



Latin American and Caribbean Law and Economics Association

From the SelectedWorks of Carlos A. Patrón

January 2008

Peru (Mergers & Acquisitions Review)

Contact
Author

Start Your Own
SelectedWorks

Notify Me
of New Work



Available at: http://works.bepress.com/carlos_patron/20

THE MERGERS & ACQUISITIONS REVIEW

SECOND EDITION

EDITOR
SIMON ROBINSON

LAW BUSINESS RESEARCH

Chapter 41

PERU

*José Antonio Payet and Carlos A Patrón**

I OVERVIEW OF 2007/2008 M&A ACTIVITY¹

2007 represented yet again another year of substantial growth for M&A activity in Peru, fuelled by the economy's strong performance. Peru's real GDP growth continued to accelerate for a fifth consecutive year, reaching an estimated 8.9 per cent in 2007, compared with 7.8 per cent in 2006 and 6.5 per cent in 2005, primarily as a result of double-digit growth in domestic demand and historically high prices for Peru's principal mineral commodity exports.

Underpinning the economy's performance was Peru's stable macroeconomic policy, which has resulted in a general government balance surplus for a second consecutive year, improved fiscal performance, nominal reductions in government debt and increased accumulation of international reserves. As a result, in 2008, Peru's foreign-currency debt rating was raised to investment grade by both Fitch Ratings and Standard & Poor's.

Reflecting on the strong economic performance experienced, private investment continued to grow, surpassing historic highs. In parallel, a free-trade agreement with the US (FTA) was ratified by the US Congress on December 2007. The FTA is expected to be fully in force and implemented by 1 January 2009 and to further boost non-traditional exports. All this has translated into a very strong year generally for mergers and acquisitions in Peru, and particularly for transactions involving Peruvian targets. Total value of publicly disclosed completed M&A transactions involving Peruvian targets (excluding multi-jurisdiction acquisitions and takeover bids involving Peruvian

* José Antonio Payet and Carlos A Patrón are partners at Payet, Rey, Cauvi Abogados. The authors wish to thank their colleagues Eduardo Vega (capital markets), Germán Lora (labour) and Patricia Tamashiro (tax) for their assistance.

1 All references and information in this section are derived from published sources and have not been independently verified.

operations) exceeded \$6 billion for 2007.² The increase of M&A transactions in numbers (if not in value) has largely been supported by a long-term trend towards the restructuring and consolidation of historically fragmented economic sectors (e.g., fishing) as well as by the expansion and development of industries linked to growth in domestic demand and consumption (e.g., retail, distribution, food and beverages).

In general, M&A activity was dynamic across the board, encompassing all sectors of the economy, including traditionally active sectors such as banking and finance, industrial and manufacturing, energy, mining and telecoms, and expanding to non-traditional sectors such as agriculture, fishing, real estate and retail.

The most significant deals involving Peruvian targets announced in 2007 include the acquisition of Peru Copper Inc by China Aluminum Corporation of China ('Chinalco') for \$790 million and the acquisition of Grupo de Supermercados Wong, Peru's largest grocery retailer, by Chilean retailing group Cencosud for \$500 million.

In line with international market trends, private equity investors have begun to play a more prominent role in M&A activity in Peru. For the most part, there is a growing presence of regionally oriented private equity investors that have begun to target small and mid-sized (often family owned) Peruvian companies. In addition, a particularity of the Peruvian private equity market has been the surge of activity of private investment funds specifically oriented to channel funds from institutional investors, mainly Peruvian private pension funds ('AFPs'), which have been actively investing in mid-sized non-listed companies, initially in the infrastructure sector, and more recently in a broader range of sectors (e.g., real estate, agribusiness, industrial and manufacturing).

II GENERAL INTRODUCTION ON THE LEGISLATIVE M&A FRAMEWORK

The statutory framework for the sale and purchase of corporate entities in Peru is based upon (i) Law No. 26887, as amended ('the Companies Act'), which sets out the basic rules for the organisation and governance of different types of corporate entities and for business combinations; and (ii) the Civil Code, which regulates, *inter alia*, rights over real and moveable property, contracts in general and purchase and sale contracts in particular, as well as other types of economic transactions. Rules contained in Law No. 27287, as amended ('the Law on Securities') are also relevant, inasmuch as they relate to the issuance and transfer of securities (*títulos valores*), including shares and debt instruments. In addition, Law No. 26677, as amended, which regulates granting of security interests over moveable assets (including shares), may be applicable in the context of an acquisition or its financing.

In addition, in the case of corporations whose securities are listed in a Peruvian stock exchange, the rules concerning the offering and trading of securities in Peru and disclosure set forth in Legislative Decree No. 861, as amended ('the Securities Market Act') and regulations issued by Conasev, the Peruvian securities regulator, may also come into play.

2 *Semana Económica*, 31 March 2008.

Of particular relevance are the rules related to mandatory tender offers and to insider trading and disclosure of material corporate transactions.

In transactions involving investments by certain Peruvian institutional investors, rules relating to authorised investments of each type of entity may also be relevant. Of particular importance are the regulations concerning permitted investments by AFPs, set forth in Decree Law No. 25897, as amended, and its complementary regulations.

Peruvian merger control rules contained in Law No. 26876 and its complementary regulations may also be applicable. These rules apply exclusively to concentrations occurring in the electricity market that result in the vertical or horizontal concentrations of electricity generation, transmission or distribution activities within Peruvian territory. Accordingly, concentrations performed locally or abroad that directly or indirectly involve companies that do not carry out said activities within the Peruvian territory are not subject to prior administrative controls nor require to be notified to local competition authorities. However, administrative authorisation for the acquisition of participations in companies engaged in certain regulated businesses, such as banking, insurance, securities trading and utilities, *inter alia*, may be required.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW

The basic framework contained in the Companies Act has remained fairly stable since its enactment in 1998.

In June 2008, Legislative Decree No. 1061 amended the Companies Act in order to improve the governance of corporations and reinforce the protection of minority shareholder rights. These amendments:

- a* include the right of any shareholder to vote in a shareholders' meeting by postal mail or electronic mail;
- b* modify provisions concerning the mandatory distribution of dividends to preferred shares, in order to establish that 'where there are distributable profits the company is obligated to distribute the preferential dividend [...] without the need of an additional shareholders' resolution';
- c* reinforce provisions regarding the rights of minority shareholders to require Conasev the conveyance of a shareholders' meeting in open corporations;³ and
- d* perfect rules regarding the obligation of open corporations to publish a list of shareholders who have unclaimed shares or dividends.

These amendments are to come into force on 1 January 2009.

3 Generally, a joint-stock corporation is considered to be 'open' when: (i) it has performed a public primary offering of shares; (ii) it has more than 750 shareholders; or (iii) more than 35 per cent of its capital stock belongs to 175 or more shareholders, without considering within this number those shareholders whose individual stockholdings do not reach at least 0.2 per cent of the capital or exceed 5 per cent of the capital. Open corporations are subject to certain special rules under the Companies Act and are subject to the supervision of Conasev on certain matters.

Legislative Decree No. 1061 also introduced certain amendments to the Securities Market Act. Regarding transparency and the rights of minority shareholders, Legislative Decree No. 1061 amended Section 12 of the Securities Market Act, which deals with fraudulent transactions, to include a specific mention of transactions on securities in which the consideration is not effectively paid. It also clarified certain provisions of the Securities Market Act regarding listing of shares, with the effect of reinforcing the right of shareholders representing at least 25 per cent of the shares of a company to require the listing of their shares in a stock exchange. In addition, it amended the definition of privileged information to eliminate the requirement that the information originate in the issuer. In order to promote securities transactions, Legislative Decree No. 1061 has eliminated the requirement to appoint a trustee in bond issuances directed to institutional investors ‘under the conditions that Conasev shall establish’, and has also granted Conasev authority to issue rules to facilitate the trading of shares with multiple listings in Peruvian stock exchanges. Finally, among other provisions, Legislative Decree No. 1061 has restricted some of the self-regulatory functions of the Lima Stock Exchange, has eliminated certain restrictions to the operation of mutual funds and has allowed the operation of specialised entities to provide certain valuation services.

Peru’s mandatory takeover rules, which are only applicable in the event of acquisitions of control in companies whose voting shares are listed in a Peruvian stock exchange, were substantially amended in 2006 by Conasev (Resolution No. 009-2006-EF/94.10 as amended; ‘the New Tender Offer Rules’). The New Tender Offer Rules establish, in general and subject to exceptions, that any person or group of persons that acquires ‘significant participation’ in a company whose voting shares are listed in the Lima Stock Exchange is required to make a tender offer. Under the prior Peruvian tender offer rules, a significant participation meant a participation of 25, 50 or 60 per cent in the voting rights of the company. The New Tender Offer Rules have now also included any participation granting the right to appoint more than one half of the company’s board members or to amend its bylaws.

Under the New Tender Offer Rules, a tender offer needs to be performed *ex ante* (i.e., before the acquisition of a significant participation), except when the acquisition of significant participation is performed (i) in not more than four transactions within a period of 36 months, (ii) in an indirect transaction (i.e., by purchase of another entity holding the shares of the listed company) or (iii) pursuant to a public sale offer; in which cases the tender offer must be made after the acquisition of the target. In the case of *ex post* tender offers, both the minimum number of shares subject to the offer and the minimum price offered need to be calculated in the manner established in the New Tender Offer Rules. The New Tender Offer Rules also contain provisions regarding the delisting of shares (including the obligation to perform a purchase offer directed to shareholders who did not vote for the delisting), but does not contain provisions allowing a forced purchase of the shares of minority shareholders.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

Foreign investors have a strong presence in the Peruvian market, as reflected by the fact that 70 per cent of the Peruvian companies listed among the Latin American Top 500 Companies ('LATAM 500') are controlled or jointly controlled by foreign capitals.⁴ This is largely a reflection of Peru's openness to foreign investment, which has attracted an accumulated stock of foreign direct investment of \$27.4 billion (2007 estimate).

Not surprisingly, during 2007 the majority of the purchasers of Peruvian targets in publicly disclosed completed M&A transactions were foreign investors,⁵ while almost all headline-grabbing transactions announced during 2007 and the first half of 2008 have involved inbound investments.

Cross-border takeovers and multi-jurisdiction acquisitions have had M&A implications over the operations and assets held by multinational US and EU investors in Peru. Examples include the Enel and Acciona takeover of Grupo Endesa, the largest private investor in the Peruvian electricity sector, which spawned multiple *ex post* tender offers in the Lima Stock Exchange, the acquisition by Siemens AG of Bayer AG's worldwide diagnostics business and the sale of McDonald's Latin American operations.

Among Latin American investors, during 2007 and the first half of 2008, Peruvian targets attracted Mexican heavyweights such as Telmex (which continued its expansion in the Peruvian market, now by acquiring two Peruvian cable-TV operators), Grupo Bimbo (which continued consolidating Peruvian bread-manufacturing companies) and, more recently, Grupo Alfa (which acquired a leading Peruvian cold-meat processor). Chilean inbound investments have been heavily geared towards the retail and real estate sectors, the most notable transaction being the acquisition of Grupo de Supermercados Wong – Peru's LATAM 500 grocery retailer – by Cencosud. Other Chilean investors active in the Peruvian M&A market over the past year include Alvi Supermercados Mayoristas (grocery retailing) and Forus (footwear, clothing and accessories retailing). In turn, Colombian inflows have begun to arrive in a broad range of sectors, spawning from infrastructure and electricity to hotels and agribusiness. Active Colombian acquirers during 2007 include Inversiones Manuelita, Grupo Nacional de Chocolates and Abonos Colombianos, as well as private equity funds investing in medium-sized industrial Peruvian targets.

Also noteworthy is the entrance of Chinese investors, seeking to secure supply of strategic mineral commodities by acquiring Peruvian mining corporations. Two of the largest transactions, in terms of value, announced during 2007 and the first half of 2008 include the aforementioned acquisition of Peru Copper Inc by Chinalco (\$790 million) and the acquisition of Northern Peru Copper by China Minmetals and Jiangxi Copper (\$446 million).

Notwithstanding the above, M&A activity in Peru is not all one-way traffic. In several important sectors of the economy, consolidation through the acquisition of small and mid-sized targets by Peruvian buyers has continued to be a strong trend. Likewise, larger Peruvian groups have begun to look abroad for investment opportunities, albeit

4 LATAM 500, as reported by *América Economía*, 21 July 2008.

5 *Semana Económica*, 27 December 2007.

accumulated stock of direct foreign investment abroad is still modest (\$1.5 billion, according to the 2007 estimate), most notably Grupo Romero (transport, food processing and consumer goods, financial services and fuel marketing in several countries across Central and South America), Grupo Gloria (dairy, food processing, consumer goods in Puerto Rico, Colombia, Ecuador, Bolivia and Argentina) and the Hochschild Mining Group (mining in Mexico, Chile and Argentina).

V SIGNIFICANT TRANSACTIONS, KEY DEVELOPMENTS AND HOT INDUSTRIES

i Significant transactions

In August 2007, Chinalco Canada BV Holdings Ltd, a wholly owned subsidiary of Chinalco, successfully concluded a \$790 million tender offer as result of which it acquired approximately 91 per cent of the voting shares in Peru Copper Inc ("PCI"), a Canadian corporation listed in the Toronto Stock Exchange, the American Stock Exchange (AMEX) and the Lima Stock Exchange. Accordingly, the offer was carried out pursuant to the rules applicable in the US and Canadian markets. Peruvian regulations did not foresee a specific procedure that would allow Peruvian holders of a foreign security listed in the Lima Stock Exchange to participate in Peru in an offer carried out abroad. Therefore, a special procedure had to be approved by Conasev, in order to allow holders of PCI shares listed in the Lima Stock Exchange to participate in the offer. It was the first time that an offer of this nature was carried out in the Peruvian securities market.

The year 2007 closed with the announcement of the \$500 million acquisition by Cencosud, Chile's leading retailer, of Grupo de Supermercados Wong, Peru's emblematic and largest grocery retailer and one of the few Peruvian LATAM 500 that was still controlled by Peruvian capitals. The acquisition marked Cencosud's entry into the Peruvian retail market, already dominated by Chilean Falabella and Ripley, reflecting on the country's double-digit growth in domestic demand.

ii Unsolicited tender offers

While ultimately unsuccessful, the takeover bid attempted by Brazilian Votorantim Metais to acquire control over Compañía Minera Milpo ("Milpo"), a leading Peruvian polymetal mining company and one of the largest zinc producers, deserves special attention. It is one of the few unsolicited tender offer over a Peruvian target listed in the Lima Stock Exchange ever attempted (in 2004 a similar tender offer over Milpo was unsuccessfully attempted by Mexican Minera Peñoles, while in 2001 a hostile takeover bid by Milpo over Minera Atacocha also failed to succeed). The Brazilian bidder obtained less than 1 per cent of the target's shares, failing to acquire the 26.12 per cent it required to obtain control, as Milpo's more than 3,500 shareholders held out for a better offer after the company's board considered that the price offered by the bidders was not adequate.

iii Trends and hot industries

A vast majority of Peruvian companies are privately held. While there has been an incipient trend of going public through IPOs in the local, as well as in foreign, stock exchanges, this process has slowed down in light of the volatility of international capital

markets. In this context, Peruvian and regionally-based private equity firms have become very active in acquisitions.

Record prices for Peru's main mineral commodity exports have spurred M&A activity and investments in the mining sector. Particularly noteworthy has been the entrance of Chinese investors into the Peruvian M&A market, seeking to secure supply of strategic mineral commodities (e.g., Chinalco, China Minmetals and Jiangxi Copper).

Two particularly dynamic sectors during 2007 and 2008 have been fishing and financial services. The fishing sector is undergoing a consolidation process through the acquisition of small and medium-sized Peruvian targets by Peruvian buyers as well as by multinational corporations. Examples of foreign buyers targeting Peruvian fisheries include the \$147 million acquisition by Norwegian pelagic fishery specialist Austevoll Seafood ASA of *Corporación del Mar SA*.

In the financial services sector, in 2008, the Bank of Nova Scotia ("Scotiabank") acquired a 47.5 per cent stake in AFP Profuturo, a Peruvian AFP, as well as a 100 per cent interest in Grupo Altas Cumbres' Peruvian operation, Banco del Trabajo, adding to its acquisition in 2006 of Banco Wiese and Banco Sudamericano. The combination of its Peruvian consumer finance operations with Banco del Trabajo will make Scotiabank the number one bank in the Peruvian consumer finance segment and number two in micro-lending.

Also active acquiring micro-lending targets during 2007 and 2008 was *Fundación BBVA para las Microfinanzas*, which completed the acquisition of three local regional credit unions, which were subsequently merged in mid-2008.

Other sectors of the economy have undergone or are undergoing, to some extent, similar concentration processes. Hot markets include the agro export and commercial real-estate sectors, while growth in domestic demand and consumption continues to shake-up the retail, distribution and food and beverages markets.

VI FINANCING OF M&A: SOURCES AND DEVELOPMENTS

Traditionally, acquisitions in Peru have been self-financed through funds of the acquirer or by debt financing obtained abroad by non-domiciled acquirers. However, more recently, there are new sources of funds in the local market that are increasingly being tapped by both local and foreign acquirers.

First of all, there is a significant pool of funds accumulated by local AFPs, which are required by law to maintain a substantial part of the assets under their management in Peruvian investments. To facilitate the diversification of the AFP portfolios, regulations issued by the Superintendency of Banking, Insurance and AFP ("SBS") establish that debt instruments issued by a foreign entity are to be considered as Peruvian investments by an AFP when the issuer, directly or through its subsidiaries, has investments in Peru, be it through debt or equity, provided that the amount and term of the securities to be issued are not to exceed the direct or indirect Peruvian investments of the issuing entity. The securities may be issued in public or private offerings. In private offerings, the issuer is not subject to the disclosure requirements established in the Securities Market Act, although some limited disclosure obligations established by the SBS need to be undertaken.

These provisions allow foreign entities investing in Peru to tap the local institutional capital market almost as if they were Peruvian entities. For example, in May and June 2008, the Chilean retailer Cencosud, which had completed in January 2008 the acquisition of Grupo de Supermercados Wong for \$500 million, issued bonds in a private placements directed to Peruvian institutional investors for a total of \$143 million. According to a press release issued by Cencosud's investment banker to the transaction, tapping the Peruvian institutional market implied 'lower costs, fast execution, term – ten years in this case – and lower rates than those prevailing in Chile'.

A second significant development in acquisition financing, also linked to AFPs, is the growth of local private equity funds specifically oriented towards allowing AFPs to participate in the equity of non-listed companies that otherwise they could not acquire. To facilitate the use of this type of vehicles, Legislative Decree No. 1046, enacted in June 2008, substantially deregulated investment funds whose shares are not subject to public offers or public trading and eliminated the maximum participation that a single investor could have in public funds (formerly 33 per cent). Currently, private investment funds may be placed to a limited number of institutional investors, in order to channel funds from one or more AFPs to finance or refinance part of a specific acquisition, without having to fulfil registration requirements before Conasev.

Although not a new issue, it is worth mentioning the financial assistance prohibition contained in the Companies Act, which states that 'in no event may the company grant loans or give guarantees, with the guarantee of its own shares or for the acquisition of said shares, under responsibility of the board'. This provision creates an important hurdle for leveraged acquisitions and forces acquirers to use creative, and many times overly complex, structures in order to allow the financing granted for the acquisition to be supported by the cash flow or assets of the target.

VII EMPLOYMENT LAW

In light of Peru's overregulated labour market, employment law is a critical issue to be taken into account during due diligence, planning and execution of corporate acquisitions.

To facilitate the negotiation, approval and implementation of the FTA, Peru has recently enacted laws and regulations to reinforce workers' rights. Law No. 28806, published in July 2006, and its complementary regulations have substantially upgraded the inspection system of the Ministry of Labour, in order to better enforce labour laws. Under the new set of rules, the inspection service functions and authority have been strengthened to allow inspectors to enter into an employer's premises, review documents, conduct interviews and decree corrective measures.

In June 2008, Law No. 29245, regulating outsourcing services, was enacted after a long and intense debate. This Law seeks to distinguish true outsourcing of services, where a company contracts with another to provide certain services in an autonomous form and under its own responsibility, from cases in which formal outsourcing contracts are employed to veil the bestowing of workers from one entity to another. In the latter case, the Law deems the personnel hired by the alleged

outsourcing entity to have a labour relationship with the entity receiving the services (and consequently all labour benefits ensuing from that relationship). This Law is part of a fairly complex and rigid system of labour contracts under Peruvian law, where (i) employees normally need to be contracted for an indefinite term (fixed-term contracts are only allowed under limited conditions); (ii) employees cannot be freely dismissed without significant compensation (1.5 monthly salaries per year of work, up to a total of 12 monthly salaries); and (iii) outsourcing and the bestowing of personnel are subject to strict regulations and controls.

In early 2007, the Labour Commission of the Peruvian Congress approved a draft of a new General Labour Act that would regulate individual labour relations within the private sector. The draft legislation included, *inter alia*, provisions establishing joint and several liability of companies belonging to a group of companies with respect to labour rights in certain cases, restricting some of the situations in which fixed-term contacts may be used and extending the rights of employees to be reinstated in their position upon unjustified dismissal under certain circumstances. The draft legislation was not put to vote before Congress, in part because of opposition from the business sector. However, in its current form or further amended, it will likely be debated in a future legislature.

Another important law under debate in Congress seeks to amend the current mandatory workers' profit participation regime. Under the current regime, and subject to certain exceptions, companies with more than 20 full-time employees need to distribute among their employees between 5 and 10 per cent of their net yearly profits.⁶ Fifty per cent of the amount is distributed in proportion to the number of days effectively worked by each employee during the year and the remainder in proportion to the remuneration of each employee. No employee may receive more than 18 monthly salaries. Profits not distributed to workers as a result of the 18 monthly salaries cap are to be disbursed to the corresponding regional government. The legislation being debated in Congress essentially seeks (i) to eliminate the individual cap of 18 monthly salaries per year; (ii) increase the proportion of the distribution to be made in relation to number of days worked to 75 per cent; and (iii) to include within the distribution employees of entities that perform certain services for the company generating the profits (this is especially relevant in the mining industry). The proposed legislation does not face significant business opposition since it does not increase costs for employers, but rather only affects the allocation of the profits to be distributed, and is set to be debated in the next legislature.

VIII TAX LAW

In March 2007, Legislative Decree No. 972 introduced important changes related to the taxation of securities transactions, dividends and interests, to come into effect on 1 January 2009.

⁶ 10 per cent in the fishing, telecommunications and manufacturing sectors; 8 per cent in the mining, restaurants, retail and wholesale distribution sectors; and 5 per cent in other sectors.

Until 2008, capital gains on the sale of securities issued by Peruvian entities are essentially subject to the following regime:

- a* if the seller is a Peruvian individual, the gain is taxable only if the seller makes more than 10 purchases and 10 sales of securities during the fiscal year, at a rate of 30 per cent;
- b* if the seller is a non-domiciled individual or legal entity, the gain is taxable at a rate of 30 per cent; and
- c* if the seller is a domiciled legal entity, the gain is taxable at a 30 per cent rate.

However, if the transaction is made through the Lima Stock Exchange, capital gains are in all cases exempt from Peruvian income tax. In addition, interest on bank deposits and many types of securities (including bonds issued through public offerings) are also tax-exempt. Interests on loans granted by non-domiciled entities are subject to income tax in Peru at a rate of either 4.99 or 30 per cent.⁷ Dividends received by domiciled legal entities are not taxable. Dividends received by resident individuals and by non-domiciled individuals or legal entities are subject to a 4.1 per cent tax.

Starting in 2009, capital gains on the sale of securities are to be subject to the following regime:

- a* if the seller is a Peruvian individual, the gain is to be taxable at a 30 per cent rate if the seller makes more than 10 purchases and 10 sales of securities during the fiscal year, and at a 5 per cent rate otherwise;
- b* if the seller is a non-domiciled individual or legal entity, the gain will be taxable at a 5 per cent rate if the transaction is conducted in Peru and at a 30 per cent rate if it is conducted abroad; and
- c* if the seller is a domiciled legal entity, the gain will be taxable at a 30 per cent rate.

No tax exemptions for transactions conducted in the Lima Stock Exchange will be applicable. In addition, only interests on bank deposits received by domiciled individuals will remain tax exempt. Other interests received by domiciled individuals are to be taxed at a 5 per cent rate. Interests received by domiciled legal entities are to be taxed at the general corporate tax rate of 30 per cent. Interests on loans granted by non-domiciled legal entities are to remain subject to income tax in Peru at a rate of either 4.99 or 30 per cent. Dividends received by resident individuals and by non-domiciled individuals or legal entities will also remain subject to a 4.1 per cent tax.

It is also worth noting an incipient trend in the decisions of the Peruvian Tax Court concerning the deductibility of interests on debts obtained to finance corporate acquisitions. Although the Income Tax Law expressly states that interests on debts contracted to acquire goods or services related to the generation of taxable income are

⁷ In general, the 4.99 per cent rate applies if the proceeds of the loan are disbursed in Peru through the financial system, the interests of the loan (when granted) do not exceed the preferential rate of the place where it was granted, and the creditor and debtor are not related parties for Peruvian income tax purposes.

tax-deductible subject to certain limits (including those deriving from thin capitalisation rules), the tax authorities had traditionally adopted a very restrictive reading of this provision and disallowed the deduction of interests on debt obtained to finance the purchase of shares of other companies. In recent decisions, the Tax Court has adopted a more open position on this issue. In particular, in a 2005 decision, the Tax Court stated that even when an acquisition is not made with the purpose of obtaining dividends or a taxable capital gain, ‘investment in the shares of another company may generate several economic benefits that contribute to the maintenance of the income source or the generation of taxable income’.⁸

A final recent relevant development is the enactment of Legislative Decree No. 1011, published in May 2008, which has simplified procedures for entering into a Legal Stability Agreement (‘LSA’) with the Peruvian government to guarantee the stability of certain legal rules (including certain taxation rules) applicable to an investment. Previously, investors were required to execute their LSA before performing investments, which often times delayed the latter. Under the new rules, the investment may be performed prior to the execution of the LSA, so long as it is made after filing a petition requesting said agreement with Proinversion, the Peruvian investment promotion agency.

IX COMPETITION LAW

In August 2006, Congress withdrew a legislative proposal intended to expand notification and prior control requirements to concentrations occurring in all sectors of economic activities, involving parties with joint annual sales of \$100 million or more. Since then, in July 2008, the government enacted Legislative Decree No. 1034 (‘the Competition Law’), which has replaced the general competition legislation in place since November 1991. The Competition Law does not contain merger or concentration control rules, and has not abrogated merger control rules applicable to concentrations occurring in the electricity market.

Since January 2007, Peruvian competition authorities have not decided, nor have they been notified of, merger or concentration cases. This is largely because:

- a* electricity generation, transmission and distribution activities within the Peruvian electricity market are already highly concentrated;
- b* the expansion of activities through the development and implementation of new productive assets is not subject to prior authorisation controls;
- c* the mere change in the controlling partners of a Peruvian operating company that does not result in the vertical or horizontal concentration of generation, transmission or distribution activities within Peruvian territory is not subject to merger control rules under the current interpretation of local authorities; and
- d* most M&A activity carried out within the Peruvian electricity market has focused on smaller operations and has not exceeded notification thresholds currently in place (i.e., 15 per cent combined market share in horizontal concentrations and 5 per cent market share in either market in vertical concentrations).

8 Resolución del Tribunal Fiscal No. 4757-2-2005.

X FUTURE DEVELOPMENTS AND OUTLOOK

The short and long-term effects of the deterioration of the US subprime market and the ensuing liquidity crisis affecting the international financial system will test the resilience of the Peruvian M&A market. Analysts, however, forecast a similarly strong performance for M&A activity during 2008, so long as international commodity prices and the growth in internal demand and consumption hold-up.

Significant legislative changes to the framework applicable to M&A transactions in Peru are not expected to occur within the following year.