Peru (Mergers & Acquisitions Review)

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The past year has seen the financial crisis continue to escalate. Financial markets have witnessed a number of events that have had global effects, from the collapse of Lehman Brothers in September 2008, to Iceland’s banking crisis and the nationalisation of various financial institutions by several governments. The consensus is that the decision not to rescue Lehman was a mistake, although, to date, this appears to be an isolated – if serious – error by the authorities in response to the banking sector crisis. Other responses to these turbulent market conditions include the decision to reduce interest rates to historically unprecedented levels and massive fiscal stimulus in many countries. More controversially, several monetary authorities have implemented a ‘quantitative easing’ policy. Taken together, these efforts seem, at the moment anyway, to have averted a full-scale depression, but this has clearly been achieved at the price of huge public-sector deficits and substantial debt burdens for future generations.

The current debate centres around whether the next stage will be a continuing crisis, a return to ‘normality’ or, as seems more likely, a slow and anaemic recovery. In any case, many observers predict significantly higher levels of inflation than seen in recent years. Although some tentatively predict that a recovery from the financial crisis is on the horizon, the topic remains one of ferocious debate.

Some questioned whether the banking crisis would seriously affect the wider economy. The last year has proved beyond doubt that those who predicted a wider financial crisis were correct. The crisis in the real economy has much further to run and a significant increase in unemployment, particularly in Europe, regrettably seems inevitable.

M&A activity has reflected this crisis. Lending remains very constrained and the most significant activity has been in the financial sector, although property companies are also severely stressed. The less welcome development over the past year or so has been the steady stream of distressed corporate rescues, some by takeover. More optimistically, many are now commenting that, for those with cash, there are bargains to be had.

From the lawyers’ perspective, the next stages are likely to be of great interest as the authorities take steps to rebuild confidence in financial institutions. The regulatory architecture will change significantly, although the final form is not yet obvious.

I again wish to thank all the contributors for their continued support and cooperation – and all the unnamed others who have helped to produce this book, which, given the current economic climate, should hopefully provide interesting reading.

Simon Robinson
Slaughter and May
London
August 2009
Chapter 45

PERU

José Antonio Payet, Carlos A Patrón and Susan Castillo*

I  OVERVIEW OF 2008/2009 M&A ACTIVITY

M&A activity in Peru remained strong during the first three quarters of 2008, as Peru’s real GDP grew at a two-digit pace, reaching an estimated 9.84 per cent for 2008, despite a downturn in the last quarter. The GDP growth achieved in 2008 was the highest recorded in the past 14 years and the highest overall rate in Latin America for the year. The Peruvian economy thus completed 10 consecutive years of expansion.

Domestic demand grew 12.3 per cent in 2008, favoured by the continuous expansion of private investment and consumption. Reflecting upon the country’s macroeconomic stability, in 2008 Peru’s foreign-currency debt rating was raised to investment grade by both Fitch Ratings and Standard & Poor’s. In addition, despite the international financial crisis, the Peruvian banking system’s indicators improved in 2008 and banks ended the year with record-breaking profits.

Notwithstanding the above, the effects of the deterioration of the US subprime market and the ensuing liquidity crisis affecting the international financial system resulted in a slowdown of growth rates during the fourth quarter of 2008 and the first half of 2009. This is largely a result of declining commodity prices and a reduction in the volumes and values of traditional exports, coupled with a deceleration of gross fixed investment and increased financing costs during the first quarter of 2009. However, as of June 2009, year-end GDP growth for 2009 is still estimated at 3 per cent, the highest projected rate in the region.

* José Antonio Payet and Carlos A Patrón are partners, and Susan Castillo is an associate at Payet, Rey, Cauvi Abogados. The authors wish to thank their colleagues, Patricia Tamashiro (Tax) and Germán Lora (Labour), for their assistance.

1 All references and information in this section are derived from published sources and have not been independently verified.
During the first three quarters of 2008, 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 expanding to non-traditional sectors such as agriculture, fishing, real estate and retail. In the 12 months leading up to August 2008, no less than 50 mergers and acquisitions involving Peruvian companies were recorded,\(^2\) worth almost $35 billion, up 17 per cent from a year earlier.

The most significant deals involving Peruvian targets announced in 2008 include the acquisition of Grupo de Supermercados Peruanos Wong – Peru’s largest grocery retailer – by Cencosud, a Chilean retailing group, for $500 million, the acquisition of 100 per cent of Northern Peru Copper shares by China Minmetals and Jiangxi Copper for $446 million, and the acquisitions of Banco del Trabajo by The Bank of Nova Scotia for an approximate value of $131 million.

Contrary to international trends, private equity investors continue to play a 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, local private investment funds specifically oriented to channel funds from institutional investors, mainly Peruvian private pension funds (‘AFPs’), 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, fishmeal and mining).

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 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 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, 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 the case of corporations whose securities are listed on 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.

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

\(^2\) Dealwatch, online M&A monitoring service.
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 neither 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, that came into force on 1 January 2009:

- include the right of any shareholder to vote in a shareholders’ meeting by postal mail or electronic mail;
- 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’;
- reinforce provisions regarding the rights of minority shareholders to require Conasev the conveyance of a shareholders’ meeting in open corporations;
- perfect rules regarding the obligation of open corporations to publish a list of shareholders who have unclaimed shares or dividends.

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

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3 Generally, a joint-stock corporation is considered to be ‘open’ when: (1) it has performed a public primary offering of shares; (2) it has more than 750 shareholders; or (3) 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 the Conasev on certain matters.
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 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 restricted some of the self-regulation functions of the Lima Stock Exchange, 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 (Resolution No. 009-2006-EF/94.10 as amended; ‘the Tender Offer Rules’) – which are only applicable in the event of acquisitions of control in companies whose voting shares are listed in a Peruvian stock exchange – 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. According to such rules, a significant participation meant a participation of 25, 50 or 60 per cent in the voting rights of the company, as well as any participation granting the right to appoint more than one half of the company’s board members or to amend its by-laws.

Under the 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 in not more that four transactions within a period of 36 months, in an indirect transaction (i.e., by purchase of another entity holding the shares of the listed company), or 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 Tender Offer Rules. The 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 53 per cent of the top 500 Peruvian companies are controlled by foreign investors.\(^4\)

\(^4\) The 500 Club, as reported by América Economía, November 2008.
This is largely a reflection of Peru’s openness to foreign investment, which has attracted an accumulated stock of foreign direct investment of $32.14 billion (2008 estimate).5

Not surprisingly, during 2008 the majority of the purchasers of Peruvian targets in publicly disclosed completed M&A transactions were foreign investors,6 while almost all headline-grabbing transactions announced during 2008 have involved inbound investments.

During 2008, cross-border takeovers and multi-jurisdiction acquisitions had M&A implications over the operations and assets held by multinational 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 mandatory ex post tender offers in the Lima Stock Exchange.

Among Latin American investors, during 2008 and the first half of 2009, Peruvian targets attracted Mexican heavyweights such as Grupo Alfa (which acquired Breadt SA, a leading Peruvian cold-meat processor, for an undisclosed amount) and Grupo Bimbo (which continued consolidating Peruvian bread manufacturing companies). 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 Empresas Banmédica, which acquired the holding company that controls Laboratorios ROE (clinical laboratories) and the San Felipe Clinic (health services).

Also noteworthy is the continuing presence 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 2008 and the first half of 2009 include the aforementioned acquisition of Northern Peru Copper by China Minmetals and Jiangxi Copper ($446 million) and the execution of an agreement between Cardero Resource Corp and Nanjinzhao Group Co for the acquisition of Cardero Hierro del Peru (originally announced at $200 million).

While Peru is still clearly a ‘capital importing’ country, 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 accumulated stock of direct foreign investment abroad is still modest ($1.476 billion, according to the 2008 estimate).7 For example, in September 2008, Minsur SA, a privately owned mining conglomerate held by the Peruvian Brescia Group, acquired the Paranapanema Group’s Taboca tin division in Brazil for approximately $472 million. In addition, in November 2008, Soldexa, a Peruvian company specialising in technology for welding and cutting material also held by the Brescia Group, acquired Soldaduras Westarco and Soldaduras Megriwelek in Colombia for a total value of $97 million.

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5 The World Factbook – Peru. Central Intelligence Agency.

6 Perú Económico, 12 December 2008.

7 The World Factbook – Peru. Central Intelligence Agency.
Other Peruvian players involved in outbound M&A include 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 TRENDS AND HOT INDUSTRIES

M&A activity in the mining sector continued to be a regular fixture in the Peruvian landscape during 2008 and 2009. Record prices for Peru’s main mineral commodity exports spurred M&A activity and investments in the mining sector up until the third quarter of 2008. Particularly noteworthy, as previously mentioned, was the participation of Chinese investors in the Peruvian M&A market, seeking to secure supply of strategic mineral commodities (e.g., China Minmetals, Jiangxi Copper and Nanjinzhao Group Co). Recent important transactions in the mining sector include the acquisition by Grupo Arias SAC of 50 per cent of the issued shares of Compañía Minera Poderosa SA, a gold and silver mining company, from Atagold SA, for $52 million.

Other particularly dynamic sectors during 2008 and 2009 have been the fishing and financial services industries. 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 relevant transactions include Pesquera Diamante’s acquisition of 72 per cent of Pesquera Polar and 100 per cent of the outstanding shares of Pesquera Atlantico and Consorcio Malla, for a total value of $165 million.

In the financial services sector, in 2008, the Bank of Nova Scotia (‘BNS’) acquired a 47.5 per cent stake in AFP Profuturo, a Peruvian AFP, for an undisclosed amount, as well as a 100 per cent interest in Grupo Altas Cumbres’ Peruvian operation, Banco del Trabajo ($131 million). Adding to its acquisition in 2006 of a controlling interest in Banco Wiese and Banco Sudamericano, which resulted in the creation of Scotiabank Perú, in 2008 BNS acquired an additional 20 per cent stake in Scotiabank Perú held by Intesa Sanpaolo S.p.A. ($206 million). The combination Scotiabank Perú’s consumer finance operations with Banco del Trabajo make BNS the number one bank in the Peruvian consumer finance segment and number two in micro-lending.

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

A sector to watch in the short-term is the sugar cane industry. Sugar cane exports reached almost $25 million during 2008 (a 32 per cent increase compared to 2007), and, presumably, will continue to grow in 2009 if climate conditions and the level of available water for irrigation do not suffer significant changes. Many sugar companies have begun to diversify their export crops (e.g., paprika and aji piquillo), while others continue to cultivate sugar for the production of alcoholic beverages. Several larger companies are studying the feasibility of producing biofuel, such as ethanol. The concentration of
Peru

agricultural land by larger producers has prompted concerns by certain political sectors, and the Agrarian Commission of Peruvian Congress has announced that it is evaluating the possibility of drafting legislation to limit the total amount of hectares that may be held by a single company in the Peruvian coast.

ii Private equity involvement in M&A

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, contrary to international trends, Peruvian and regionally-based private equity firms have assumed a 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, as noted above, private investment funds specifically oriented to AFPs, have been actively investing in mid-sized non-listed companies, thus allowing pension funds to diversify their equity holdings.

During 2008 and 2009, private equity funds have been active in several sectors of the economy. Examples of such involvement include the acquisition in May 2008 by ‘Fondo de Inversión en Infraestructura, Servicios Públicos y Recursos Naturales’, a private equity fund managed and structured by AC Capitales, of 10 per cent of the outstanding shares of Lima’s airport operator, Lima Airport Partners, for $6.5 million. Likewise, during the past year, ‘Descubridor 1’, a newly created private equity fund managed by Enfoca Fund Manager, acquired 18 per cent of Maestro Home Center, a Peruvian hardware and home improvement retailer, for $12 million; and, in October 2008, acquired an important stake in Pesquera Diamante, a leading fishmeal producer, for $87 million.

More recently, in April 2009, ‘Compass Fondo de Inversión en Capital Privado I’, a private equity fund created in May 2008 to invest in medium and large-sized Peruvian companies, completed the acquisition of 10.15 per cent of Compañía Minera Poderosa SA, a gold and silver mining company, for $10.5 million.

iii Unsolicited tender offers

In April 2008, a 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, was launched in Peru. 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 offers 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. Notwithstanding, the Brazilian company was later able to increase its stake to over 30 per cent of the outstanding shares, becoming the largest shareholder in Milpo. Subsequently, Milpo
acquired a controlling stake in another Peruvian mining company, Compañía Minera Atacocha SAA.

VI FINANCING OF M&A: SOURCES AND DEVELOPMENTS

Acquisitions in Peru have usually 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 – 10 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 institutional investors, in order to channel funds from one or more AFPs to finance or refinance part of a specific acquisition.

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 over-regulated 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.

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 employees normally need to be contracted for an indefinite term (fixed-term contracts are only allowed under limited conditions); employees cannot be freely dismissed without significant compensation (1.5 monthly salaries per year of work, up to a total of two monthly salaries); and outsourcing and the bestowing of personnel are subject to strict regulations and controls.

VIII TAX LAW

Pursuant to Peruvian Income Tax Law, until the end of the 2009 fiscal year, capital gains on the sale of securities issued by Peruvian entities are 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. 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.

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8 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.
Starting in 2010,\(^9\) 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 interest on bank deposits received by domiciled individuals will remain tax exempt. Other interest from local sources 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. Interest 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 from local sources 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 a decision of the Peruvian Tax Court concerning the deductibility of ‘negative goodwill’ derived from the acquisition of shares for less than their patrimonial value. According to the tax administration (‘SUNAT’), income generated as a consequence of the registration of a ‘negative goodwill’ was to be considered as taxable income for Income Tax purposes. However, in a recent decision, the Peruvian Tax Court has overturned the SUNAT’s position and established that income derived from the registration of a ‘negative goodwill’ shall not be considered as capital gain taxable with income tax.

Finally, it is worth noting that there is currently a political discussion regarding the taxation in Peru on the sale of shares of international holding companies that mainly hold Peruvian assets. This is the result of a recent transaction by which the shares of Offshore International Group Inc, an international holding company that held as its principal asset shares in the Peruvian oil company Petro-Tech Peruana, were sold in the US to ECOPETROL SA and Korea National Oil Corporation for $900 million. No income tax was reported to be paid in Peru in connection with this transaction, since it was performed outside the Peruvian territory and Peru has not entered into a double taxation treaty with US. In this context, the Peruvian Congress is now evaluating the possibility of modifying the Income Tax Law to prevent losing out on possible revenues from similar sales in the future.

\(^9\) As a result of the enactment of Legislative Decree No. 972 and Law No. 29308.
IX COMPETITION LAW

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 general merger or concentration control rules, and has not abrogated existing merger control rules exclusively applicable to concentrations occurring in the electricity market.

During 2008, 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, when the new controlling partner does not previously control other companies involved in 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).

X OUTLOOK

The short-term effects of the deterioration of the US subprime market and the ensuing liquidity crisis affecting the international financial system have tested the resilience of the Peruvian M&A market, which has continued to develop, albeit at more moderate levels than in previous years, largely because internal demand and consumption have held steady. Analysts forecast that, in the long-term, the path to stronger M&A activity will be dependent upon the return to positive levels of international growth and a turn around of falling commodity prices.

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