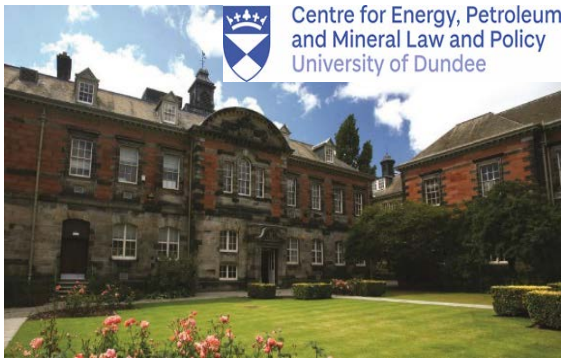
INVESTING IN ELECTRICITY TRANSMISSION IN PERU: HOW TO MITIGATE POLITICAL RISK RELATED TO CHANGES IN TARIFF REGULATION APPLICABLE TO GUARANTEED TRANSMISSION SYSTEM PROJECTS?



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ABSTRACT: *According to the Peruvian regulatory framework, an SGT Transmission Line project can only be allocated to a private investor by virtue of a concession aiming to encourage competition within the transmission market. Once the concession is allocated, the concessionaire undertakes a BOOT Contract with the Peruvian Government that sets forth a set of rules, including payment rules which have been implemented according to the regulatory framework. Consequently, the payment owed to the transmission concessionaire is being established through a regulatory procedure according to specific regulations. This could represent a risk given that there is no specific guarantee that there will not be a change in regulations that may endanger the payment owed to the concessionaire. The purpose of this research paper is to describe how the transmission tariff can become a risk for investing and developing a transmission line and also to describe how this risk is being mitigated.*

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ABBREVIATIONS

BOOT	Built, Own, Operate and Transfer
COES	Committee for the Economical Operation of the System (System Operator)
LCE	Electricity Concession Law, Decree Law 25844
LDEG	Law for assuring the efficient development of Electricity Generation, Law 28832
MEM	Ministry of Energy and Mines
OSINERGMIN	Peruvian energy regulatory agency. This acronym stands for Supervisor Entity of the investments on Energy and Mining.
PROINVERSION	Agency for Promotion of Private Investment
RLCE	Rules for the Electricity Concession Law, Supreme Decree N° 9-93-EM
SEIN	Interconnected Electricity National System or National Grid
SCT	Complementary Transmission System
SGT	Guaranteed Transmission System
SPT	Main Transmission System
SST	Secondary Transmission System
Transmission Act	Transmission Act and Amendment to Electricity Concession Law, Supreme Decree N° 27-2007-EM

1. Introduction

The Peruvian Transmission Grid is composed of high voltage transmission lines. Some of those transmission facilities have been classified as Guaranteed Transmission Facilities or the Guaranteed Transmission System (SGT) due to its specific characteristics and due to the fact that there is a specific regulatory framework that establishes a particular concession regime and a specific tariff regime.

According to the Peruvian regulatory framework, an SGT Transmission Line Project can only be allocated to a private investor by virtue of a concession due to the fact that this procedure will encourage competition within the transmission market. Thereto, a bidding process is held where the bidders are not only required to fulfil a list of obligations but most importantly, they should prepare an economic offer which will contain the amount that bidders consider that will cover investment costs and operation and maintenance costs. The Peruvian government will grant the concession to the participant that holds the most competitive economic offer.

By virtue of this concession regime, the concessionaire undertakes a built, own, operate and transfer contract (BOOT) with the Peruvian government. Under this agreement, a set of rules are established, including payment rules which have been implemented according to the regulatory framework. The awardee shall receive a payment that will cover investment costs and operation and maintenance costs. This payment, denominated the base tariff, is included as part of the tariff that has been regulated within specific rules and regulations.

Consequently, the payment owed to the transmission concessionaire is being set forth through a regulatory procedure according to specific regulations. This could represent a risk given that there is no specific guarantee that there will not be a change in regulations that may endanger the payment owed to the concessionaire.

Considering the abovementioned situation, we can wonder how it is possible to somehow mitigate such high risk. Thereto, the purpose of this research paper is to explain how the Peruvian government deals with this risk. In order to answer this question, it has been analysed the legal framework for developing transmission activity in Peru, and it has been assessed how these rules have changed throughout time, seeking to enhance private investment in an emerging market.

Section 2 explains how the regulatory framework governs transmission activity in Peru. Section 3 describes the SGT and the rules that govern this system. Whilst section 4 describes the mechanism that has been implemented in order to mitigate risks related to change in tariff regulation. Finally, section 5 concludes that despite the fact that it is not possible to prevent changes in the current regulatory framework from occuring, the concessionaire will be duly covered by having the tariff regime in the BOOT Concession Agreement. Thereto, in case the concessionaire does not obtain tariff payment due to any changes in the regulatory framework, the Peruvian government will be liable in such a situation.

2. Peruvian Transmission System and the Regulatory Framework that Underlies it

2.1 Electricity Transmission Activity After Electricity Market Liberalisation: Facilities and Regulation

Electricity transmission relates to energy transportation at high voltage levels from generators to consuming centres.[2] Thus, energy transportation occurs throughout the transmission system, which is formed by the following facilities: (i) transmission lines and (ii) substations. Transmission lines (towers and cables) allow energy transportation between different sections of the national grid, such as (i) a generation power plant and a substation, (ii) two different substations, (iii) a substation and distribution system and, (iv) a substation and large consumers.[3]

Transmission activity within the Peruvian market has faced several adjustments throughout time. Before the Peruvian government enacted the Electricity Concession Law, Decree Law 25844 (LCE), this activity was conducted by a State Monopoly.[4] However, after LCE was enacted in 1992, a liberalisation process was held within the electricity market which outcome was to have an unbundled market. Under this new structure, two (2) transmission systems were created[5]:

(i) SPT: The Main Transmission System (SPT) is composed of transmission lines which work in very high voltage power and allows electricity exchange and

[2] DE LA CRUZ, Ricardo and GARCÍA CARPIO, Raúl. *La Problemática de la actividad de transmisión de energía en el Perú: Algunas opciones de política. Informe Final.* Lima. Consorcio de Investigación Económica y Social. 2003. p., 7
[3] Cfr. Ítem 1.19, Article 1, Transmission Act.
[4] SANTIVAÑEZ, Roberto and SUMAR, Paul. Cuarenta años de evolución del marco legal peruano de la transmisión eléctrica, in Revista peruana de energía, Issue N° 1, Lima. 2012. p., 84.
[5] Cfr Article 58, LCE.

commercialisation in any bus bar of the grid. Under this system, no dominant flow can be identified.[6]

(ii) SST: The Secondary Transmission System (SST) part of the transmission system which enables (i) to transfer electricity to a distributor or free consumer from a SPT bus bar; or (ii) generators to deliver the electricity produced in its facilities to a SPT bus bar.

Pursuant to LCE, SPT shall receive a monthly payment from all generation companies that are connected to this system. This payment covers annual investment costs and operation and maintenance costs. On the other hand, SST will be paid by generation companies that use these facilities to deliver the energy produced in their power generation facilities. Additionally, consumers will assume payment of SST when distributors use these transmission lines for delivering the energy consumed by their clients. [7]

Under this new regulatory framework, the Peruvian government intended to open transmission activity to competition in order to have a liberalised market and private investment.[8] Nonetheless, the results after issuing LCE and the Rules for the Electricity Concession Law, Supreme Decree N° 9-93-EM (RLCE) did not cover Peruvian government expectations. During the 1990s the transmission system was not fully integrated since there were SPT facilities in Peru's north region and there was another SPT in the south region. [9] Furthermore, these facilities were state-owned, and the tariff offered to transmission companies were calculated under a simulation (not considering real investment costs).[10] Considering these flaws and the lack of investment in transmission facilities, Peruvian government introduced a BOOT Contract system in order to attract the investment needed to incorporate new

[6] MASTROPIETRO, Paolo; BARROSO, Luis and BATLE, Carlos. Power Transmission Regulation in a Liberalised Context: Proposals based on the analysis of two decades of novel solution in South American Markets. Utilities Policy, vol. 33. 2014. p., 22 [website] http://www.iit.upcomillas.es/batlle/Docs/2014%20Power%20transmission%20regulation%20in%20a%20liberalised%20context%20Proposals%20based%20on%20the%20analysis%20_%20Mastropietro%20et%20al.pdf (accessed 26 January 2016)

[7] Cfr. Article 58 to 62, LCE.

[8] SANTIVAÑEZ, Roberto and SUMAR, Paul. *op. cit.* p., 89

[9] Oficina de Estudios Económicos OSINERGMIN. Documento de Trabajo N° 3: Determinación de la Inversión en el Sector Eléctrico Peruano. Documentos de Trabajo OSINERGMIN. Lima, 2005. p., 51.

[10] GARCÍA CARPIO, Raúl and MOLINELLI, Fiorella. Regulación y Supervisión del Mercado Eléctrico Peruano. Fondo Editorial de la Pontificia Universidad Católica del Perú. Lima. 2008. p., 269.

transmission facilities that enable the unification of SPT transmission lines located in Peru's northern region with the ones that were located in the southern region.[11]

In order to achieve such goal, in 1996, the Peruvian government enacted the Supreme Decree 59-96-PCM[12] aiming to promote private investment in public infrastructure. This regulatory framework set forth appropriate incentives and guarantees, such as[13]:

- Tariff system, including tolls or prices that allow investors to have guaranteed revenue. This system is based upon a BOOT Contract.

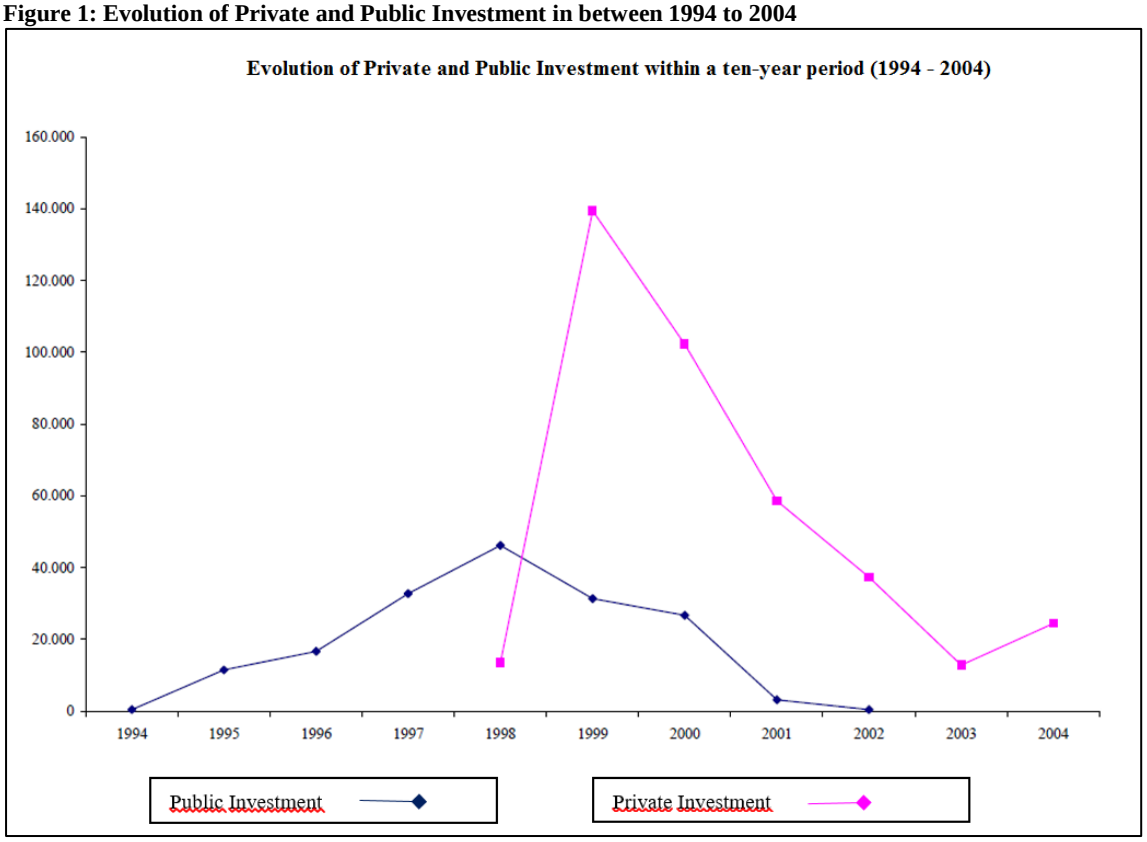
- Indemnities included in the BOOT Contract in case the government decides to revoke or terminate the concession by any reason non-stipulated under the legal framework.

- A dispute resolution system based upon national or international arbitrage.

Consequently, this new mechanism derived in transferring the state-owned transmission companies to the private sector. Furthermore, new investment on SPT transmission lines were made which led to four (4) new transmission lines in the Peruvian Electricity market. Ultimately, this also led to Peru having a sole transmission system, named the Interconnected Electricity National System or National Grid SEIN.[14]

[11] DE LA CRUZ, Ricardo and GARCIA CARPIO, Raúl. *op. cit.* p., 35.
[12] Supreme Decree 59-96-PCM has been recently revoked by virtue of Legislative Decree Nº 1224 dated as of 25 September 2015.
[13] Cfr. Articles 13, 17, 25, 35 from Supreme Decree N° 59-96-EM.
[14] SANTIVAÑEZ, Roberto and SUMAR, Paul. *Op. cit.* p., 93.

Figure 1: Evolution of Private and Public Investment in between 1994 to 2004



Source: Oficina de Estudios Económicos OSINERGMIN. Documento de Trabajo Nº 3: Determinante de la Inversión en el Sector Eléctrico Peruano. 2005 p., 52

These transmission facilities were granted by virtue of a concession system which entitled these companies to undertake a BOOT contract with the Peruvian government. Under this new concession system, concessionaires were guaranteed certain rights over the concession goods and they were also obliged to assume a specific performance. This concession type obliged concessionaires to undertake the design, provision of goods, construction, maintenance and operation of the transmission facility.[15]

Thus, BOOT agreements granted predictability to the private sector since they were guaranteed that within the validity term of such agreement, the concessionaire would own the transmission line and thereto, it will be responsible for providing transmission service. Furthermore, these agreements provide a stabilised tariff regime, which is included as part of the agreement.

[15] Cfr. Article 13, Supreme Decree Nº 59-96-EM

Tariffs purported to provide a proper revenue to the concessionaire and to guarantee it to recover its investment on such facility.

2.2. Incorporation of New Transmission Facilities in the Peruvian Transmission System

During 2005, the Peruvian energy regulatory agency (OSINERGMIN) and the Ministry of Energy and Mines (MEM) constituted a Special Commission[16] in order to assess all those changes that needed to be incorporated in the electricity market aiming to improve its functionality and performance. One of the issues that was analysed related to the transmission tariff regime that was regulated by LCE. As mentioned above, the tariff regime described in LCE did not guarantee investors would recover their investment costs because the payment calculation was done without considering real investment and operation costs. Thereto, LCE's tariff regime lacked predictability.[17]

After the Special Commission determined what changes needed to be incorporated in the regulatory framework for electricity activity, DLEG was enacted in July 2006. Under this new regulatory rule was incorporated two (2) new transmission systems[18]:

(i) SGT:[19] SGT comprises high voltage transmission facilities that are included in the Transmission Plan approved by MEM. These transmission facilities are developed under a bidding process that aims to grant in concession one specific transmission line. Afterwards, the awardee company shall enter into a BOOT contract with the Peruvian government. Technically, these transmission lines share the same features that an SPT Transmission Line. Nonetheless, SGT transmission lines are subject to a different tariff regime.[20]

(ii) SCT: The Complementary Transmission System SCT comprises medium voltage transmission facilities that are also listed on the Transmission Plan. However, it is also possible to build SCT Transmission Facilities that have not been included in the Transmission Plan. These transmission lines allow one to connect generators to

[16] The Special Commission was created by virtue of Law 28447.
[17] Comisión MEM-OSINERG. *Libro Blanco – Proyecto de Ley para Asegurar el Desarrollo Eficiente de la Generación Eléctrica.* OSINERGMIN. Lima, 2005. p., 38.
[18] Cfr. Article 20, DLEG.
[19] In Section 3 will be provided extensive and broader information about SGT and its tariff regime.
[20] Cfr. Article 2, Transmission Act.

a bus bar from the SPT or SGT or allows generators to deliver energy to distribution companies and/or to free consumers.[21]

Accordingly, all transmission facilities that were built after July 2006 shall be classified under one of the two (2) new transmission systems. This also meant, that currently, the transmission system is formed by the following systems: (i) SPT, (ii) SST, (iii) SGT and (iv) SCT. The classification set forth on LCE (SPT and SST) remains in full force for all the transmission lines that were built before July 2006 and that are still paid under the tariff regime established in LCE.[22]

3. SGT: Main Features, Tariff Regime and Applicable Regulatory Framework

In order to incorporate SGT to the Peruvian Electricity Market, both DLEG and the Transmission Act and Amendment to Electricity Concession Law, Supreme Decree N° 27-2007-EM (Transmission Act), established a set of rules governing the process to allocate SGT Transmission Lines to private investors. Thus, under the regulatory framework, SGT projects will be assigned through a bidding process which will lead investors to enter into a BOOT contract with the Peruvian government.

This section aims to provide information about how a SGT Transmission Line can be developed within the Peruvian market.

3.1. Transmission Plan and Bidding Process: How to Allocate a Concession for a SGT Transmission Line?

As it was mentioned above, before incorporating SGT as a part of the transmission system, a special commission was formed in order to assess and determine which changes were required to enlarge and improve the electricity market. Regarding transmission activity, the Commission noted that it was necessary to organize the transmission market by establishing which transmission lines were required to implement looking forward to enlarge the system and deliver the energy demanded in specific locations. Consequently, the Commission stated that it was needed to have a document issued by the System Operator reflecting which transmission facilities were required. Such document was denominated the Transmission Plan.[23]

[21] Cfr. Article 3, Transmission Act.
[22] Cfr. Article 20, DLEG.
[23] Comisión MEM-OSINERG. Op.cit. p., 107.

Therefore, according to DLEG a Transmission Plan is a mandatory document that aims to identify all transmission facilities that will be required for allowing an economic and secure delivery of the energy produced within the Electricity Market.[24] In order to elaborate a Transmission Plan, MINEM will consider a specific term and it will be analysed to determine which infrastructure will be required during that term. This document should propose a referential commercial operation date.[25] The Committee for the Economical Operation of the System (COES) has been designated as the entity that will be in charge of preparing the Transmission Plan. In order to do so, COES shall prepare a report backed up in a diagnosis paper where it should determine main issues and flaws that surround the SGT Transmission System. This report will be submitted for approval to MEM and OSINERGMIN. [26] The Transmission Plan requires to be updated and publicly released every two (2) years.

Thus, the Transmission Plan is a binding document that establishes which transmission lines shall be built within a two (2)-year period. Once this document is released, a bidding process shall be summoned for allocating the transmission facilities included under the Transmission Plan. MEM can either call the auction on its own or commission the whole process to the Agency for Promotion of Private Investment (PROINVERSION).[27] After calling the auction, MEM or PROINVERSION shall prepare a document setting forth the terms and conditions of the auction process. This document shall (i) define the technical features of the SGT Transmission Line, (ii) establish the applicable tariff regime, (iii) include a BOOT Contract model, and (iv) explain the bidding process.[28]

After the bidding process is conducted, the concession for implementing the SGT Transmission Line will be allocated to the bidder that have met all the requirements that have been set forth in the auction's term and conditions. Specifically, to determine who will be awarded with the concession, this document will establish a set of requirements to be fulfilled by all bidders, such as[29]:

[24] Cfr. Article 21, DLEG and article 13 and 14, Transmission Act.
[25] Cfr. Article 15, Transmission Act.
[26] Cfr. Article 17, Transmission Act.
[27] Cfr. Article 22, DLEG.
[28] Cfr. Article 21, Transmission Act.
[29] PROINVERSION. Terms and conditions established for the Bidding Process for SGT Transmission Line Carhuamayo-Paragsha-Conococha-Huallanca-Cajamarca-Cerro Corona-Carhuaquero. Lima. 2008. [website] http://www.proyectosapp.pe/modulos/JER/PlantillaStandard.aspx?are=0&prf=2&jer=7649&sec=22 (accessed 28 January 2016)

(i) Financial requirements: Bidders need to prove that they have a specific capital stock

(ii) Technical requirements: Bidders need to prove that they have plenty of experience in building, operating and maintaining transmission lines. In order to achieve this requirement, bidders will be required to partner with a company that will be considered the Technical Operator. The Technical Operator needs to hold a specific percentage of the Concessionaire Entity.

(iii) Legal requirements: Bidders shall prove that they do not hold any direct or indirect ownership in any other participant on the auction process. Furthermore, they will also be required not to have any legal proceedings against any governmental entity that prevents them from participating in the auction process.

Nonetheless, one of the most important requirements to be met by bidders is the economic offer that they should file within the bidding process. In such an offer, bidders will establish the price that they will charge for building, operating and maintaining the SGT Transmission Line. The offer will be composed of these items; (i) investment costs and (ii) operation and maintenance costs. OSINERGMIN will do its own calculation of the costs involved for implementing the SGT Transmission Line in order to set a price parameter. Thereto, those offers that are above this parameter will not be considered. Finally, PROINVERSION or MEM will verify who is the awardee that have met all the requirements and that have established the most competitive offer.[30]

3.2. BOOT Agreement: Concession and its Features.

After the auction process is finished and an awardee has been elected, it will be entitled to enter into a BOOT concession agreement with the Peruvian government. However, before signing the concession agreement, there are some additional requirements that the awardee should meet[31]:

- The awardee shall incorporate under Peruvian jurisdiction the company that will be the concessionaire and it shall prove that this company has been duly recorded in an Electronic Entry from the Peruvian Public Registry.

[30] *Ibid.*
[31] *Ibid.*

- The technical operator shall hold at least 25% of the concessionaire's share capital.

- The concessionaire's share capital should not be less than US$ 5,000,000.00.

- The concessionaire shall prove that it has no restrictions to enter into an agreement with the Peruvian government.

Once the concessionaire has met the listed requirements it will be entitled to enter into the BOOT concession agreement with the Peruvian government. The BOOT contract will have the following specifications[32]:

(i) Purpose: The concessionaire is obliged to design, finance, provide goods and services, obtain land ownership or easements rights, build, operate and maintain the transmission line.

(ii) Validity period: According to DLEG, article 22, the concession will have a validity period of thirty (30) years counted as from the commercial operation date. The validity period will also include the construction stage.

(iii) Concessionaire's main obligations:

- Design, finance and provide goods and service that will be required for the concession.

- Obtain land ownership and easement rights over the lands where the project will be built.

- Compensate landowners that will be impacted and prejudice for any easement right constituted over their site.

- Prepare the project schedule considering mandatory dates that have been established in the concession agreement.

[32] BOOT Concession Agreement SGT Transmission Line Carhuamayo-Paragsha-Conococha-Huallanca-Cajamarca-Cerro Corona-Carhuaquero, entered into Abengoa Transmisora Norte S.A. and the Peruvian Government, dated as of 22 May 2008. [website] http://www.proyectosapp.pe/modulos/JER/PlantillaStandard.aspx?are=1&prf=2&jer=8186&sec=30 (accessed 28 January 2016).

- Commercial operation date shall take place on the date that has been set forth by the Peruvian government.

- Acquire and maintain in full force all those liability insurances that are required by virtue of the concession agreement.

- Obtain prior approval from the Peruvian government, in case the concessionaire assigns the concession agreement to any other third party.

(iv) Technical Operator: The necessity of having a technical operator is one of the most important requirements to be covered by the concessionaire since it will back up the concessionaire's performance during the validity term of the concession. The technical operator needs to have experience related to building, operating and maintaining transmission lines. Therefore, according to the concession agreement, it should hold 25% of the concessionaire's share capital during a period of 10 years, at least.

(v) Termination:

Peruvian government will be entitled to terminate the contract in case the concessionaire commits any of the following transgressions:

- Have a delay of the commercial operation date longer than 150 days.

- Not provide services on the transmission line for a period of 180 hours within a year.

- Assign or transfer the concession agreement to a third party without the prior consent of the Peruvian government.

- Have fines for an amount equivalent to 10% of the base tariff.

- Be under a liquidation procedure or declared to be in bankruptcy.

- Enter into any finance agreement without including any of the terms and conditions set forth in current regulation.

- Transfer the technical operator's capital stock before the ten (10) year period.

The concessionaire will be entitled to terminate the concession agreement in case the Peruvian government breaches any of its obligations.

(vi) Dispute Resolution: Any dispute in between the concessionaire and the Peruvian government will be solved under direct negotiation within a period no longer than 15 days. In case, the dispute is not settled under direct negotiation; both parties are entitled to settle the dispute in international or national arbitrage.

3.3. Tariff Regime

Pursuant to the law for assuring the efficient development of Electricity Generation, Law 28832 (LDEG) it has established a specific tariff regime for SGT Transmission Lines aiming to provide stability and predictability in the revenues that a concessionaire shall receive. Accordingly, concessionaire's revenue will be paid under a base tariff determined by OSINERGMIN.[33] Furthermore, the BOOT concession agreement specifically established that tariff regime will be governed according to DLEG and Transmission Act dispositions.[34]

The base tariff is an annual amount to be paid to SGT Transmission Lines and that will be used by OSINERGMIN in order to calculate and determine payments owed to SGT's concessionaires. The base tariff is formed by the following components[35]:

(i) Investment costs which are calculated as an annual payment to cover a recovery period of 30 years. OSINERGMIN will apply an annual discount rate equivalent to 12%.

(ii) Operation and maintenance costs.

(iii) Annual net liquidation which purports to cover any differences in between the base tariff (revenues that a concessionaire should receive according to the concession agreement) and the revenues that have been actually paid to the concessionaire.

[33] SANTIVAÑEZ, Roberto and SUMAR, Paul. *op. cit.* p., 101
[34] *Ibíd.*
[35] Cfr. Article 24, LDEG.

LDEG and the Transmission Act set the terms and conditions that govern the base tariff, which provides a clear set of rules of how the base tariff is composed and how it will be calculated. Nonetheless, the amount of each component of the base tariff will be defined by the concessionaire during the bidding process, as they are required to file an offer containing the following components: (i) investment costs considering that the concession will be valid for a term of 30 years and (ii) operation and maintenance costs.[36]

Consequently, the concessionaire is entitled to establish the amount that will cover costs related to the SGT Transmission Line. Moreover, this amount will be recognised as the base tariff and it will be included in the BOOT concession agreement. Thereto, only during the auction process can bidders determine and establish the base tariff that they will ultimately receive.

After having defined how the base tariff is composed, it is important to bear in mind that base tariff will be paid by electricity final consumers under a chain payment scheme. The compensation amount will be calculated by OSINERGMIN within an annual tariff procedure, considering the base tariff included in the concession agreement. After OSINERGMIN determines the compensation amount, this will be paid and collected monthly through a transmission toll.[37] Thus, if in a specific year the compensation collected through the transmission toll does not fully cover the base tariff for that year, the concessionaire will be entitled to receive an additional payment in order to cover the amount owed. [38]

4. Mitigating Risks Related to Changes on Tariff Regulation Applicable to SGT

A SGT Transmission Line project is not only governed by the rules that have been set forth in the BOOT concession agreement but also it is governed by the regulatory framework and the interpretation that any competent public entity can execute over such rules. For instance, one of the elements that are subject to regulation is the base tariff. This a key element for any investors since any adverse change in regulations may have an impact on how the tariff is calculated or applied. Thereto, this situation represents a risk for lenders that may affect the project's bankability.

Furthermore, the company holding the BOOT concession agreement is subject to the rules that not only have been set forth in the agreement itself, but also is subject to the applicable

[36] Cfr. Article 25, DLEG.
[37] Cfr. Item 22.2, Article 22, Transmission Act.
[38] Cfr. Item 22.4, Article 22, Transmission Act.

regulatory framework for a period of thirty (30) years. Considering the length of these agreements it is very likely to face some changes in regulation that may have an impact on the agreement. Hence, an investor requires to have some certainties regarding the revenues of the project and how they will be paid.

Currently, the applicable rules to SGT Transmission Lines are very clear, and it is expected not to have major changes in the regulatory framework but for making this kind of projects bankable it required additional measures that guarantee the concessionaire will have enough protection against any violation on the contracting rules.

The abovementioned situation can be considered to be a political risk given that this risk is related to political events, discriminatory actions or inactions derived from the host government that can ultimately result in unexpected changes in the business environment or could lead to the unwanted potential effect on the expected profits of a project.[39]

In order to assess the magnitude of political risk such as a change or revocation of current policies, first, it should be considered the historical stability of the country where the project is being developed.[40] In this case, Peru holds an electricity market structure that has been defined by virtue of LCE. However, in the specific case of power transmission, there have been some changes imposed by a new set of rules underlined in the new regulation. Despite remarking the fact that transmission activity has been subject to several changes, it is important to point out that all these changes did not prejudice the market or its counterparties. When new policies were enacted, they aimed to improve transmission market in order to provide clear rules for its participants.[41]

Hence, historically, there have not been many events that can lead an investor to conclude that Peru is a country with a high rate of political risk. Notwithstanding, it is impossible to state that a change in the regulation governing SGT Transmission Lines will never occur because this situation can be considered an exogenous factor that could not be under anyone's control.

In order to mitigate any possibility of having a change on the regulation framework that governs the tariff regime that may prejudice the project's development, the Peruvian government

[39] XIAOPENG, Deng and PHENG, Low Sui. Understanding the Critical Variables Affecting the Level of Political Risks in International Construction Projects. KSCE Journal of Civil Engineering. Vol. 17, Issue Nº 5. 2013. [website] http://link.springer.com/article/10.1007%2Fs12205-013-0354-5 (accessed 28 January 2016)
[40] *Ibid.*
[41] DE LA CRUZ, Ricardo and GARCIA CARPIO, Raúl. *Op. cit.* p., 52

introduced a BOOT contract mechanism. Considering the features of this kind of agreement, it is possible to include within its content a tariff clause based upon the applicable regulatory framework.[42] Consequently, by including the tariff clause that reflects the regulatory framework, it is being created a specific rule that will be enforceable among the investors and the host government. This provides stability to the investor, given that he will be entitled to demand the Peruvian government to fully fulfil its obligations undertaken in a BOOT concession contract. Furthermore, this will also provide additional stability to the tariff regime applicable to SGT projects given that tariff will not only be established in the regulatory framework but also it will be duly developed in the concession agreement.

Consequently, any amendment on DLEG or Transmission Act that Peruvian government can enact in the future that affects the applicable rules could be considered as a direct prejudice to the tariff clause included in the BOOT concession agreement. In this case scenario, the concessionaire may apply the financial balance clause which aims *to put the concession holder back into the same financial position he would have been put for the occurrence of certain risks*.[43]

Additionally, the concessionaire may also ask for termination of the BOOT concession agreement according to what has been set forth in this contract. This clause may be applicable considering that the Peruvian government will be under a breach of the concession agreement which will enable the concessionaire to terminate the contract, in case needed. Furthermore, if termination applies, the concessionaire will be entitled to receive from the Peruvian government an indemnity payment.

5. Conclusion

Despite the fact that it is not possible to prevent that no changes in the current regulatory framework will occur while the concession agreement is in full force, it is important to bear in mind that any political risk related to any change on current regulation governing SGT Transmission Lines will be mitigated by having this same tariff regime included in the concession agreement.

[42] VINTER, Graham, PRICE, Gareth and LEE, David. Project Finance. Thomson Reuters and Sweet & Maxwell. United Kingdom. Fourth Edition. 2013. p., 101.
[43] Ibíd. p., 102

Considering that a concession agreement is binding in between its parties, the party that can be prejudiced by any breach from the other party will be entitled to apply any of the mechanism set forth in this agreement to mitigate or to reduce any prejudice that this situation may cause.

REFERENCE LIST

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