products mainly in the Pacific Coast of Latin America.

Nevertheless, Petrochemical Industrial Planning in a country such as Peru, in which investment is linked to decisions of private companies, requires an important agreement between sector authorities of the Government and potential investors.

In this sense, the implementation of laws, including the ones affecting energy security and the future of petrochemical industry (Laws No. 29163, 29690, and 29970) demonstrates a great opportunity for private companies willing to invest.

Having raw material (supply) and a developing market (demand) worldwide are some of the variables that today make it attractive to start a competitive petrochemical industry in Peru.



Source: EY



## [ Added value and investment opportunities ]

The arrival of natural gas to the southern part of the country is a unique opportunity for developing investment projects in petrochemical, which will add value to the chain of natural gas.

### Natural Gas

Natural gas has many components that can be transformed into other derivatives

#### Propane C<sub>3</sub>

- ▶ Propylene
- ▶ Polypropylene (plastics)

#### Ethane C<sub>2</sub>

- ▶ Ethylene
- ▶ Polyethylene
- ▶ Ox. of ethylene

#### Methane C<sub>1</sub>

- ▶ Ammonia
- ▶ Urea (fertilizers)
- ▶ Ammonia Nitrate (fertilizers, ANFO)
- ▶ Methanol (paints)

## [ Renewable Energy Sources (RER) ]

Peru offers a promotional regime to boost investment in RER. RER activities include the following:

- ▶ Wind
- ▶ Solar
- ▶ Geothermal
- ▶ Biomass
- ▶ Tidal





Through Legislative Decree No.1058, RER investors can benefit from a global accelerated depreciation regime of 20% per year.

This special depreciation regime has proven effective. Peru has seen some interesting projects developed in RER, like the Marcona wind farm, which began operations in 2014, and accounted for an investment of US\$61 million.

Majes is another example of how RER is growing in the Peruvian Market. With an investment of almost US\$165 million, T-Solar has executed what is considered a model of how infrastructure projects between Governments and private companies should be.

### **[ Petrochemical Complex ]**

The development of a Peruvian Petrochemical Industry must search for a synergy between the SPP, first and second generation Industrial Petrochemical Complex and third generation

industrial complex: plastic transformation industry (bags, containers, etc.).

Competitive availability of raw material is the main factor to make this Project feasible. In this case, the existence of a reasonable gas flow at the end of the SPP is very important. This hypothesis will only be possible if a new LNG unit is developed in the region, since it is the only project that can add natural gas demands.

The planning of a petrochemical complex involves a number of other important decisions. Not only the ones that guarantee raw material supply, but also location, access to transportation (highways, sea ports and airports), supplies such as water and electricity, and of course human resources.

The opportunities explained above are great for investors to visualize how this synergistic interrelationship will benefit them, the government and the population in general.



A list of integrated units in a petrochemical complex, with their respective investment estimations, demonstrates that they all could be more than US\$15,000 million:

Project	Investment US\$ Millions
LNG	5,000
Ethylene Polyethylene	5,000
Ammonia Urea	1,800
Methanol	1,500
Infrastructure and services	1,000
Energy	1,000

### [ Benefits for the country ]

The installation of a petrochemical industry in the country will not only increase added value to nonrenewable resources such as natural gas, but with the following decrease of imported petrochemical products (improving trade balance), it will also contribute to improving national and regional economic growth. This growth will create qualified jobs and new road and port infrastructure, among other significant benefits for the country, especially to the southern region. Benefits for the country in respect to taxes will be significant.

### [ Opportunity to join several stakeholders to achieve the desired goals ]

It is appropriate to consider that the development of a Petrochemical Industry is one of the objectives on the Energy policy of the Peruvian Government. To achieve this goal, it is necessary to establish a Strategic Plan together with the Government, regional and private sectors that will allow this megaproject to be developed in the short term.











# IV

## Oil and gas tax and legal framework

# 01 | Hydrocarbon terms

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## [ Hydrocarbons agreements ]

Oil and gas exploration and production activities are conducted under license or service contracts granted by the Government. Under a license contract, the investor pays a royalty, whereas under a service contract, the Government pays remuneration to the contractor.

As stated by the Peruvian Constitution and the Organic Law for Hydrocarbons, a license contract does not imply a transfer or lease of property over the area of exploration or exploitation. By virtue of the license contract, the contractor acquires the authorization to explore or to exploit hydrocarbons in a determined area, and Perupetro (the entity that holds the Peruvian state interest) transfers the property right in the extracted hydrocarbons to the contractor, who must pay a royalty to the state.



License and service contracts are approved by supreme decree issued by the Peruvian Ministry of Economy and Finance, and the Peruvian Ministry of Energy and Mining, and could only be modified by a written agreement signed by the parties.

Before initiating any negotiation, every oil and gas company must be duly qualified by Perupetro, in order to determine if it fulfills all the requirements needed to develop exploration and production activities under the contract modalities mentioned above.

It must be noted that the terms and conditions under which license contracts are negotiated and subscribed remain the same for on-shore and offshore blocks.

On the other hand, contractors will have the right to use water, grit, wood, and other construction materials, and to negotiate permissions, easements and the right to use water and surface rights, that necessarily result in carrying out their activities. If the exercise of such rights generates economic damages, they must be compensated.

Regarding the subscription of contracts, Perupetro has begun revising the scope of the current applicable regulations related to hydrocarbon royalties, qualification requirements for Oil & Gas companies and the terms of the license contracts to be signed with companies.

## [ Upstream, midstream and downstream activities ]

The activities performed in the hydrocarbon sector can be divided into three stages: "upstream", "midstream" and "downstream". The activities included in the "upstream" stage comprise the exploration and exploitation of hydrocarbon deposits, while the "midstream" and

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“downstream” stage refers to refining, natural gas processing, transportation, distribution and commercialization of oil, gas and by-products.

### **Upstream Activities (\*)**

#### **► Exploration phase**

The exploration phase is aimed at discovering areas with oil potential. To reach that objective, oil companies must plan, execute and evaluate every type of geological, geophysical, geochemical activity and carry out other studies, geophysical activities, drilling exploring oil wells and other related and necessary activities for oil discoveries.

This phase will have a maximum duration of 7 years, counted from the effective date of the contract (60 days after the signing date) established on each contract. This term can be divided into several periods as agreed to in the contract.

Exceptionally, the Ministry of Energy and Mines can authorize an extension of three years for this stage, if the contractor has complied with the minimum working program established in the contract, and also commits to fulfill an additional working program that justifies such extension.

The contractor shall be responsible for providing the technical and economic resources required for the execution of the operations of this phase.

#### **► Exploitation phase**

The exploitation phase is comprised of development and production activities related to oil and gas extraction, in order to transport it to relevant markets. These activities include, among others, drilling of exploitation wells, the

construction of pipelines to transport the extracted hydrocarbon production and any other activity for extracting hydrocarbon.

This phase will have a maximum duration of 30 years for crude oil, and 40 years for non associated natural gas and condensates, both counted from the contract effective date.

### **Midstream Activities**

These activities can be considered as a crucial part of the oil and gas sector activities, as they consist of the transport by pipelines, and storing of hydrocarbons. In order to start activities related to the transportation of hydrocarbons by pipelines, a company must be granted a concession, whilst it will only need to comply with specific requirements according to Peruvian regulations so as to store them.

Midstream related activities can also be related to the operation of gas processing plants and gas treating and conditioning facilities in order to make it transportable, the operation of fuel pipelines systems, maritime transportation by tankers, and operating oil storage terminals.

Investment projects in gas processing facilities can be subject to the benefits granted to upstream projects. In this regard, a contract shall be signed by the investor and government, and it can only be modified by mutual agreement.

### **Downstream Activities**

#### **► Refinery**

This activity involves the construction of industrial facilities, in which crude oil, natural gasoline or other hydrocarbon sources are transformed into fuel products, such as liquefied petroleum

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(\*) Peru's Oil & Gas Investment Guide is mainly focused on upstream activities



gas (LPG), gasoline, diesel and industrial fuels. Contractors must obtain an authorization from the General Hydrocarbons Bureau for executing such construction.

### **Distribution and commercialization**

Liquid fuels and other hydrocarbon byproducts obtained as a consequence of the activity of refinery are distributed to wholesalers, who in turn, dispatch them to oil stations, to retailers and/or direct consumers, etc. In the case of liquid hydrocarbon and similar hydrocarbon byproducts, contractors must obtain an authorization from the Ministry of Energy and Mines (MEM). In the case of natural gas, distribution must be granted by a concession.

### **[ Government policies on the sale of natural gas ]**

Contractors must consider that the authorization to explore or to exploit proven natural gas reserves requires them to guarantee the supply of the national market, for a specific period stated in the contract.

### **Assignment of an oil interest**

The contractor can partially or totally transfer its interest or associate with any other qualified investor, provided that the operation is approved by the Ministry of Energy and Mines (MEM).

The transfer of the contractor's interest will lead to the maintenance of the same responsibilities regarding the guarantees and obligations assumed by the contractor. In this sense, the stabilized tax regime applicable to the contractor will also apply to the transferee.

### **Environmental obligations**

Before initiating any hydrocarbon activity (e.g. seismic exploration, drilling of exploration wells, etc.) the contractor must fill and obtain an approval for an Environmental Impact Study (EIS), which incorporates technical, environmental and important social matters that contribute to the evaluation and determination of the necessary mechanisms for preventing, minimizing, mitigating and remediation of the possible negative environmental impacts that the hydrocarbon activity will trigger.

Depending on the type of hydrocarbon activity the contractor is intended to execute, it should fill the following types of environmental studies:

- ▶ Environmental Impact Statement (EIS)
- ▶ Detailed Environmental Impact Study (DEIS)
- ▶ Semi detailed Environmental Impact Study (SEIS)

Environmental Certification National Service for Sustainable Investment (SENACE), is the public and technical entity in charge of approving the DEIS of projects that involve activities, structure implementation works and other commercial and service activities that may cause significant environmental impacts. The organization is part of the Ministry of Environment.

For this purposes, SENACE reviews environmental plans presented for large investments projects, seeks technical opinions, makes proposals to enhance environmental evaluation processes and manage the National Registry of Environmental Consultants, among other activities.

Notice that the competent authority for protection and environmental conservation in the case of hydrocarbon activities, is the Ministry of Energy and Mines (MEM), through the General Bureau of Energetic Environmental Affairs (GBEEA).

# 02 | Peruvian oil and gas fiscal system

The economic attractiveness of a country is strongly influenced by the fiscal system that applies to oil and gas activities, especially upstream. If tailored properly, fiscal terms are able to achieve the overall objective of collecting an adequate share of the economic benefit for the government generated by the oil and gas industry, while maintaining high levels of exploration and production activities.

Keeping in mind those objectives and considering that the levels of investment required in the exploration stage in itself involves a great associated risk, Peru has established several tax incentives in order to reduce the tax impact that applies to those operations by establishing a tax stability regime, VAT exemption on the import of goods and supplies for the exploration stage and early-definitive VAT recovery regime



## At a glance

The fiscal regime that applies to the oil and gas industry in Peru consists of a combination of corporate income tax, royalties and other levies.

Income Tax rate	29.50% <sup>(1)(2)</sup>
Hydrocarbon Royalties	5% imposed on the value of the hydrocarbons produced in certain block
Capital allowances	Ring-fence rules and preoperative investment amortization
Investment incentives	Tax losses can be carried forward for 4 years or indefinitely; stabilization agreements; VAT recovery; VAT exemptions on imports of goods for exploration activities

(1) Oil and gas companies with license or service agreements are subject to a 2% premium. This 2 points should be added to the current Income Corporate Tax rate, resulting in an Income Tax rate of 31.5%.

(2) In addition, they must pay a 5% employee profit sharing.

## [ Fiscal regime corporate income tax ]

In general terms, oil and gas companies are subject to the general corporate income tax regime; nevertheless, there are certain special tax provisions for the oil and gas sector.

## Basic aspects

Resident companies (incorporated in Peru), are subject to income tax on their worldwide taxable income. Branches and permanent establishments of foreign companies that are located in Peru and nonresident entities are taxed on income from Peruvian sources only.

Taxable income is generally computed by reducing the gross revenue by cost of goods sold and all expenses necessary to produce the income or maintain its source. Certain types of revenue, however, must be computed as specified in the tax law and some expenses are not fully deductible for tax purposes. Business transactions must be recorded in legally authorized books of account that must be in full compliance with the International Accounting Standards (IAS). Contractors (Peruvian corporations and branches) are entitled to keep their accounting records in foreign currency, but taxes must be paid in Peruvian Soles (PEN).

The general corporate income tax rate for fiscal year 2017 (onwards) is 29.5%. However, companies carrying out exploration and production activities under hydrocarbon agreements must apply an income tax rate of 31.5%, the current tax rate plus 2 points. In addition to this, Dividend Tax at a rate of 5% is imposed on distributions of profits to non residents and individuals by resident companies and by branches, permanent establishments and agencies of foreign companies.

This tax is generally withheld at source. However, under certain circumstances, the company must pay the tax directly.

The mandatory closing date for business enterprises is December 31st. Tax returns must be filed by between March and April according to the schedule established by the Tax Administration. Taxes and related penalties not paid by the due dates are subject to interest charges, which are not deductible for corporate income tax purposes.

### Advanced payments

Companies and branches must make monthly advance payments of their annual corporate income tax. Advance payments will be equal to the greater amount that results from comparing the quotas obtained from the application of the following methods:

- Percentage method: by applying 1.5% to the total net revenue of the month.
- Ratio method: by dividing the tax calculated in the previous year by the total accrued net revenue of the same year and applying the ratio to the net accrued revenue of the month. This ratio must be multiplied by a factor of 1,0536 to determine advance payments in 2017 and January-February 2018.

Income Tax prepayments apply as credit against the annual income tax obligation or they are refunded at the end of the fiscal year (once the tax return is filed), if requested by the taxpayer.



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## Capital gains

Capital gains are treated as ordinary income. Under this consideration, capital gains determined by resident entities are subject to a 29.5% tax rate.

Starting from January 1, 2016, capital gains derived from the sale of shares and other securities representing shares (i.e. ADR, GDR, and ETF) carried out through the Lima Stock Exchange are Income Tax exempt. To claim the exemption, a taxpayer must meet the following conditions:

- In any given 12-month period, the taxpayer and its related parties must not transfer more than 10% of the shares or “securities that represent shares” issued by the company whose shares are sold.
- Shares should meet a liquidity threshold: 180 working days prior to their sale, they should have been traded at least in 27 days (not necessarily consecutive) for a daily fee of US\$4,647 (equivalent to 4 Tax Units).

Under the latest Tax Reform, effective since January, 2017, the aforementioned exemption was extended up to December 31, 2019.

Also, by means of this amendment other securities (bonds, participation certificates in Mutual Investment Funds, Real Estate Investment Trusts (REITs), Securitization Trusts for the Investment in Income of Real State, and Negotiable Invoices) have been included into the scope of this exemption, provided that they are listed and traded on the LSE, and (depending on each case) fulfill the other requirements states in Law No. 30341 and its regulations.

## [ Capital allowances ]

### Trade or business expenses

In general terms, all corporate expenses incurred in the generation of taxable income or the maintaining of its source are deductible for corporate income tax purposes. This rule is subject to certain exceptions and limitations expressly provided in the income tax law.

### Tax depreciation

Depreciation rates apply to the acquisition cost of fixed assets. The following are some of the maximum annual depreciation rates allowed by Law:

Data processing equipment	25%
Machinery and equipment for construction, mining and oil activities	20%
Vehicles	20%
Machinery and equipment for other activities	10%
Buildings and constructions*	5%*
Other fixed assets	10%

\*This is a fixed rate rather than a maximum rate.

Taxpayers may apply any depreciation method for their fixed assets other than buildings and constructions, as long as the resulting depreciation rate does not exceed the maximum rates stated above. In general, except for buildings and constructions, tax depreciation must match financial depreciation.

## Valuation of inventory

Inventory is valued for tax purposes at the acquisition or production cost. Financial charges are not allowed to be part of the cost. Taxpayers may choose any of the following methods to calculate annual inventory for tax purposes, provided that the method is consistently used: first-in, first-out (FIFO), daily, monthly or annual average, specific identification, detailed inventory, and basic inventory.

## Pre-operative expenses

Pre-operative expenses may either be expensed in the year production commences, or may be amortized over a period of up to ten years from the year in which production commences.

## Special rules for investments on hydrocarbon activities

Hydrocarbon law provides that exploration and development expenditures, including the investment contractors may make up to the production date (when the commercial extraction of hydrocarbon starts) can be accumulated in an account. At the contractor's option and regarding each contract, the amount is amortized using either of the methods below:

- On the basis of the production unit.
- Through lineal amortization, deducting the expenditures in equal portions during a period of no less than five fiscal years.

Any investments in a contract area that did not reach the commercial extraction stage and that were totally released, can be accumulated with the same type of investments made in another

contract that is in the process of commercial extraction. These investments are amortized in accordance with the amortization method chosen in the letter contract.

If the contractor has entered into a single contract, the accumulated investments are charged as a loss against the results of the contract for the year of total release of the area for any contract that did not reach the commercial extraction stage, with the exception of investments consisting of buildings, power installations, camps, means of communication, equipment and other goods that the contractor keeps or recovers to use in the same operations or in other operations of a different nature.

Once commercial extraction starts, all amounts corresponding to disbursements with no recovery value are deducted as expenses for the fiscal year. Expenses with no recovery value occur as of the start of commercial extraction for the following purposes:

- Investments for drilling, completing or producing start-up wells of any nature, including stratigraphic ones, and excluding acquisition costs of surface equipment.
- Exploration investments, including those related to geophysics, geochemistry, field geology, gravimetry, aerophotographic survey and seismic surveying, processing and interpreting.

The Manual of Accounting Procedures to be filed before Perupetro must detail the accounts considered as expenditures without any recovery value.



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### Ring-fence rules for oil and gas contracts

The contractor determines the tax base and the amount of the tax, separately and for each contract. If the contractor carries out related activities (i.e., activities related to oil and gas, but not carried out under the terms of the contract) or other activities (i.e., activities not related to oil and gas), the contractor is obligated to determine the tax base and the amount of tax separately and for each activity.

The corresponding tax is determined based on the income tax provisions that apply in each case (subject to the tax stability provisions for contract activities and based on the regular regime for the related activities or other activities).

The total income tax amount that the contractor must pay is the sum of the amounts calculated for each contract, for both the related activities and for the other activities. The forms to be used for tax statements and payments are determined by the tax administration.

If the contractor has more than one contract, it may offset the tax losses generated by one or more contracts against the profits resulting from other contracts or related activities. Likewise, the tax losses resulting from related activities may be offset against the profits from one or more contracts.

It is possible to choose the allocation of tax losses to one or more of the contracts or related activities that have generated the profits, provided that the losses are depleted or are compensated to the limit of the profits available. This means that if there is another contract or related activity, the taxpayer can continue compensating tax losses until they are totally used.

A contractor with tax losses from one or more contracts or related activities may not offset them against profits generated by the other activities. Furthermore, in no case may tax losses generated by the other activities be offset against the profits resulting from the contracts or from the related activities.

### Hydrocarbon Royalty

As mentioned before, oil and gas exploration and production activities are conducted under license or service contracts granted by the Government. Under a license contract, the investor pays a royalty, while under a service contract, the Government pays remuneration to the contractor.

In both cases, however, the distribution of the economic rent (royalty or remuneration) between the Government and the investor is determined based on the following methodologies:

#### ► Production scales

This methodology establishes a percentage of royalty (or brackets of royalties starting at 5%) over certain scales of production (volume of barrels per calendar day) for the fiscalized liquid hydrocarbons and the fiscalized natural gas liquids, and other royalty percentages for the fiscalized natural gas for each valuation period.

Note that the fiscalized hydrocarbons (i.e. liquid hydrocarbons, natural gas, etc.) means those produced and measured in a specific fiscalized production point set between the investor and the Government in order to establish the quality and volume of hydrocarbons, according to API (American Petroleum Institute) and ASTM (American Society for Testing and Materials) regulations.

Based on the scales of production, the percentage of royalty is:

Scales of production (per barrels per calendar day)	Percentage of royalty
< 5	5%
5-100	5% to 20%
> 100	20%

► Economic results (RRE)

According to this methodology, the royalty percentage is the result of adding the fixed royalty percentage of 5% to the variable royalty percentage. The variable royalty percentage is calculated once the ratio between revenues and expenditures, as of the previous year, is at least 1.15. The variable royalty will be applicable in a range between 5% and 20%.

► Other Methodologies

“R” Factor and Cumulative Production per Oil Field with price adjustments are alternative methodologies. In the case of “R” Factor, the royalty is calculated by applying a ratio between revenues and expenditures within a certain period established in the contract. For these purposes, the minimal percentage of royalty is:

“R” Factor	Percentage of royalty
► From 0.0 < 1.0	15%
► From 1.0 < 1.5	20%
► From 1.5 > 2.0	25%
► From 2.0 or more	35%

The definitive percentages will be negotiated and established in each Contract.

On the other hand, in the case of Cumulative Production per Oil Field with price adjustments, the royalty is calculated based on a specific percentage per Oil Field of a Contract. The royalty is adjusted based on two factors: the cumulative production of each Oil Field and the average price per barrel of such production.

Hydrocarbon royalties paid by oil and gas companies shall be considered a deductible expense for income tax purposes.

Incentives

- Relief for losses (consolidation of losses on hydrocarbon activities):

Tax losses can be carried forward and offset against net income derived in future fiscal years. The provisions currently in force require the taxpayer to elect one of the following procedures to offset the tax losses:

- Offset the total net tax losses from Peruvian sources incurred in a tax year against net income derived in the four fiscal years following its generation. The amount of losses not offset after this term are cancelled.
- Offset the total net tax losses from Peruvian sources obtained in the tax year against 50% of the net income obtained in the following years, without limitation.

The election should be made when the annual income tax return is filed and it cannot be changed until the accumulated losses are fully utilized.

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Loss carrybacks are not allowed.

► Special incentives for hydrocarbon investors:

#### *Stability regime*

The Organic Law for Hydrocarbons and the related tax regulations foresee that the signing of an oil and gas agreement implies the guarantee that the tax regime in effect at the date of signature will not be changed during the life of the contract. This is intended to preserve the economy of the contract so that no further tax costs are created for the contractors.

The signing of an agreement for the exploration or exploitation of a block “freezes” the tax regime in force at the date in which the contract is signed for the entire contract applicable term. Taxes covered by this provision are the taxes in which the responsibility rests on the contractor as a taxpayer.

Specifically, tax stability covers the following:

- Income Tax, but an additional two percentage points must be applicable to the rate in force at the signing date (i.e. current Income Tax rate of 29.5% plus 2%). Taxes that affect profit distributions arising from the contract activities (i.e., dividend tax or branch profits tax) are also covered by the tax stability.
- Indirect taxes (Value Added Tax, Municipal Promotion Tax, and Selective Consumption Tax), but only as to its transferable nature.
- Tax exemptions and other tax benefits, but subject to the term and conditions established in the provision that contain such benefits.
- Tax recovery regimes, temporal admission regimes, export regimes and other related.

Peru's tax system has included certain specific rules for oil and gas companies (ring fence rules, expense amortization, etc.)

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It is important to note that tax stability is, in essence, granted for the contract activities and not directly for the entities that signed the contract. Therefore, changes in the contractor's ownership will not affect the tax stability. The tax stability only covers the contract activities (i.e., the exploration and exploitation of hydrocarbons) and no other related or distinct activities that may be performed by the legal entity (e.g., downstream activities). Revenues obtained from the sale or exports of the extracted hydrocarbon are included in the activities covered with tax stability.

#### *Early recovery VAT system*

The early recovery VAT system allows obtaining an early recovery of the VAT paid on the acquisition of goods, services, construction contracts, importations, etc.; executed for carrying out taxable operations or exports. VAT is reimbursed through negotiable credit notes (which are redeemable in exchange for a check). This system prevents waiting to recover such amount from a client when the invoice, including VAT, for the sales of goods, services or construction contracts is issued to the client.

In other words, this regime provides relief of financial costs (cost of money) for projects with a significant pre-operating stage and for which no advance invoice (transferring the VAT burden) can be issued periodically to the client.

The law provides a general and a specific early recovery system; each one with its own scope and requirements:

- General early recovery VAT system: This regime applies to companies that are in a preoperative stage, allowing them to recover the VAT paid on the acquisition of capital goods. This regime does not require companies to sign an investment contract, nor specific amount of investment.
- Specific early recovery VAT system: This regime applies to companies that are in a preoperative stage, and that also meet the following conditions: (i) they enter into investment contracts with Peruvian government, to invest in economic Industry; and (ii) they make a minimum investment commitment of US\$5 million for projects with a preoperative phase of at least 2 years.



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If the previous conditions are met, companies will be able to recover VAT paid on the acquisition or imports of capital or intermediate goods, services, and construction contracts. The use of one system does not preclude the possibility of using the other, as they have a different scope (items).

#### *Definitive recovery VAT system*

Under this regime, VAT paid on the acquisition of goods and services used directly in oil and gas exploration activities can be recovered without having to wait until a commercial discovery takes place or production begins. This regime will be applicable from the contract signing date until the end of the term of the exploration phase.

Goods and services included in the regime should be incorporated in a list and approved by the Ministry of Energy and Mines. The validity of this regime has been extended until December 31, 2018.

#### *Amazon promotion investment regime*

► VAT and ISC exemption on the sale of hydrocarbon products: oil and gas companies (principally those dedicated to oil refining and storage activities) located in the regions of Loreto, Ucayali and Madre de Dios will be VAT and ISC exempted when selling oil, natural gas and by-products to retailers or to direct consumers. For this purpose, it is required that retailers must also be located in the regions of Loreto, Ucayali and Madre de Dios, and should perceive third category income mainly from commercializing oil, natural gas and/or its byproducts. Direct consumers include corporations and individuals located in the regions of Loreto, Ucayali and Madre de Dios, that perceive third category income due to activities different from hydrocarbons commercialization.

The law also states that retailers will only be allowed to sell the exempted hydrocarbon product to the public, or for its own consumption; and that the direct consumer will also be limited to use the exempted hydrocarbon product only for the activities carried out in the regions of Loreto, Ucayali and Madre de Dios.

► ISC reimbursement on oil products acquisitions: oil and gas companies located in the region of Madre de Dios can obtain a reimbursement on the ISC that levied their oil products acquisitions.

In both cases, oil and gas companies should be located in the mentioned regions, be registered in the Public Registry of such location, and must have more than 70% of its shares and/or activities in the Amazon region. These requirements do not apply to oil and gas extractor and refining companies.

#### **Withholding taxes**

##### *Dividends*

A dividend tax at a rate of 5% applies to profits distributed to nonresidents and individuals. The dividend tax applies to distributions by Peruvian companies, as well as to distributions made by Peruvian branches, permanent establishments and agencies from foreign companies. Peruvian Income Tax Law specifies various transactions that are considered as profit distributions for the purposes of the application of the dividend tax, including the distribution of cash or assets, the reduction on the capital of the company or the liquidation of the company.

This law also provides that if a resident company or branch, permanent establishment or agency, pays expenses that are not subject to further tax control or does not report any income, the



amount of the payment or income will be subject to dividend tax (i.e. it will be treated as a deemed dividend distribution).

It should be noted that the effect of the reduction of the dividend tax rate combined with the increase of the corporate tax rate results in a total tax burden of 33.03% (approximately).

#### *Interest*

Interest paid to non residents is generally subject to a withholding tax at a rate of 30%. For interest paid to unaffiliated foreign lenders, the rate is reduced to 4.99% if all the following conditions are satisfied:

- ▶ For loans in cash, the proceeds of the loan are brought into Peru as foreign currency through local banks or are used to finance the import of goods.
- ▶ The proceeds of the loan are used for business purposes in Peru.
- ▶ The participation of the foreign bank is not primarily intended to avoid the tax treatment applicable to transactions between related parties (i.e. the use of back-to-back loans is consequently precluded).
- ▶ The interest rate does not exceed LIBOR plus 7 points.

#### *Technical Assistance Services*

Payments for technical assistance services used within Peru are subject to withholding tax at an effective rate of 15%, regardless of the country the

services are rendered. To ensure the application of the 15% rate, the local service recipient must obtain and present to the Tax Authorities upon request a report issued by an audit firm certifying that the technical assistance was effectively provided. However, this is only required when the fees under the corresponding agreement for the technical assistance exceed 140 tax units (each tax unit is equivalent to PEN S/4,050 or approximately US\$1,191).

#### **Royalties**

Peruvian source royalties paid for the use of intangible property are subject to withholding tax at an effective rate of 30%.



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## Indirect transfer of shares

Law No. 29757, which amended Law No. 29663 introduced a new category of Peruvian sourced income that may lead to a scenario under which a nonresident will be levied with income tax. Broadly, Law No. 29663 provides that 30% income tax is imposed on any capital gain realized upon the transfer of the shares of a company located outside Peru that, directly or indirectly, holds shares (or participation interests) in one or more Peruvian subsidiaries (i.e. an “indirect transfer”) on one of the following situations:

- Where 50% or more of the fair market value of the nonresident holding company's shares is derived from the shares or participations representing the equity capital of one or more Peruvian subsidiaries at any time within the 12 months preceding the disposition.
- The overseas holding company is located in a tax haven or low-tax jurisdiction, unless it can be adequately demonstrated that the scenario described above did not exist.

New Law No. 29757, which amends Law No. 29663, clarifies that the transaction described in the preceding paragraph will only be taxable where shares or participation interests representing 10% or more of the nonresident holding company's equity capital are transferred within the 12-month period. This means that the transfer of shares (or participations) representing less than 10% of the nonresident holding company's equity capital are not subject to taxation in Peru even when 50% or more of the fair market value of those shares is derived from the shares (or participations) representing the

equity capital of one or more Peruvian subsidiaries at any time within the 12 months preceding the dispositions.

## Transfer pricing

Peru has adopted transfer pricing guidelines, based on the arm's-length principle. The accepted methods are the comparable uncontrolled price (CUP) method, the resale price method, the cost plus method and the transactional net margin, as well as other related methods based on margins. The OECD guidelines can be used as a complementary source of interpretation. Advance Pricing Agreements (APA) may be negotiated with the tax authorities.

In Peru, these rules do not only apply to transactions between local and international related parties, but also to transactions with entities that reside in tax havens. Note that adjustments to the value agreed between the related parties would apply only in cases where the value agreed between the parties would have led to an underpayment of taxes.

One or more legal entities are related parties if one of them participates directly or indirectly in the management, control or equity of the other entity, or whenever the same person participates directly or indirectly in the direction, control or equity of diverse related entities.

On 31 December 2016, Peru published Legislative Decree N° 1312 amending the Peruvian transfer pricing (TP) reporting requirements by implementing the changes proposed by the OECD under BEPS Action 13 final report. The bill expands the TP documentation requirements by introducing an obligation to submit both a local file (2017) and a master file (2018), as well as the implementation of country-by-country reporting (2018), provided that certain revenue thresholds

are reached. Failure to comply could result in penalties.

Legislative Decree N° 1312 also introduces revised guidance for pricing cross border commodity transactions. It provides that the CUP method can be the most appropriate transfer pricing method for commodity transactions between associated enterprises using a quoted price as a reference to determine the arm's length price.

These rules establish that the arm's length price for Peruvian income tax purposes shall be determined by reference to the quoted price of (i) the date of shipment of the commodities exported or (ii) the date of disembarkation of the commodities imported.

Additional guidance and clarification is expected to be established in forthcoming tax regulations as to the products that will be covered by these new transfer pricing rules, the commodity prices and quotes to be considered, the international market, the commodity exchanges or similar markets

that may be taken as a reference, and finally the adjustments that shall be accepted to reflect the commodity features and the economically relevant characteristics of the particular transaction.

In addition, it introduces general transfer pricing guidelines for intra-group services and in particular for services that qualify as low value-adding intra-group services.

Specifically, it requires that the "benefit test" should be satisfied to demonstrate that the services were in fact received in order for the cost or expense to be deductible. The test will be met by considering whether an independent company in comparable circumstances would have been willing to pay for the activity if performed for it by an independent company or would have performed the activity in-house for itself.

The deduction of cost or expenses for services received should be determined based on the total cost and expenses incurred by the service provider entity, plus the applicable mark-up, for its deductibility.



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The bill provides specific guidance relating to a particular category of intra-group services referred to as low value-adding intra-group services. In such cases, the provider of the services shall apply a profit mark-up of no more than 5% to the relevant costs incurred in performing the low value-adding services.

Low value-adding intra-group services for the purposes of this approach are services performed by one member or more than one member of an MNE group on behalf of one or more other group members which

- Are of a supportive nature.
- Are not part of the core business of the MNE group.
- Do not require the use of unique and valuable intangibles and do not lead to the creation of unique and valuable intangibles, and
- Do not involve the assumption or control of substantial risk by the service provider and do not give rise to the creation of significant risk for the service provider.

The tax regulations will provide examples of services that would likely meet the definition of low value-added services.

### **Controlled Foreign Corporation Rules (CFC Rules)**

As of January 1, 2013, the “International Fiscal Transparency Regime” is applicable to all Peruvian residents who own a “controlled foreign corporation” (CFC). Under these rules, passive income earned by CFC’s in other jurisdictions, must be included and recognized in the taxable

income of resident taxpayers in Peru, even though there has been no effective distribution.

A non-resident subsidiary company will constitute a CFC of a Peruvian company if:

- The Peruvian company owns more than 50 percent of the subsidiary’s equity, economic value or the righting votes.
- The non-resident entity must be a resident of either: i) a tax haven jurisdiction; or, ii) a country in which passive income is either not subject to CIT or is subject to a CIT that is equal or less than 75% of the CIT that would have been applicable in Peru.

For the application of this Regime, the Law has established an exhaustive list of items that qualify as passive income (i.e. dividends, interest, royalties, capital gains from the sale of properties and securities, etc.).

### **Tax treaties**

Peru has entered into a multilateral tax treaty with the Andean Community countries (Bolivia, Colombia and Ecuador), which calls for exclusive taxation at source and double tax treaties with Brazil, Chile, Canada, Mexico, South Korea, Portugal and Switzerland (the last four have entered in force as of January 1, 2015).

The principal purpose of this double tax treaty network is to prevent taxes from interfering with the free flow of international trade and investment by mitigating international double taxation with respect to certain income items.

This, however, is not a static list. Some existing treaties are still under renegotiation and others are in various stages of negotiation with countries

such as France, Italy, Thailand, Sweden, Singapore and the UK.

Except for the double tax treaty with the other Andean Community countries, tax treaties entered into by Peru generally follow the OECD Model, although they incorporate provisions from the UN Model, to give more weight to the source principle than does the OECD Model.

Each of the treaties currently in force between Peru and other countries deals with the same matters. Many of the treaties contain common provisions addressing the same issue. It should, however, be noted that Peru's tax treaties show a remarkable degree of individuality, considering that almost every treaty is different in at least some respects. For that reason, it is essential to analyze the specific treaty that may apply to a particular tax issue.

### Financing considerations

#### *Thin capitalization*

Debt to equity rule: Interest on loans from related parties in excess of a 3:1 debt to equity ratio is not deductible.

### Indirect taxes

A 18% Value Added Tax (VAT) applies and it is important to notice that by means of Legislative Decree No. 1347, the current VAT rate may be reduced to 17%. This amendment will be in force

after July 1st, 2017, if tax collection, related to VAT net of internal refunds reaches a percentage of 7.2 GDP by May 31, 2017. VAT applies to the following transactions:

- Sale of goods within Peru.
- Services performed or used within Peru.
- Construction contracts performed within Peru.
- First sale of real estate by the builder.
- Importation of goods from outside Peru, regardless of the status of the importer.
- VAT paid upon acquisition of goods or services can be deducted from VAT related to the sale of finished products or services.

Exporters are reimbursed for any VAT paid on the acquisition of goods and services. Also, exporters can apply such reimbursement as a credit to offset VAT or income tax liabilities.

#### *Selective Consumption Tax (i.e. Luxury Tax or "Impuesto Selectivo al Consumo")*

The selective consumption tax (ISC) applies to luxury goods such as jewelry, cars, cigars, cigarettes, liquor, soft drinks, fuel, etc. ISC rates range from 10% to 100%, generally based on the CIF (imports) or sale value, depending on the goods. However, for certain goods, such as soft drinks and fuel, the ISC is calculated on a specific basis depending on the amount of goods sold or imported.



## Selective Consumption Tax

Tariff heading	Products	S/ per gallon	US\$ per gallon*
2710.12.13.10 2710.12.19.00 2710.12.20.00 2719.20.00.90	Gasoline for motors with Research Octane Number (RON) less than 84	0.93	0.28
2710.12.13.21 2710.12.19.00 2710.12.20.00 2710.20.00.90	With RON equal or over 84, but less than 90 and engines of 7.8% volume of fuel alcohol	0.88	0.27
2710.11.13.20 2710.11.19.00 2710.11.20.00 2710.20.00.90	With RON equal or over 84, but less than 90	0.93	0.28
2710.11.13.30 2710.11.19.00 2710.11.20.00 2710.20.00.90	With RON equal or over 90, but less than 95 and engines of 7.8% volume of fuel alcohol	0.99	0.30
2710.12.13.39 2710.12.19.00 2710.12.20.00 2710.20.00.90	Other fuels with RON over or equal to 90 but less than 95	1.05	0.32
2710.11.13.40 2710.11.19.00 2710.11.20.00	With RON equal or above 95, but less than 97 and engines of 7.8% volume of fuel alcohol	1.07	0.33
2710.12.13.49 2710.12.19.00 2710.12.20.00 2710.20.00.90	Other fuels with RON over or equal to 95 but less than 97	1.14	0.35
2710.11.13.50 2710.11.19.00 2710.11.20.00 2710.20.00.90	With RON equal or above 97 and engines of 7.8% volume of fuel alcohol	1.13	0.34
2710.12.13.59 2710.12.19.00 2710.12.20.00 2710.20.00.90	Other fuels with RON equal or above 97	1.19	0.36
2710.19.14.00 / 2710.19.15.90	Kerosene and Jet Fuels (Turbo A1), except certain sales in the country or imports of airships.	1.94	0.59
2710.19.15.90	Jet Fuels (Turbo A1) only for: ► Certified air operators according to Law 27261. ► Certified aviation fuel marketers.	0.26	0.08
2710.19.21.10 / 2710.19.21.90	Gas oils, except Diesel B2	1.47	0.45
2710.29.21.20	Diesel B2	1.44	0.44
2710.19.22.10	Residual 6, except sales in the country or imports by certified seacraft fuel marketers.	0.52	0.16
2710.19.22.90	Other fuels	0.50	0.15

\*US\$1 = S/3.29

Taxable persons for ISC purchases are producers and economically related enterprises engaged in domestic sales of listed goods, importers of listed goods, importers and economically related enterprises engaged in domestic sales of listed goods and organizers of gambling activities.

Liability to ISC arises under the same rules that apply to VAT.

To avoid double taxation, a credit is granted for the ISC paid on imports and in other specific cases.

Custom Duties

▸ Rates and Tax bases

The applicable customs duties and taxes are summarized below:

Tax	Rate	Tax bases
Custom Duties*	0%, 6% and 11%	CIF Value**
VAT	18%	CIF Value + Customs Duties + Excise Tax (if applicable)

\* Customs Duties rates depend on the kind of items imported. Capital goods are generally subject to a 0% rate.

\*\* World Trade Organization (WTO) rules are applicable to arrive at customs value.

VAT exemptions on import of goods for the exploration phase

The import of goods and supplies required for carrying out exploration activities in the exploration phase is exempted from all taxes. The list of goods to which this exemption applies is published by the Ministry of Economy and Finances (MEF).

This exemption will not be applicable if the imported goods are used in other activities rather than exploration or if they are sold to third parties, unless:

- They are sold or delivered to third parties for use in exploration activities.
- They are re-exported with the previous authorization of Perupetro.
- They are used in exploration activities during the exploration phase of another hydrocarbon contract for the same contractor.
- They are sold or delivered to a company authorized to import those goods free from all taxes.

Temporary importation

Goods required for the execution of hydrocarbon contracts may be brought into Peru on a temporary basis for a period of 2 years without the payment of duty or taxes and re-exported afterwards in the same state as they were at import. This term can be extended for a one-year period, for up to two times.

There are conditions placed on temporary imports. The most important condition is that you export the goods within the time limits approved. In addition, a guarantee needs to be filed at the time of import.

The guarantee is an amount equal to the duty and taxes that would have been payable at import. If the goods are not exported within the time limit you will have to pay an amount equal to the duty and taxes that would have been payable when you first imported the goods, as if the goods had not been treated as temporary imports, plus interests.

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## International Trade Agreements

The main agreements executed by the Peruvian government in order to gain access to international markets are the following:

### *Andean Community (CAN):*

Peru fully enjoys the benefits from the free trade zone established by this agreement for all its member countries (Bolivia, Colombia, Peru and Ecuador). Since Venezuela is no longer a member of the CAN, Peru has celebrated a Bilateral Agreement with Venezuela, which has been in force since August, 2013. Also, Peru, as member of the Andean Community, has other obligations and commitments regarding other topics besides the free trade zone.

### *Southern Common Market (Mercosur):*

Partial agreements executed by the Peruvian government with each of the member countries (Brazil, Argentina, Paraguay and Uruguay) are in force. By means of the aforementioned agreements, Peru and Mercosur member countries have reciprocally granted each other preferential customs duty rates.

Bilateral Free Trade Agreements with the United States, Canada, China, Chile, EFTA States (Iceland, the Principality of Liechtenstein, the Kingdom of Norway and the Swiss Confederation), Mexico, Japan, Singapore, Thailand, Republic of Korea, Panama, European Union, Venezuela, Honduras and Costa Rica are already in force. In addition, Peru has celebrated the Partial Agreement with Cuba (ACE 50). In order to apply these preferential treatments, goods must meet certain requirements, including origin and direct expedition requirements.

Peru has also concluded Free Trade Agreement negotiations with Guatemala and Brasil, as well as with the Trans-Pacific Partnership.

Furthermore, Peru maintains negotiations with Turkey, India and El Salvador.

Peru, Mexico, Colombia and Chile are members of the Pacific Alliance, which will grant their goods preferential treatment as long as they meet certain requirements, including origin and direct expedition. Up to date, only the framework agreement is in force, which describes the objectives of the Alliance. Market access, origin rules between other measures are not in force yet.

Finally, it is important to mention that Peru is a founding member of the World Trade Organization (WTO). Therefore, the WTO's regulations regarding antidumping practices, subsidies, countervailing duties and service market liberalization, among others, are applicable in Peru.

## Worker's profit

Employers are required to distribute a share of their profits among their employees. The rate depends on the company's activity, as follows:

- Fishing – 10%
- Telecom – 10%
- Industry – 10%
- Mining – 8%, including exploitation of coal mines; production of petroleum and natural gas; and extraction of iron, uranium, thorium, iron-free minerals, construction stone, clay, talc, sand and gravel, feldspar and salt.
- Commerce and restaurants – 8%

- Other – 5%, including farming, stockbreeding and forestry; production and distribution of electricity; production of gas; transportation services and services related to air transportation (such as travel agencies, storage and deposit); financial services of insurance and real estate; legal, audit and accounting activities; business consulting, consulting related to informatics and data processing; and advertising, health and medical services, and education.

Many oil and gas companies calculate this employee benefit using the 5% rate that applies to the “other” group of activities. This has been a matter of discussion at the judiciary level. Profit sharing is calculated on pretax income, and the amount is deductible as an expense for determining income tax. An example of the combined-effect calculation using a 5% profit-sharing rate is as follows:

- Net income: 100
  - Profit sharing: 5
  - Net income for CIT purposes: 95
  - Income tax (30%\* of 95): 28.5
  - Combined effect:  $28.5 + 5 = 33.5$  (33.5% of net income)
- \*Tax Rate plus 2% premium

The amount paid is allowed as a tax deduction for corporate tax purposes. Not all foreign governments recognize this as a creditable tax and as such double taxation can occur.

### General Anti-Avoidance Rule

As of July 19, 2012, an anti-avoidance rule has been introduced in the Peruvian Tax Code to assist the Tax Administration in responding

to situations of tax avoidance and simulated transactions.

Indeed, when facing tax avoidance situations, the Tax Administration will be able to coercively request the corresponding tax debt, reduce tax credits, tax losses or eliminate a tax benefit (including the restitution of the taxes unduly refunded). To exercise powers under the GAAR, Tax Administration must determine that the taxpayer has: a) performed artificial or improper acts to achieve a specific tax result - whether individual or jointly with others; and, b) the use of such artificial or improper acts creates legal or economic results different than regular tax savings obtained from the routine or proper acts.

Despite the aforementioned, recently the government has suspended the application of the General Anti-avoidance Rule, with exception of the provisions of the first and last paragraphs, to acts, facts and situations produced prior to July 19, 2012.

### Other tax issues

#### *Tax Unit (UIT)*

The UIT is the reference value employed for tax purposes to determine the taxable income, deductions and penalties, between others. This value is modified every year. To the year 2017, the UIT amounts to PEN S/4,050.00 (US\$1,191 aprox.)

#### *Temporary net assets tax*

A so called Temporary Net Assets Tax (ITAN) is equivalent to 0.40% of the value of total assets determined as of December 31st of the previous year over PEN S/1,000,000. The amount paid is usable as credit against the Corporate Income Tax, or subject to refund.

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Pre-operative entities are exempt from of this tax, during their first year of operations, but will be subject to the tax the following year.

#### *Tax on financial transactions*

A 0.005% tax is generally imposed on debits and credits in Peruvian bank accounts.

#### *Osinergmin Contribution*

This contribution must be paid by Oil and Gas companies that import or produce fuels, including liquefied petroleum gases and natural gas, or carry out transportation and distribution activities. The rate of this contribution is 0.36% for 2017, 0.35% for 2018 and 0.34% for 2019 (for import or production activities) and 0.57% for 2017, 0.56% for 2018 and 0.55% for 2019 (for transport and distribution activities) and it is based on their monthly billing, deducting VAT.

#### *OEFA Contribution*

Oil and Gas companies that import or produce fuel, including liquefied petroleum gases, or carry out transport and distribution activities should pay OEFA Contribution to the Environmental Audit and Evaluation Agency (Organismo de Evaluación y Fiscalización Ambiental "OEFA"). The rate of this contribution for years 2017-2019 is 0.09% (for import or production activities) and 0.11% (for transport and distribution activities) and it is based on their monthly billing, deducting VAT.

#### *FISE Contribution*

The Energetic Social Inclusion Fund (Fondo de Inclusión Social Energético "FISE") is a fund established by the Peruvian State and managed by the energy regulator, which originally worked as a mechanism to promote the inclusion of the population in need to the supply of energy,

with the following objectives:

1. To massify natural gas for housing and vehicle purposes
2. Extend the energy frontier by the use of renewable energy
3. Generate access to LPG to vulnerable sectors of the population
4. Work as a compensation mechanism related to residential electricity

Its financing sources come from the great electricity consumers (mining and industry, mainly), natural gas transport service through pipelines (Camisea), and production and imports of fuels.

With the funds received from those sources, FISE can execute any of the aforementioned goal through a myriad of diverse energy projects established by the Energy and Mines Ministry.

Recently, the Government issued Legislative Decree No. 1331, by means of which it added dispositions in order to expand the application of FISE goals. Certainly, with the implementation of those dispositions, funds from FISE could now be used to finance connections to the gas supply that may be available by new distribution concessions.

In this way, natural gas distribution concessions through pipelines could benefit from FISE by the promotion of gas connections subsidized with funds from the latter.

► Stamp tax

Not applicable.

► Exchange controls

Not applicable.





A full-page background image of a sunset or sunrise over the ocean. The sky is filled with large, billowing clouds in shades of orange, red, and yellow. The sun is partially visible through the clouds, creating a bright glow. The ocean is in the foreground, with dark, choppy water reflecting the colors of the sky. A dark, silhouetted landmass is visible on the horizon. A large, bold, yellow letter 'V' is superimposed on the right side of the image, partially overlapping the clouds.

V

# Miscellaneous **matters**

# 01 | Labor legislation

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## [ Hiring personnel ]

Indefinite term contracts are the legal default scheme for hiring in Peru, although as an exception, fixed term contracts can also be signed. The fixed term contracts requires an objective cause established by the law to enter into this type of contracts (for example, start up of a new business, works or specific services, substitution, etc.) and its validity is subject to compliance with certain formal requirements.

These contracts provide employees with all the rights and benefits granted to employees hired for an indefinite term.

There are also other types of hiring schemes that grant different benefits, such as Labor Training Modalities or the Law that Promotes Youth Access to the Labor Market and Social Protection, among others.

The trial period is counted from the first day of the labor relationship and must be a maximum term of: i) three months for all employees in general; ii) six months for qualified or confident personnel, and iii) 12 months for management personnel.

Once this period is completed, the employees are regarded as permanent and can only be dismissed under circumstances concerned with their behavior at work or ability to carry out their duties.

## [ Termination of employment contract ]

In accordance with the Peruvian Legislation, employees are protected against arbitrary dismissal.

In the event of unjustified dismissal, an employee may demand a severance payment equivalent to one and a half months salary per year of service

(under an indefinite term working contract); or, one and a half months salary per pending month (under a fixed term work contract). The maximum severance payment is twelve salaries. Alternatively, the employee can demand the restitution to the same job he had. The law allows collective dismissals under certain circumstances such as acts of God or force majeure, financial or technical streamlining, dissolution, bankruptcy or operating downsizing without having to grant the severance payment.

## [ Employees' benefits ]

Employers are required to provide the following benefits for employees:

- ▶ Family allowance: equivalent to 10% of the Minimum salary (PEN S/75 for 2016).
- ▶ Vacation: equivalent to 30 calendar days of paid rest.
- ▶ Legal bonuses: 2 bonuses per year, one paid in July and one in December, each one equivalent to one monthly salary approx. Additional Extraordinary Bonus equal to 9% of the legal bonus must be paid.
- ▶ Compensation for Time of Services (CTS): equivalent to 1.16 months salary per year. 50% has to be deposited in May and the remaining 50% in November, in the bank elected by the employee.
- ▶ Profit sharing: the amount to be distributed ranges between 5% and 10% of the taxable income, depending on the activity of the employer. This benefit does not apply to companies employing less than 20 individuals.

All these benefits are deductible for income tax purposes.

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Employers can negotiate with employees earning a monthly salary higher than 2 tax units (PEN S/7,900 during 2016, approximately US\$2,324) of the total annual compensation, including all the benefits described above, except for profit sharing.

### [ Social contributions ]

- ▶ **Health Care Contribution:** This contribution is paid by the employer and its purpose is to finance the social health system (EsSalud, in Spanish), which provides health care services and pay subsidies in case of employee disability. It is collected by the Peruvian Tax Administration (SUNAT). The amount contributed is equal to 9% of the employee's remuneration.
- ▶ **If the company provides health coverage to its employees using its own resources or through an EPS (in Spanish, Entidad Prestadora de Salud) it can request a credit of up to 25% of the Health Care contribution, subject to certain limits established by law.**
- ▶ **Pension System Contribution:** The employee can alternatively join the Government Pension System (GPS) or the Private Pension System (PPS). In the GPS, the employee must make contributions equal to 13% of his remuneration. In the PPS, the employee has to make contributions equal to an average of 12.90% of his monthly remuneration paid in cash. Regardless of the system chosen by the employee (GPS or PPS), the employer is responsible to withhold employees' contributions from their salaries.
- ▶ **Mandatory Life Insurance:** This is a mandatory insurance paid for employees with four years of services with the same employer. It is also possible for it to be granted by the employer on a voluntary basis to employees that have three

months of service. The premium depends on the number of insured employees, the risk of the work they carry out, and in general, on the terms agreed with the insurance company.

- ▶ **High Risk Labor Insurance (SCTR):** This is a mandatory insurance to be paid by companies whose activities have a certain level of risk, such as fishing, construction, air transport, manufacturing, among others described in Appendix 5 of Supreme Decree No. 009-97-SA and provides additional coverage for health and pension plans. The contract for health services may be entered with EsSALUD or with a Private Health Care Provider (EPS); a contract for the pension coverage can be entered with the Government Agency for Pension Fund (ONP, due to its acronym in Spanish) or with a private insurance company. The rates depend on the type of activity and/or the terms agreed on with the insurance entity.
- ▶ **Other contributions:** Additional contributions are applicable based on the company's activities, such as the Complementary Retirement Fund, which applies for mining, metal and steel companies; among other contributions.

### [ Expatriates ]

Foreign individuals that enter into Peru to perform dependent activities for a local employer need to submit their work contract for approval to the Labor Authorities, and obtain their work visa. These employees have the right to receive the same labor benefits as Peruvian employees, and are subject to the same taxes and contributions. As a general rule, foreign employees should not exceed 20% of total personnel. Additionally, wages paid to foreign employees should not exceed 30% of total payroll cost. Such limits can be waived for professionals and specialized technicians or

management personnel of a new entrepreneurial activity or in case of a business reconversion, among others.

No restrictions apply to foreign individuals working in Peru with Peruvian immigrant visa, individuals married to Peruvians or having Peruvian children, parents or siblings and foreign investors with a permanent investment in Peru of at least 5 tax units (PEN S/20,250 during 2017 approximately US\$6,136). This also applies to Spanish citizens and countries members of the CAN, which is a regional organization that aims Andean Integration of their members such as Bolivia, Ecuador, Colombia and Peru.



[ Immigration ]

Foreigners can enter Peru under the following migratory qualifications, among others:

Visa	Rate	Tax bases
Tourist visa	Temporal	This visa does not allow the holder to perform paid activities.
Business visa	Temporal	This visa does not allow the holder to perform activities that can be considerate Peruvian source income. This visa allows the expatriate to sign contracts.
Work visa	Resident or Temporal	This visa allows the holder to work in Peru. (as dependent or independent). In the case of a work contract with a Peruvian company, it should be duly registered / approved by the labor ministry.
Designated employee visa	Temporal	This is a visa that applies to an employee of a foreign company. The service agreement and assignment letter must be submitted to the migratory authority. Those documents must be legalized by the Peruvian consulate and the Peruvian foreign minister.
Visa for independent foreign national	Resident	Investment or independent work.
Immigrant	Resident	This visa is granted to foreign nationals who get into the country with purpose to develop activities on a permanent basis in Peru.



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## [ Individual taxes ]

According to Peruvian Income Tax Law, the compensation received for services rendered within Peruvian territory will be considered as Peruvian Source Income regardless of the location of the entity or individual that is paying the income. Hence, the salary received by the employees or the expatriate for services rendered in Peru, will be taxable basis for Peruvian Income Tax.

It must be noted that the employers will be liable to withhold and remit to the Tax Authorities the employee's income tax. For such purpose, it must determine the amount debt and withhold the appropriate amount on a monthly basis, and pay the income tax to the Tax Authorities, based on the tax resident condition of the individuals and procedure established by law.

In case the employee is considered as non resident for tax purposes, a tax rate of 30% will be applicable over the salary received for his work in Peru, as of the first day of service, regardless where it is paid.

In the case of tax residents, apply a five cumulative income tax scale: 8% (for the first PEN S/19,750), 14% (from S/19,751 to S/79,000), 17% (from S/79,001 to S/138,250), 20% (for S/138,251 to S/177,750) and 30% applicable to excess income of more than S/177,750. Note that the tax unit used in fiscal year 2016 is S/3,950.

However, non-resident individuals entering the country temporarily to perform the following activities are not taxed for revenues obtained in their home country, since they are not considered as Peruvian source income:

- Acts that precede a foreign investment or any other business.
- Supervision or control of an investment or business (i.e. gathering data or information, meeting public or private sector personnel, etc.)
- Hiring local personnel.
- Signing agreements or similar documents.

If foreigners come from countries that have agreements with Peru in order to avoid double taxation (Chile, Canada, Brazil, Mexico, South Korea, Switzerland and Portugal) or countries from the Andean Community (Ecuador, Colombia and Bolivia) other tax regulations may apply.

Finally, notice that domiciled individuals will be liable to file a tax return, provided they receive income other than employment income and the law establishes such obligation (i.e. a domiciled individual who receives remuneration and interest from a bank account abroad). Hence, there is no obligation to file a tax return if domiciled individuals receive only employment income.



## 02 | Accounting standards

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The Peruvian Business Corporation Act (LGS) establishes that the financial statements of companies incorporated in Peru must follow the general accounting principles accepted in Peru and other applicable legal provisions. The Peruvian Accounting Standards Board (CNC) has established that the general accounting principles are the standards issued by the International Accounting Standards Board (IASB) and the specific provisions approved for particular businesses (banks, insurance companies, etc.). Likewise, on a supplementary basis, the U.S. - General Accounting Principles (GAAPs) are applicable.

The Peruvian Accounting Standards Board (CNC) is responsible for issuing the accounting standards and methodologies that apply to both private business and government entities. The CNC adheres to the standards approved by the IASB, which are explicitly approved by the CNC and

published in the official gazette El Peruano, indicating their date of approval.

Companies that issue debt or shares in the capital market are subject to regulation by the Stock Exchange Superintendency (SMV).

Companies supervised by this institution must issue their financial statements in accordance with the International Financial Reporting Standards (IFRS), issued by IASB; they are as effective in Peru as they are worldwide.

The annual financial information given by companies supervised by the SMV must be audited and include the previous year for comparative purposes. Quarterly reports do not need to be audited. The audit must be conducted according to regulations of the International Auditing and Assurance Standards issued by the International Federation of Accountants (IFAC).











A close-up, low-angle shot of a worker wearing a white hard hat and a brown work jacket. The worker is leaning over a large, dark, metallic industrial machine, possibly a pump or valve, with their hands near a handle. The scene is dimly lit, with a strong light source from the right creating highlights on the worker's jacket and the machine's surface. The background shows more industrial structures, including pipes and a yellow wheel.

**VI**

**Appendix**

# 01 | Hydrocarbon sector regulators and stakeholders

## ► AMCHAM

The American Chamber of Commerce of Peru (AmCham Peru) is an independent and non-profit organization, founded on January 17, 1968, that represents Peruvian, American and foreign companies. It has about 3,000 members representing more than 580 associated companies.  
([www.amcham.org.pe](http://www.amcham.org.pe))

## ► COMEXPERU

COMEXPERU is the private association that groups the leading companies involved in foreign trade in Peru. Its main purpose is to contribute to the improvement of competitive conditions within a free market, which will make Peru an attractive destination for private investment.  
([www.comexperu.org.pe](http://www.comexperu.org.pe))

## ► CONFIEP

The National Confederation of Private Business Institutions (CONFIEP) brings together and represents private business activities within Peru and abroad. Its principal objective is to contribute to the process of sustained economic growth, based on investment and job creation from the perspective of individual effort and initiative, and the promotion of entrepreneurship and private property.

## ► Environmental Assessment and Supervisory Board - OEFA

The OEFA is the guiding entity of the National Environmental Assessment and Supervisory System (SINEFA) and is responsible as such for the evaluation, supervision, and auditing of the compliance with environmental laws nationwide, integrating the efforts of the State and society in

a coordinated and transparent manner to ensure the effective management and protection of the environment.

([www.oefa.gob.pe](http://www.oefa.gob.pe))

## ► General Bureau of Environmental Health - DIGESA

This is the technical-regulator body in aspects related to basic sanitation, occupational health, hygienic food, zoonosis and environmental protection. It issues regulations and assesses environmental health processes in the sector. It is an entity under the Ministry of Health.  
([www.digesa.sld.pe](http://www.digesa.sld.pe))

## ► Lima Chamber of Commerce - CCL

The CCL, founded in 1888, is a private entity that promotes free enterprise and business development by enforcing its legitimate rights, facilitating new business opportunities, providing assistance and services and improving their competitiveness. It is one of the most representative business associations that has more than 13,500 associated companies.  
([www.camaralima.org.pe](http://www.camaralima.org.pe))

## ► Ministry of Agriculture (MINAGRI)

This is the entity that promotes the development of organized agrarian producers in productive chains, in order to achieve an agriculture that is fully developed in terms of economic, social and environmental sustainability.  
([www.minagri.gob.pe](http://www.minagri.gob.pe))

## ► Ministry of Culture

This is the nation's cultural authority in charge of the establishment, execution and supervision

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national policies related to cultural matters. It is also in charge of the arrangement and coordination of the national policy of the prior consultation right.  
([www.cultura.gob.pe](http://www.cultura.gob.pe))

► Ministry of the Economy and Finance - MEF

The Ministry of the Economy and Finance is an entity of the Executive Branch responsible for planning, directing, and controlling matters related to the budget, treasury, debt, accounting, fiscal policy, public spending, and economic and social policies. It also designs, establishes, performs, and supervises national and sector policies under its competence, assuming a guiding role therein.  
([www.mef.gob.pe](http://www.mef.gob.pe))

► Ministry of Energy and Mines - MINEM

This is the central and governing body for the Energy, Hydrocarbons and Mining Sector, a part of the Executive Branch. Its purpose is to formulate and assess national policy in matters of sustainable development in mining-hydrocarbon-power activities. It is the governing authority in environmental matters in reference to hydrocarbons-mining-energy activities.  
([www.minem.gob.pe](http://www.minem.gob.pe))

► Ministry of the Environment - MINAM

This is the nation's environmental authority, the overseeing entity of the National Environmental Management System (SNGA), and a part of the Executive Branch. Its main functions are focused in promoting environmental sustainability by preserving, protecting, recovering and securing the environment, ecosystems and natural resources.  
([www.minam.gob.pe](http://www.minam.gob.pe))

► Ministry of Foreign Affairs: Executive Office for Economic Promotion - DPE

The Executive Office for Economic Promotion (DPE) is the institution of the Ministry of Foreign Affairs (MRE) responsible for coordinating with Peruvian missions abroad in an effort to promote Peru as a country capable of providing goods and services in international markets, as well as positioning it as a world-renowned tourist destination, and a country with interesting business and investment opportunities in different economic sectors.

It should be noted that the DPE has a Quality Management System certified with ISO 9001:2008 International Standards, governed under the values of equality, social commitment, honesty, transparency, and teamwork, thus ensuring that the needs of its national and international users are met.  
([www.rree.gob.pe](http://www.rree.gob.pe))

► Ministry of Labor and Employment Promotion - MTPE

This is the body governing labor in Peru, with all powers necessary to lead the implementation of policies and programs for generating and improving employment, and also responsible for enforcement of legislation for labor matters.  
([www.mintra.gob.pe](http://www.mintra.gob.pe))

► National Environmental Certification Service for Sustainable Investment - SENACE

The SENACE is a public specialized entity in charge of the review and approval of the detailed Environmental Impact Studies (EIA-d) related to nationwide public, private or mixed capital investment projects which contemplate activities, constructions, building sites and other



commercial activities or services that may cause significant environmental impacts. This entity is under the Ministry of Environment.  
([www.senace.gob.pe](http://www.senace.gob.pe))

► National Society of Industries - SNI

The SNI is a non-profit private organization created to promote the development of manufacturing industry in Peru, guaranteeing the freedom and responsibility required to perform business activities according to Peruvian market economy assurance.  
([www.sni.org.pe](http://www.sni.org.pe))

► National Service for Natural Areas under State Protection - SERNANP

This is a public specialized entity responsible for directing and establishing the technical and management criteria for the preservation of Protected Natural Areas (ANPs), and overseeing the conservation of biological diversity. It is an entity under the Ministry of Environment.  
([www.sernanp.gob.pe](http://www.sernanp.gob.pe))

► National Superintendency of Tax Administration - SUNAT

A decentralized public entity in the Economy and Finance Sector that enjoys economic, administrative, functional, technical and financial autonomy. It is the main tax-collecting agency in the Peruvian economy.  
([www.sunat.gob.pe](http://www.sunat.gob.pe))

► National Water Authority - ANA

This is the nation's water authority. Its purpose is the conservation and development of the hydric resources within a hydrographic river basin.  
([www.ana.gob.pe](http://www.ana.gob.pe))

► Perupetro

Perupetro is the state-owned Company that promotes, negotiates, signs and supervises exploration and production contracts, on behalf of the Peruvian State.  
([www.perupetro.com.pe](http://www.perupetro.com.pe))

► Petroperu

Petroperu is a state-owned company of private law that carries out exploration, exploitation, transport, and refining activities.  
([www.petroperu.com.pe](http://www.petroperu.com.pe))

► ProInversión

ProInversion is the Peruvian investment agency in charge of the promotion of business opportunities with high growth and profitability expectation in Peru. Its purpose is to promote investment unrelated to the Peruvian government by private parties in order to boost Peru's competitiveness and development and to improve the well-being of the population.

Likewise, its vision is to be considered by investors and by the public as an efficient and strategic option for the development of investments in Peru.

ProInversion provides information to potential investors regarding the incorporation of a legal entity, identifying investment by industries and investment projects (granted and pending), among other topics.  
([www.proinversion.gob.pe](http://www.proinversion.gob.pe))

► Presidency of the Cabinet - PCM

This is the technical-administrative body covered by the Executive Law; its highest authority is the President of the Cabinet. It coordinates and

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conducts a follow-up on the Executive's multi-sector policies and programs, coordinates actions with Congress and independent constitutional bodies, among other roles. ([www.pcm.gob.pe](http://www.pcm.gob.pe))

► Peruvian Chamber of Vehicular Natural Gas-CPGNV

The CPGNV, founded in 2004, is a private nonprofit institution that promotes the development and use of natural gas for vehicles in Peru, providing facilities to companies dedicated to the production, transportation, distribution, supply and marketing of the vehicular natural gas and related products. ([www.cpgnv.org.pe](http://www.cpgnv.org.pe))

► Supervisory Body of Private Investment in Energy and Mines - OSINERGMIN

This is the regulatory, supervisory body that regulates, enforces and oversees the activities undertaken by internal public-or-private-law

legal entities and individuals in the electricity, hydrocarbons and mining sub-sectors. ([www.osinergmin.gob.pe](http://www.osinergmin.gob.pe))

► Sociedad Nacional de Minería, Petróleo y Energía - SNMPE

This is a nonprofit organization, which groups the companies related to the mining, oil & gas and energy related activities in the country. ([www.snmpe.org.pe](http://www.snmpe.org.pe))

► Sociedad Peruana de Hidrocarburos - SPH

The SPH is the main hydrocarbons guild in Peru. Founded in 2013, it groups the main companies dedicated to exploration and exploitation activities in the country. ([www.sphidrocarburos.com](http://www.sphidrocarburos.com))



## 01 | EY services for the oil and gas sector

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### [ Our strength in the hydrocarbon sector ]

EY's hydrocarbon professionals combine technical capabilities with a thorough understanding of the industry's operating processes, strategic and operating risks, growth drivers, regulatory considerations, and market dynamics.

We use our wide experience of working with the world's largest hydrocarbon companies to help you address your key business issues. This might involve helping you to overcome current sector issues such as rising costs where we can help you streamline operational and business processes and improve productivity on key profit drivers.

In this environment of increased sector consolidation, we can assist you with your divestment strategies, to ensure that you realize your full value upon exit. If you are looking to expand your operations to new regions, you can draw on our deep understanding of how to manage operational risks – both political and otherwise.

EY has a number of multi-service line solutions to help our clients meet these challenges.



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## [ Our services ]

EY Peru has a global focus on hydrocarbons, with over 1,300 specialist global professionals including engineers, accountants, economists, administrators and lawyers. Our global team is closely networked and share industry and technical knowledge to provide our clients with seamless global service. Some of our specialist hydrocarbon based services include:

### **Environment and sustainability**

Providing an extensive range of services in areas such as sustainability reporting and assurance, sustainability strategy, reputation issues, environmental risk management, greenhouse gas emissions advisory, renewable energy and emissions trading.

### **Hydrocarbons advisory**

Improving supply chain responsiveness to demand volatility; delivering core business re-engineering (e.g., merging a number of blocks mines into one management structure), and delivering projects aimed at reducing costs or increasing production.

### **Mergers and acquisitions advisory**

Mergers and acquisitions, at either the holding company or asset level, require specific knowledge and skills in order to complete transactions. The knowledge and skills required relate to the regulatory environment, including the rules and regulations of each country's stock exchange, accounting, legal, structuring and taxation disciplines, in addition to an understanding of transaction value-drivers.

### **Valuation and business modeling (V&BM)**

Providing a range of services to companies in the hydrocarbon sector including valuations for purchase price allocation / acquisition accounting,

tax planning, finance and stamp duty purposes and containing specialists with extensive skills ranging from valuations of businesses and intangible assets to specialized oil and gas capital equipment and real estate. Further V&BM has deep expertise in model builds and reviews and is able to construct or review life of mine cash flow models as part of an acquisition strategy.

### **Project finance advisory**

Advising on the development, optimization and implementation of finance plans covering the full range of project financing options for resources projects, non and limited recourse debt and tax effective leasing, as well as a number of associated infrastructure projects such as preparation plants, conveyor systems and gas pipelines.

### **Transactions advisory**

Our global transaction capability covers over 80 countries and comprises over 7,000 professionals. These transaction professionals work across many elements of the transaction life cycle dealing with critical areas of financial due diligence, tax due diligence and structuring, valuation and business modeling and transaction integration.

### **Transaction integration**

Providing commercial and operational due diligence, integration planning and methodology development, synergy assessment, and integration program management, corporate strategy advice on market opportunities and areas to exploit along the companies value chain, as well as practical operational advice in areas such as overhead and capital expenditure cost reduction, process efficiency, supply chain and procurement, and in functional areas such as finance and human resources.









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