An overview of public-private partnerships in Peru: The past, present and future
by Miguel Ronceros and Ronald Fernandez-Davila, Rossello Abogados

This article attempts to give a view of public-private partnership development in Peru through the evolution of private investment participation in the public sector, from its beginnings, through the sale of State-owned shares and assets in State-owned companies, to public-private partnerships through co-financed concessions, a mechanism which is allowing the development of private investment in projects where this participation would have been impossible as a result of limited economic profitability.
Likewise, this article gives an introduction to private initiatives, a new tool aimed to foster private participation through the direct award of concessions.

The past: The privatisation process and the beginning of concessions
During the 1970s the political and economic trend in Peru led the government to participate to a significant extent in the country’s economic life by taking over those productive sectors then considered as key economic sectors, becoming the sole financier of infrastructure and provider of public services.

In the 1980s, Peru plunged into a deep economic crisis, characterised by significant expenditure in inefficient State-owned companies due to the existence of permanent subsidies which impacted the public budget. As a consequence, during the 1990s the government launched an aggressive privatisation programme of State-owned companies setting forth a legal framework allowing the private sector to re-emerge in activities previously developed by the State and granting the conditions and guarantees to promote private investment in public services infrastructure.

Private participation in infrastructure could not have existed had it not been for the legal framework designed for promoting private investment. For such purpose a series of statutes were issued aimed at promoting private investment, including the Framework Law for Private Investment Growth, which was enacted by Legislative Decree 757 and which laid the foundations for ensuring free initiative and investments carried out by the private sector by establishing guarantees, rights and obligations applicable to those investors, both local and foreign.

In this scenario, the execution of Legal Stability Agreements entered into by the Peruvian Government and private investors played a fundamental role. A Legal Stability Agreement is the mechanism through which the State, represented by the national competent agency, guarantees investors and the companies where they invest in, stability of the income tax rate in force on the date of signing the agreement, stability of the modalities of hiring of personnel, stability of the regime on the free availability of foreign currency, stability of non-discriminating rights, among others. Up to this date, Legal Stability Agreements keep showing their potential to attract foreign investment.

Subsequently, other regulations were enacted, specifically aimed to promote private investment in infrastructure projects through concessions. These regulations were subsequently compiled in Supreme Decree No 059-96-PCM, a Single Uniform Text (acronym in Spanish: TUO) which included all those provisions having the same legal hierarchy as the laws regulating the delivery of infrastructure and public utilities public works concessions to the private sector.

In accordance with article 12 of the TUO, a concession is one of the forms whereby private investment is fostered within the scope of infrastructure and public utilities public works. In this respect, Article 14 of the TUO indicates the forms where under concessions may be granted, namely: (i) for valuable consideration; (ii) for non-valuable consideration; (iii) co-financed by the State; or (iv) through a combined form.

The process to promote the granting of concession involving economically self-sustainable infrastructure projects saw its beginning in 1994, with the awarding of the Arequipa–Matarani Toll Road concession. This was the first infrastructure concession ever awarded in Peru. The concessionaire assumed the obligation to recondition, operate and maintain an already existing 105 km road under a BOT (Built–Operate–Transfer) contract.

Subsequently, an expansive stage involving other
self-sustainable concessions began. These concessions included the Centre, South and Southwest Railroad concessions, awarded in 1999 for a period of 30 years; the Matarani Port Terminal, awarded in 1999 for a period of 30 years; the Jorge Chávez International Airport, awarded in 2000 for 30 years; the transportation and distribution concessions of hydrocarbons from the Camisea Project, awarded in 2000 for 33 years each; the Ancón-Huacho-Pativilca Road, awarded in 2003 for 25 years; among others. These projects allowed the private sector to generate more and better public services infrastructure in Peru and created revenues (and still continue to do so) for the Peruvian State through the collection of a percentage of the proceeds obtained from the corresponding concessionaires.

All of these concessions were granted under a BOT system, except for the transportation of hydrocarbons coming from the Camisea Project, which was granted under a BOOT (Built–Own-Operate-Transfer) contractual scheme.

In parallel to the delivery of these concessions, the sale of shares of State-owned companies continued, primarily through the spin-off of equity blocks owned by mining, electric power generating, transmission and distribution companies, cement, sugar and many other State-owned companies.

The present: The emergence of co-financed concessions

Upon the delivery to the private sector of a major part of the financially self-sustainable projects, the State entered a stage in which it had to assume a major participation through the co-funding of projects which, per se, were not economically viable. However, due to their social importance, these projects had to be executed and, thus, the concept of social profitability was introduced.

In 2004, the Olmos–Tinajones Diversion project was delivered to the private sector. Such a project encompasses a hydro-energetic and irrigation complex harnessing the diversion of water coming from the eastern basin of the Andes towards the western basin, through a tunnel and dam being built by the concessionaire of the first stage of the project.

Another project which has been partly awarded to the private sector is the group of roads forming the “Initiative for the Integration of South American Regional Infrastructure” (acronym in Spanish: IIRSA) project, whereby a concession has been granted on the IIRSA-North road and sections 2, 3 and 4 of the Southern Interoceanic Road Corridor joining Peru and Brazil, clearly one of the most important infrastructure projects in South America. This project is aimed at linking the Pacific and Atlantic coasts through a network of roads starting in the Peruvian coast down to the coasts of Brazil, crossing the Andes and the Amazonian Jungle in its path. This is certainly a considerable project not only because of the engineering and size of the investment involved, but also because along with the Olmos-Tinajones Diversion project it constitutes one of the first infrastructure projects executed under the scheme of an investment co-financed by the Peruvian State and private companies.

Furthermore, the IIRSA project represents a milestone in the development of Public-Private Partnerships in Peru, not only for the design of the co-financed concession, but also for the creation of the Certificate of Recognition of Annual Payments Per Work (acronym in Spanish: CRPAO), a financial instrument which allowed to complete the financing of the IIRSA Norte and the sections 2 and 3 of the IIRSA Sur project, for amounts exceeding US$900m.

The structure of these concessions enables the concessionaire to, as it moves forward with the construction stage, generate rights on the Annual Payments per Works (acronym in Spanish: PAO), which the State has undertaken to make in the future as part of the co-financing of the project. These rights are reflected in the CRPAO, which constitutes a financial instrument incorporating an unconditional and irrevocable obligation undertaken by the Peruvian State to pay the holder of such instrument, on the established due date, a certain amount set forth therein.

The CRPAOs have been structured so that they are governed by New York Law, subject to New York jurisdiction, rank pari passu with other similar obligations of the Government of Peru, are not subject to any kind of set-off or claim which may derive from the concession agreements, are freely transferable and contain cross-default and acceleration clauses protecting the acquirers of such instruments.

The future: Infrastructure needs and private initiatives

The number of projects that may be awarded under the self-sustainable concession scheme is limited despite the existence of still interesting self-sustainable projects, with the most recent example of successful biddings for self-sustainable projects being the concession granted in 2006 for the DFBOT (Design, Finance, Build, Operate and Transfer) project of the New Containers Terminal at the South Dock of El Callao Port, which will
represent an investment of over US$650m.

Notwithstanding the existence of the several projects mentioned in this article, there is still a significantly hefty agenda pending in order to succeed in reducing the infrastructure gap in public utilities, which, in Peru, has been estimated in over US$23,000m.

For this reason, this agenda will include significant projects such as the concession of port terminals located in the provinces, a significant number of regional airports (12 airports were awarded in 2006), and a variety of roads which are part of both the national road network and the IIRSA. However, a major part of these projects will not meet the characteristics necessary to become self-sustainable projects and, therefore, most of these projects will require the State’s participation through co-financing, a true example of public-private partnerships.

At this point, the concession process of sections 1 and 5 of the Southern Interoceanic Road is in progress. The same is true for the Road Sections of the Amazonas-Centre Multiform Arterial Road Network of IIRSA, which represent appealing perspectives to investors, as well as for other less important co-funded concessions, mainly composed of rural roads stretching from the coast towards the highlands.

In the other hand, it is important to mention that traditionally the private sector’s participation through a variety of forms mentioned in this article, including public-private partnerships, has been conceived as a mechanism whereby the State identifies an investment alternative and offers it to the private sector through a competitive bidding. However, Peruvian law has introduced an innovative alternative – private initiatives – which break away from the traditional scheme.

Private initiatives allow the private sector to search, identify and design a project involving a certain State-owned resource. Once the action plan has been drawn up, the private entity submits the alternative to the State.

The State studies such proposal and, if deemed convenient and provided that there is no other similar alternative already in progress, the subject-matter proposal is approved, and subsequently publications in connection with such initiative are made in order to call for declarations of interest from other investors.

If, after being made public, no other interested party shows up within a maximum term of 30 calendar days, the project is awarded to the proposing party. However, should there be another bidder, both parties should compete for the awarding of the project. In this last case, if the proposing party were not awarded the project, the awardee must refund the expenses which it incurred in respect of research and project development.

This system is important not only because it enables private entities to have the investment initiative, but also because this mechanism may include any State-owned resource, such as assets, companies, projects, services, and infrastructure and public utilities public works.

Moreover, another important factor is added: the State does not spend resources on identifying and preparing the project.

Decentralisation, governmental institutions and investment opportunities

These projects could not have been organised had it not been for the State system, which has been experiencing an ongoing modernisation and specialisation process in recent times. This system is responsible for providing the necessary conditions for the promotion of private investment, starting with the ministries, which are the sector entities responsible for the projects to be delivered through PPPs by the Central Government.

In recent times, the leading role players involved in this process have been the transport, telecommunications, energy and mines, and sanitation sectors.

Notwithstanding, it must be considered that Peru is experiencing a decentralisation and regionalisation process and therefore it is expected that the regional and local levels of government also assume an important role in the promotion of private investment. For such purpose, the role that the Private Investment Promotion Agency (PROINVERSION) may assume in entering into collaboration agreements with such levels of government will be of primary importance.

In this respect it is important to highlight that PROINVERSION is the private investment promotion agency of the central level of government, in charge of identifying investment projects which may be appealing to private investment, providing the necessary information and promoting such projects locally and abroad, as well as directing the delivery thereof to the private sector.

On the other hand, the regulatory bodies, which include the Supervisory Agency for Investment in Energy and Mining (OSINERGMIN), the Supervisory Agency for Private Investment in Telecommunications (OSIPTEL), the Supervisory Agency for Investment in Public Transport Infrastructure (OSITRAN) and the National Sanitation Services Superintendency
(SUNASS) are technical, specialised and independent entities having the special mission of regulating the market within their competence. For such a purpose, they may issue legal regulations and fix rates in those markets where natural monopolies exist in order to simulate competition, by recreating markets in which rates are established by the law of supply and demand, as well as to supervise the obligations incurred by private entities with regard to the Peruvian State when undertaking a public project.

As it may be appreciated from this article, the Government has adopted a liberal policy framework and has created several mechanisms to attract the private sector’s interest in infrastructure projects.

Indeed, as mentioned before, the Legal Stability Agreements have been one of the most successful tools in such an endeavour. After meeting certain requirements (such as proving minimum investment amounts), a series of benefits are granted to investors, including the stabilisation of Income Tax according to the applicable regulations of the tax regime in force, ensuring, in addition, the free availability of foreign currency and profit remittance, as well as guaranteeing an equal treatment to Peruvian and foreign companies. These agreements are valid for a 10-year term, except in the case of concessions where the term is equal to the full term of the concession awarded. In addition, any dispute arising from these agreements will be submitted to arbitration.

Furthermore, the Government has also created certain specific tax benefits which take into account the nature and characteristics of infrastructure projects. In this respect, perhaps one of the most attractive benefits is the one referred to the advanced recovery of the Value-Added Tax.

Under this benefit, those investors that have entered into concession contracts with the Peruvian State for the development of infrastructure and public utilities works may request the refund of the Value-Added Tax paid in import, capital goods acquisition and services contracts, as well as in construction contracts required to execute the investment project subject-matter of the contract.

The Peruvian legal framework in general has created an interesting scheme for the development of infrastructure projects in Peru,
a country where the infrastructure needs are huge.

The areas where private investment should be promoted are countless and it is expected that the Government will launch several calls for the development of projects in the near future in sectors such as transportation, energy, telecommunications, sanitation, hospitals, schools, and even prison facilities; and that the private sector will take advantage of the creation of the private initiatives.