Case Study:

PERU

PROJECT:
Regulatory Frameworks and The Role Of State–Owned Oil & Gas Companies

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REGULATORY FRAMEWORKS AND THE ROLE OF STATE–OWNED OIL & GAS COMPANIES

PERU CASE STUDY

CONTENTS

INDEX OF TABLES

INDEX OF GRAPHS

ACRONYMS

CONAM: *Consejo Nacional del Ambiente* (National Environmental Council)

CONSUCODE: *Consejo Superior de Contrataciones y Adquisiciones del Estado* (Upper Council of State Contracting and Acquisitions)

DGAAE: *Dirección de Asuntos Ambientales Energéticos* (Dept. of Environmental Energy Affairs)

DGH: *Dirección General de Hidrocarburos* (General Hydrocarbons Dept.)

DIGESA: *Dirección General de Salud Ambiental* (General Health & Environment Dept.)

FONAFE: *Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado* (national fund to finance State–owned business activities)

INC: *Instituto Nacional de Cultura* (National Cultural Institute)

INRENA: *Instituto Nacional de Recursos Naturales* (National Institute of Natural Resources)

MEF: Ministry of Economy and Finance

MEM: Ministry of Energy and Mines

MINAG: Ministry of Agriculture

MINSA: Ministry of Health

OSINERGMIN: *Organismo Supervisor de la Inversión en la Energía y Minería* (Supervisory Body for Investments in Energy and Mining)

PCM: Presidency of the Council of Ministers (Presidency of the Council of Ministers)

SNIP: *Sistema Nacional de Inversión Pública* (National Public Investment System)

EXECUTIVE SUMMARY

One cannot overlook the intervention of private capital in some or all of the oil & gas activities of a country, primarily in countries whose production does not allow them to be self–sufficient or else the exportable margin is not their primary source of income. What should be kept in mind is that this participation should be through contracts that are fair and equitable for all parties and be based on clear, stable rules, as well as an inspection entity that completely fulfills its function. However, this stability is relative because an oil contract, for example, is formalized to be effective for a rather long time period of 20, 30 or 40 years, while not even its signatories believe that the assumptions on which it was negotiated will remain inalterable for that long. There are several factors that intervene and some of them are extremely volatile, as in the case of oil & gas oil & gas prices. This is due not only to market reasons, but that that market responds to political, social, religious, ethnic, environmental, and other factors.

The rational thing is to discuss with the companies regarding the need for change and the possibilities to achieve them. This does not mean that the State cannot impose its conditions, especially when changes go against the country's best interest. In the end, countries are sovereign to renew or cancel contracts, provided the causes motivating them are fair, and world history supports this position.

States and companies are aware of the need for regulatory reforms for technical, environmental, social other reasons, and also to keep a country competitive on the capital market.

In the case of Peru, although the privatization of the 90's could not be applied as conceived, its partial implementation has been positive, primarily with regard to up–stream activities, with which it was possible to increase reserves of both liquid hydrocarbons and natural gas; pipelines were built for these fuels, putting especially natural gas at the people's service; the *La Pampilla* refinery was modernized, storage or sales plants were improved, distribution networks were created to end consumers with suitable service, and safety and environmental standards and factors were enhanced and enforced. In addition, the use of natural gas made it possible to cushion the power price increase.

However, a high price was paid in the form of a truthing of fuel prices. This action was taken at the right moment and with the people's consent, due to the political circumstances of the time and the people's hope for change under the new regime (August 1990). However, as of 2004, Peru has started to subsidize hydrocarbon–derived fuels so that the population will not be fully affected, above an established band, by the price increases.

Regarding the preeminence of oil industry nationalization or privatization, one should remember that over the past 4 decades, Peru has made reforms in its oil industry that go from a situation of nationalization during the 70's in the administration of General Velasco, when the Company PETROPERU was created, to privatization of the industry during the 90's in the time of President Fujimori, whose purpose was to sell PETROPERU leaving the State with the oil contracting function, for which purpose PERUPETRO was formed.

In sum, the company PETROPERU went from its apogee in the military period when all activities were developed by this company, except for exploration and exploitation that could be done with its own resources or through contracts with third parties and commercialization to end users, for which third parties were also authorized, to its downfall that turned critical and resulted in its disappearance being planned in the 90's.

Although most of PETROPERU's assets were sold, privatization did not achieve its initial goals. The company was able to survive, and even though it sold the *La Pampilla* refinery (Repsol) and rented out the Pucallpa refinery (Maple), it was able to keep and later strengthen its ownership of the other 4 refineries, with a processing capacity of 47 % (92 MBPD) throughout the country and currently supplies 53 % of the domestic market for petroleum fuel products. This resurrection was helped by the fact that true, effective competition in fuel sales was not achieved, leaving latent the threat of a dominant private company position.

Although privatization was partial, the results obtained could be qualified as successful, especially regarding oil contracts, as both exploration and exploitation activities increased substantially, with its ups and downs following the shifts in oil & gas prices and the contractual incentives that the country has provided and will continue to provide in order to remain competitive on the capital market. One result was that by June 2007 there was a total of 64 contracts in effect, 19 for exploitation and the rest in the exploratory phase, with investments in the order of US$ 2 700 million for the 2000 – July 2007 period.

The greatest achievement of this openness policy has been the development of the Camisea project, both its First Stage – Camisea I already in operation – and Camisea II under execution, which will enable the country to recover its self–supply and go back to exporting hydrocarbons. In turn it will increase its reserves of liquid hydrocarbons by 700 MB and of natural gas by 11.2 billion ft^3, aside from having an energy matrix change in progress based on prioritizing natural gas consumption and thus decrease its current dependency on importing crude oil and oil products to completely supply the local market.

In addition to this, since the country's primary function was inspection, it had to develop an entire corpus of regulations on technical, environmental and safety matters, in order to carry out this function. These regulations are currently still under review, primarily as regards natural gas.

Since new projects are mostly implemented in the jungle region in areas qualified as poor and extremely poor, this oil bonanza in turn is making it possible to distribute major economic resources among the regions where the resource is exploited and where the pipelines pass through, in order to attend to their needs and achieve a higher standard of living. In 2006, the share of regional and local governments in oil revenues reached US$ 345.4 million nation wide, 36.7 % of the total, US$ 127.5 million of which came from development of the Camisea project.

The struggle against poverty in the regions where oil & gas activities are carried out, particularly in the Peruvian jungle areas, has 2 tools: the State with resources from oil revenues; and the oil companies, which under the social aid regime also provide resources to meet the basic needs of the surrounding populations. One of the basic services whose coverage has been notably expanded is that which supplies mostly electric energy, essential to enhancing health through water supply, medicine conservation, communications, and with it education and additional income generation by extending work hours. The progress made in this struggle would not have been possible without private investments.

In turn, these investments are making it possible to attend to the training needs of personnel related to the hydrocarbons sub–sector, including the universities and public research institutes, with the contribution that oil companies must by contract make for this purpose.

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REGULATORY FRAMEWORKS AND THE ROLE OF STATE–OWNED OIL & GAS COMPANIES:
A PERUVIAN CASE STUDY

1. SIGNIFICANT BACKGROUND

The following is a "narration" of Peruvian oil industry highlights, in very general terms over the past 55 years, which began in 1863 in the locality of Zorritos in the Northeast of the country and continued in a pendular fashion (from essentially private to State–owned). We will cite the primary laws or devices that have affected its development, emphasizing the different modalities on which this development was based. The main oil regulations that governed this industry in Peru include:

Law Nº 11780, dated 12–03–52, whose general provisions determined that reservoirs of oil and analogous hydrocarbons are imprescriptible State–owned assets; that the exploration, exploitation, manufacture, refining, transportation, and storage of oil and analogous hydrocarbons were public utilities; that the State could likewise carry out all exploration, exploitation, manufacture, refining, transportation, and storage operations and also grant concessions for these purposes to individuals or corporations, whether national or foreign. This law was fundamentally oriented towards oil industry development through private capital, although by that time there was already a State–owned company named *Empresa Petrolera Fiscal*, which was not strengthened.

Petroleum Law Nº 17440, dated 18–02–69, determined that oil reservoirs and analogous hydrocarbons were unalienable, imprescriptible State–owned assets; that the industry and trade of oil, derivatives and analogous hydrocarbons were a public service insofar as they met the needs of the people; that the industry and trade of oil, analogous hydrocarbons and their products, as well as basic petrochemicals, were of national interest, public utility and essential to the integral security of the State. This Law abolished, the oil concessions system, while respecting ongoing oil contracts, and determined that the industry and trade of oil and analogous derivative products would be exercised fundamentally by the State. Private company participation could be admitted during the prospecting, exploration, exploitation, and manufacture stages through a contracting system, in accordance with national interests, through the Ministry of Energy and Mines or the *Empresa Petrolera Fiscal*. Refining and commercialization until oil products are deposited at supply plants pertained solely to the Estado, respecting any acquired rights. In sum, this was a State–centered legal framework that further strengthened the *Empresa Petrolera Fiscal*.

Through Decree Law Nº 17753, dated June 24, 1969, the *Empresa Petrolera Fiscal* became *PETRÓLEOS DE PERU S.A.* (PETROPERU), an entity that for many hears held a hegemony[1] over the Peruvian oil industry, and in addition to the small reservoirs (Zorritos and *Los Órganos*) belonging to the *Empresa Petrolera Fiscal*, began operating the reservoirs of *La Brea* and Pariñas and all their related assets, including the Talara refinery that the Peruvian State had been able to recover from the hands of the International Petroleum Company (IPC). Subsequently, the Peruvian State was also able to recover the *Los Lobitos* reservoirs operated by the IPC, which also passed over to the PETROPERU operations. Note that all these activities were carried out and are still ongoing in the Northeast of Peru, but now with privatized reservoirs.

Decree Law Nº 22774, dated December 6, 1979, set the groundwork for oil contracts and defined PETROPERU as the entity authorized to negotiate, renegotiate and sign oil contracts whose purpose was oil & gas exploration and exploitation in a limited area of up to 500 000 hectares. Reconditioning wells and secondary and tertiary recovery was still done solely by PETROPERU. Oil contracts included 2 phases: exploration (up to 6 years) and exploitation (until completing 30 years including the exploration years), with mandatory calendars to work and release (return) the areas. By contract, contractors received payment in cash or in kind for extracted oil & gas. This form of payment meant that PETROPERU (the State) was repeatedly unable to meet the respective payments, especially in the 80's, which lead to international problems. This situation was caused by PETROPERU's inability to set fuel prices, which were set by the Ministry of Economy at levels below production costs, which of course deteriorated PETROPERU's economy.

Then came the '90s, when Peru decided to privatize its oil industry under the framework of the Organic Hydrocarbons Law, Law No. 26221, after of having had it for over 20 years under a State regime controlled by the company *Petróleos de Perú S.A.* (*PETROPERU S.A.*), with limited private sector participation, centered basically on oil & gas exploration and exploitation and on retail sale of fuels. In this regard, below is a textual quote of part of the World Bank report on Reform and Privatization in the Hydrocarbons Sector.

[1] T.N.: The original text used the term '*hegemonía*', but assumedly meant to say '*monopoly*'.

"It is based on modern free market concepts that the Government of Peru (GoP) took on the task of restructuring the hydrocarbons sector. A series of new laws were passed in 1991 and 1992 that enabled free movement of capitals, gradual price deregulation, free monetary convertibility, equal treatment for both foreign and national investors, simplified tax procedures, etc., thus forming the macroeconomic context that would enable investors to come into all sectors of the economy.

A new Hydrocarbons Law was passed in mid–1993, confirming the political bases defined and decided on for the sector. Its principles were totally opposed to the existing legal framework, established by the military regime in the late 60's. It is good to remember that reservoir nationalization in the Northeast in 1968 and discovery of new reservoirs in the Northern Jungle in subsequent years were presented, politically, as events central to exercising Peru's sovereign rights. PETROPERU was recognized as a "symbol of Peruvian nationality." The new principles given for sector reform and formulation were in complete opposition to the vision of the 70's." [2]

The concepts contained in the above paragraphs show the will of the Peruvian Government to once again place oil industry development in the hands of private capital. To this end, the primary action was to sell PETROPERU in its entirety. As is logical, this privatization excluded the petroleum contracting function by reason of this being an inherent role of the Peruvian State. For this purpose it created *PERUPETRO S.A.*, which is presently in charge for such contracting.

Over the years, this "privatization policy" did not crystallize entirely, as PETROPERU was able to survive. With the passage of time it became a body with a certain "preeminence" in the national oil industry, especially due to its refining capacity and to being the owner of the *Oleoducto Norperuano*, as well as most of the sales plants, although in the latter case almost all are under operation contracts with private companies. The reason for this resurgence was the need for a State agency that in one way or another would make it possible to regulate Peru's fuel market, especially as regards consumer prices, after not being able to achieve true, effective competition through the privatization modality, especially as regards refining and commercialization of oil fuel products. Law Nº 28244 (June 2, 2004), authorizes PETROPERU to negotiate contracts with *PERUPETRO S.A.* for the exploration and exploitation of oil operations or services. In other words, *PETROPERU S.A.* could now play the role of a contractor.

2. GENERAL SECTORAL POLICY

The Ministry of Energy and Mines, being the entity governing the sector, orients State efforts towards promoting private investment in electricity, hydrocarbons and mining activities, watches over State interests, acts directly to expand the rural electricity frontier, and prioritizes State interventions according to social criteria. It fosters and sustains the enactment of laws to regulate better producer–consumer relations, ensuring conditions of free competition for private investments, and efficient energy and mining development in harmony with social–environmental considerations and with the fight against poverty in the country.

As of 1990, Peru's development model was based on economic freedom, private investment and free competition, as well as legal stability. This implies downsizing the State administrative apparatus and transferring production activities to the private sector.

The purpose for is development model is to make Peru a country of owners, with a small, efficient State administrative apparatus concentrating its efforts on attending to social services: the country's health, education, security, and infrastructure, and also to regulating, promoting and supervising private business. Peru has made great headway in this regard, but it is still on the road toward the goals that were set, and of course is reviewing and in some cases revising the original guidelines.

As for the hydrocarbons sub–sector, through Organic Hydrocarbons Law N° 26221, enacted in August 1993, the State promotes the development of oil & gas activities with private investment participation, based on free competition. It charges the Ministry of Energy and Mines with developing, approving, proposing, and applying the sector policy, dictating the pertinent regulations, and overseeing compliance, which essentially gives it the power to regulate, promote, license, and oversee the sector.

Subsequently, Law N° 26734 created the *Agency Supervisor de la Inversión en Energía* (OSINERG, now OSINERGMIN) under the President of the Council of Ministers by Law N° 27332, which is assigned supervision duties.

[2] See E. Mayorga and P. Touzett. Peru. *Reforma y Privatización en el Sector Hidrocarburos*. ESMAP, Report 216 / 99 Sp, July 1999.

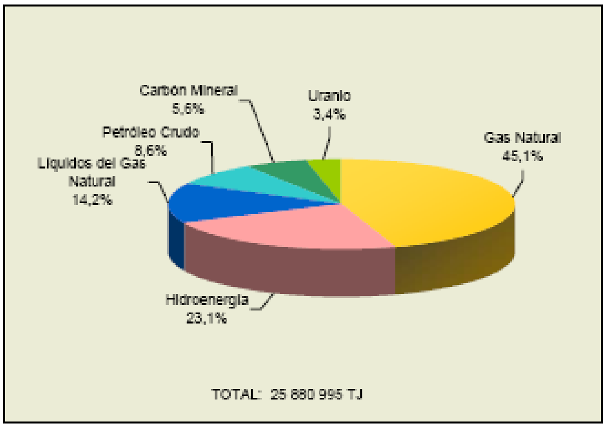
Energy Policies.– The National Energy Balance[3] is an essential energy policy–making tool. It plays an analogous role in the energy sector to that of input – product matrices in the economic sector and offers a detailed understanding of the national energy sector structure, calculates efficiency ratios, gives energy projections, short, medium and long term outlooks, and determines environmental impacts, plus the development and use of energy sources.

Energy policies in Peru[4] are centered on promoting optimal use of energy resources, especially renewable energy, in order to increase the country's competitiveness and raise the people's standard of living, planning national sustainable development. With regard to fuels, the sector policy is to promote the sustainable use of biofuels and ensure fuel supply at competitive prices within the supply and demand framework established by the Organic Hydrocarbons Law, as well as to promote industrial cogeneration through the use of natural gas and biofuels.

Energy Reserves.– (Table 1, Graph 1) The proven reserves of commercial energy at December 31, 2005, were approximately 25 880 995 TJ. The proven reserves of natural gas at the same date had the highest percentage in energy terms (45 %), reaching 337.8 x 10^9 m^3 (11.93 x 10^{12} ft^3), of which 317.15 x 10^9 m^3 (11.2 x 10^{12} ft^3) pertained to the reservoirs in the Camisea (Cusco) area. Note that for 2004, the proven reserves of natural gas grew 4 %. By the end of 2005, the proven reserves of natural gas liquids were in the order of 110.55 x 10^6 m^3 (695.392 x 10^6 barrels). In relation to 2004 there was a decrease of 3.1 %.

Graph 1

ESTRUCTURA DE LAS RESERVAS PROBADAS
DE ENERGÍA COMERCIAL: 2005



Fuente: DGH, DGM, DGE

STRUCTURE OF PROVEN RESERVES OF COMMERCIAL ENERGY: 2005
Natural gas liquids, crude oil, coal, uranium, natural gas, hydropower
Source: DGH, DGM, DGE

Table 1. Proven reserves of Commercial energy, 2005 (TJ)

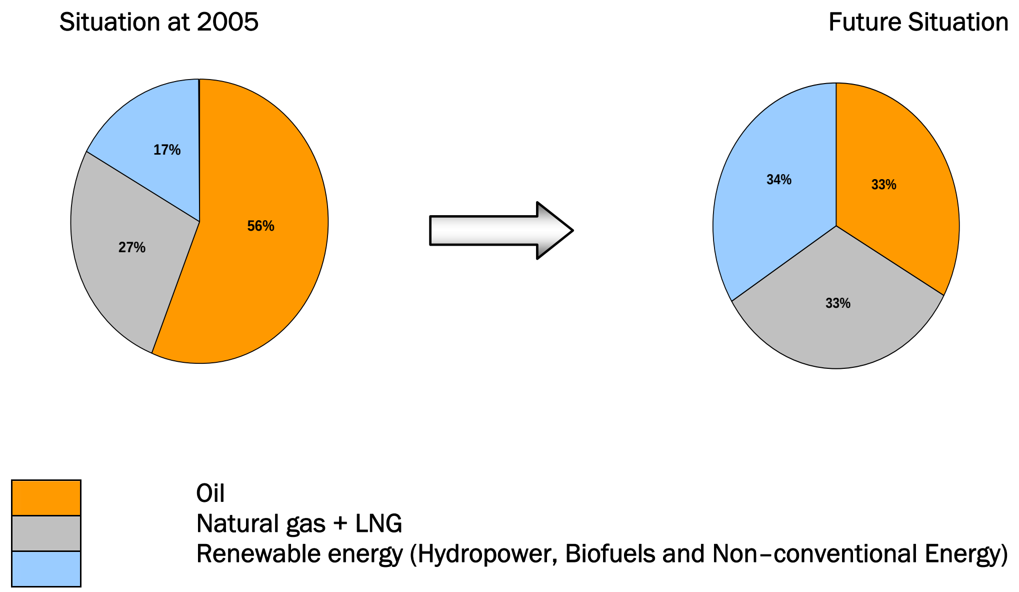
FUENTE	PROVEN RESERVES	(%)
Natural Gas	11 677 188	45,1
Hydropower	5 965 666	23,1
Natural gas liquids	3 680 539	14,2
Crude oil	2 217 043	8,6
Coal	1 461 920	5,6
Uranio	878 639	3,4
TOTAL	**25 880 995**	**100,0**

Source: MEM–DGH, DGM, DGE

Energy Change Matrix (Graph 2).– Aims to maximize the use of renewable non–conventional energy and significantly increase the use of natural gas, based on the proven reserves of energy sources as per Graph 1.

Graph 2. Energy Change Matrix

[3] National Energy Balance 2005. Ministry of Energy and Mines, *Oficina de Planeamiento y Policies Sectoriales*.
[4] Statements of the Undersecretary of Energy, Dr. Pedro Gamio Aita, "*Hacia una Nueva Matriz Energética en Perú*, *May 2007*".



Source: MEM-DGH, DGM, DGE

3. DEFINITIONS[5]

Oil & Gas Activities.- Operations relating to the exploration, exploitation, refining, processing, storage, transportation, commercialization, and distribution of hydrocarbons.

Oil Activity Authorization.- Granted by the Director General of Hydrocarbons, it enables installation and operation of refineries and processing plants, storage plants and terminals, LPG bottling plants, supply plants, importers and exporters, wholesale and retail distributors, jet and ship fuel dealers, direct consumers, oil and products transportation (automobiles, ships), service and filling stations, and LPG sales establishments.

Qualification.- Determining, upon assessment, an oil company's legal, technical, economic, and financial capacity to meet all of its contractual obligations, by virtue of the characteristics of the requested area, the foreseeable investments required and strict compliance with environmental protection standards.

Direct Consumers.- Persons who locally purchase or import liquid fuels for their own use, solely for their activities, and who have installations to receive and store fuels.

Contracting party.- *PERUPETRO S.A.*

Contractor.- As defined in article 9 of Law Nº 26221, "includes both the contractor under service contracts and the license holder under license contracts, unless otherwise stated." That is, legal persons who contract blocks in order to perform oil & gas exploration and/or exploitation activities and, where applicable, their related activities.

Contract (Oil contract).- Includes a license contract, a service contract, and other contracting modalities authorized by the Ministry of Energy and Mines, as approved through application of Law Nº 26221, Article 10, as well as in Technical Assessment Contracts.

Concession Contract.- Entered into by the *Dirección General de Hidrocarburos* with a concession holder, by which the latter obtains the authorization required to install and operate the infrastructure needed to perform hydrocarbons transportation through pipelines or piped natural gas distribution.

License Contract.- "Entered into by *PERUPETRO S.A.* with a contractor, by which the latter obtains authorization to explore and exploit or develop oil & gas in the contract area; by virtue of which *PERUPETRO S.A.* transfers property rights over extracted oil & gas to the contractor, who should pay a royalty to the State."

[5] T.N.: Terms have been kept in the same order as the Spanish original, which was in alphabetical order.

Service contract.– "Entered into by *PERUPETRO S.A.* with a contractor, for the latter to exercise the right to carry out oil & gas exploration and exploitation or development activities in the contract area, and the contractor receives a retribution by virtue of its audited production of hydrocarbons."

Technical Assessment Agreement.– Entered into by *PERUPETRO S.A.* with an oil company to perform assessment works regarding the possibility for an area to contain oil & gas in commercial volumes. It implies no more commitment for the oil company than to perform the agreed activities and deliver a report to *PERUPETRO S.A.* within a fixed term. It may contain a preference clause if the area might be contracted.

Oil Company.– A natural or legal person, whether national or foreign, which has carried out or demonstrated the capacity to carry out oil & gas exploration and exploitation or development activities, whose organization includes managerial and professional level staff accrediting specialization and experience in geology, geochemistry, geophysics, production, reservoirs, well drilling, or other disciplines pertaining to this industry, depending on the orientation of the company or the project to develop. Also includes the national or foreign individuals or corporations that, pursuant to these regulations, request qualification to enter into evaluation agreements.

Service and Filling Station. An establishment devoted to selling liquid fuels to the public.

Inspection.– An action performed by OSINERGMIN, by which it oversees compliance with all legal technical norms relating to the electricity, hydrocarbons and mining sub–sectors, plus those relating to environmental conservation and protection in the development of the activities of these sub–sectors.

Block.– An area of land, whose dimensions are determined by *PERUPETRO S.A.* or negotiated with the interested parties and on which the latter (the contractor) will carry out the oil & gas activities established in a contract.

Oil country.– A country with sufficient oil & gas reserves to meet its own demand and have an exportable margin.

Country with oil.– A country having oil & gas reserves that do not meet its domestic demand.

Audited production.– Oil & gas produced at an inspection point in a given contract area, which is measured under the terms and conditions agreed in each contract.

Inspection point.– One or more places located by the contractor within the contract area, or located by agreement among the parties outside of it, where volumetric measurements and determinations are made, and where water and sediment contents and other measurements are made, in order to establish the oil & gas volume and quality.

Regulation.– A function that enables OSINERGMIN to approve tariffs submitted by concession holders for the hydrocarbons transportation services through pipelines and piped natural gas distribution, as these activities have characteristics that can be derived in a monopoly situation.

Supervision.– An action carried out by OSINERGMIN to oversee fulfillment of concession contracts.

Terminals.– Installations for carrying out the operations of receiving, storing and dispatching liquid fuels and other products derived from hydrocarbons. They are also called sales plants or supply plants.

4. LEGAL FRAMEWORK OF THE HYDROCARBONS SUB–SECTOR

The hydrocarbons legal framework presently consists, in the first place, of Peru's Constitution (December 1993), which is the fundamental law of the country and defines the general principles for the economic, environmental and natural resources regimes. Then there is the Organic Hydrocarbons Law No. 26221 (August 1993), a basic instrument that regulates oil & gas activities within the national borders and places emphasis on an environmentalist vocation. This law in turn is supplemented with specific regulations, mostly technical and safety–related, for each of the activities. Something that should be mentioned is that this legal framework is to a certain point "dynamic", if it may be classified as such, as a consequence of the fact that to a great extent until the end of the last century Peru was a country with oil, but as of August 2004 the situation changed through the exploitation of the Camisea natural gas reservoirs, making it a country with natural gas and oil. This has required and continues requiring the development of new regulations that are suited to the current situation, which is even requiring a change in the energy matrix.

4.1 Constitution of Peru

The Peruvian Constitution determines the basic principles under which to develop, among others, the hydrocarbons industry, under an economic regime of free competition and an environmental policy that promotes the sustainable use of its natural resources (Table 2).

Table 2. General principles in the Peruvian Constitution relating to oil & gas activities

Article	Topic
	ECONOMIC REGIME
58	"Private initiative is free, and is exercised in a social market economy. Under this regime, the State steers the country's development, and acts primarily in the areas of promoting employment, health, education, security, public services, and infrastructure."
	STATE PROMOTES COMPANY FREEDOM
59	"The State encourages the creation of wealth and ensures freedom of labor and freedom of enterprise, trade and industry. Exercising these freedoms should not be damaging to the morals, health, or public security. The State provides sectors suffering from any inequality opportunities to get ahead and, in this sense, promotes small companies in all their modalities."
	ECONOMIC PLURALITY
60	"The State recognizes economic pluralism, and the national economy is based on the coexistence of diverse forms of property and of enterprise. Only when authorized by express law may the State carry out a supplementary business activity, directly or indirectly, by reason of a high public interest or manifest national interest. Business activities, whether public or not, receive the same legal treatment."
	FREE COMPETITION
61	"The State facilitates and oversees free competition. It fights all restricting practices and the abuse of dominant or monopoly positions. No law or agreement may authorize or establish monopolies. . "
	FREE CONTRACTING PRINCIPLE
62	"The freedom to contract ensures that all parties may validly pact in accordance with the laws in effect at the time of the contract. Contractual terms may not be modified by laws or other provisions of any type. Any conflicts deriving from the contractual relation may only be solved by arbitration or judicial means, as per the protection mechanisms provided in the contract or contemplated by law. Through the contracts law, the State may establish guarantees and grant securities. They may not be modified through legislation, without prejudice to the protection referred to in the above paragraph."
	HOMOGENEITY OF ECONOMIC CONDITIONS
63	"National and foreign investments are subject to the same conditions. The production of goods and services and foreign trade are free. If another country or countries adopts protectionist or discriminatory measures that harm national interests, the State may, in self defense, adopt analogous measures. All contracts with states and public law persons with foreign domiciles include their submission to the laws and legal entities of the Republic and their waiver of all diplomatic claims. Financial contracts may be exempted from national jurisdiction. The State and all other public law persons may submit any disputes deriving from contractual relations to courts set up by virtue of treaties in effect. They may also submit them to national or international arbitration, in any form provided by law."
	FOREIGN CURRENCY
64	"The State guarantees free holding and provision of foreign currency."
	NATURAL RESOURCES
66	"All natural resources, whether renewable or non renewable, are a national heritage. The State is sovereign in their utilization. The organic law sets the conditions for their use and for granting them to private parties. Concessions grant their holders with real rights, subject to said law."
	ENVIRONMENTAL POLICIES
67	"The State makes national environmental polities, and promotes the sustainable use of its natural resources."
	PROMOTION AND CONSERVATION OF BIODIVERSITY
68	"The State is obliged to promote the conservation of biological diversity and of natural protected areas."

4.2 Organic Hydrocarbons Law, Law N° 26221

The first 9 articles of this law (Table 3) establish the general principles that govern the development of the entire "oil industry". It sets the bases for oil contracting, among which it defines the ownership and availability of extracted oil & gas, which may be to the company extracting them and to its free access, thus ensuring its revenue. Throughout this report mention is made of the other articles of this law, depending on the hydrocarbons activity being referred to.

Table 3. General principles of Law Nº 26221

Article	Topic
	GENERAL PRINCIPLES
1°	"This organic law regulates all oil & gas activities within national borders."
2°	"The State promotes the development of oil & gas activities on the basis of free competition and free access to economic activities for the purpose of achieving the human wellbeing and national development."
3°	"The Ministry of Energy and Mines is responsible for developing, approving, proposing, and applying the sector policy, as well as dictating all other pertinent norms. The Ministry of Energy and Mines and the OSINERG are in charge of overseeing fulfillment of this law."
4°	"Any regulatory norms or devices dictated by other sectors that relate to oil & gas activities should have the favorable opinion of the Ministry of Energy and Mines, except as set forth in Rule XIV of the Preliminary Chapter of the Tax Code."
5°	"The OSINERGMIN is the agency in charge of inspecting all legal and technical aspects of oil & gas activities within national borders."
6°	"Creates a State–owned private law company in the energy and mines sector, under the corporate name of *PERUPETRO S.A.*, organized as a stock company in accordance with the General Law of Companies, whose organization and functions will be approved by law. . . . . . . Its corporate purpose is described under Point 5.2.3 – *PERUPETRO S.A.*
	EXPLORATION AND EXPLOITATION
	Principles
7°	"The term "hydrocarbons" includes all organic compounds, whether gaseous, liquid or solid, which consist primarily of carbon and hydrogen."
8°	"In situ hydrocarbons are owned by the State. The State grants *PERUPETRO S.A.* ownership rights over extracted oil & gas so that it may enter into contracts for their exploration and exploitation or development, under the terms established in this Law. The property right of *PERUPETRO S.A.* over extracted oil & gas, as stated in the above paragraph, will be transferred to license holders upon formalizing license contracts."
9°	The term "contract" includes license contracts, service contracts and other contracting modalities approved in application of Article 10. The term "contractor" includes both contractors under service contracts and license holders under license contracts, unless stated otherwise. The term "contracting party" refers to *PERUPETRO S.A.*

Norms establishing the collection and the distribution of oil revenues: Tax Act, Law Nº 27506. The object of Law N° 27506 has been modified by article 1º of Law N° 28077 (Table 4), published on 26.09.03 (and subsequently by article 1º of Law N° 28322, published on 10.08.04), and stands as follows:

> "Article 2.– Object of the Law. This Law determines natural resources whose exploitation generates taxes and regulates their distribution to favor the regional and local governments of the areas where the natural resources are exploited, in conformity with what is established in article 77° of the Peruvian Constitution."

As can be seen, the Law specifies the collection and distribution of taxes and in general of oil revenues.

Table 4

Marco Legal para la distribución de los Canon(*)

Ley Nº 27506 (Jun 2002 - May 2004)

%	Beneficiarios	Criterios
20%	Municipalidades de la Provincia donde se hallan los recursos naturales	Según población rural y población urbana
60%	Municipalidades del Departamento donde se hallan los recursos naturales	Según densidad poblacional (Hab.Km²)
20%	Gobierno Regional	

Ley Nº 28077 (Jun 2004 - Dic 2004)

%	Beneficiarios		Criterios
10%	Municipalidades distritales donde se hallan los recursos		Si existe más de una municipalidad en partes iguales
25%	Municipalidades de la provincia donde se hallan los recursos, excluyendo al distrito productor		Según población y pobreza vinculados a las Necesidades Básicas y Déficit de Infraestructura
40%	Municipalidades del Departamento donde se hallan los recursos, excluyendo a la provincia productora.		Según población y pobreza vinculados a las Necesidades Básicas y Déficit de Infraestructura
25%	Gobierno Regional	80 % Gobierno Regional	
		20 % Universidad	

Fuente: MEF
Elaboración: CBC

(*) Todos los canon excepto el petrolero

<table>
<tr><th colspan="7">Legal Framework for Tax Distribution (*)</th></tr>
<tr><th colspan="3">Law No. 27506
(June 2002 – May 2004</th><th colspan="4">Law No. 28077
(June 2004 – Dec. 2004</th></tr>
<tr><th>%</th><th>Beneficiaries</th><th>Criteria</th><th>%</th><th colspan="2">Beneficiaries</th><th>Criteria</th></tr>
<tr><td rowspan="2">20 %</td><td rowspan="2">Municipalities of provinces where natural resources are found</td><td rowspan="2">By rural population and urban population</td><td>10 %</td><td colspan="2">District municipalities where resources are found</td><td>Equal parts where there is more than one municipality</td></tr>
<tr><td>25 %</td><td colspan="2">Municipalities of the province where the resources are found, except for producing district</td><td>According to the population and poverty relating to basic needs and deficient infrastructure</td></tr>
<tr><td>60 %</td><td>Municipalities of departments where natural resources are found</td><td>According to the population census (inhabitants / km^2)</td><td>40 %</td><td colspan="2">Municipalities of the department where the resources are found, except for producing province</td><td>According to the population and poverty relating to basic needs and deficient infrastructure</td></tr>
<tr><td rowspan="2">20 %</td><td rowspan="2">Regional Government</td><td rowspan="2"></td><td rowspan="2">25 %</td><td rowspan="2">Regional Government</td><td>80 %
Regional Government</td><td></td></tr>
<tr><td>20 %
University</td><td></td></tr>
<tr><td colspan="3">Source: Ministry of Economy and Finance
Developed by: CBC</td><td colspan="4">(*) All taxes except for the oil tax</td></tr>
</table>

Although these actions are carried out in accordance with what is provided by law, they have not been able to benefit indigenous communities directly as distribution is limited to the level of local governments, which distribute them according to their priorities. A proposal is under study to legislate the percentages that these communities should receive.

Law Nº 28451 creating the *Fondo de Desarrollo Socioeconómico de Camisea* (FOCAM) and its amendment, Law Nº 28622.– Creates the FOCAM as an intangible fund devoted a contributing to the sustainable development of the departments through which the primary pipes pass containing hydrocarbons from Blocks 88 and 56 (Camisea natural gas), enhancing the wellbeing of involved communities and supporting environmental preservation and the ecology. FOCAM's resources are 25 % of all royalties belonging to the national Government from Blocks 88 and 56, after deducting the Gas Tax and other deductions pertaining to *PERUPETRO S.A.*, OSINERG and the Ministry of Energy and Mines, in accordance with what is set forth in article 6º of Law Nº 26221. In addition, Law N° 28622 establishes 2.5 % of all royalties received by the Peruvian State from exploiting the Camisea reservoirs for the Department of Ucayali.

According to article 4º of Law N° 28451, specified by article 4º of Supreme Decree Nº 042–2005–EF, the resources of FOCAM are distributed to the departments (regions) of Ayacucho, Huancavelica, Ica, and Lima, except for Metropolitan Lima, in accordance with the following percentages and with certain distribution criteria: 30 % for the regional governments, 30 % for the provincial municipalities, 15 % for the district municipalities that the pipelines pass through, 15 % for the other district municipalities, and 10 %, in equal parts, for the public universities.

4.3 Technical and safety standards

Law Nº 26221 (reformed by Laws Nº 26734, 27377 and 27391) is supplemented by regulations given by Supreme Decrees that began to be approved in 1993 and continue to be supplemented and modified by virtue of policies changing the energy matrix, primarily by reason of introducing natural gas on the market, especially from Camisea. The complete texts of these Regulations are found at: www.minem.gob.pe/hydrocarbons/normas_regulation.asp.

4.4 Regulated Activities

With the understanding that regulated oil & gas activities (Graph 3) are those requiring some type of express authorization to be developed and that their design, construction or installation, operation and maintenance are regulated, one must point out that in Peru practically all require some type of authorization on behalf of the State, whether it is an oil contract (oil & gas exploration and/or exploitation), concession contract (hydrocarbons transportation through pipelines and piped natural gas distribution) or registration in the hydrocarbons registry of the General of Hydrocarbons Department (all other activities), and as mentioned above, each of the different oil & gas activities are regulated by specific regulations.

<u>*Return of facilities.*</u> Only contracts and concessions estipulate that upon termination, the assets revert to State hands, free of all charges and encumbrance of any kink, in good working conditions, except for normal wear and

tear as a consequence of time and diligent use of same. Should any other type of activity such as hydrocarbons refining or processing be included in an oil contract, those facilities should be considered among the assets to be delivered to the State upon termination of same, if not stipulated otherwise in the contract itself.

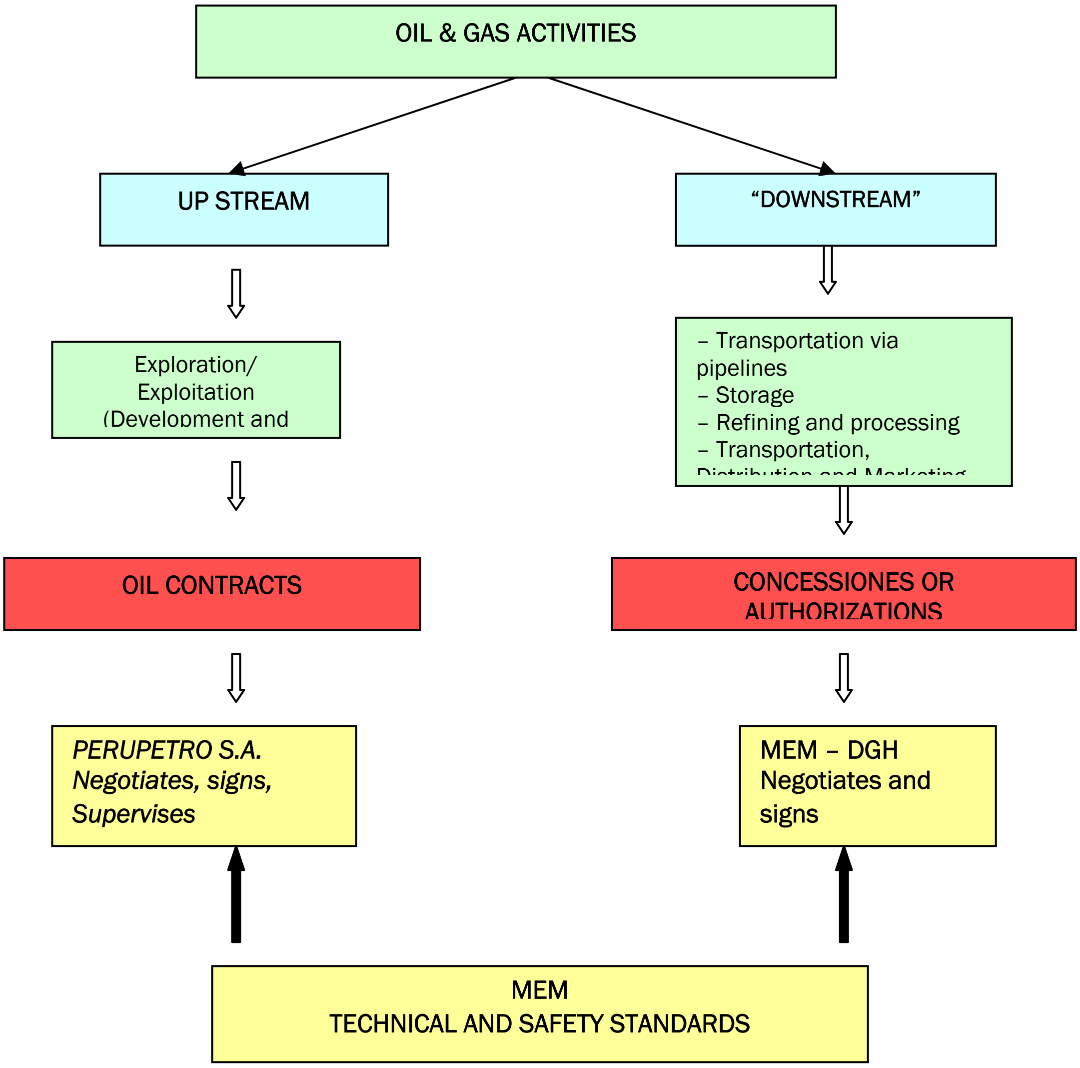
Delivery of assets to the State is because these activities have definite contractual terms or causes for termination and once the respective contracts have concluded, they need to be continued, either because there are oil & gas reserves to be extracted (oil contracts), or a service public to continue providing (concession contracts).

4.5 Legal framework for activities, operating approvals, return of facilities

The legal framework has been described under parts 4.1, 4.2, 4.3, and 4.4, and the legal instruments to operate depend on the type of activity to be carried out, whether up stream oil & gas activities that require oil contracts (license, services or others), to be formalized with *PERUPETRO S.A.* or down stream activities such as hydrocarbons transportation through pipelines and piped natural gas distribution, which require a concession contract to be signed with the *Dirección General de Hidrocarburos* (DGH), and all other activities that need to be authorized by the DGH in the form of “*Constancia de Registro en Hidrocarburos*.” However, the design, construction and operation of each every one of the above activities require technical and inspection reports from OSINERGMIN. In addition to the above, they should have authorizations from local governments (municipalities) defined in the “licenses” (for construction and operation).

We must note that the infrastructure for oil & gas activities in order to be designed and built should have an approved environmental study after informing (through public hearings) the surrounding population that is directly and indirectly involved. These environmental studies go from the categories of Environmental Impact Assessments Environmental Impact Assessments (EIA), Semi–Detailed Environmental Impact Assessments (sdEIA) and Environmental Management Plans (EMP), to die Environmental Impact Statements (EIS). The ones having the greatest scope and development are the EIAs.

Graph 3. Oil & Gas Activities



Source: Self developed

4.6 Non-regulated Activities

As mentioned under point 4.4 Peru has no hydrocarbons activities that are not regulated by a legal device of the State.

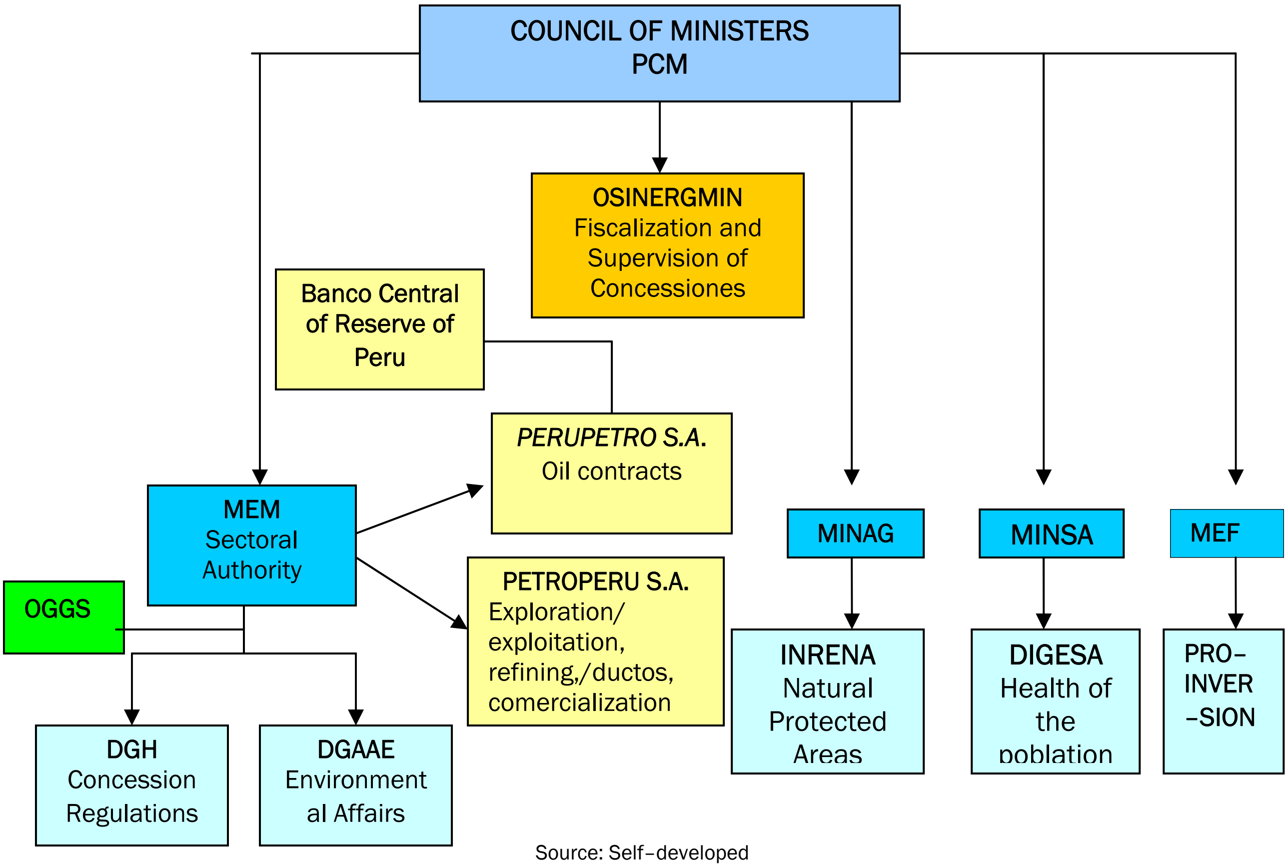
5. INSTITUTIONS AND AGENCIES – ORGANIZATION, FUNCTIONS AND INTERRELATIONS

Although the Ministry of Energy and Mines is the governing body for oil & gas activities, there are other agencies above the Ministry of Energy and Mines and at the same level, and even at lower levels, which have a say in the development of the oil industry, its regulations, its inspection and over all the social-environmental issues that should be respected. Graph 4 shows in summary form the primary State agencies that in one way or another intervene in the development of the Peruvian oil industry.

5.1 *Presidencia del Consejo de Ministros* (PCM)

This is the agency to which the Ministers report functionally, including of course that of Energy and Mines. Regulatory and inspection agencies also report to it, including OSINERGMIN. This direct report from OSINERGMIN to the PCM makes it possible to revert or annul a situation, action or proposal generated by the Ministry of Energy and Mines.

Graph 4. Primary State Agencies Intervening in Peruvian Oil Industry Development



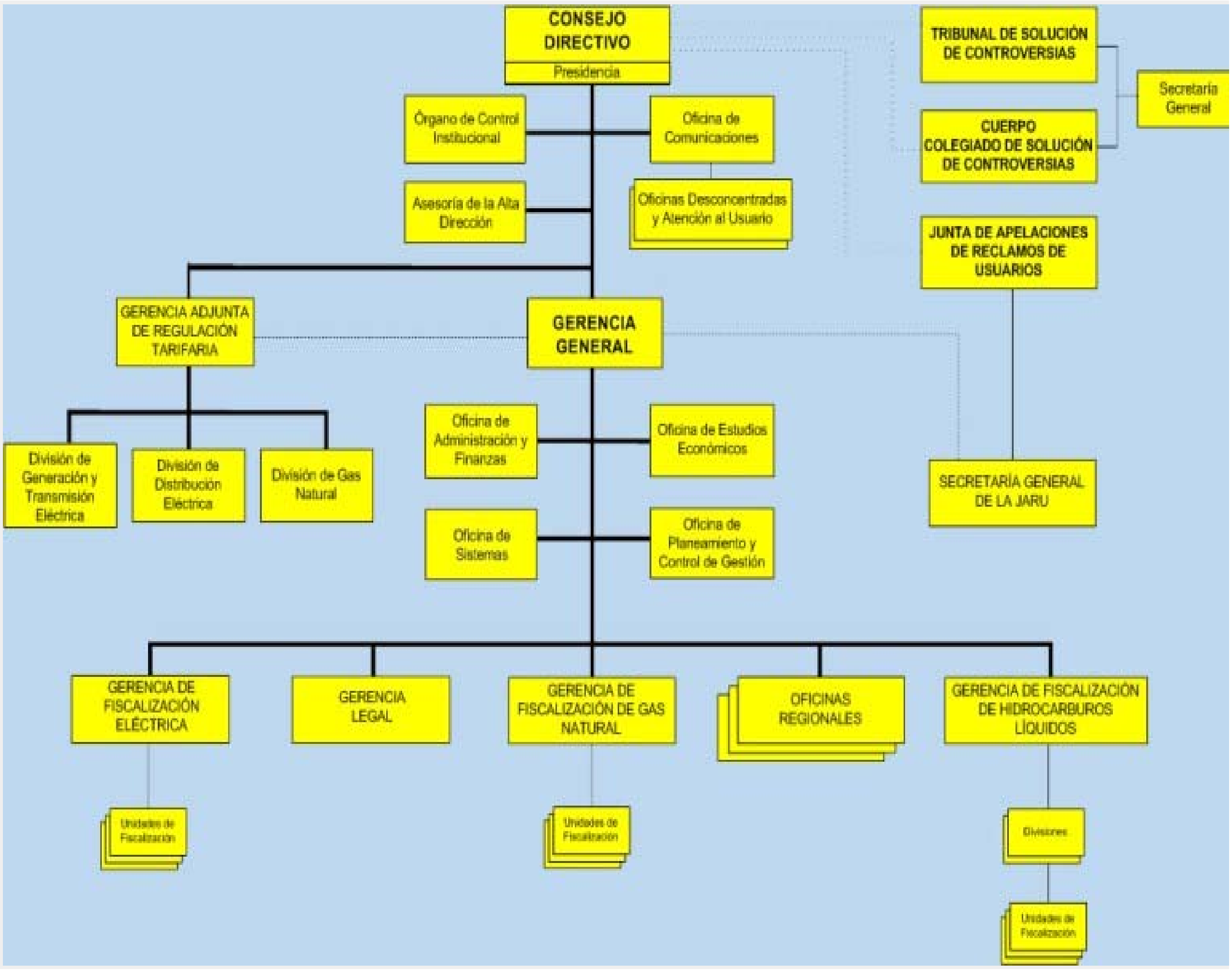
Source: Self-developed

5.1.1 *Organismo Supervisor de la Inversión en la Energía y Minería* (OSINERGMIN)

OSINERG is an agency created by Law N° 26734, in charge of supervising and inspecting the fulfillment of legal and technical functions relating to the electricity and hydrocarbons sub-sectors, as well as fulfillment of the legal and technical norms referring to environmental conservation and protection during the development of such activities. Law No. 28964 of January 24, 2007, transferred the competency to supervise and inspect mining activities to OSINERG, turning it into OSINERGMIN (Graph 5).

It is also the agency in charge of reviewing tariffs submitted by concession holders transporting hydrocarbons through pipelines and natural gas through networks of pipelines and approving them or not, as the case may be, being monopoly activities by nature. See greater details under point 6.3 – Concession Contracts.

Graph 5. Organizational Chart of OSINERGMIN



Source: OSINERGMIN

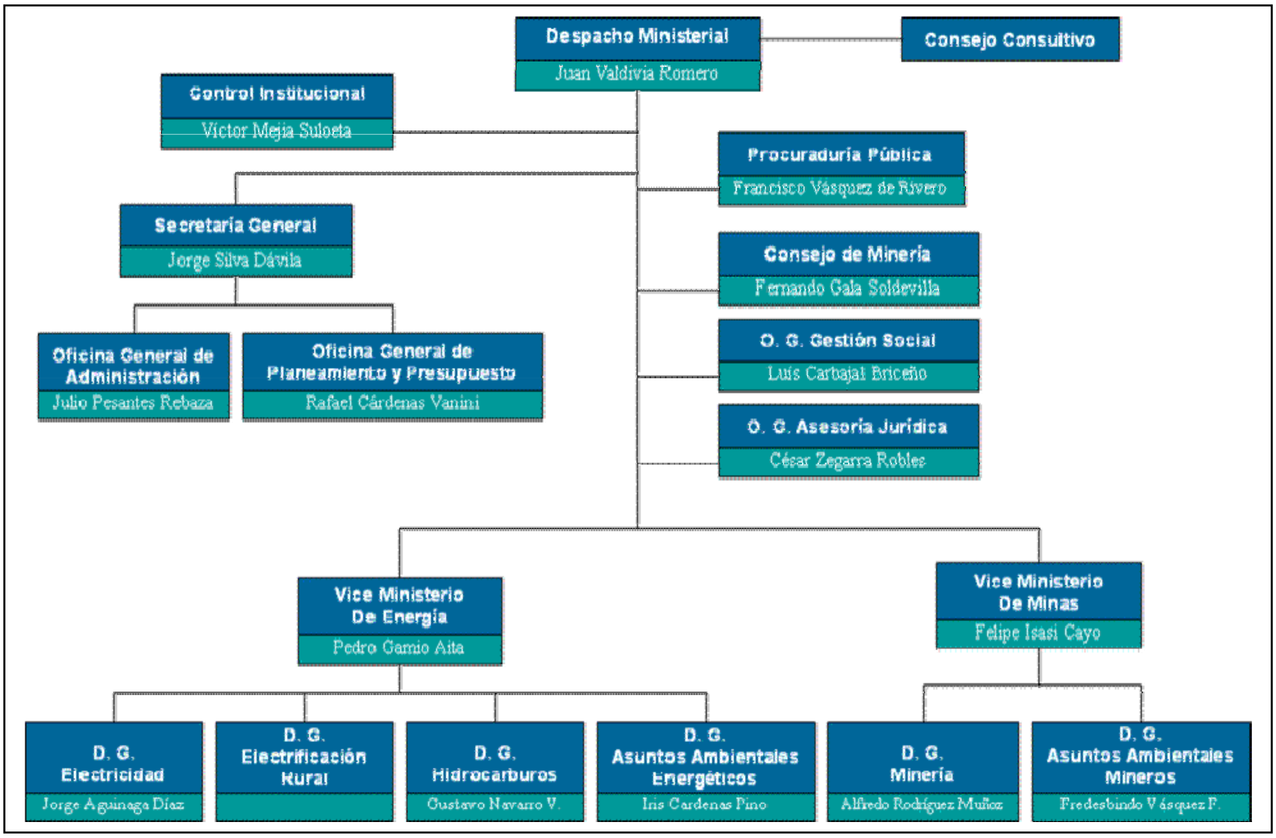
5.2 Ministry of Energy and Mines (MEM)

This is a public agency belonging to the Executive Branch, with legal status under public law, and is the governing body of the energy and mines sector. It is functionally and administratively under the *Presidencia del Consejo de Ministros*. Its purpose is to promote the integral, sustainable development of all mining and energy activities, regulating and/or supervising, as the case may be, fulfillment of nation–wide policies.

Developing activities in the energy and mines sector are decentralized and private public agencies, public and private companies, and natural persons devoted to the exploration, exploitation, refining, processing, transportation, distribution, and commercialization of energy (electricity and hydrocarbons) and mining resources. Article 3 of Law N° 26221 determines that the Ministry of Energy and Mines is in charge of preparing, approving, proposing, and applying the policies of the sector, as well as dictating all other pertinent norms. Jointly with OSINERGMIN, it is in charge of overseeing compliance with said Law.

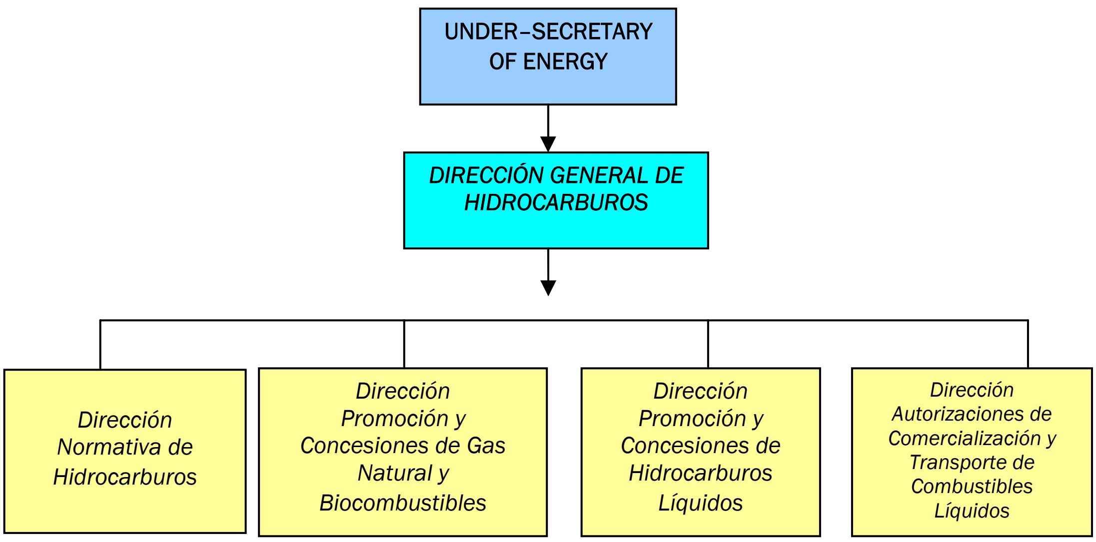
Graph 6 shows the organizational and functional structure of the MEM in effect, which was approved through Supreme Decree N° 031–07–EM published in the Peruvian Official Gazette, on June 26, 2007.

Graph 6. Organizational Chart of the Ministry of Energy and Mines



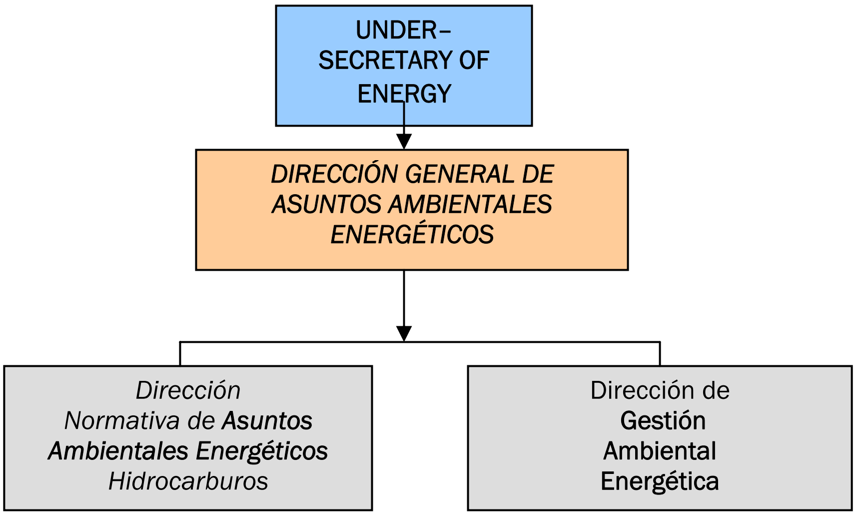
5.2.1 *Dirección General de Hidrocarburos* (DGH).- This is the technical and regulatory agency in charge of proposing and assessing the policy and legal framework for the hydrocarbons sub-sector in concordance with the sectorial and national development policies. It promotes investments and oil & gas exploration, exploitation, transportation, storage, refining, processing, distribution, and commercialization activities, and has the role of grantor, on behalf of the State, for all oil & gas activities, as applicable. It is also the one in charge of developing and evaluating the Referential Hydrocarbons Plan and the Hydrocarbons Development Plan, and of participating in the preparation of the Energy Development Plan, in coordination with the other General Departments of the energy sector. It participates in the formulation of the National Energy Balance. The functions and powers of the General of Hydrocarbons Department are detailed at: www.minem.gob.pe/ministry/dgh.asp .

Graph 7. Organizational Chart of the MEM's *Dirección General de Hidrocarburos*



5.2.2 *Dirección General de Asuntos Ambientales Energéticos* (DGAAE).– The *Dirección General de Asuntos Ambientales Energéticos* is the technical and regulatory agency in charge of proposing the environmental conservation and protection policy for the sustainable development of energy activities, in concordance with sectorial and national sustainable development policies. Its functions include formulating, proposing and approving, where applicable, the related technical and legal standards, regulating the assessment of environmental studies for energy sector activities; analyzing and issuing an opinion on reports of infringement of environmental standards, and establishing preventative and corrective measures needed to control those impacts. It qualifies and authorizes public and private institutions to develop environmental studies on the impact of energy activities; evaluates and approves environmental and social studies submitted to the Ministry of Energy and Mines as relate to the energy sector, among others. The duties and powers of the DGAAE are detailed at: www.minem.gob.pe/ministry/dgae.asp.

Graph 8. Organizational Chart of the DGAAE



5.2.3 *PERUPETRO S.A.*

This is a State–owned private law company in the energy and mines sector, organized as a stock company in accordance with the General Law of Companies, in charge of promoting investments in oil & gas exploration and exploitation activities. In representation of the State, it negotiates, formalizes and supervises oil contracts and Technical Assessment Contracts. It also commercializes hydrocarbons from areas under service contracts through third parties under free market principles.

It acts with full economic, financial and administrative autonomy, in accordance with the goals, policies and strategies approved by the Ministry of Energy and Mines. It was created by Law Nº 26221, and began its activities on November 18, 1993. It is subject to subsequent performance inspection by the Comptroller General of the Republic, and operates under the common tax regime for private companies. By Law Nº 27170 of 09.09.99, *PERUPETRO S.A.* passed under FONAFE, a company linked to the economy and finance sector, in charge of regulating and directing State business activities.

5.2.4 *PETROPERU S.A.*

Petróleos de Perú S.A. was created by Decree Law N° 17753 on July 24, 1969, and is governed by the organic law approved on March 4, 1981, through Legislative Decree Nº 43, reformed by Law N° 26224 on August 23, 1993, Law N° 24948 (State Business Activity Law of December 2, 1988), reformed by Law N° 27170 (Law of the *Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado* of September 8, 1999). The norms that govern the company's economic, financial and labor activities, as well as its relations with the different levels of government and administrative regimes are several, notable among which are:

The current Corporate Bylaws of PETROPERU approved by Supreme Decree 024–2002–EM on August 21, 2002, sets as its purpose to carry out oil & gas activities in pursuant to what is set forth in the Organic Hydrocarbons Law. In doing its job, *PETROPERU S.A.* acts with full economic, financial and administrative autonomy in accordance with the goals, policies and strategies approved by the Ministry of Energy and Mines. Furthermore, it can develop and enter into all types of acts and contracts and in its foreign trade operations follow the uses and customs of the foreign trade and by generally–accepted rules of international law and the hydrocarbons industry.

Law Nº 28244 (02.06.04) authorized PETROPERU to negotiate contracts with *PERUPETRO S.A.* in oil exploration and exploitation operations or services, with which PETROPERU may play the contractor role that had been forbidden to it by Law Nº 26221, the Organic Hydrocarbons Law. It is currently out from under the FONAFE.

5.3 *Banco Central de Reserva de Peru*

Conducts the Monetary Policy whose primary mission is to preserve monetary stability. This includes price stability, inflation control, regulating money amounts, and others. It is an autonomous, legal public law entity, and its purpose is to preserve monetary stability. Its functions are to regulate the currency and credit of the financial system, managing the international reserves entrusted to it and all others stated in its organic law.

It intervenes in oil contracts in representation of the State, guaranteeing that contractors enjoy the exchange regime in effect on the signing date of the Contract and, in consequence, have a fight to the availability, free holding, use, and domestic and foreign provision of foreign currency, as well as free convertibility of domestic currency to foreign currency on the exchange supply and demand market.

5.4 Ministry of Health: *Dirección General de Salud Ambiental* (DIGESA)

5.4.1 DIGESA

This is the technical and regulatory agency for all matters relating to basic sanitation, nutritional health, zoonosis and environmental protection. It regulates and evaluates health processes in the sector, and seeks support and coordination to comply with its regulations among the agencies that support or have responsibilities for environmental control. Likewise, it coordinates the technical and regulatory framework with specialized institutes, public health agencies, and with the national and international scientific community.

Being the technical and regulatory agency for all matters relating to basic sanitation, nutritional health, zoonosis, and environmental protection, it intervenes in coordination with the DGAAE in developing guidelines or regulations to protect the health of populations around oil & gas projects, such as the maximum allowable limits of certain elements in the water supply, soil, air, etc.

5.5 Ministry of Agriculture, *Instituto Nacional de Recursos Naturales* (INRENA)

5.5.1 INRENA

This is a Decentralized Public Agency under the Ministry of Agriculture, created by Decree Law Nº 25902 on November 27, 1992, to perform actions needed to make sustainable use of renewable resources, ensure the conservation and sustainable management of the rural environment and wildlife diversity. As a national authority, it works closely with regional and local governments, the organized society civil, and public and private institutions.

This agency is the first one to determine and/or approve that an area can be contracted out to an oil & gas business, by defining natural protected areas and their category. It should coordinate closely with *PERUPETRO S.A.*, especially for contracting out blocks.

5.6 Ministry of Economy and Finance, FONAFE and PROINVERSION

5.6.1 The *Fondo Nacional de Financiamiento de la Actividad Empresarial del Estado* (FONAFE) is a public law enterprise in the economy and finance sector, created by Law No. 27170, in charge of regulating and directing State business activities. When it was created, FONAFE took on the functions of the former *Oficina de Instituciones y Organismos Estatales* (OIOE).

In accordance with what is set forth in article 9º of the regulations to Law No. 27170, enacted by Supreme Decree No. 072–2000–EF and reformed by Supreme Decree No. 115–2004–EF, FONAFE has a Board of Directors consisting of members, all Ministers of State from the following sectors: economy and finance; transportation and communications; housing, construction and sanitation; energy and mines; the Minister whose sector PROINVERSION is a member of; and the *Presidencia del Consejo de Ministros*. However, since PROINVERSION is under the Ministry of Economy and Finance, in practice FONAFE's Board of Directors is made up of five Ministers of State, whose main powers include the following:

a) Hold the title to the shares representing the capital stock of all companies (whether already created or to be created), in which the state participates and manage all resources arising from that title.
b) Approve the consolidated budget of all companies in which FONAFE has a majority share, within the framework of the respective budgetary regulations.
c) Approve the operational regulations for those companies.
d) Designate the representatives to the General Shareholders Assembly of the companies in which it has a majority share.

FONAFE encompasses only those companies in which the State has a majority share, regardless of whether they are active or in process of liquidation. Within its sphere are also companies that it has been entrusted with. This includes *PERUPETRO S.A.*, while PETROPERU was excluded.

5.6.2 PROINVERSION

PROINVERSION is Government agency under the Ministry of Economy and Finance that is in charge of promoting investment and privatization. Its mission is to "Promote investments that do not depend on the Peruvian State, under private law agents, in order to further Peru's competitiveness and sustainable development to enhance the wellbeing of the population. Its Directive Council is set up as follows:

- The President of the Council of Ministers, who presides;
- The Minister of Economy and Finance;
- The Minister of Transportation and Communications;
- The Minister of Energy and Mines;
- The Minister of Housing, Construction and Sanitation;
- The Minister of Production;
- The Minister of Foreign Trade and Tourism;
- The Minister of Agriculture.

Being made up of Ministers, this council makes it possible to attach priorities to projects, usually of nation–wide scope, which are of importance to the country due to their significant impact on the economy and, therefore, on social aspects. This was the case of the contests carried out to award the contract to exploit Block 88 and the concession for liquids and natural gas pipelines of the Camisea project. Public bidding contests are currently being held to award the regional gas pipelines of the Central Zone, the concession for the *Pisco Lurín* products pipeline, and the regional gas pipelines of the Northern Zone.

5.7 Interrelations

The Ministry of Energy and Mines (energy and mines sector), is the governing body for oil & gas activities. Its *Dirección General de Hidrocarburos* and *Dirección General de Asuntos Ambientales Energéticos* are the agencies in charge of developing, approving, proposing, and applying sector policies, as well as dictating the relevant regulations, at the different levels.

The State–owned companies *PERUPETRO S.A.* (oil contracting) and *PETROPERU S.A.* (oil company), belong to the energy and mines sector and so act in accordance with the policies issued by it.

Although OSINERGMIN is an agency that reports to the *Presidencia del Consejo de Ministros* (PCM), its function is inspection of all activities relating to the energy and mines sector (energy, hydrocarbons and electricity), and supervision of concession contracts entered into by the *Dirección General de Hidrocarburos*. It intervenes in approving the design, construction and operation of needed infrastructure for oil & gas activities, through its Favorable Technical Reports (ITF from the Spanish).

The MEM should coordinate its actions with other agencies such as BCR, INRENA, DIGESA, and PROINVERSION, which while belonging to other sectors, are empowered by law to grant authorizations within their scope of action relating to the oil contracting. For example, with the BCR it coordinates the State guarantee of the exchange regime and the availability of foreign currency for contractors; with INRENA it coordinates authorizations to carry out oil & gas activities in natural protected areas such as Indigenous Reserves, National Parks, Sanctuaries, etc.; with DIGESA it coordinates environmental of health issues of populations suffering direct or indirect impacts of the oil industry; and with PROINVERSION it coordinates matters relating to the promotion and bidding processes for oil contracts.

The *Consejo Nacional del Ambiente* (CONAM) is the governing body for national environmental policymaking. Its purpose is to plan, promote, coordinate, control, and oversee the environment and the natural heritage of the nation. It is a decentralized public agency under the aegis of the Presidency of the Council of Ministers, and therefore directly relates and coordinates with all sectors.

The *Dirección de Arqueología*, an agency that reports to the *Dirección de Patrimonio Histórico Colonial y Republicano* of the *Instituto Nacional de Cultura* (INC), is in charge of identifying, recording and studying immoveable archeological heritage as part of the national cultural heritage, and preserving, conserving and enhancing its value and social use. Its duties include issuing the *Certificado de Inexistencia de Restos Arqueológicos* (CIRA), which is demanded by the INC as a prerequisite to earth movements. This document is indefinite and certifies the absence of archeological sites on the surface, to authorize of oil & gas exploration and exploitation activities.

6. CONTRACTS, AGREEMENTS AND OIL CONCESSIONS: COMPETENT AGENCIES, CHARACTERISTICS. CONTRACT MODELS, ROYALTIES AND RETRIBUTIONS

The oil contracting function is carried out by *PERUPETRO S.A.* under the mandate of Law Nº 26221, article 6º, part b) of which says: “Negotiate, formalize and supervise, in its capacity as the contracting party by the powers invested by the Peruvian State by virtue of this Law, all contracts and Technical Assessment Contracts established by the latter.” Likewise, the second, third, fourth, and fifth chapters of Title II of Law N° 26221 give *PERUPETRO S.A.* the respective instructions. The main contracts are summarized as:

- Oil contracts
- Technical Assessment Contracts
- Concession contracts

6.1 Oil contracts

These are legal instruments managed by *PERUPETRO S.A.*, which entitle duly qualified national or foreign individuals or corporations to enter into oil & gas exploration and exploitation or development contracts. The main characteristics contained in Law No. 26221, which define Peruvian oil contracts, are shown below. Oil contracts may be:

– License contracts
– Service contracts
– Other modalities

- License contracts: *PERUPETRO S.A.* transfers the property rights over extracted oil & gas to a contractor, who should pay a royalty to the State.
- Service contracts: Under this modality, contractors receive a payment for their audited production of hydrocarbons.
- Other contracting modalities may be entered into following authorization from the Ministry of Energy and Mines.

6.1.1 Characteristics of Oil Contracts

- Oil contracts may be formalized, at the discretion of the contracting party, either through direct negotiation or through a call for bids.

- Contracts authorize the contractor to carry out oil & gas exploration and exploitation operations during the contract term, including secondary and enhanced recovery.

- The extension and delimitation of the initial contract area is determined according to the oil & gas potential, the geographic area, the minimum insured program, and/or the area in which oil & gas exploration and exploitation activities of will be effectively carried out.

- Contracts contemplate two phases: exploration and exploitation, except in the case of solely exploitation contracts.

- Contract periods are of up to 7 years for the exploration phase, and in exceptional cases may be extended for another 3 years; up to 30 years for the exploitation phase and in the case of crude oil, including the years of exploration; and in the case of non–associated natural gas and of associated natural gas and condensates, up to a full 40 years. In addition to these terms, a retaining period of up to 10 years may be contemplated when an oil & gas discovery is not commercial for transportation reasons, until it is feasible.

- The contract area will be reduced (area reduction) as agreed upon by the parties, until reaching a surface area under which there are production horizons plus a surrounding safety area.

- The diverse exploration periods of contracts should have a minimum mandatory work schedule, which should be guaranteed with a bond whose among will be set by the contracting party.

- Contractors should provide, at their own risk, all technical and economic–financial resources required for contract execution, and will be solely responsible and in charge of all investments, costs and expenses incurred.

- Contractors are responsible for transporting produced hydrocarbons from their contract areas to a place agreed upon by the parties.

- In agreement with the contracting party, contractors will provide the resources and means needed for effective technology transfer and staff training in the hydrocarbons sub–sector.

- The exploitation and economic recovery of oil & gas reserves will be carried out in accordance with generally accepted technical and economic principles in use by the international hydrocarbons industry, without prejudice to complying with environmental protection standards.

- The Contractor is obliged to keep *PERUPETRO S.A.* continually informed with regard to its operations. All studies, information and data, whether processed or not, obtained by contractors and sub–contractors, will be delivered to *PERUPETRO S.A.*

- Contractors have free access to their respective hydrocarbons in conformity with the contract and may export them tax free.

- Contractors have a right to use hydrocarbons produced in the contract area in their operations at no cost.

- In case of a national emergency declared by law, by virtue of which the State should acquire hydrocarbons from local producers, this will be done at international prices in accordance with valuation and payment mechanisms to be established in each Contract.

- For natural gas that is not utilized in operations, contractors may market them, re–injected them into the reservoir, or both. If gas is not utilized as described above, it may be flared upon approval by the Ministry of Energy and Mines.

- In the case of license contracts, contractors pay royalties based on the oil & gas production coming from the area they operate. Contractors may pay royalties in cash in accordance with the valuation and payment mechanisms established in each Contract, taking into account that liquid hydrocarbons should be appraised based on international prices, and natural gas based on sales prices on the domestic or export markets, as the case may be. Royalties are considered expenses.

- In the case of service contracts, payment is determined based on audited hydrocarbons production and paid as agreed.

- Contractors are subject to the common income tax regime, to the specific rules established in Law N° 26221, and are governed by the applicable regime in effect on the date when the contract is formalized.

- Contractors carrying our oil & gas exploration and exploitation or development activities in more than one contract area, and who also develop other activities relating to oil, natural gas and condensates, and oil & gas–related energy activities, should determine the outcomes of each period independently for each contract area and for each activity in order to calculate income tax.

If one or more of the contracts or activities generates losses that can be carried over, they will be compensated by the profits generated by one or more of the other contracts or activities.

Investments made in a contract area that has not reached the commercial extraction stage will be added to the same type of investments made in another contract area that has reached that stage, and the total will be amortized by the chosen method, based either on production units or on linear amortization, for no less than a 5 year period.

The contract will establish the amortization method to be used by the contractor, which may not be varied.

- Contractors may temporarily import assets destined to its activities for a 2-year period with suspension of import taxes. This temporary import may be extended for one year periods up to two times.

- The State guarantees contractors that the exchange and tax regimes in effect on the contract signing date will remain inalterable for its entire duration.

- Contractors may keep their accounting in foreign currency, in accordance with the accounting practices accepted in Peru.

- The *Banco Central de Reserva de Peru*, in representation of the State, guarantees both national and foreign contractors the availability of the foreign currency they are entitled to, in accordance with this law and what is established in the contracts.

- Contracts may establish that any technical differences that arise among the parties be submitted to the *Comité Técnico de Conciliación*, in the terms they deem advisable.

- International arbitration for license and service contracts and for any other contracting modality will be applicable in any case.

- Contracts terminate automatically with no prior requirements, in the following cases:
  a) Upon completion of the contractual term.
  b) By agreement among the parties
  c) By unappealable mandate by the Judicial Branch or a court of arbitration
  d) For the causes that the parties agree to in the contract.
  e) At the end of the exploration phase, if the contractor has not claimed a commercial discovery and the retention period is no longer effective.

- Upon contract termination, all real estate, energy facilities, camps, communications, pipes, and other means of production to enable operations continuity are transferred to the State, free of charge, unless it does not require them.

- Contractors are obliged to carry out the actions determined in the Environmental Protection Regulation for Oil & Gas Activities.

A model license contract for oil & gas exploration and exploitation can be found at: www.PERUPETROSA.com.pe/legal04-s.asp .

Graph 9. Peruvian Block Distribution Map

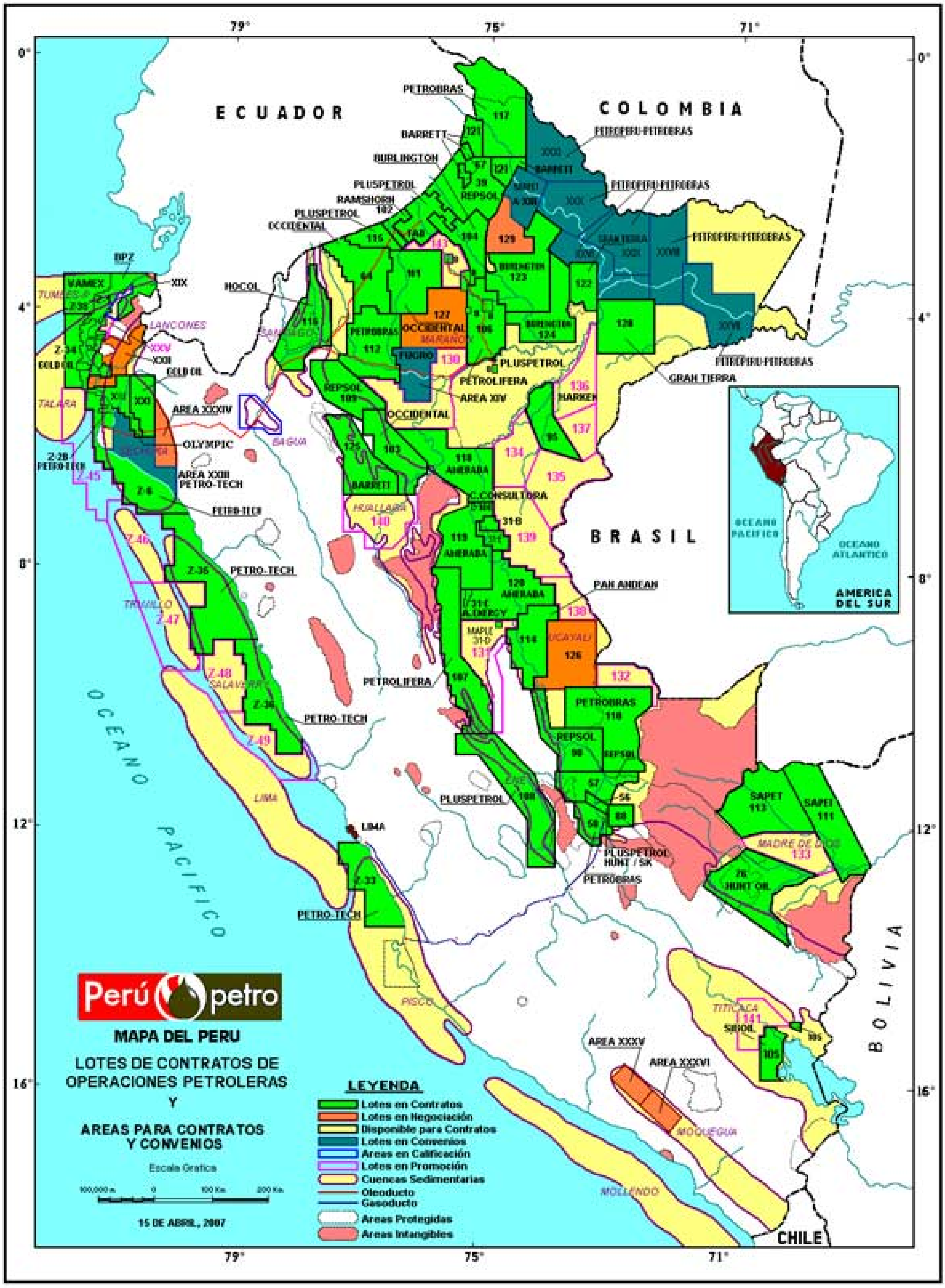


Table 5 shows a list of exploration contracts that were in effect at June 11, 2007, which cover a total area of 37 470 071.9 hectares, distributed in 45 blocks, under the license contract modality.

Table 5. Exploration contracts at 11.06.07

COMPANIES	BLOCK	LOCATION	SIGNING DATE:	AREA (Ha.)
Occidental Petrolera / Amerada Hess / Talismán	64	Northern Jungle	07-12-95	953 790.8
Repsol / Burlington	39	Northern Jungle	09-09-99	886 820.3
Maple Production	31-E	Central Jungle	06-03-01	141 003.4
BPZ Energy	Z-1	Continental shelf	30-11-01	299 273.1
Petrotech	Z-6	Continental shelf	20-02-02	981 503.0
Repsol / Burlington	90	Southern Jungle	10-12-03	880 670.5
BPZ Energy	XIX	Northeast	12-12-03	191 441.2
Repsol / Burlington	57	Southern Jungle	27-01-04	611 067.8
Consultora de Petróleo	100	Central Jungle	26-03-04	7 700.0
Occidental Petrolera / Amerada Hess / Talismán	101	Northern Jungle	02-04-04	744 434.5
Occidental Petrolera	103	Central Jungle	09-08-04	870 896.2
Petrotech	Z-33	Continental shelf	01-09-04	849 566.6
Harken	95	Northern Jungle	07-04-05	515 731.1
Burlington	104	Northern Jungle	28-04-05	1 092 132.2
Petrobras Energía	58	Central Jungle	12-07-05	340 133.7
Petrolífera Petróleo	106	Northern Jungle	12-07-05	809 777.1
Petrolífera Petróleo	107	Northern Jungle	01-09-05	1 267 674.6
Petrotech	Z-35	Continental shelf	20-09-05	1 550 001.1
Sapet	111	Southern Jungle	07-12-05	1 516 324.5
Sapet	113	Southern Jungle	07-12-05	1 231 353.7
Petrobras Energía	110	Southern Jungle	13-12-05	1 483 104.9
Petrobras Energía	112	Northern Jungle	13-12-05	1 080 675.5
Pluspetrol	108	Southern Jungle	13-12-05	1 241 676.0
Pluspetrol	115	Northern Jungle	13-12-05	241 226.7
Ramsshorn / Shona Energy / Andean Oil and Gas	102	Northern Jungle	13-12-05	126 676.1
Siboil	105	Sierra Sur	13-12-05	443 213.2
Repsol	109	Northern Jungle	16-12-05	899 754.9
Hunt Oil	76	Southern Jungle	02-05-06	1 434 059.9
Amerada Hess	118	Central Jungle	04-05-06	988 023.2
Amerada Hess	120	Central Jungle	04-05-06	975 023.0
Gold Oil of Peru S.A.C.	XXI	Northeast	04-05-06	303 331.2
Amerada Hess	119	Central Jungle	04-05-06	960 490.0
Petrobras Energía Peru	117	Northern Jungle	16-05-06	1 368 525.1
Petrotech	Z-36	Continental shelf	14-07-06	999 995.4
Barrett	121	Northern Jungle	14-07-06	351 933.2
Pan Andean, *Consultora de Petróleo*	114	Central Jungle	14-07-06	770 727.6
Burlington Resources Peru	124	Northern Jungle	29-09-06	991 078.5
Burlington Resources Peru	123	Northern Jungle	29-09-06	1 256 259.3
Grantierra	122	Northern Jungle	03-11-06	492 766.1
Barrett	125	Northern Jungle	12-12-06	950 927.9
Grantierra	128	Northern Jungle	12-12-06	897 750.0
Hocol	116	Northern Jungle	12-12-06	853 381.7
Gold Oil Peru S.A.C (50 %) / Plectrum (50 %)	Z-34	Continental shelf	08-03-07	371 339.2
Vietnam American Exploration Company (100 %)	Z-38	Continental shelf	12-04-07	487 545.5
Burlington Resources Peru (100 %)	129	Northern Jungle	24-05-07	472 433.7
TOTAL	45			37 470 071.9

Source: Petroleum Statistics 2007, *PERUPETRO S.A.* * All are license contracts

Table 6 shows a list of exploitation contracts, which were in effect at June 11, 2007, which cover a total area of 1 723 709.8 hectares, distributed in 19 blocks, 5 of which are under service contracts and the rest under license contracts.

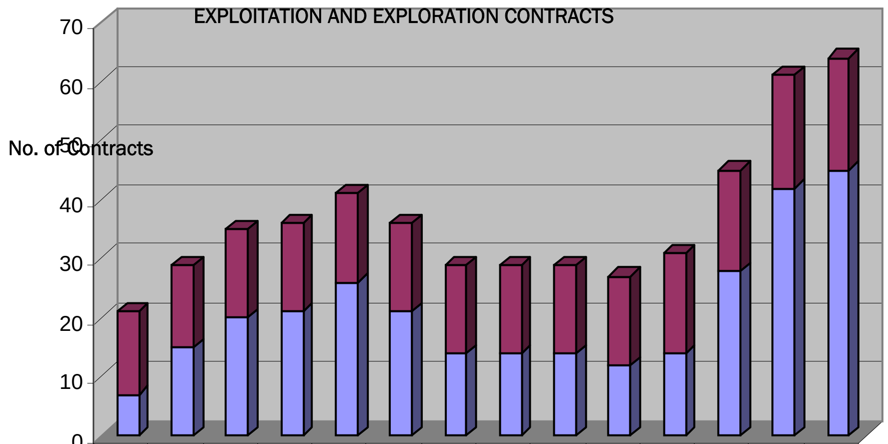
Table 6. Exploitation Contracts at 11-06-07

COMPANIES	BLOCK	LOCATION	SIGNING DATE:	AREA (Ha.)
Pluspetrol Norte	1-AB	Northern Jungle	22-03-86	497 027.3
GMP *	I	Northeast	27-12-91	6 943.3
Río Bravo	IV	Northeast	04-03-93	30 722.0
Mercantile Peru Oil & Gas	III	Northeast	05-03-93	35 793.9
Unipetro *	IX	Northeast	17-06-93	1 554.1
GMP *	V	Northeast	08-10-93	9 026.0
Sapet	VII/VI	Northeast	22-10-93	34 444.8
Petrotech *	Z-2 B	Northern Continental shelf	16-11-93	199 865.2
Maple Gas	31 B and 31 D	Central Jungle	30-03-94	71 050.0
Aguaytía Energía	31 C	Central Jungle	30-03-94	16 630.0
Petrobras Energía	10	Northeast	20-05-94	46 952.3
Pluspetrol Norte / Knock / SK Corp / Daewoo	8	Northern Jungle	20-05-94	182 348.2
Barrett	67	Northern Jungle	13-12-95	101 931.7
Petrolera Monterrico	III	Northeast	05-01-96	7 707.4
Petrolera Monterrico	XV	Northeast	26-05-98	9 999.7
Pluspetrol / Hunt / SK / Tecpetrol / Sonatrach / Repsol	88	Southern Jungle	09-12-00	143 500.0
Olimpic Peru Inc.	XIII	Northeast	30-05-04	263 357.8
Pluspetrol / Hunt / SK / Tecpetrol / Sonatrach / Repsol	56	Southern Jungle	07-09-04	58 500
Petrolera Monterrico	XXI	Northeast	19-01-06	6 356.0
TOTAL	19			1 723 709.8
* Service contracts, the rest are license contracts				

Source: Petroleum Statistics 2007, *PERUPETRO S.A.*

Graph 10 shows a summary of the number of exploration and exploitation contracts in effect during the 2000 – June 2007 period.

Graph 10. Exploitation and Exploration Contracts at June 2007

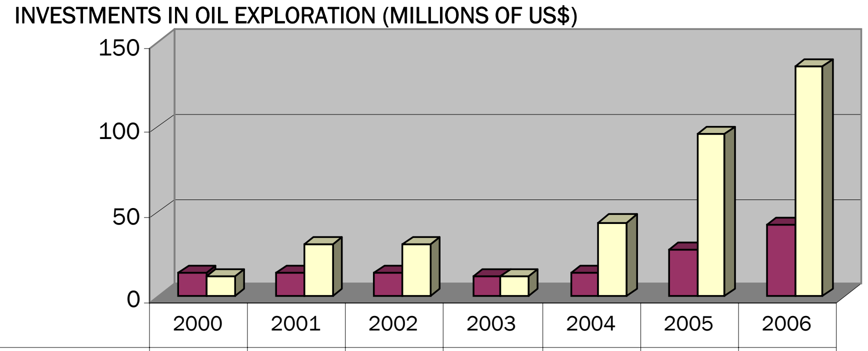


	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Jun-07
Explotation	14	14	15	15	15	15	15	15	15	15	17	17	19	19
Exploration	7	15	20	21	26	21	14	14	14	12	14	28	42	45

Source: Oil Statistics 2007, *PERUPETRO S.A.*

Graph 11 shows yearly exploration investments made by contractor companies. It clearly shows that the increase in the number of contracts is also reflected in the investments made.

Graph 11. Investments in Oil Exploration (Millions of US$)



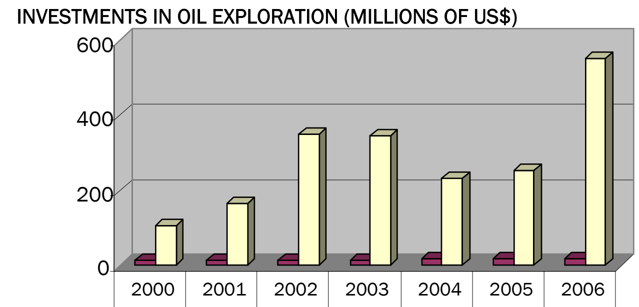
	2000	2001	2002	2003	2004	2005	2006
NUMBER OF CONTRACTS	14	14	14	12	14	28	42
INVESTMENTS	12.1	30.5	31.3	12.2	44	96.4	136.3

YEARS

Source: Self-developed, based on information from *PERUPETRO S.A.*

Graph 12 shows yearly investments in exploitation made by contractor companies. As in the case of exploration contracts, there is a substantial increase in the number of contracts and therefore of investments made, primarily during the 2002-2006 period, related to the Camisea project.

Graph 12. Yearly Investments in Oil Exploitation
(Millions of US$) Years 2000-2006



	2000	2001	2002	2003	2004	2005	2006
NUMBER OF CONTRACTS	15	15	15	15	17	17	19
INVESTMENTS	108.3	163.8	351.8	347.4	232.8	254.9	551.9

years

Source: Self-developed, based on information from *PERUPETRO S.A.*

The total investment amount for the 61 blocks totals US$ 2 373.7 million, distributed over the 2000-2006 period, US$ 362.8 million of which pertains to exploration and US$ 2 010.9 million to exploitation.

6.1.2 Royalties under License Contracts and Payment under Service Contracts

Oil revenues generated, taking only what is collected from up stream activities, are obtained from the following sources:

- Royalties
- Retributions and shares
- Income tax
- Training
- Social aid

Royalties.- Payments made by contractors to the State for extracted oil & gas, as freely available. Pursuant to the Organic Hydrocarbons Law and Supreme Decree N° 049-93-EM, the regulation for the application of royalties and retributions in oil contracts and their amendment under Supreme Decree Nº 017–03–EM, royalties are determined by the following methods:

- By the "R" factor, which calculates royalties by a coefficient called the "R" Factor, which is calculated as follows:

  R = X / Y

  Where: X is equal to the accrued revenues
  Y is equal to the accrued expenses

  The revenues and expenses to be considered will be those occurring from the contract signing date and will be recorded in US$ (Dollars of the United States of America). The minimum royalty percentages to be applied are the following:

"R" Factor	Minimum Royalty Percentage (%)
From 0.0 to less than 1.0	15
From 1.0 to less than 1.5	20
From 1.5 to less than 2.0	25
2.0 or more	35

- Accumulated production per reservoir with a price adjustment, the royalty is set for each reservoir based on its accrued production and is subject to price adjustments in accordance with the average weighted price per barrel. The condition for applying it is that it should reflect economic results that are equal to what would be obtained from applying the "R" Factor.

- By Production Scales (Supreme Decree Nº 017–03–EM), which are applied in accordance with the audited hydrocarbons production in a given contract area. The audited production levels and percentages for calculating royalties are the following:

Audited Block Production Levels (In MBPDC)	Royalty Percentage (%)
Less than 5	5
From 5 to 100	5 to 20
More than 100	20

  For an audited production range from 5 to 100 000 barrels per calendar day (MBPDC), 5 000 BPDC receives a royalty of 5 %. For intermediate production levels apply the interpolation.

- By Economic Results – REE, which is applied by the following ratio:

  RRE = Fixed Royalty + Variable Royalty

  Variable Royalty % t = $((X_{t-1} - Y_{t-1} / X_{t-1}) * (1-1/(1 + \text{Factor } R_{t-1} - \text{Factor R Base})))$

  Where:
  X: Accrued revenues
  AND: Accrued expenses
  X_{t-1}: Income for the yearly period prior to calculating the Variable Royalty % t
  Y_{t-1}: Expenses for the yearly period prior to calculating the Variable Royalty % t
  Factor R: is X / Y
  Factor R_{t-1}: is the Factor R, calculated considering accrued income and expenses to include the corresponding X_{t-1} Y_{t-1}.

  The following parameters are established to determine royalties:
  - The Fixed Royalty is equal to 5 %
  - The "R" Factor base is equal to 1.15
  - The Variable Royalty is applied after the Factor Rt–1 reaches a value of 1.15
  - The Variable Royalty is applied in the range of: 0 less Variable Royalty less 20 %
  - The Variable Royalty will be calculated with the data available on revenues and expenses for the former year.

Retributions and shares.– We have mentioned that in service contracts, the State pays the contractor a retribution for each barrel extracted. Then the State markets these hydrocarbons through *PERUPETRO S.A.* and from the product of that sale, the regions where the resource is found have a right to a share that is distributed according to the tax percentages established by Law for regional and local governments, and other institutions.

Service contracts for exploration and exploitation of hydrocarbons set maximum percentages on retributions that *PERUPETRO S.A.* should pay the production companies for the output obtained. These percentages are according to the following table:

"R" Factor	Maximum Retribution Percentage (%)
From 0.0 to less than 1.0	83
From 1.0 to less than 1.5	79
From 1.5 to less than 2.0	76
2.0 or more	66

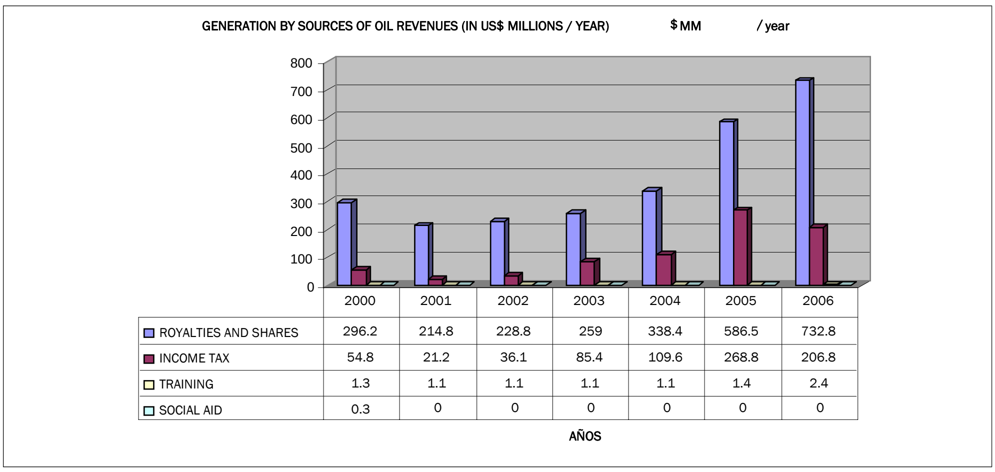
Income tax.– The income tax rate in Peru is 30 %. In 2002 it was modified and reduced to 20 %, but later it went back up to 30 %. In 2001, it was established that the rate could drop by 10 percent points if profits were reinvested. There is also a minimum income tax, which is 1.5 % of net assets. Income tax payments are either the accounting calculation or the minimum tax, whichever is greater.

Training.– License and service oil contracts establish payments for training in accordance to what is set forth in Article 29º of Law Nº 26221, which states: "Contractors will provide the resources and means agreed to with the contracting party for effective transfer of technology and training for the hydrocarbons sub–sector staff as designated by the Ministry of Energy and Mines." This fund is managed by the *Comité de Administración de Recursos para Capacitación* (CAREC).

Social aid.– Granted through agreements between the oil companies and the surrounding communities. In this regard, in the past years several agencies have been created whose duty it is to regulate, enforce and supervise the social work of the State and the companies. With regard to the State, this is oriented fundamentally towards capturing, distributing and utilizing money from the exploitation of natural resources (oil revenues). As for the companies, it is aimed at commitments taken on with the surrounding communities in their community relations plans, a tool that defines their activities to attend to the needs of the populations around their industrial development. This plan can be inspected by OSINERGMIN, as it is part of the Environmental Impact Assessment. However, it is necessary to strengthen the regulations in such wise that companies show the will to work with social responsibility according to the economic profits they receive, without this being a replacement for the State.

In the regions where the oil industry is developed, company participation is clearly noted in the health care infrastructure such as health posts and hospitals, and support for community meeting halls, fixing roads and bridges, and others. However, the amounts involved in this support are not fully known because of company reserve on this topic. The amounts generated as oil revenues from the diverse sources are shown in Graph 13.

Graph 13. Oil Revenue Generation by Sources in US$ Million / Year



	2000	2001	2002	2003	2004	2005	2006
ROYALTIES AND SHARES	296.2	214.8	228.8	259	338.4	586.5	732.8
INCOME TAX	54.8	21.2	36.1	85.4	109.6	268.8	206.8
TRAINING	1.3	1.1	1.1	1.1	1.1	1.4	2.4
SOCIAL AID	0.3	0	0	0	0	0	0

Source: Self–developed, based on information from *PERUPETRO S.A.*
*Not Available

Total **oil revenues** received during the 2000–2006 period were US$ 3 450 million, with the observation that the largest collections were in royalties and shares. In 2000 a total of US$ 352.6 million were received, and in 2006, US$ 942.0 million were collected. This is almost three times more as a result of national policies and campaigns promoting investments in the petroleum sector.

OIL REVENUES 2000–2006	2000	2001	2002	2003	2004	2005	2006
TOTAL: 3 449.0	352.6	237.1	266.0	346.5	449.1	856.7	942.0

The policies and promotion mentioned above caused Camisea reservoir development to materialize. To this we must add the fact that a new contract was formalized (Camisea II) that will make it possible to double the production of liquid hydrocarbons and natural gas in this area. This will double the income from oil revenues (probably as of 2010), and benefit the communities around these activities and the Peruvian population as a whole, since it is very probable that Peru will reach the status of a self–supplying country with an exportable margin, primarily of natural gas, which will also lead to lower fuel prices.

Although the panorama described above is positive, there is a certain opposition to the formalization and startup of these contracts. It comes from a few indigenous communities and radical NGOs that egg them on with the possibility that it might generate negative socio–environmental impacts. However, these impacts are increasingly smaller because standards are stricter and technology is rapidly evolving to avoid them. To deny that negative impacts might occur would not be serious –they will happen– but what is sought is to minimize them and, if they occur, to correct them through prompt, speedy remediation. This, of course, is in regard to environmental matters. As to social affairs, one must place in the balance what is most desirable for indigenous communities: a) to continue relegated due to the National Government's inability to care for their needs, or b) to change their lifestyle somewhat, but with their own income that will enable them to develop their communities and thus achieve a higher standard of living while maintaining their cultural patterns.

With regard to income from oil revenues, there is the possibility to improve them, and since Peru is a sovereign country and the owner of its natural resources, it may at any time renegotiate its contracts and even cancel them, provided it is sufficiently justified, of course. World history teaches us that it is common, without going to any extremes, to renegotiate or annul oil contracts when they are going against the interests of a country. With prices surpassing US$ 80 per barrel, might that not be necessary?

6.2 Technical Assessment Contracts.– These are legal instruments managed by *PERUPETRO S.A.*, which entitle duly qualified national or foreign individuals or corporations to enter into contracts to study the possibility that a certain area contain oil or gas, before deciding to formalize a contract including all or part of the area included in the Technical Assessment Contract. They may also provide additional information for the promotion of an area, in which case they are called <u>Promotion Assessment Contracts</u> and, finally, <u>Value Added Contracts</u> that enable reprocessing and updating seismic dada in order to reappraise an area, among others.

The commitment of the oil company is to carry out all contract activities within the stated period and present an activity report, as well as to deliver the data gathered and their results. Its duration is normally two (2) years and can be extended for up to another 2 years. At December 31, 2006, 11 Technical Assessment Contracts were in effect, 7 of which were Technical Assessment Contracts, 2 were Promotion Assessment Contracts and 2 were Value Added Contracts.

6.3 Concession Contracts.– These are legal instruments managed by the *Dirección General de Hidrocarburos*, which entitle national or foreign individuals or corporations to build, operate and maintain pipelines for transportation of hydrocarbons and derivative products, and for natural gas distribution through networks of pipelines (public utility), with the understanding that these activities are by nature monopolies and therefore have regulated tariffs.

Table 7 shows the main characteristics of concession contracts as described in Supreme Decree No. 041–99–EM that approves the regulations for transporting hydrocarbons through pipelines and Supreme Decree 042–99–EM that approves the regulations for piped natural gas distribution.

Table 7. Primary Characteristics of Concession Contracts

Characteristics	Hydrocarbons transportation via pipelines	Piped natural gas distribution
Term	No more than 60 years, including extensions, nor less than 20 years.	No more than 60 years, including extensions, nor less than 20 years
Concession award	a) By competitive bidding or public contest b) Upon request by the party.	Exclusive: a) By competitive bidding or public contest and

		b) Upon request by the party.
Fulfillment guarantee for work execution	Amount equal to 5 % of the work budget.	Amount equal to 1 % of the estimated project investment.
Tariffs	Basic tariffs regulated and set by agreement of the parties. Should cover capital amortization and operation and maintenance costs. Adjustable.	Basic tariffs regulated and set by agreement of the parties, which should provide the concession holder with the resources to cover the cost of efficient service provision.
Partial or total loss and deterioration of hydrocarbons	Contractor liability	Natural gas supplied to consumers should be corrected to standard pressure and temperature conditions.
Total or partial contract assignment	May be granted with the approval of the *Dirección General de Hidrocarburos*	May be granted the approval of the *Dirección General de Hidrocarburos*
Concession termination	a) Expiry of contract term b) Declaration of expiration c) Acceptance of concession relinquishment d) Other causes according to contract.	a) Expiry of contract term b) Declaration of expiration c) Acceptance of concession relinquishment d) Other causes according to contract.
Concession assets due to transfer, devolution or termination	All concession assets should be returned to the Peruvian State, free of all charges and encumbrances and in good working conditions	All concession assets should be returned to the Peruvian State, free of all charges and encumbrances and in good working conditions
Concession expiry	a) Failure to execute works or studies b) Failure to operate the transportation system for 876 hours in one year without reasonable cause c) Non–compliance with providing service within the prescribed periods d) Failure to start up the transportation system within the contractual term e) For reasons of expiry f) Due to bankruptcy, dissolution, or liquidation of the concession holder g) Assignment or transfer without the approval of the *Dirección General de Hidrocarburos*. h) Imposition of fines during one year whose total surpasses 10 % of its annual revenues.	a) Failure to execute works or studies b) Failure to operate the transportation system for 876 hours in one year without reasonable cause c) Non–compliance with providing service within the prescribed periods d) Failure to start up the transportation system within the contractual term e) For reasons of expiry f) Due to bankruptcy, dissolution, or liquidation of the concession holder g) Assignment or transfer without the approval of the *Dirección General de Hidrocarburos*. h) Imposition of fines during one year whose total surpasses 10 % of its annual revenues.
Open access	Obligation to allow non discriminatory access to those requesting it, provided it is technically feasible.	The concession is exclusive within a given area. Areas that are not attended to within a 12 year period may be given to third parties.
Response to service requests	Within 30 days of receipt.	
Use of public and third part assets	Rights of use, rights of way, and expropriation of land	Rights of use, rights of way, and expropriation of land

To date there are 2 hydrocarbon pipeline transportation contracts and 1 piped natural gas distribution contract in effect:

a. The concession contract for the *Oleoducto Norperuano*.– Formalized between the Peruvian State (DGH) and PETROPERU (concession holder), this pipeline transports oil produced in the Northeastern zone of the country (Department of Loreto) towards the Northern coast (Department of Piura), along 800 km.
b. The concession contract for the natural gas and condensate transportation system from the Camisea zone – Central Jungle (Department of Cusco) to Lurín (Department of Lima – 600 Km.) in the case of natural gas, and from Camisea to Pisco (Department of Ica – 450 Km.) in the case of condensates.
c. Piped natural gas distribution concession contract, circumscribed to metropolitan area of Lima.

With regard to using Camisea gas, there are projects for 3 gas pipelines, all branches of the primary Camisea – Pisco pipeline. The goals of these 3 gas pipelines are:

a. Gas pipeline from the main Camisea pipeline to Cañete (Department of Lima) to send the Coast 600 million ft^3 / day of natural gas for export to the Pacific Coast of México and the USA.
b. In the case of the other 2 gas pipelines, their purpose is to supply natural gas for the central and southern regions of the country.

7. STATE-OWNED COMPANIES – ORGANIZATION AND FUNCTIONS, PERFORMANCE REVIEW AND EVALUATION

7.1. *PERUPETRO S.A.*

7.1.1 Organization, Functions and Regulations

The vision of *PERUPETRO S.A.* is to be a Peruvian State enterprise whose work turns Peru into a net hydrocarbons exporter country, and its mission is to position Peru as an attractive country for investments and for developing oil & gas exploration and production activities. The legal norms that govern its actions as a State-owned company, in addition to those cited under numeral 4 of this report, are detailed at:

www.PERUPETROSA.com.pe/downloads/Framework_legal.pdf

The strategic objectives of *PERUPETRO S.A.* are defined in the company's strategic plan for 2004-2008 and are aimed to fulfill the mission and reach the vision defined in that plan. Its strategic objectives are aligned with those of FONAFE and the rest of the sector.

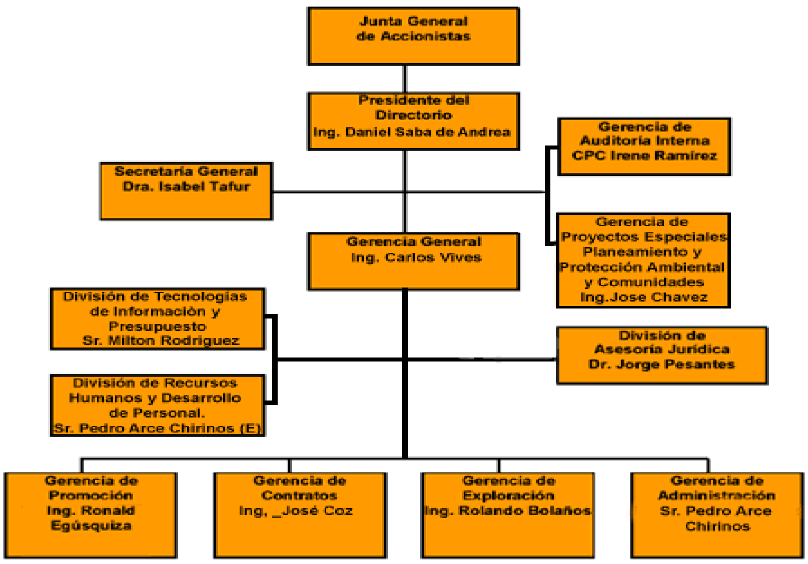
Organization and functions.- The main function of *PERUPETRO S.A.* is to promote, negotiate, formalize, and supervise oil contracts. For this purpose it must keep a database updated with information regarding oil & gas exploration and exploitation. It is the receiver of the revenues generated by oil contracts and makes the necessary payments on taxes, surtaxes and shares in oil revenues. See the functions of *PERUPETRO S.A.* in detail at:

www.*PERUPETROSA*.com.pe/downloads/leyorganicadehidrocarburos.doc

The General Shareholders Assembly is the organizational policymaker for *PERUPETRO S.A*. This assembly is made up of 3 members in representation of the State, named by a Supreme Resolution endorsed by the Minister of Energy and Mines, which also designates its President. In turn, the Board of Directors of *PERUPETRO S.A.*, which is the body that directs and controls company policies, is made up of 5 members, 3 in representation of the Ministry of Energy and Mines and 2 for the Ministry of Economy and Finance. The President is assigned by Supreme Resolution. Graph 14 shows the organizational chart for the main positions.

The staff distribution of *PERUPETRO S.A.* by categories shows that from 1999 to date it has had 6 top management officers, 37 to 44 professionals, 8 secretaries and 5 workers, for total of 62 employees on a yearly average. Additionally, it has hired staff for personnel services and outstanding university students (practicing), which raises the number of persons working at PETROPERU to 100.

Graph 14. General Organizational Chart of *PERUPETRO S.A.*



7.1.2 Operational and Financial Performance Assessment Indicators of *PERUPETRO S.A.*

Over the past years, Peru has achieved great international prestige by creating a solid, competitive hydrocarbons contractual arrangement and having maintained a transparent legal framework with legal security and tax stability, which represents its greatest strength in this regard.

Peru has had several oil contracting peaks, one of which was in 1993, when it approved the legal framework (Law N° 26221) and created *PERUPETRO S.A.* It immediately achieved the participation of private companies in oil & gas exploration and exploitation activities, which encouraged Shell (in a consortium with Mobil Oil) to return and develop the Camisea reservoirs. As a result, natural gas reserves were confirmed, but this ended in a new frustration when Shell again withdrew, this time with the consortium.

Recent innovations in the contract regime, based on the guidelines in the legal and contractual framework established in Law N° 26221 (1993) and Supreme Decree N° 049–93–EM, date from 2003 (Supreme Decree N° 017–03–EM), when the new contract and royalties models were approved. On this basis an aggressive strategy and promotion campaign was launched that has positioned Peru in oil company sights as a country with potential for risk investments in oil & gas prospecting.

2005 saw a new period of substantial improvements in the country's exploratory activities, which were re-launched opening new possibilities for future natural gas and oil discoveries. During 2005,[6] 15 new exploration contracts were signed, outstripping former years. By year end, 45 contracts were in effect, 28 for exploration and 17 for exploitation, surpassing the number of contracts in all the years prior. At that date, 31.4 % of all surface sediment basins available in the country were under exploration or exploitation contracts, with a total surface of 23.0 million hectares. By 2006 there were 61 oil contracts, 19 of which were in the exploitation (production) phase and 42 in the exploration phase. That same year saw investments of US$ 688.2 million and US$ 942 million in State revenues from royalties and shares, income tax, training, and social aid.

The work of *PERUPETRO S.A.* should be measured by its efficiency in performing its duties as established by law for the promotion, negotiation, contracting, technical information management, supervision, and resource administration; and, very especially, by the results obtained in oil contracting, and on that basis consider whether it is meeting all expectations.

PERUPETRO S.A., acting by State mandate as the Collection Agent for royalties and retributions paid by contractors in the exploitation phase, fully completed the transfers for tax payments to the Treasury Department. In accordance with the law, it does not nor can it receive any economic profits. Royalties on license contracts and hydrocarbons production that it receives under service contracts and then sells are a result of the audited production that is measured at one or more inspection points established in each contract. For this purpose, *PERUPETRO S.A.* is continually present at these control points through its own personal or by contracting out the service. This action is one of the major responsibilities of *PERUPETRO S.A.*, as the revenues received by the Peruvian State and the consequential community shares depend on it.

The policy of relations with native communities and organizations, holding workshops and meetings for information and training – in coordination with the *Dirección General de Asuntos Ambientales Energéticos* and with other State entities, before contractor begin any exploratory work, has been producing excellent results. The purpose for these activities is to inform the communities in the direct and indirect surroundings regarding the oil & gas activities and of any compensations and indemnifications to which they are entitled and benefits they may receive.

It is important to highlight the significant progress in the management, systematization and added value of geological, geophysics and petroleum engineering data making up the database of *PERUPETRO S.A.* This is a basic tool that enables potential investors to study *a priori* the different areas, the legal framework and the contractual conditions that govern oil contracting. The corporate performance of *PERUPETRO S.A.* in 2005 was audited by the firm *Weis & Asociados S.C. Auditores, Asesores y Consultores*, designated by the Comptroller General of the Republic. The audited financial statements are part of the memoirs.

[6] MEMORIA *PERUPETRO S.A.* –2005, Board of Directors decision No. 069–2006.

Table 8. PERFORMANCE INDICATORS OF *PERUPETRO S.A.* Aligned with the company's strategic objectives				
INDICATORS	Units of measure	2004	2005	Var. (%)
Production under service and license contracts:	Volume			
– Crude oil	B	34 448 011	40 622 578	18 %
– Gas	MPC	30 355 679	53 567 118	76 %
Sales under service contracts of:	Volume			
– Crude oil	B	4 328 695	4 352 580	1 %
– Gas	MPC	4 870 550	4 662 050	– 4 %
Purchases under service contracts of:	Volume			
– Crude oil	B	4 328 695	4 352 580	1 %
– Gas	MPC	4 870 550	4 662 050	– 4 %
Market share	%	100	100	0 %
Capital Profitability – ROE (Profits / Equity)	%	0	0	
Return on Assets– ROA (Operational Profits / Assets)	%	419.52	375.52	–10 %
Assets / Equity	%	7 140.75	13 386.65	87 %
Current liquidity (Current Assets / Current Liabilities)	%	98.68	97.57	– 1 %
Rotation Accounts Receivable (Sales / Accts Receivable / 365)	Days	0.08	0.06	–22 %
Overhead / Net Sales	%	0.46	0.27	–41 %

FINANCIAL DATA (in New Sols)

INDICATORS	2004	2005	Var (%)
Balance			
Assets	136 153 876	255 245 386	87 %
Cash & Banks + negotiable securities	27 070 498	55 840 291	106 %
Liabilities	134 247 160	253 338 669	89 %
Net equity	1 906 716	1 906 716	0 %
Loss & Profit Statement			
Gross Revenues	1 668 759 159	2 657 016 789	59 %
Operational gains	578 839 589	965 695 840	67 %
Net gains	–	–	–
Budget			
Operational Revenues	1 669 214 114	2 671 394 200	60 %
Operational Expenses	1 668 979 204	2 671 014 598	60 %
Personnel Expenses	8 930 116	8 681 545	–3 %
Capital Expenses	234 910	379 602	62 %
Others			
Pension Obligations	–	–	–
Medium and long term debt	–	–	–

INVESTMENT PORTFOLIO – FBK (In New Sols)
Aligned with the company's strategic objectives

INVESTMENTS	2004	2005	Var (%)
1. Grids and/or Lines			
2. Strengthening works			
3. Operational equipment (generation, distribution, transmission, metering, control, etc.)			
4. Building and/or remodeling operational units and sites			
5. Information, communication and control systems	212 219	331 135	56 %
6. Administrative equipment	22 691		–100 %
7. Building and/or remodeling administrative units	0	48 467	0 %
8. Studies			
9. Motor Vehicles			
10. Others			
TOTAL	234 910	379 602	62 %

SOURCES OF FINANCING FOR INVESTMENT PORTFOLIO – FBK (In New Sols)

SOURCES OF FINANCING	2004	2005	Var (%)
1. Own resources	234 910	379 602	62 %
TOTAL	234 910	379 602	62 %

Table 8 shows the performance indicators for *PERUPETRO S.A.* and compares the results from 2004 and 2005. 2005 amply surpasses 2004, basically as regards crude oil and natural gas production, because in 2005 the Camisea reservoirs were in full production and in 2004 they only 4 and a half months were accounted to these ends (production began in August 2004). Added to this is the fact that 2005 saw a new rise in international oil & gas prices. The exchange rates used are S/ 3.41 per US$ for 2004 and S/ 3.60 per US$ for 2005.

7.1.3 Pros and cons of *PERUPETRO S.A.*

Advantages.– The creation of PERUPETRO responded to the need to have an agency that would not depend on the regulations to which public offices are subject. Therefore, it was formed as a State–owned, private law enterprise that acts with economic, financial and administrative autonomy, and that has qualified personnel, with similar salaries to private companies. Its economic resources enable it to carry out international campaigns to promote areas with oil & gas potential, and to continually train its personnel and that of other State offices in the hydrocarbons sub–sector.

The purpose sought through these requirements was achieved, and today we can state that PERUPETRO has fulfilled and continues to fulfill what was expected of this company. This autonomy of action that it enjoys enables it to remain competitive on the international oil contracting market. However, it was not enough to PERUPETRO but al so supply the oil business with a suitable legal framework to provide investors with economic and financial securities, as well as legal stability.

The companies gave their acceptance of this contractual reality through oil contracts, which totaled an unprecedented 64 by June of this year, 45 of which are exploration contracts and 19 exploitation contracts.

The downsizing of the State bureaucratic apparatus is another advantage, which in the case of PETROPERU during the State oil monopoly had as many as 11 500 workers on role. Currently, totaling the number of workers in *PERUPETRO* and PETROPERU, the figure is in the order of 1 800 workers.

Disadvantages.– Hydrocarbons constitute a highly strategic issue in any country, regardless of whether or not it has large volumes. Therefore it is a matter that is managed at the highest level of their respective governments and, depending on who is in office, may be directly under the maximum authority of the country, leaving aside the authority of the Ministries or agencies under which it is regulated. This causes a lack of coordination among the agencies that oversee the oil business. In the case of Peru, *PERUPETRO S.A.* should report to and coordinate in all matters with the sectoral authority of the Ministry of Energy and Mines. However, there are times when for the above reasons this is not followed, which distracts efforts that should be centered on achieving common goals.

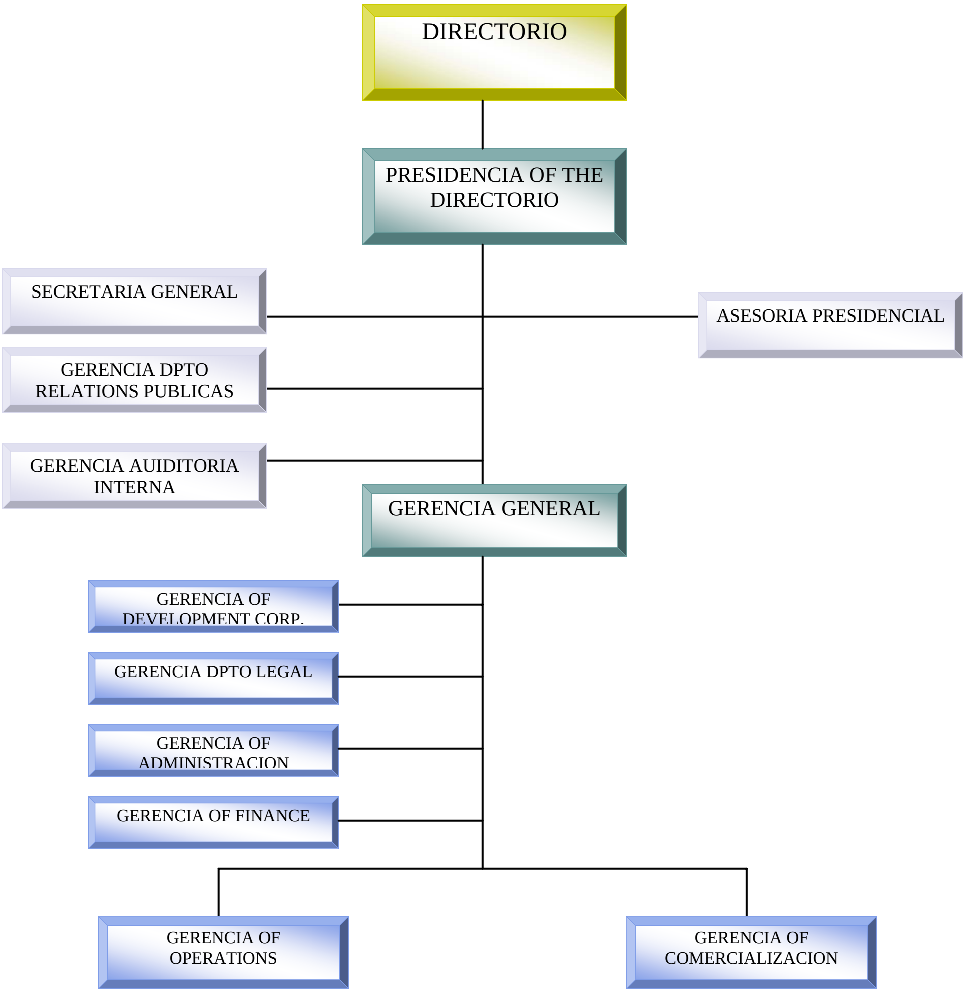
7.2 *PETROPERU S.A.*

A State–owned enterprise of the energy and mines sector, fully owned by the State with its domicile in the city of Lima, empowered to establish operation centers, agencies, branches, affiliates and/or subsidiaries in any place of Peru and/or abroad, in accordance with the regulations in its Corporate Bylaws. It may also acquire shares and/or stock in other companies.

7.2.1 Organization, Functions and Regulations

PETROPERU S.A. works within the framework of the Organic Hydrocarbons Law, Law N° 26221 of August 19, 1993, and its reforms. Through Law Nº 28244 of June 2, 2004, the national Congress, excluded *PETROPERU S.A.* from the privatization process and reinstated its participation in oil & gas exploration and production activities.

Graph 15. Organizational Structure of *PETROPERU S.A.*



On July 23, 2006, Congress passed Law Nº 28840, which strengthens and modernizes *PETROPERU S.A.* for the purpose of providing the company greater autonomy in the performance of its duties, removing it from under FONAFE, and the rules and regulations of the *Sistema de Inversión Pública* (SNIP). It also expedited its acquisitions and contracting processes in coordination with the High Council of CONSUCODE.

Articles 10 and 11 of this Law N° 28840, provide for the formation of a General Shareholders Assembly, to be presided by the Minister of Energy and Mines and made up of four (4) members named in representation of the State by Supreme Decree. It also instructs the creation of the *PETROPERU* Board of Directors with 6 members, named as follows: a) five (05) directors with professional experience and capacity, designated by the General Shareholders Assembly, one of which is designated as the Chair of the Board, who works full time; b) one (1) director designated by the Company workers in a direct, secret, universal election supervised by the *Oficina Nacional de Procesos Electorales* (ONPE).

The Board members referred to under letter a) are designated for a renewable period of three (3) years, and the Board member representing the workers is elected for a period of two (2) years. The Board members may be removed by the General Shareholders Assembly should they not meet the yearly goals or for serious faults. Como happens each year, laws are passed during each accounting period that determine how and under what conditions the respective budget should be applied. Thus, Law N° 28927 on the public sector budget for fiscal year 2007, published on December 12, 2006, and Law N° 28928 on public sector indebtedness for fiscal year 2007, published on December 12, 2006, both apply to PETROPERU management.

The vision of *PETROPERU S.A.* in its strategic plan is to consolidate its leadership position on the country's hydrocarbons market and to internationalize its products. Its mission is to meet the energy needs of its clients with products and services of excellent quality, thus contributing to national development. The corporate purpose of PETROPERU is to do business in accordance with what is set forth in the Organic Hydrocarbons Law, and its area of business is as shown in Table 9.

Table 9. Business Area of PETROPERU

ACTIVITY	INFRASTRUCTURE
Oil transportation	• *Oleoducto Norperuano* • Northern Branch Pipeline • Hired ocean and river fleet
Oil refining	• Talara Refinery • Conchán Refinery • Iquitos Refinery • *El Milagro* Refinery • Pucallpa Refinery (rented)
Marketing oil products	• Own sale plants • Hired storage capacity in privately operated terminals and sale plants • Network of affiliated service stations
Oil exploration and/or exploitation, and service operations	• No oil contract has been formalized to date

Source: *PETROPERU S.A.*

7.2.2 Operational and Financial Performance Assessment Indicators of *PETROPERU S.A.*

PETROPERU S.A. has been able to position itself as the most important company in the country. In addition to generating significant dividends for its shareholders, in this case the Peruvian State, it contributes directly to national industrial development and to generating employment, becoming the most influential company in the Peruvian economy. Its total income in 2004 was recorded at S/. 7.3 billion (US$ 2.14 billion). This business figure is the result of the company's participation in the domestic fuel market and the internationalization of its products, representing 3.3 percent of the GDP for 2004.

The activities carried out by *PETROPERU S.A.* involve a significant number of companies that supply goods and services. The company purchases most of the domestic oil production, and 2004, made purchases of S/. 2 895 million (US$ 849 million). *PETROPERU S.A.* promotes the production of several domestic industries, promotes business competitiveness, fosters the development of small and micro enterprises, generates employment opportunities both directly and indirectly, vitalizes the country's economy, and contributes to enhancing the purchasing power of people offering its products and services throughout the national territory (see Table 10).

Table 10. *PETROPERU S.A.* – Purchases from Domestic Suppliers

Compras de PETROPERÚ a proveedores nacionales
(Expresado en millones de nuevos soles)

	2000	2001	2002	2003	2004
Bienes y servicios	746	692	689	665	597
Petróleo y productos	2 791	2 045	1 879	1 660	2 298
Total	3 537	2 737	2 568	2 325	2 895

Source: PETROPERU. Figures adjusted to 2004. Exchange rates of S/. per US$: 2000 – S/. 3.49; 2001 – S/. 3.51; 2002 – S/. 3.52; 2003 – S/. 3.53; 2004 – S/. 3.41.

PETROPERU purchases from domestic suppliers (in millions of new sols)					
	2000	2001	2002	2003	2004
Goods and Services					
Oil and products					
Total					

Transfers to the Public Treasury. In 2004, the highest level of production for the *PETROPERU S.A.* refineries, as a consequence of greater participation on the domestic market, caused an increase in the volume of oil purchases. Likewise, the international hike in oil and oil products prices explains the greater economic value of *PETROPERU's* purchases. In turn, it has become consolidated as the main contributor of current income. That same year it transferred 3 185 million New Sols to the Public Treasury, over 10 % of the total current revenues recorded by the State for taxes, and in 2005 it was S/. 3 274.9 million

Creating jobs.– *PETROPERU's* operations require the direct employment of 1 695 workers throughout the country, and also requires contracting goods and services from domestic suppliers. Therefore, an estimated 4 820 indirect jobs have been created throughout the national territory.

Meeting the domestic fuel demand.– *PETROPERU S.A.* supplies 53 % of the fuel domestic demand, and from its beginnings has supplied fuels to the different regions of the country, including the most remote, hard–to–reach areas, with quality products at competitive prices. There is a tacit market distribution with REPSOL, since this company primarily covers the Lima market and *PETROPERU S.A.* attends to the interior of the country, thus fulfilling a social role. During 2004, *PETROPERU S.A.* increased its market share from 51 % in January to 53 % in December, especially in the country's most important economic sectors: fishing, industry, mining, commerce, electricity, agriculture, transportation, and services, among others. In the specialty area, its leadership in the domestic asphalt market stood out due to its quality, reaching a 73 % share. In 2004, *PETROPERU S.A.* implemented new marketing strategies to increase sales levels on the domestic and foreign markets, generating foreign currency for the country through exports, significantly improving the exported volume of oil products, and setting a new record of S/. 736 million in 2004.

Financial Situation of *PETROPERU S.A.* in 2005[7].– Profit and Loss Statement for 2005.– During 2005, the company was able to raise its net profit by 35 %, for a total of S/. 245 million, which is the highest amount obtained in the past 5 years (Table 11).

Chart 11. Profit and Loss Statement 2001–2005 (millions of New Sols)

	2001	2002	2003	2004	2005
Ingresos totales	5 238,6	4 664,1	5 093,9	6 117,8	7 595,7
Costo de ventas	(4 478,7)	(4 065,1)	(4 538,3)	(5 389,2)	(6 659,6)
Gastos de venta y administración	(324,5)	(322,5)	(293,7)	(277,3)	(278,5)
Utilidad operativa	**435,4**	**276,5**	**261,8**	**451,3**	**657,6**
Otros ingresos (egresos)	(238,8)	(119,5)	(209,7)	(137,9)	(247,6)
Participación de los trabajadores	(24,6)	(17,6)	(11,3)	(35,5)	(44,6)
Impuesto a la Renta	(66,6)	(42,9)	(27,5)	(95,7)	(120,4)
Utilidad (pérdida) neta	**105,4**	**96,5**	**13,3**	**182,2**	**245,0**

Exchange rates of S/. per US$: 2001 – S/. 3.51; 2002 – S/. 3.52;
2003 – S/. 3.48; 2004 – S/. 3.41; 2005 – S/. 3.30.

Total revenues
Sales cost
Sales expenses and overhead
Operational profits
Other income (outlays)
Workers' shareholding
Income tax
Net profit (loss)

The important increase in operational profits is attributed to an improvement in the refining business margin, caused by a strengthening of prices for products vis–à–vis crude oil. In addition, oil import costs dropped by US$ 50 million through the use of credit generated under the franchise merchandise replacement regime.

In counterpart, the profitability of transporting crude oil through pipelines decreased due to the lower transported volume and to the imbalance in transportation tariffs vis–à–vis the higher oil prices. Although the *Oleoducto Norperuano* has a transportation capacity of 200 000 BDC, it is only transporting an average of 42 000 BDC.

[7] PETROPERU. *Memoria Anual* 2005.

On the other hand, the net of other income and extraordinary financing expenses rose due to greater contingencies relating to judicial labor and customs processes and the increase in financial and banking expenses. In contrast, the yearly provision for the pension fund dropped by S/. 48 million, as a consequence of changes in the pension regime.

Balance Sheet (2001–2005).– The Balance Sheet for 2005 reflects a working capital of S/. 634 million, which is 31 % over 2004. Table 12 shows what current assets were recorded as a consequence of higher stock appraisals due to the oil price hike and the increase in credit facilities for customers. Non current liabilities shows a significant decrease due to adjustments in the actuarial pension reserve and amortization of the debt with the Ministry of Economy and Finance for guarantee procedures. The increase of the net equity is due basically to the S/. 245 million in net profits for the period.

Table 12. Balance Sheet of *PETROPERU S.A.* (2001–2005)

Balance general (millones de nuevos soles)

	2001	2002	2003	2004	2005
Activo corriente	778,2	1 025,5	1 248,4	1 458,8	1 577,3
Activo no corriente	895,3	849,5	863,8	817,1	778,7
Total activo	**1 673,5**	**1 875,0**	**2 112,2**	**2 275,9**	**2 356,0**
Pasivo corriente	762,8	842,6	967,7	974,5	943,7
Pasivo no corriente	822,9	866,6	885,2	840,6	817,3
Total pasivo	**1 585,7**	**1 709,2**	**1 852,9**	**1 815,1**	**1 761,0**
Patrimonio neto	87,8	165,8	259,3	460,8	595,0
Total pasivo y patrimonio neto	**1 673,5**	**1 875,0**	**2 112,2**	**2 275,9**	**2 356,0**

Cifras ajustadas al 2004. Ejercicio 2005 en valores corrientes.

Exchange rate in S/. per US$: year 2001 – S/. 3.51; 2002 – S/. 3.52; 2003 – S/. 3.48; 2004 – S/. 3.41; 2005 – S/. 3.30

Balance sheet (millions of new sols)
Current assets
Non–current assets
Total assets
Current liabilities
Non–current liabilities
Total liabilities
Net equity
Total liabilities and net equity

Financial Indicators (2001–2005).– The Return on Assets (ROA) and the net financial profitability of equity or shareholder profitability (ROE) show significant growth in 2005 with regard to 2004, as consequence of the profits gained. The liquidity ratios indicate that the company has sufficient resources attend to its short–tem obligations. The improvement in the Equity Indebtedness Index, which represents the commitment of own resources in relation to short and long–term debts, shows a downturn in obligations to third parties as a product of economic strengthening in *PETROPERU S.A.* (Table 13).

Table 13. Financial Indicators (2001– 2005)

Indicador	Unidad	2001	2002	2003	2004	2005
Rentabilidad						
Rentabilidad económica (ROA)	%	26,0	14,7	12,4	19,8	27,9
Rentabilidad financiera (ROE)	%	120,1	58,2	5,1	39,5	41,2
Liquidez						
Liquidez general	S/.	1,05	1,22	1,29	1,33	1,67
Prueba ácida	S/.	0,42	0,53	0,52	0,57	0,71
Solvencia						
Endeudamiento patrimonial	cantidad de veces	18,06	10,31	7,15	3,93	2,96

Exchange rate in S/. per US$: year 2001 – S/. 3.51; 2002 –

S/. 3.52; 2003 – S/. 3.48; 2004 – S/. 3.41; 2005 – S/. 3.30

Indicator	Unit
Profitability	
Return on Assets (ROA)	
Return on Equity (ROE)	
Liquidity	
General liquidity	
Acid test	
Solvency	
Capital indebtedness	Number of times

Situation of *PETROPERU S.A.* in 2006

As a preview of the economic financial results for *PETROPERU S.A.* in 2006, we can say that it obtained an economic surplus of S/. 158 million. This is S/. 17 million less than the results recorded in 2005, due to higher purchase prices, which rose by an average of 11 %, and a decrease in domestic sales. This was because the Mobil chain of gas pumps that used to purchase from *PETROPERU S.A.* stopped doing, and also because of greater domestic competition with importers.

Table 14 presents the *PETROPERU* investment program for 2007. It is easy to see that it aims to modernize its refineries. They are at a critical stage due to several delays in award processes, even for preliminary studies, which did not allow them to comply with the environmental regulations in force without postponing their startup.

Table 14. Investment Program for *PETROPERU S.A.*

PETROPERU S.A.

PROGRAMA DE INVERSIONES
Miles de Nuevos Soles

PROGRAMA DE INVERSIONES	IV TRIM 2006	I TRIM 2007	II TRIM 2007	Al II TRIM 2007	PRSP Al II TRIM 2007
PROYECTOS DE INVERSION	**635**	**867**	**658**	**1,525**	**4,042**
Modernización de la Refinería Talara	233	41	236	277	3,894
Reemplazo de tanques 293 y 294 - Ref. Talara	9	3	8	11	0
Construcción de Tanques - Ref. Iquitos	8	0	0	0	0
Mejoras de Flexibilidad Operativa - Ref. Iquitos	0	0	6	6	0
Construcción tanque y compra de equipo laboratorio - Refinería Conchán	3	20	51	54	20
Despacho marítimo de asfaltos - Ref. Talara	1	0	45	45	128
Mejoras en Unidades de proceso - Ref. Talara	0	819	313	1,132	0
Instalación de 10 EE.SS Gas natural vehicular	0	0	0	0	0
INVERSION CORRIENTE	**33,913**	**10,912**	**11,244**	**22,156**	**32,436**
Adecuación a Reglamentos - Ley 26221	4,451	3,751	995	4,746	7,628
Reemplazo de maquinaria y equipos	11,204	5,857	8,128	13,985	16,788
Seguridad y equipos contra incendio	553	68	862	930	1,273
Mantenimiento General	12,800	17	754	771	433
Sistemas y equipos de computo	1,833	992	(78)	914	942
Mejoras en plantas de ventas	298	(3)	0	(3)	0
Administración	2,774	230	583	813	5,371
TOTAL	**34,548**	**11,778**	**11,902**	**23,681**	**36,478**

Exchange rate in S/. per US$: year 2006 – 3.28; 2007 – 3.14

PETROPERU S.A.
INVESTMENT PROGRAM
Thousands of New Sols

INVESTMENT PROGRAM	IV QTR 2006	I QTR 2007	II QTR 2007	AT II QTR 2007	BUDGET AT II QTR 2007
Modernization of Talara refinery					
Replace tanks 293 and 294 at Talara refinery					
Build tanks at Iquitos refinery					
Enhance operational flexibility at Iquitos refinery					
Build tank and buy lab equipment – Chonchan refinery					
Marine dispatch of asphalts – Talara refinery					
Enhance process units – Talara refinery					
Install 10 service stations for vehicular natural gas					
CURRENT INVESTMENTS					
Adjust to regulations – Law 26221					
Replace machinery and equipment					

Firefighting safety and equipment					
General maintenance					
Computer systems and equipment					
Enhance sales plants					
Administration					
TOTAL					

7.2.2 Pros and cons of *PETROPERU S.A.*

Much of the information presented above comes from *PETROPERU S.A.*, so it reflects the viewpoint of the company itself. However, the true role of *PETROPERU S.A.* in supplying the domestic market with petroleum fuel products (53 % of the market), is that of a regulatory entity, and to a large extent its prices are conditioned by the government policy to buffer increases, which often collides with the interests of this company and with those of private companies (47 % of the market). This has been necessary because privatization did not achieve the existence of at least 3 actors in regards to refining, importing products and marketing, in order to achieve true, effective competition. One disadvantage is the ties to State management, which hampers speedy operations.

With this tonic, in order to avoid encumbering end users with excessive fuel price hikes, the *Fondo para la Estabilización del Precio de Combustible y Derivados de Petroleo* was created in September 2004 (Emergency Decree N° 010–2004) as an intangible, non–attachable and non–transferable fund meant to prevent transferring the high volatility in the crude oil and product prices to consumers. The fund equity is made up of contributions and discounts by producers and importers in products prices, depending on whether parity prices on fuel imports are above or below the goal price band for each of the products.

When prices surpass the upper limit of the band, the government takes charge of this excess as a way to compensate the companies, expecting that when the prices drop below the lower band limit the State will recover its contribution. However, despite its ups and downs, the trend in international prices has been upwards, causing the State to disburse in the order of US$ 110 million over the past three years. This compensation modality is being reviewed, not having fulfilled its original essence, which was the possibility to compensate for price increases with price decreases, in order to balance out State contributions. In other words, the Peruvian State has been subsidizing all fuels.

7.3 Other types of companies:

7.3.1 Governmental Investment Companies: State equity shares over 50 %

This type of company does not presently exist in the country.

7.3.2 Government–Funded Companies: less than 50 % government ownership

This type of company does not presently exist in the country.

7.3.3 Subsidiaries of Government Investment Companies.

This type of company does not presently exist in Peru.

8. PRIVATE SECTOR COMPANIES – FUNCTIONS AND PERFORMANCE REVIEW. COORDINATING ORGANIZATION

8.1 Representative Companies and their Activities

8.1.1 Up–stream Activities.– There are 3 representative companies – *Grupo Pluspetrol*, PETROBRAS and PETROTECH – that jointly produce 91 % of all domestic liquid hydrocarbons production, which was 42.2 million barrels in 2006.

With regard to natural gas, there are 3 representative companies – *Grupo Pluspetrol*, AGUAYTÍA and PETROTECH – that jointly produce 84 % of all domestic production, which reached 68 564 million cubic feet in 2006.

The largest of the 4 companies mentioned above is *Grupo Pluspetrol*, primarily *Pluspetrol Camisea*. Further details are given below on its economic and financial management and status, as are those for *Aguaytía Energía de Peru*.

GRUPO PLUSPETROL.– *Pluspetrol Camisea S.A.*, a subsidiary of Pluspetrol Resources Corporation domiciled on the Caiman Islands, was created in Peru on June 1, 2005, through a General Shareholders Assembly to divide up *Pluspetrol Peru Corporación S.A.* dated April 13, 2005. Company activities include exploitation and sale of gas and gas liquids from Block 88 and from Block 56 that will soon begin production. These blocks are contiguous and are in the area of Camisea, Province of Echarate, Department of Cusco.

By virtue of a contract license signed years ago by *Pluspetrol Peru Corporación S.A.*, the company has a 25 % share of the contract to exploit hydrocarbons in Block 88. This contract was entered into jointly with other oil companies and *PERUPETRO S.A.* on December 9, 2000, for the purpose of exploiting and producing hydrocarbons. The term for oil exploitation is 30 years and the term for the non–associated natural gas and condensate exploitation phase is 40 years. The activities carried out under the hydrocarbons exploitation contract for Block 88 have been ensured tax stability, exchange rate stability and other benefits established in the Organic Hydrocarbons Law No. 26221.

Its share in the domestic liquid hydrocarbons production reached 30 % in 2006. Adding the 39 % of oil production achieved by *Pluspetrol Norte*, the *Grupo Pluspetrol* was responsible for 69 % (29.1 million barrels), which was 44 % for natural gas (27 628 million cubic feet).

Financial Statements at December 31, 2006[8]

As shown in the performance indicator table, net profits for *Pluspetrol Camisea* were over 30 %, backed by the favorable price levels recorded in 2006 for marketed products. The return on investment was 38 %, and there was a 25 % of return on assets. Tables 15 and 16 show the main indicators and essential figures.

Table 15. Primary Indicators
(Based on audited financial statements)
(thousands of US$)

Fiscal year at December 31	2006
Rates of return:	
Return on Sales	33 %
Return on Investment	38 %
Return on Assets (x)	25 %
Management Index:	
EBITDA (thousands of US$)	96 281
Gross Margin	50 %
Operational Margin	48 %

(x) Operating profits / Total assets

Table 16. Primary Figures
(Base Audited financial statements – Thousands of US$)

Fiscal year at December 31	2006	2005	2004
Income	189 195	161 204	45 016
Operational profits	90 222	75 195	12 200
Net profits	63 079	53 087	770
Cash & Banks and short-term investments	173 963	18 759	4 757
Total Assets	364 219	209 823	195 928
Short and long-term debts	151 598	1 806	2 349
Shareholder equity	166 349	103 270	50 183

Balance Sheet.– As a result of the activities of *Pluspetrol Camisea*, at December 31, 2006, total assets grew by 74 %, liabilities rose 86 % and equity increased 61 %, in comparison with the figures presented at December 31, 2005 (Table 17).

The growth in assets is basically due to an increase in cash and cash equivalents, which went from US$ 19 million at December 31, 2005 to US$ 174 million at December 31, 2006. This was in response to the Corporate Bonds placement by *Pluspetrol Camisea S.A* in the first schedule of instruments representing the debt during the last quarter of the period. This increase was compensated in part by the decrease in commercial accounts receivable that went

[8] *Pluspetrol Camisea S.A.– Memoria Anual 2006. Análisis y Discusión de la Gerencia de Pluspetrol Camisa S.A.*

from US$ 8 million to US$ 5 million, respectively. Currently, company assets consist of 54 % current assets (19 % at December 31, 2005) and 46 % fixed assets (81 % at December 31, 2005).

The behavior of liabilities is mostly due to the increase in long–term indebtedness caused by the Corporate Bonds placement. This increase was compensated in part by payment of the long–term debt with related companies, which at December 31, 2005, totaled US$ 71 million. Liabilities are made up of 13 % current liabilities (15 % at December 31, 2005) and 87 % non current liabilities (85 % at December 31, 2005). The equity account grew by 61 %, due to an increase in the accumulated loss and gains account because of the results obtained during the 2006 period, which totaled US$ 63 million.

Chart 17. Balance Sheet
(based on audited financial statements)
(thousands of US$)

Fiscal year at December 31	2006	2005	2004
Total Current assets	197 740	36 774	19 709
Total non–current assets	166 479	171 049	176 219
Total Assets	364 219	209 823	195 928
Total Current liabilities	25 504	16 084	8 561
Total Non current liabilities	172 366	90 469	137 184
Total Liabilities	197 870	106 563	145 745
Capital	50 183	50 183	50 183
Legal reserve	5 309	5 309	–
Retained profits	110 857	47 778	–
Total equity	166 349	103 270	50 183

Profit and Loss Statement.– The net profits obtained by the company during 2006 (US$ 63 million) was 19 % greater than that recorded during 2005 (US$ 53 at December 31, 2005). This total equals 33 % of all sales of US$ 189 million, which is 17 % greater than those shown for 2005. Sales costs remained in the order of the 50 % of net sales and operational expenses stayed at approximately 3 % over the same calculation base (Table 18).

Table 18. Loss and Profit
(based on audited financial statements – thousands of US$)

Fiscal year at December 31	2006	2005	2004
Income	189 195	161 204	45 016
Sales cost	(93 891)	(82 171)	(25 895)
Gross profits	95 304	79 033	19 121
Operational profits	90 222	75 195	12 200
Profits before taxes	89 846	69 307	11 800
Net profits	63 079	53 087	770

Based on audited financial statements, thousands of US$

PETROTECH PERUANA S.A.– Created on July 21, 1993, in the State of Delaware, USA, it began its operations on January 1, 1994, as a company committed to oil exploration and exploitation on the northern coast of Peru, for which purpose it entered into oil service contract for lot Z–2B with the State–owned company *PETROPERU S.A.*, later replaced by *PERUPETRO S.A.* On July 07 it produced 11 % (4.6 million barrels) of the yearly domestic production of hydrocarbons liquids, and 10 % (6 166 million cubic feet) of all natural gas. Not quoted on the stock market. No information available.

PETROBRAS.– Operating in Peru through *Petrobras Energía*, this company has oil and natural gas exploration and exploitation rights in two blocks in Peru: Block X and Block 57. Its main operations are centered on Block X, which is in production, while in Block 57 Petrobras develops exploratory activities as an operator. The company's share in the production within the Peruvian territory is currently around 13 thousand barrels of oil equivalent per day. It produces 11 % (4.6 million barrels) of the yearly domestic production of hydrocarbons liquids. Not quoted on the stock market. No information available.

AGUAYTÍA ENERGÍA[9].– Since May, 2001, *Aguaytia Energy de Peru S.R.L.* was split into three (3) commercially independent companies, because of the different operations they carried out in three major business areas: a) ***AGUAYTIA ENERGY DE PERU S.R.L.***, a company devoted to operations relating specifically to marketing natural gas and

[9]www.aguaytía.com/i_energy01.htm

its derivatives, including exploitation, production, conditioning, separation, fractioning, transportation, and marketing of natural gas and its derivatives; b) ***TERMOSELVA S.R.L.,*** a company committed to operations relating specifically to the business of electricity generation, which uses dry gas produced by *Aguaytía Energía de Peru* S.R.L. as a fuel; c) ***ETESELVA S.R.L.,*** a company dedicated to operations relating specifically to the business of electricity transmission, which includes a stretch that is currently declared as part of the main transmission system of the National Interconnected System. **These three companies make up the *Grupo Energético Aguaytía*, which develops the commercial activity of the Project Integral of Aguaytía independently.**– The Aguaytía natural gas field is located in Curimaná, province of *Padre Abad*, department of Ucayali, approximately 75 km West of Pucallpa, 77 Km northeast of Aguaytía and 475 km northeast of Lima. *Aguaytia Energy de Peru S.R.L.* began its business operations in July 1998 with potential rich natural gas reserves estimated at 440 billion cubic feet. Natural gas production: 70 MMPCSD. Processing of natural gas with condensates: 65 MMPCSD of dry natural gas and 4 400 barrels per day of natural gas liquids, barrels per day of LPG and 3 000 barrels per day of natural gasoline, transportation of dry natural gas, LPG and Natural Gasoline.

Table 19. Financial Summary: *Aguaytía Energía de Peru*

Resumen Financiero - Aguaytía Energy del Perú S.R.L. y subsidiarias

(Cifras en miles de Dólares)

	Jun-07	Jun-06	Dic-06	Dic-05	Dic-04	Dic-03	Dic-02
Tipo de Cambio Soles / USD a final del período	3.168	3.259	3.196	3.43	3.282	3.463	3.514
Indicadores Financieros							
EBITDA/Intereses Pagados(X)	10.46	5.70	8.92	8.98	8.56	3.52	4.51
(EBITDA-Inv. en Act. Fijo)/Intereses Pagados(X)	10.16	4.65	8.22	8.29	7.95	3.48	4.15
Deuda Financiera Total/EBITDA (X)	1.44	2.80	1.48	1.43	1.60	2.14	2.28
Deuda Financiera Neta/EBITDA (X)	1.04	2.20	1.13	1.17	1.23	1.82	2.07
Deuda Financiera Total/Capitalización (%)	25.5%	29.4%	26.4%	29.7%	31.3%	34.2%	37.2%
Resultados							
Ventas Netas	52,302	45,681	120,050	119,551	96,558	80,409	72,093
%Cambio	14.5%	-15.7%	0.4%	23.8%	20.1%	11.5%	7.0%
EBITDA	19,432	11,731	40,409	45,917	44,738	38,681	37,375
Margen EBITDA (%)	37.2%	25.7%	33.7%	38.4%	46.3%	48.1%	51.8%
Depreciación y Amortización	6,020	4,821	12,981	11,664	13,512	11,562	11,853
EBIT	13,412	6,910	27,428	34,253	31,226	27,119	25,522
Intereses Pagados	(1,857)	(2,057)	(4,531)	(5,116)	(5,229)	(10,980)	(8,293)
Costo de Financiamiento Estimado (%)*	6.4%	6.3%	7.2%	7.6%	6.8%	13.1%	9.3%
Utilidad Neta	8,390	3,159	15,762	21,379	17,267	14,555	22,539
Retorno sobre Patrimonio Promedio(%)	10.2%	4.0%	9.7%	13.7%	10.9%	9.6%	16.9%
Flujo de Caja							
Flujo de Caja Operativo	14,909	5,561	28,879	32,844	33,734	30,453	34,484
Variación del Capital de Trabajo	3,329	802	(12,187)	(5,315)	(3,981)	(34,129)	(14,029)
Flujo de Caja Operativo Neto	18,238	6,363	16,692	27,529	29,753	(3,676)	20,455
Inversión en Activos Fijos	(574)	(2,162)	(3,186)	(3,487)	(3,146)	(418)	(2,993)
Adquisiciones y Ventas de Activos Fijos, Neto	(574)	(2,162)	(3,186)	(3,487)	(3,146)	(418)	(2,993)
Otras Inversiones, Neto	(77)	(89)	-	-	-	7,050	(7,871)
Variación Neta de Deuda	(4,932)	(1,188)	(5,944)	(5,785)	(11,245)	1,204	(7,455)
Variación Neta de Capital	-	-	-	-	-	-	-
Pago de Dividendos	(11,618)	(699)	(5,206)	(22,823)	(19,249)	-	-
Otros Financiamientos, Neto	-	-	-	-	-	-	-
Variación Neta de Caja y Valores Liquidos	1,037	2,225	2,356	(4,566)	(3,887)	4,160	2,136
Flujo de Caja Disponible**	20,330	8,314	20,505	31,999	32,382	(6,846)	12,060
Balance							
Caja e Inversiones Corrientes	15,336	14,117	14,188	11,832	16,398	12,285	8,125
Activos Totales	235,357	252,446	239,317	241,820	249,004	267,472	273,210
Deuda Corto Plazo	11,266	9,865	10,539	7,867	9,435	10,621	12,903
Deuda Largo Plazo	44,581	55,846	49,131	57,747	61,964	72,023	72,442
Obligaciones Financieras Fuera de Balance†	-	-	-	-	-	-	-
Deuda Financiera Total‡	55,847	65,711	59,670	65,614	71,399	82,644	85,345
Patrimonio (Incl. Participación Minoritaria)	162,804	157,938	166,034	155,478	156,922	158,903	144,348
Capitalización	218,651	223,649	225,704	221,092	228,321	241,547	229,693
Liquidez							
Deuda Corto Plazo/Deuda Financiera Total	20.2%	15.0%	17.7%	12.0%	13.2%	12.9%	15.1%
Caja e Inversiones Corrientes/Deuda Corto Plazo(X)	1.36	1.43	1.35	1.50	1.74	1.16	0.63
EBITDA/(Deuda Corto Plazo + Gastos Financieros)(X)	2.59	1.68	2.68	3.54	3.05	1.79	1.76
Otros							
Producción de Energía (GWh)	509.2	455.1	1148.0	1291.1	1130.3	834.8	745.2
Producción de Barriles (bbls)	549,340	617,931	1,216,385	1,350,225	1,428,065	1,469,790	1,493,371
Precio del Petróleo WTI (US$/barril)	61.5	66.8	66.0	56.5	41.2	31.1	26.2

Vencimientos de Deuda Largo Plazo (a junio 2007)	2007	2008	2009	2010	2011
Vencimientos (US$ mill.)	8,273	8,273	8,273	8,273	22,099

*Costo de Financiamiento Estimado = Intereses Pagados / Deuda Financiera Total Promedio. **Flujo de Caja Libre=EBITDA-Intereses Pagados-Variación en Capital de Trabajo - Inv. en Activos Fijos. †Incluye arrendamientos operacionales multiplicado por ocho, y otros tipos de obligaciones con características de deuda financiera.
‡Deuda Financiera Total incluye Obligaciones Financieras Fuera de Balance. Capitalización = Deuda Financiera Total + Patrimonio (Incl. Participación Minoritaria)
EBITDA=Resultado de Operación + Depreciación y Amortización. Las cifras a diciembre de cada año son cifras auditadas.

Exchange rate in Sols / US$ at end of period
Financial Indicators
EBITDA / Interest Paid (X)
(EBITDA – Inv. In Fixed Assets) / Interest Paid (X)
Total Financial Debt / EBITDA (X)
Net Financial Debt / EBITDA (X)
Total Financial Debt / Capitalization (%)

Loss & Profits
Net Sales
% Change
EBITDA
EBITDA Margin (%)
Depreciation and Amortization
EBIT
Interest Paid
Estimated Financing Cost (%)*
Net Profit
Average Return on Equity (%)
Cash Flow
Working Cash Flow
Working Capital Variation
Net Working Cash Flow
Investments in Fixed Assets
Changes in Net Indebtedness
Payments in Dividends
Changes in Net Cash and Liquid Amounts
Available Cash Flow **
Balance
Current Cash and Investments
Total Assets
Short–Term Debt
Long–Term Debt
Total Financial Debt ‡
Equity (including minority share)
Capitalization
Liquidity
Short–Term Debt / Total Financial Debt
Cash and Current Investments / Short–Term Debt (X)
EBITDA / (Short–Term Debt + Financial Expenses) (X)
Other Indices
Inventory Days
Average collection period
Average WTI quote (US$ / barrel)
Long–Term Debt Maturities (at December 2006)
Year
Maturity (thousands of US$)
* Estimated Financial Cost = Interest Paid / Average Total Financial Debt
** Free Cash Flow = EBITDA – Interest Paid – Changes in Working Capital
*** No Long–Term Debt is recorded at present
Capitalization = Total Financial Debt + Equity (including minority shares)
EBITDA = Operational Results + Depreciation and Amortization
N.A. = not available
* Does not include expenses due to exchange rate differences

8.1.2 Downstream Activities

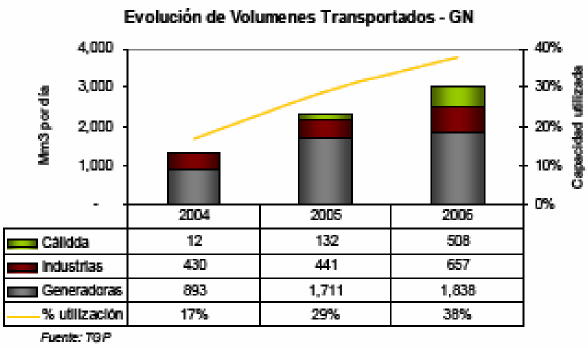
The most outstanding are activities relating to hydrocarbons transportation through pipelines, refining, fractioning plants, storage plants, distribution and service stations, which are the most representative in the country.

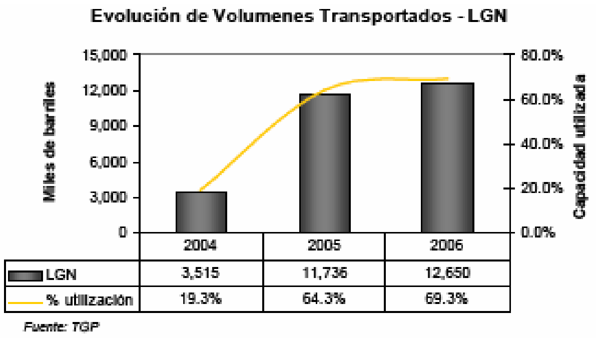
Hydrocarbons transportation via pipelines

Within the framework of promoting private investment, directed by the Peruvian State, following an international public bidding contest, *Transportadora de Gas de Peru* (TgP) was awarded the concession of the gas transportation segment within the Camisea project. In keeping with this process, concession contracts were formalized with the Peruvian State in December 2000 to build and operate the natural gas and natural gas liquids transportation systems. TgP is a Peruvian company whose shareholders are TECGAS NV, Hunt Oil, Sonatrach, Pluspetrol, SK Corporation, Suez–Tractebel, and *Graña y Montero*. In turn, TECGAS NV acts as a Qualified Strategic Operator within the framework of the BOOT contracts.

From January 2002 to August 2004 two pipelines were built to transport natural gas and gas liquids from Camisea, in the Cusco jungle, to the Pacific coast. The liquids pipeline runs for 560 kilometers, from the Camisea reservoirs to the fractioning plant in Pisco. The natural gas pipeline runs along 732 kilometers (Table 20), from Camisea to the city gate of Lurín, from where the gas is distributed in Lima and Callao. During 2006, 1 097 000 Mm³ (3 003 Mm³ / day) were transported, which is 37.9 % of the current capacity actual. Up to now for 2007 the gas pipeline is transporting an average of 160 MMPCD and 35 MBD. As for liquids, the transported volume during 2006 reached 12.7 million barrels, equal to 69.3 % of installed capacity (Graphs 16 and 17).

Graphs 16 and 17





Evolution of Transported Volumes – NG	Evolution of Transported Volumes – NGL
Mm3 per day	Thousands of barrels
Utilized capacity	Utilized capacity
Quality	
Industries	NGL
Generators	
% utilization	% utilization
Source: TGP	Source: TGP

Table 20. Pipeline Characteristics

	Natural Gas Pipeline	Natural Gas Liquids Pipeline
Route	Camisea – City Gate (Lurín, Lima)	Camisea – Playa Lobería (Pisco, Ica)
Length	732 Km	560 Km
Diameter	32.24 and 18 inches	14 and 10 inches
Capacity		
Initial	280 MMPCD	50 MBPD
Up to	314 MMPCD	70 MBPD

Pursuant to Resolution N 075–2006–OS/CD, OSINERGMIN set the tariffs for the period from May 1, 2006 to April 30, 2008, at the figures shown below (Table 21):

Table 21. Natural Gas Transportation Tariffs.
TCM (thousand cubic meters)
OSINERGMIN

Type	US$ per TCM

Base Rate	33.07
Regulated Rate	41.42

The Concession Contract has a payment guarantee for natural gas (Primary Network Guarantee or GRP from the Spanish) that ensures the company's early revenues at approximately US$ 124 million (2/3 of total income), calculated on a base rate at a guaranteed transportation volume regardless of its actual demand. Table 22 details the TGP Financial Summary.

Table 22

Resumen Financiero - Transportadora de Gas del Perú
(Cifra en millones de US$ a Dic 31, 2006)

	Dic-06	Dic-05	Dic-04	Dic-03
Indicadores Financieros				
EBITDA/Gastos Financieros Deuda Senior(X)	2.5	3.5	4.7	-
EBITDA/Gastos Financieros Totales(X)	1.6	2.0	1.8	-
(EBITDA-Inv. en Act. Fijo) / Gastos Financieros D. Senior(X)	1.5	3.3	-2.7	-
Deuda Financiera Senior / EBITDA (X)	4.5	3.8	11.0	0.0
Deuda Financiera Total / EBITDA (X)	5.5	4.6	15.7	757.2
Deuda Financiera Neta / EBITDA (X)	4.7	3.9	14.5	717.8
Deuda Financiera Senior / Capitalización (%)	58.5%	59.9%	52.1%	
Deuda Financiera Total / Capitalización (%)	72.1%	72.4%	74.4%	68.2%
Resultados				
Ventas Netas	181,472	179,670	64,339	-
%Cambio	1.0%	179.3%	-	-
EBITDA*	102,726	122,013	35,589	595
Margen EBITDA (%)	56.6%	67.9%	55.3%	-
Depreciación y Amortización	29,174	27,132	10,796	595
EBIT	73,552	94,881	24,793	-
Gastos Financieros Deuda Senior	(41,533)	(34,587)	(7,535)	-
Gastos Financieros Totales **	(65,153)	(59,750)	(19,569)	-
Costo de Financiamiento Estimado (%)***	7.3%	6.2%	1.5%	-
Utilidad Neta	4,467	23,959	10,424	-
Retorno sobre Patrimonio Promedio(%)	2.0%	11.8%	5.2%	-
Flujo de Caja				
Flujo de Caja Operativo	56,987	74,834	16,114	595
Variación del Capital de Trabajo	(9,537)	(16,351)	(31,989)	(11,350)
Flujo de Caja Operativo Neto	47,450	58,483	(15,875)	(10,755)
Inversión en Activos Fijos	(39,039)	(7,615)	(55,998)	(18,339)
Otras Inversiones, Neto	(990)	-	(10,864)	-
Variación Neta de Deuda	(14,395)	987	391,281	-
Variación Neta de Capital	-	-	-	-
Pago de Dividendos	-	-	-	185
Otros Financiamientos, Neto	-	(74,802)	(287,671)	42,060
Variación Neta de Caja y Valores Liquidos	(6,973)	(22,947)	20,875	13,151
Flujo de Caja Disponible****	95,684	132,634	(44,862)	-
Balance				
Caja e Inversiones Corrientes	88,257	95,230	44,285	23,411
Activos Totales	939,006	920,916	902,575	803,892
Deuda Corto Plazo	20,939	18,051	5,469	-
Deuda Largo Plazo	440,304	449,792	385,813	-
Deuda Subordinada	106,929	97,434	167,421	450,681
Deuda Financiera Total‡	568,172	565,277	558,703	450,681
Patrimonio (Incl. Participación Minoritaria)	220,262	215,795	191,837	209,926
Capitalización	788,434	781,073	750,539	660,606
Liquidez				
Deuda Corto Plazo/Deuda Fianciera Total	3.7%	3.2%	1.0%	n.d.
Caja e Inversiones Corrientes/Deuda Corto Plazo(X)	4.2	5.3	8.1	n.d.
EBITDA/(Deuda Corto Plazo + Gastos Financieros)(X)	4.9	6.8	6.5	n.d.

Vencimientos de Deuda Largo Plazo (a diciembre 31, 2006)

Año (miles de US$)	2008	2,009	2010	2011	2012	2013...
Vencimientos	18,707	20,454	22,365	24,456	26,745	247,699

*EBITDA=Resultado de Operación + Depreciación y Amortización **Incluye Intereses de deuda con accionistas e intereses por la GRP

***Costo de Financiamiento Estimado = Intereses Pagados / Deuda Financiera Total Promedio.

****Flujo de Caja Disponible=EBITDA-Intereses Pagados-Variación en Capital de Trabajo-Inv. en Activos Fijos.

‡Deuda Financiera Total Incluye Obligaciones Financieras Fuera de Balance. Capitalización = Deuda Financiera Total + Patrimonio (Incl. Participación Minoritaria)

Financial Summary – *Aguaytia Energy del Peru S.R.L.* and Subsidiaries
(figures in thousands of Dollars)
Exchange rate in Sols / US$ at end of period
Financial Indicators
EBITDA / interest Paid (X)
(EBITDA – Inv. In Fixed Assets) / Interest Paid (X)
Total Financial Debt / EBITDA (X)
Net Financial Debt / EBITDA (X)
Total Financial Debt / Capitalization ($)
Loss & Profits
Net Sales
% Change
EBITDA
EBITDA Margin (%)
Depreciation and Amortization
EBIT
Interest Paid
Estimated Financing Cost (%)*
Net Profit
Average Return on Equity (%)
Cash Flow
Working Cash Flow
Working Capital Variation
Net Working Cash Flow
Investments in Fixed Assets
Purchase and Sale of Fixed Assets, Net
Other Investments, Net
Changes in Net Indebtedness
Changes in Net Capital
Payments in Dividends
Other Financing, Net
Changes in Net Cash and Liquid Amounts
Available Cash Flow **
Balance
Cash and Current Investments
Total Assets
Short–Term Debt
Long–Term Debt
Off–balance Financial Obligations †
Total Financial Debt ‡
Equity (including minority share)
Capitalization
Liquidity
Short–Term Debt / Total Financial Debt
Cash and Current investments / Short–Term Debt (X)
EBITDA / (Short–Term Debt + Financial Expenses) (X)
Others

Energy Production (GWh)
Production in Barrels (bbls)
WTI Oil Price (US$ / barrel)
Long–Term Debt Maturities (at June 2007)
Maturity (US$ million)
* Estimated Financial Cost = Interest Paid / Average Total Financial Debt.
** Free Cash Flow = EBITDA – Interest Paid – Changes in Working Capital
† Includes operational rent multiplied by eight, and other types of obligations with financial debt characteristics
‡ Total Financial Debt includes Off–balance Financial Obligations
Capitalization = Total Financial Debt + Equity (including minority shares)
EBITDA = Operational Results + Depreciation and Amortization
Figures at December of each year are audited amounts

Refining

Peru has seven oil refineries, one of which (Shiviyacu, in the Northern Jungle) is for internal use in Pluspetrol operations. The other six supply much of the country's fuel demand. These refineries process domestic and imported crude oils, as shown in the graph. Five of these refineries are owned by *PETROPERU S.A.*, 4 of which it operates (Talara, Conchán, Iquitos, and *El Milagro*), and the other one (Pucallpa) is operated by the company Maple. The sixth refinery (*La Pampilla*), with the greatest processing capacity, owned and operated by REPSOL. Currently, REPSOL's *La Pampilla* refinery is a plant that has been modernized, has a sweetening plant, and in general terms meets the country's environmental requirements. The opposite is the case with the Talara refinery, which as mentioned above belongs to the State through *PETROPERU S.A.* and can still not be modernized due to road blocks in public administration. To date, special devices have been dictated to expedite the procedures and achieve the desired modernization. Graph 18 shows the total load capacities for the country's refineries.

The load capacity of the country's refineries is 197 000 BPD, of which REPSOL can process 102 000 BPD, Pucallpa (Maple) 3 300 BPD, and the rest of the capacity pertains to the refineries of *PETROPERU S.A.* (Table 23). Graph 18 shows the total loads processed in the country's refineries. Note that *La Pampilla* and Talara have greatest capacity, in that order. Graph 19 shows the total production of these refineries for 2006. Table 24 shows the production of and demand for different products. Note that the 2006 demand far surpassed production, in contrast to what happened in 2005, which meant importing more products than crude oil for 2006.

Tables 23 and 24

Capacidad Instalada de Refinación

Refinería	Capacidad (BPD)	Porcentaje
Refinerías de Petroperú		
Talara	62,000	31.47%
Conchán	15,500	7.87%
Iquitos	10,500	5.33%
El Milagro	1,700	0.86%
Pucallpa*	3,300	1.68%
Refinerías Privadas		
Shiviyacu**	2,000	1.02%
La Pampilla	102,000	51.78%
TOTAL	197,000	100.00%

Arrendada a Maple Gas Corporation *Fuente: MINEM*

*** De propiedad de Pluspetrol y destinada para su autoconsumo.*

Producción y Demanda

MBLS	Producción 2006	Producción 2005	Demanda 2006	Demanda 2005
Gasolinas	5,660	7,466	7,229	7,182
Kerosene	785	985	646	1,632
Turbo	2,694	3,727	1,944	710
Diesel	12,764	18,468	21,457	21,386
Petróleo Industrial	11,343	14,717	7,193	8,502
Otros	2,060	2,754	1,617	1,784
Total	36,308	48,117	40,088	41,188

Fuente: Minem

INSTALLED REFINING CAPACITY		
REFINERY	CAPACITY (BPD)	PERCENTAGE
Talara		
Conchan		
Iquitos		
El Milagro		
Pucallpa		
Private Refineries		
Shiviyacu		
La Pamplina		
TOTAL		

PRODUCTION AND DEMAND		
MBLS	PRODUCTION	DEMAND
Gasolines		
Kerosene		
Diesel		
Industrial Oil		
Others		
TOTAL		
Source: MINEM		

* Rented – Maple Gas Corporation
** Owned by Pluspetrol and for self–consumption
Source: MINEM

In 2006, in terms of market share, RELAPASA produced 46.4 % of all local supply, while the rest was covered by *PETROPERU S.A.* The market price for products was based on international prices, which are the result of supply and demand.

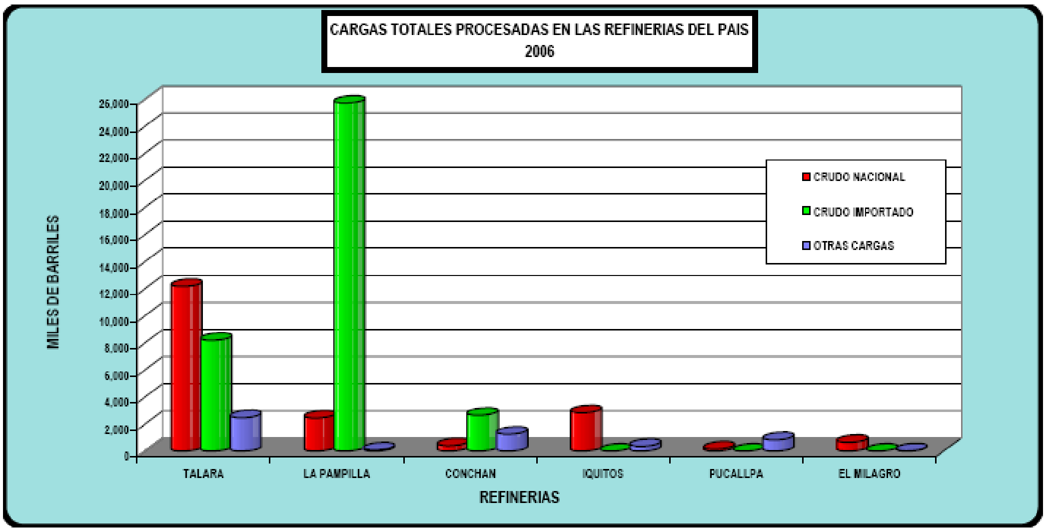
Table 25. Fuel Price Structure at December 31, 2006

COMBUSTIBLES	Precio Petroperú Ex-Refinería	IMPUESTOS Al Rodaje (8%)	IMPUESTOS Selectivo Consumo (2)	IMPUESTOS General Ventas (19%)	Precio Ex-Planta Con Impuestos	Margen Comercial (1)	Precio Al Público (*)
Gas Lic. de Pet. GLP (**)	1.78	-		0.34	2.11	1.16	3.27
Gasolina 97 Oct.SP	7.03	0.56	3.15	2.04	12.78	2.27	15.05
Gasolina 95 Oct.SP	6.86	0.55	2.92	1.96	12.29	2.08	14.37
Gasolina 90 Oct.SP	6.14	0.49	2.66	1.77	11.06	1.01	12.07
Gasolina 84 Oct.	5.19	0.42	2.05	1.45	9.11	1.22	10.33
Kerosene	6.44	-	2.11	1.62	10.17	1.41	11.58
Diesel N° 2	6.47	-	1.54	1.52	9.54	0.71	10.25
Pet. Residual N° 6	4.09	-	-	0.78	4.87	-	-
Pet. Residual 500	3.92	-	-	0.74	4.66	-	-

FUELS	PETROPERU ex–refinery price	TAXES Road tax (8 %)	TAXES Selective Con-sumption (2)	TAXES General Sales (19 %)	Ex–plant Price with Taxes	Trade Margin (1)	Public Sales Price (*)
Liquefied Petroleum Gas – LPG (**)							
97 Oct. SP Gasoline							
95 Oct. SP Gasoline							
90 Oct. SP Gasoline							
80 Oct. Gasoline							
Kerosene							
Diesel No. 2							
Residuum Oil No. 6							
Residuum Oil 500							

Source: *Anuario Estadístico de Hidrocarburos*, 2006, DGH – MINEM.
(1) Free Market Margin, estimated values
(2) Fixed amounts
(*) Source: INEI

Graph 18. Total Loads Processed in the Country's Refineries

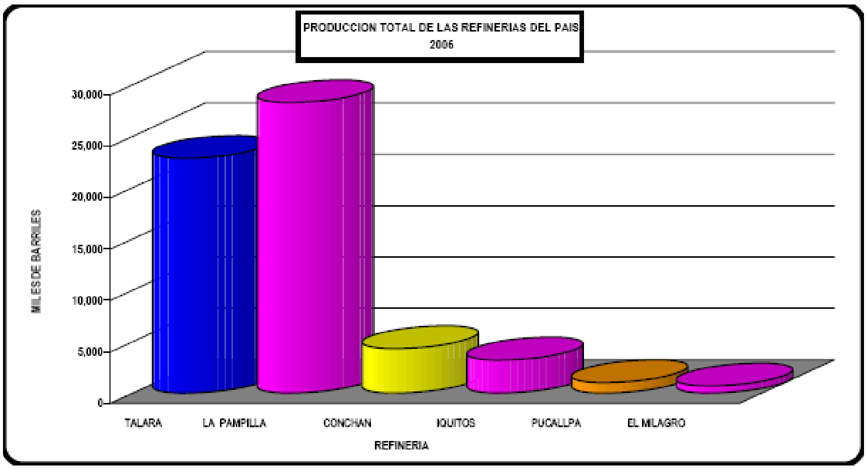


Source: *Anuario Estadístico de Hidrocarburos* 2006, DGH–MEM.

TOTAL LOADS PROCESSED IN THE COUNTRY'S REFINERIES 2006
Thousands of barrels
• DOMESTIC CRUDE OIL

	• IMPORTED CRUDE OIL • OTHER LOADS
REFINERIES	

Graph 19. Total Production of the Country's Refineries – 2006



Source: *Anuario Estadístico de Hidrocarburos* 2006, DGH–MEM

TOTAL PRODUCTION OF THE COUNTRY'S REFINERIES 2006
Thousands of barrels
REFINERIES

- **Refinery of *La Pampilla* S.A. – RELAPASA**

The Repsol YPF group has a downstream presence in Peru, with the *La Pampilla* refinery, through the investment consortium *Refinadores de Peru S.A.* This consortium has 60 % of the capital stock, and is made up of *Repsol Peru BV* with 42.792 %; *YPF S.A.* with 25.552 %; Peru Privatization & Development Fund Limited with 14.400 %; Mobil Oil of Peru with 9.242 %; IGM Refinery S.A., with 5.000 %; and Wiese Investments with 3.015 %. Subsequently, other business groups joined as shareholders through Privatization & Development Fund Limited, purchasing 7.20 % of the shares; and did workers and ex workers of *PETROPERU S.A.*, who purchased 1.565 %.

The *La Pampilla* refinery began its operations on December 17, 1967. Built and operated by PETROPERU, it is located on the road to Ventanilla, km. 25, district of Ventanilla, province of Callao, department of Lima. Its processing capacity (primary distilling at 102 000 BPD, vacuum distilling at 60 BPD) and storage capacity is: crude oil 2 248 000 BLS and products 2 621 000 BLS.

RELAPASA is the largest refinery on the Peruvian market, with 53.9 % of the total refining capacity. At the close of 2006, it had 44 % of all liquid fuel production in the country. It is operated by the REPSOL YPF group, one of the largest oil & gas groups in the world.

Repsol is exposed to interference by the State, which due to social pressures, frequently does not transfer international crude oil price volatility in its products, thus affecting the company's trade margins and limiting its self–financing capacity. Although this risk is mitigated with the creation of the *Fondo de Estabilización del Precio de los Combustibles Derivados* in December 2004, it depends on whatever funds State ultimately allocates to it, thereby offering a partial solution, not a final one.

In 2006, the total refinery production reached 28.3 million barrels of products (77 MBPD), 5 % below that of 2005, due to a reduction in the domestic refining margin that made a greater plant load unattractive.

Table 26. Financial Summary RELAPASA (thousands of US$)

Tipo de cambio soles/US$ a final del periodo	3.183	3.357	3.196	3.430	3.282	3.463	3.514	3.440
	Mar-07	**Mar-06**	**Dic-06**	**Dic-05**	**Dic-04**	**Dic-03**	**Dic-02**	**Dic-01**
Indicadores Financieros								
EBITDA/Intereses Pagados(X)	12.10	34.51	5.66	15.68	3.42	8.24	15.79	28.98
(EBITDA-Inv. en Act. Fijo)/Intereses Pagados(X)	11.23	33.32	4.57	15.18	-1.53	-5.84	1.07	-0.03
Deuda Financiera Total/EBITDA (X)	2.39	1.15	3.36	1.11	11.62	5.91	2.59	0.75
Deuda Financiera Neta/EBITDA (X)	2.37	0.65	3.25	1.10	11.00	5.85	2.55	0.73
Deuda Financiera Total/Capitalización (%)	55.8%	35.7%	48.4%	41.3%	53.7%	50.4%	42.2%	25.7%
Resultados								
Ventas Netas	596,881	524,480	2,376,476	2,240,513	1,851,531	1,583,837	1,341,375	1,184,947
%Cambio	13.8%	-76.6%	6.1%	21.0%	16.9%	18.1%	13.2%	5.0%
EBITDA	34,947	33,375	69,756	168,517	19,495	31,867	52,465	84,267
Margen EBITDA (%)	5.9%	6.4%	2.9%	7.5%	1.1%	2.0%	3.9%	7.1%
Depreciación y Amortización	6,151	6,113	24,584	23,169	20,682	19,555	16,252	12,202
EBIT	28,796	27,262	45,172	145,348	(1,187)	12,312	36,213	72,065
Intereses Pagados°	2,888	967	12,318	10,749	5,708	3,868	3,323	2,908
Costo de Financiamiento Estimado (%)*	4.1%	2.3%	5.8%	5.2%	2.8%	2.4%	3.3%	4.3%
Utilidad Neta	14,661	15,711	23,565	89,600	87	5,814	20,841	41,973
Retorno sobre Patrimonio Promedio(%)	22.8%	23.1%	9.1%	38.8%	0.0%	3.1%	11.3%	23.9%
Flujo de Caja								
Flujo de Caja Operativo	20,908	20,742	38,533	123,594	26,451	31,225	41,040	62,465
Variación del Capital de Trabajo	(67,588)	5,971	(1,814)	(89,292)	(15,686)	(18,333)	(28,536)	37,789
Flujo de Caja Operativo Neto	(46,680)	26,713	36,719	34,302	10,765	12,892	12,503	100,254
Inversión en Activos Fijos	(2,511)	(1,156)	(13,413)	(5,302)	(28,222)	(54,464)	(48,906)	(84,361)
Variación Neta de Deuda	99,894	39,174	46,879	(38,827)	27,897	50,286	73,954	(8,679)
Pago de Dividendos	0	0	(40,338)	(4)	(218)	(9,302)	(37,024)	(8,467)
Variación Neta de Caja y Valores Liquidos	50,703	64,731	29,847	(9,831)	10,223	(588)	528	(1,253)
Flujo de Caja Disponible**	(38,040)	37,223	42,211	63,174	(30,121)	(44,798)	(28,300)	34,787
Balance								
Caja e Inversiones Corrientes	2,336	67,117	7,633	2,386	12,209	1,883	2,435	1,945
Activos Totales	819,497	763,275	658,027	606,186	581,050	488,978	437,974	374,291
Deuda Corto Plazo	282,326	106,295	182,663	140,304	193,566	188,316	136,016	63,323
Deuda Largo Plazo	51,926	47,657	51,926	47,406	33,033	0	0	0
Deuda Financiera Total‡	334,252	153,952	234,589	187,710	226,599	188,316	136,016	63,323
Patrimonio (Incl. Participación Minoritaria)	264,418	277,406	249,757	266,530	195,437	185,139	186,087	182,822
Capitalización	598,670	431,358	484,346	454,240	422,036	373,456	322,103	246,144
Liquidez								
Deuda Corto Plazo/Deuda Financiera Total	84.5%	69.0%	77.9%	74.7%	85.4%	100.0%	100.0%	100.0%
Caja e Inversiones Corrientes/Deuda Corto Plazo(X)	0.01	0.63	0.04	0.02	0.06	0.01	0.02	0.03
EBITDA/(Deuda Corto Plazo + Gastos Financieros)(X)	0.49	1.24	0.36	1.12	0.10	0.17	0.38	1.27
Otros Indices								
Días de inventarios	53.1	60.8	32.3	36.6	36.2	29.0	27.5	32.6
Período promedio de cobro	19.9	14.8	19.9	16.3	12.7	13.3	18.8	13.9
Cotización promedio WTI (US$/barril)	58.1	63.3	66.0	56.3	41.5	31.1	26.2	26.0

Vencimientos de Deuda Largo Plazo (al 31 diciembre 2006)

Año	**2008**	**2005**	**2010**	**2011**
Vencimientos (miles US$)	20,481	20,481	5,482	5,482

*Costo de Financiamiento Estimado = Intereses Pagados / Deuda Financiera Total Promedio.

**Flujo de Caja Libre=EBITDA-Intereses Pagados-Variación en Capital de Trabajo

***A la fecha no registra deuda de largo plazo.

Capitalización = Deuda Financiera Total + Patrimonio (Incl. Participación Minoritaria)

EBITDA=Resultado de Operación + Depreciación y Amortización

n.d. = No disponible

° No incluye los gastos por diferencia en cambio

Natural gas Liquids Fractioning Plants

- *Pluspetrol Peru Corporación S.A.*

Owner: Consortium made up of *PLUSPETROL PERU CORPORACIÓN S.A.*; HUNT OIL COMPANY OF PERU L.L.C. Peruvian Branch; SK Corporation, Peruvian Branch; SONATRACH PERU CORPORATION S.A.C., TECPETROL OF PERU S.A.C. It began its operations in September 2004, and is located in *Playa Loberías*, district of Paracas, province of Pisco, department of Ica.

Establishment: Natural Gas Liquids Fractioning Plant, On–Shore Component.

<u>Processing capacity:</u>

01 Propane Tower
01 Butane Tower – 350 000 m^3/h (the capacity for both processing units)
01 Primary Distilling Unit –25 000 BPD

<u>Storage capacity</u>:

Propane 30 000 m3
Butane 15 000 m3
Naphtha 440 000 BLS
Diesel 75 000 BLS

In addition there are 3 processing plants with less capacity: 2 in the Northeast of Peru (*Procesadora de Gas Pariñas S.A.C.* and *Graña y Montero* S.A.) and 1 in the Central Jungle (*Aguaytía Energía*)

Supply Plants

- Callao Terminal: Located at Av. Néstor Gambeta Nº 1265, Puerto del Callao, Constitutional Province of Callao, department of Lima, and operated by Vopak Serlipsa S.A., it stores and dispatches LPG, gasolines, diesel, kerosene, turbo A–1, industrial oil 6, and chemical products. It is supplied through tanker ships from the Talara and Conchan refinery and has a storage capacity of 1 206 000 barrels.

- Mollendo Terminal: Located at Calle Apurímac Nº 401, Puerto de Mollendo, department of Arequipa, and operated by Consortium Terminals–GMT, it stores and dispatches gasolines, diesel, kerosene, turbo A–1, industrial oil 500, and asphalts. It is supplied by tanker ships from the Talara and *La Pampilla* Refineries and has a storage capacity of 556 320 barrels.

- Eten Terminal: Located at Puerto de Eten, district of Puerto Eten, province of Chiclayo, department of Lambayeque, and operated by Consortium Terminals–GMT, it stores and dispatches gasolines, diesel, kerosene, turbo A–1 and industrial oil 500. It is supplied by tanker ships from the Talara and *La Pampilla* Refineries and has a storage capacity of 409 421 barrels.

- Pisco Terminal: Located at Puerto de Pisco, district of San Andrés, department of Ica, and operated by Consortium Terminals–GMT, it stores and dispatches gasolines, diesel, kerosene, turbo A–1, industrial oil 6, and industrial oil 500. It is supplied by tanker ships from the Talara and *La Pampilla* Refineries and has a storage capacity of 376 597 barrels.

- Chimbote Terminal: Located at Av. Brea and Pariñas km. 421, Puerto de Chimbote, district of Chimbote, department of Ancash, and operated by Consortium Terminals–GMT, it stores and dispatches gasolines, diesel, kerosene, and industrial oil 500. It is supplied by tanker ships from the Talara, *La Pampilla* and Conchan Refineries and has a storage capacity of 329 808 barrels.

- Salaverry Terminal: Located at Puerto de Salaverry, district of Salaverry, province of Trujillo, department of La Libertad, and operated by Consortium Terminals–GMT, it stores and dispatches gasolines, diesel, kerosene, and industrial oil 6. It is supplied by tanker ships from the Talara, *La Pampilla* and Conchan Refineries and has a storage capacity of 274 484 barrels.

There are other sales plants in the country whose storage capacity is smaller than those indicated above, which serve to supply local demand.

Marketing

Meeting the petroleum fuel product demand of a country's population depends on the network available for distribution and sale to final consumers. In the case of Peru, it is relatively well implemented in the Andean region and even better in the Coastal region, but the problem is supplying the Jungle region, where only cities and their suburbs have a normal supply, and the rest have no facilities to access fuels. And if fuels arrive, it has prohibitive prices that are not affordable to run–of–the–mill users.

The following Table 27 quantifies the activities and infrastructure distributed throughout Peru that enable – when necessary – bottling, distribution and marketing of fuels except for natural gas, which for now is limited to Metropolitan Lima.

Table 27. Hydrocarbons Records: Marketing Companies

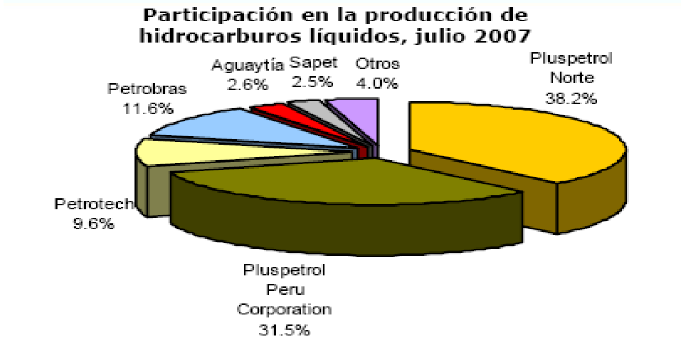
Item	30 Jun 07	31 Jul 07
Liquid fuel supply plants	47	47
Liquid fuel transportation companies	4 758	4 807
Direct consumers of liquid fuels	1 621	1 633
Wholesale of liquid fuel distributors	17	17
Retail liquid fuel distributors	332	351
Pumps and service stations	3 494	3 500
LPG bottling plants	102	103
LPG importing company	9	9
Gas centers	21	22
Direct LPG consumer	596	618
Bulk LPG transportation company	319	322
LPG transportation in bottles	1 910	1 853
Bulk LPG distribution company	24	26
Bottled LPG distributor	286	353
LPG sales sites	2 221	2 259
LPG supply plants	7	7
Lubricant plants	6	6
Total Number Recorded for Country	15 770	15 933

Source: DGH, MEM 2007

8.2 Share and size of hydrocarbons production for different actors – 2007

We mentioned above that the share structure of private companies in liquid hydrocarbons production for 2006 was 69 % for the *Grupo Pluspetrol* and 11 % for PETROBRAS and PETROTECH. In July 2007 the percentages were as follow: *Grupo Pluspetrol* had 69.7 % of the domestic production, PETROBRAS had 11.6 %, and PETROTECH had 9.6 %. Likewise, *Aguaytia Energy de Peru S.A.* and Sapet Development Peru contributed 2.6 % and 2.5 % of the total, respectively.

Graph 20. Liquid Hydrocarbons Production Shares – July 2007



Fuente: Perupetro. Elaboración SNMPE.

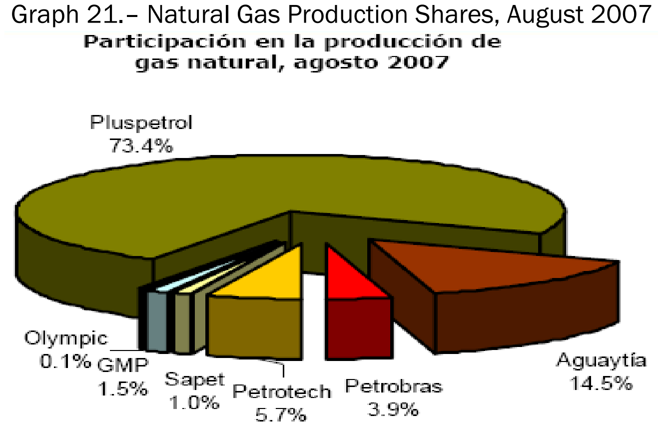
Liquid Hydrocarbons Production Shares, July 2007
Source: Perupetro. Developed by SNMPE.

The accrued production for the first seven months of 2007 is 24 716 thousand barrels, which is 1.91 % higher than that recorded for the same period in 2006. This means that liquid hydrocarbons production has evolved positively over the past 3 years, due to production deriving from the Camisea reservoir.

In August 2007 there was a production of 9 558 million cubic feet of natural gas (308.3 million cubic feet per day), which is 35.70 % more than the 7 043 million of cubic feet obtained in the same month of 2006. The largest production recorded in August 2007 was by *Pluspetrol Peru Corporación S.A.*, with 7 011 million cubic feet in Block 88 (Camisea), which is equivalent to 73.4 % of natural gas production for that month. *Aguaytía Energía de Peru* S.A. is the second largest producer in the country, with 1 382 million cubic feet, which is 14.5 % for that same month.

PETROTECH PERUANA S.A. (Operator of Block Z-2B) contributed 5.7 %, while *Petrobras Energía* Peru S.A. (Operator of Block X) had 3.9 % of domestic production.

Graph 21.- Natural Gas Production Shares, August 2007



Source: PERUPETRO, Development SNMPE

SOCIEDAD NACIONAL DE MINERÍA, PETRÓLEO Y ENERGÍA (SNMPE) [10]

This is a business organization created as a not-for-profit civil association that brings together legal persons related to mining, oil and power activities. It is registered on page 061 of the Associations Ledger of the Lima Registry of Legal Persons.

The main purposes of the association are to promote the development of mining, oil and power activities and foster sustainable use of natural resources, giving special attention to environmental conservation and the social development, with full respect for the applicable law, seeking means to become increasingly competitive.

To achieve these ends, the associated companies assume the commitment to participate in institutional activities,

[10] www.snmpe.org.pe/qsomos.htm

lending the help of their executives, technicians and specialists, contribute the economic resources needed to implement the activities and programs approved by the Board of Directors, and observe the norms contained in the Code of Conduct in the development of their activities.

The association's mission is to operate within the framework of the legislation in force in the country, work to contribute to the sustainable development of the country and support the State in matters of promoting of the image of Peru as a country that has broad potential in the areas of mining, hydrocarbons and power.

Among its members it promotes:

1. Disseminating current Peruvian legislation among domestic and foreign investors, keeping both member companies and third parties continually updated on its scope.
2. Interest in becoming more fully aware of the needs and expectations of the populations and communities located in the areas of influence of the companies. Accordingly, the association fosters the search for suitable mechanisms to lend dynamism to the regional economy and production, as well as train local human resources.
3. Sustainable development principles, that is, the need to generate development through environment–friendly technologies and production processes, continually seeking the social and economic wellbeing of the nation within the framework established in the Peruvian legislation and in international commitments taken on by Peru.
4. Full compliance with all environment and safety standards and obligations taken on by the companies.
5. Adopting modern health, safety and environment management systems, in order to ensure developing its operations in a favorable environment for workers and, in general, for the entire community.
6. Interest in evaluating and promoting the development of production chains, as well as developing industries that can offer added value for mining and energy products.
7. The importance of generating suitably–paid productive employment within the framework of the current labor laws.

Member Companies: 18

Barrett Resources (Peru) L.L.C., Peru Branch
BPZ Energy Inc., Peru Branch
Burlington Resources Peru Ltd., Peru Branch
Compañía Petrolera Unipetro ABC S.A.C.
Graña y Montero Petrolera S.A.
Hunt Oil Company of Peru L.L.C, Peru Branch
Mobil Oil de Peru S.R.L.
Occidental Petrolera de Peru Inc., Peru Branch
Peru LNG S.R.L.
Peruana de Combustibles S.A.
Petrobras Energía Peru S.A.
Petro–Tech Peruana S.A.
Pluspetrol Peru Corporación S.A.
Refinería La Pampilla S.A.
Repsol Exploración Peru, Peru Branch
The Maple Gas Corporation of Peru
Transportadora de Gas de Peru S.A.
Vopak Peru S.A.

8.3 Financial indicators, Investments

Given Peru's business modality for hydrocarbons, it was deemed advisable to include the operational and financial indices for each of the State–owned companies, and for the major private companies doing oil & gas business, both up stream and down stream.

8.4 Oil revenues, distribution and utilization

8.4.1 Distribution

Table 18 shows that the departments of Amazonas and Cajamarca, classified among the poorest of the country, receive no revenues, and neither does the department of Lambayeque (poor), being three departments that are crossed by the *Oleoducto Norperuano* (ONP). This is because there are no regulations that demand it, as there is in the case of the Camisea – Coast pipeline.

The departments of Loreto and Piura are producers and receive taxes, but are not crossed by the ONP. What is regrettable and should somehow be remedied is that there have been several spills in the ONP, the last in May 2006, but their effects (impacts) have been mediated and there have been few complaints from communities, making indemnifications minimal over the past years.

Table 28. Tax and Surtax Distribution
(oil, natural gas and FOCAM) in millions of US$

TAX AND SURTAX DISTRIBUTION (OIL, NATURAL GAS AND FOCAM)										
Millions of US$										
DEPARTMENT	2000	2001	2002	2003	2004	2005		2006		TOTAL
	TAX	TAX	TAX	TAX	TAX	TAX	FOCAM	TAX	FOCAM	
AMAZONAS										
AYACUCHO							2.0		2.4	4.4
CAJAMARCA										
CUSCO					25.6	95.8		120.7		242.1
HUANCAVELICA							1.3		1.7	3.0
HUÁNUCO	0.1	0.1	0.1	0.1	0.2	0.2		0.2		1.0
ICA							1.2		1.3	2.5
LAMBAYEQUE										
LIMA							1.1		1.4	2.5
LORETO	53.8	43.2	50.5	54.3	56.2	74.9		86.7		418.6
PIURA	36.0	29.2	28.6	32.6	40.5	61.5		78.9		307.4
TUMBES	9.0	7.3	7.1	8.2	10.1	15.4		19.7		76.8
UCAYALI	17.7	15.0	17.4	19.6	21.9	28.6		31.7	0.7	153.5
TOTAL	116.6	94.8	103.7	114.8	154.5	276.4	5.6	337.9	7.5	1 211.8

Source: Self-developed based on information from *PERUPETRO S.A.*
and from the Secretary of Decentralization of the PCM

8.4.2 Utilization of Oil revenues, 2000-2006

Regulations for the use of resources from taxes, surtaxes and royalties - CSCR.- In accordance with the Tax Act, Law Nº 27506 and its amendments, the destination for resources from the Forestry Tax, Hydropower Tax, Fishing Tax, Fishing Rights, Mining Tax, and Gas Tax, is by law solely for financing or co-financing infrastructure projects or works with a regional and local impact. Local and regional governments may use up to 20 % of the resources to maintain infrastructure generated by projects, and for expenses generated by selection processes for implementing public investment projects. This may be accounted as a current expense. Likewise, up to 5% of that percentage may be allocated to finance the development of profiles for public investment projects, which should be framed within the appropriate development plans as agreed to.

The recently approved Law No 28802 -amending the SNIP Law- grants greater autonomy to regional and local governments for project development and evaluation, without establishing limits on the amounts, provided they are within the framework of its competencies and functions. This law, questioned by the Ministry of Economy, is not applicable yet because it is still being regulated.

Resources from oil tax and surtax are allocated solely to financing or co-financing infrastructure works with a regional and local impact. In the case of Piura and Tumbes, this covers up to 20 % of maintenance expenses (accounted as current expenses). FOCAM's resources are allocated to financing Productive Investment Projects (PIP), maintaining existing economic and social infrastructure, formulating pre-investment studies and others, training and technical assistance, and environmental preservation and ecology (accounted as investment outlays). Additionally, Law N° 28654 establishes that regional governments may use the CSCR source to pay debts taken on for financing public investment projects, authorized by the *Dirección Nacional de Endeudamiento Público*.

The resources that Universities receive for CSCR should be invested in research and technology projects (understood as works of infrastructure and equipment, forbidding payroll payments, wages or similar). As for the FOCAM resources, the

Universities should invest these funds in scientific and technological research projects, prioritizing the issue of biodiversity.

Allocating resources from taxes, surtaxes and royalties[11] (CSCR) .– By 2006, the regional governments jointly (26 items made up of 25 regional governments (GR) and the Metropolitan Municipality of Lima) decided on a Modified Institutional Budget (PIM from the Spanish) of S/. 10 268 million, only 9 % (S/. 960 million) of which pertained to CSCR. Of these resources, 93 % was allocated to capital expenses, 6 % to current expenses, and 1 % to financial expenses. Under capital expenses, S/. 802 million has been allocated for **public investment projects** (roads, hospitals, high schools, among other works), S/. 80 million were allocated to transfers made by regional governments to public universities of the region through **other capital expenses,** and S/. 6.5 million were allocated to promote programs for small producers through **financial investments.**

The 1 833 local governments (GL) of the country have tripled the amount of transfers they receive from the National Government (from S/. 690 million in 2002 to S/. 2 015 million in 2006), fundamentally due to the increase in the CSCR. Reviewing the local government expenses structure, 60 % pertains to capital expenses (building roads, irrigation canals, classrooms, health posts, etc.) and 40 % a current expenses. This reveals that the capital expense proportion for local governments is greater in comparison to the national government and regional governments. However, in the first semester of 2006, transfers reached S/. 2 444 million, with CSCR representing 43 %. In the CSCR source, resources have doubled in the first semester of 2006 over 2005 (the amount went from S/. 511 million to S/. 1.041 million).

As for National Universities and the amounts transferred, this is at the discretion of regional governments, based on the fact that calculations made do not always coincide with actually allocated amounts, as there are no norms to regulate the tax transfer. This way of acting is frequently presented to the community as if it were a concession of the Regional President and not an obligation established by law.

Finally, regarding the matter of transparency in the tax use in universities, it is impossible to know what these resources are used for (except for the oil tax), because universities account for the tax expenses as donations and transfers, thus limiting social oversight on the use of these resources by the university community itself and the regional society.

According to *Vigila Peru*, and taking information from the CND and the MEF, in the first semester of 2006, 9 departments related to oil activities had a total of S/. 471.8 million available, 9.13 % of which was from mining royalties and 90.87 % from oil revenues. This did not include the transfers that the regional governments made to technological institutes. Again we should highlight that the department of Loreto, classified as Very Poor, had S/. 97.7 million available. Cusco had S/. 116.8 million available, S/. 69.3 million of which were from oil revenues that it began receiving in August 2004. This confirms the lack of spending capacity in regional and local governments and the fact that the SNIP further hampers this process.

Extractive Industry Transparency Initiative (EITI)

This initiative precisely seeks to make transparent payments made by extractive companies to the State, as well as the distribution and use made of these resources. For this purpose, the government should ensure participation in this initiative by the main mining, oil and gas companies, as well as any related civil society and State organizations. With the ratification of this initiative's principles by representatives of the Peruvian Government, of the civil society and the extractive industries, on December 11, 2006, the Work Commission created by Supreme Decree Nº 027–2006–EM commenced its functions.

This Commission is in charge of executing the Action Plan to implement the EITI. Its first task is to produce a report reconciling payments made by and revenues received from the extractive industries at all levels the government. The Action Plan also contemplates reports that show the use made of these resources regionally and locally. Finally, it is important to point out that there are no legal devices to perform an economic, social and/or environmental impact analysis of the use of these revenues in the country. Some governmental and/or private entities have done so, such as the UNDP Report (2002) "Study of Oil Tax Use in 2 Departments (Piura and Tumbes)." Although its criteria and methodology have been modified, it should be used as the groundwork for including this aspect in legislation.

8.5 Pros and Cons of Private Company Presence

The '70s and '80s were the best time in the life of *PETROPERU S.A.* Except for up stream, the company almost monopolized all oil & gas activities, following a world–wide trend towards nationalizing the oil industry. This coincided

[11] Oversight of Extractive Industries. National Report Nº 4. Peru 2006. Citizen Group Proposal – *Sistema Vigila Peru*.

with an authoritarian military regime that by that time had taken over the government, along with the vertical discipline needed to put the proposed reform into practice. This, plus the fact that the beginning of the military regime coincided with the positive exploratory outcomes, set the stage for everything to "run smoothly." However, as exploratory failures appeared, which continued after the military era, money for investments in exploration became scarce and production started to decline, and for purely political reasons the oil & gas price "truthing" was put off. As a result, the economic–financial situation of *PETROPERU S.A.* began to turn critical, especially when dependence on hydrocarbons supply from abroad deepened and oil prices continued their upward spiral.

By the early '90s, there was no other alternative than to open the doors to private investment, thus beginning the privatization of *PETROPERU S.A.*, which allowed the intervention of private capital in all oil & gas activities except for oil contracting. In the beginning, privatization of *PETROPERU S.A.* did not fully materialize for political reasons and the need for a price–regulating element. Later on, the presence of private capital enabled Camisea to develop and the country to overcome its oil & gas deficiency, substantially improving its infrastructure and consequently its end user services. Likewise, new stages of exploratory activities have been developed that have enabled the discovery of new oil reserves in the Northeast (heavy crude oil) and in the Northeast–continental shelf (light crude oil), plus natural gas on the continental shelf, whose reserves are in evaluation.

With regard to refining, the *La Pampilla* refinery (Repsol) is presently being modernized and adapted to the environmental regulations, while the Talara refinery (State–owned) is still trying to develop its feasibility study after 4 years.

With Camisea, a fuel is being placed at the country's service that was only known in the oil areas, and even there to a fairly limited extent. The natural gas of Camisea offers a new energy option that is cheaper and much less polluting, with the added benefit that its exploitation is providing the surrounding communities with a substantial share of the oil revenues it generates. To a large extent it is being distributed to populations qualified as very poor or poor, which the throughout their history have been neglected by different regimes for economic reasons.

The disadvantage of *PETROPERU's* privatization and private capital intervention in the oil & gas business, is that it required "truthing" fuel prices, using foreign market prices as a reference, and hitting the people's pockets heavily, since the subsidies granted by PETROPERU were discontinued in an underhanded way. Another disadvantage is that great control should be exerted to avoid the tendency to monopolize.

9. OIL & GAS STATISTICS

9.1 State and Private Company Shares in Energy activities

Activity	State–owned companies %	Privately owned companies %
Electricity		
Generation: Capacity	34	66
Production	40	60
Transmission	00	100
Distribution	54	46
Hydrocarbons		
Exploration–Exploitation	00	100
Refining: Capacity	47	53
Production	52	48
Domestic market	53	47

Source: *Anuario Estadístico de Electricidad*, 2005, DGE – MEM

9.2 Comparative Chart of the primary performance indices for public and private companies

ACTIVITY/ PERFORMANCE INDEX	EFFICIENT STATE		MAJOR PRIVATE COMPANIES					
	PERUPETRO	PETROPERU	*GRUPO PLUSPETROL*	PETROTECH	PETROBRAS	*AGUAYTÍA ENERGÍA* PERU	REPSOL / YPF	TgP
Oil contracting[12]	Promotes, negotiates, signs and supervises oil contracts	No	No	No	No	No	No	No
Exploration and/or Exploitation of Hydrocarbons	No	Law Nº 28244 of June 2, 2004, restitutes its participation in oil & gas exploration and production activities. – Has no contract signed	At 11.06.07: [13] 2 Exploration Contracts 4 Exploitation Contracts	At 11.06.07: 4 Exploration Contracts 1 Exploitation Contract	At 11.06.07: 4 Contracts in Exploration 1 Exploitation Contract	At 11.06.07: 1 Exploitation Contract	At 11.06.07: 4 Exploration Contracts 2 Exploitation Contracts[14]	No
Percentage of Hydrocarbons production, nationwide	No	No	At July 2007, 69.7 % of domestic production of liquid hydrocarbons and 73.4 % of all natural gas	At July 2007, 9.6 % of domestic production of liquid hydrocarbons and 5.7 % of natural gas	At July 2007, 11.6 % of domestic production of liquid hydrocarbons and 3.9 % of all natural gas	At July 2007, 2.6 % of domestic production of liquid hydrocarbons and 14.5 % of all natural gas	Its production is included in the production of Pluspetrol as a member of the Consortium in Camisea	No
Refining and Commercialization to end users	No	5 refineries are owned by PETROPERU, which operates 4 of them (Talara, Conchán, Iquitos and *El Milagro*), the other one (Pucallpa) is operated by the company Maple. – Refined foreign production over domestic production: 53 % – Capture of domestic market: 53 %	Has a refinery for its own operations	No	No	No	1 Refinery – Refined foreign production over domestic production: 47 % – Capture of domestic market: 47	No

[12] A function inhering to the State.
[13] Pluspetrol operates the blocks, but the contracts were signed with the Consortium.
[14] Repsol is part of the consortium for 2 blocks operates by Pluspetrol.

							%	
Hydrocarbons transportation via pipelines	No	Owner and operator of the *Oleoducto Norperuano* (ONP) and of the Northern Branch. Transports (Sept. 2007) an average of 42 000 BDC of crude oil.	No	No	No	No	No	In consortium, owner of the Camisea pipelines to the Central Coast, which it operates. Transports (Sept. 2007) 160 MMPCD of natural gas and 35 MBD of condensates.
Return on Equity – ROE (Profits / Capital) %	Year 2005 0	Year 2005 41.2	Year 2006 38.0	N.A.	N.A.	Year 2006 9.7	N.A.	Year 2006 2.0
Return on Assets – ROA (Operational Profits / Assets) %	Year 2005 375.2	Year 2005 27.9	Year 2006 25.0	N.A.	N.A.	N.A.	N.A.	N.A.
Total Assets	Year 2005 S/. 255.2 million	Year 2005 S/. 2 356.0 million	Year 2006 US$ 364.2 million	N.A.	N.A.	Year 2006 US$ 239.3 million	N.A.	Year 2006 US$ 939.0 million
Total Liabilities	Year 2005 S/. 253.3 million	Year 2005 S/. 1 761.0 million	Year 2006 US$ 197.8 million	N.A.	N.A.	Year 2006 US$ 78.3 million	N.A.	Year 2006 US$ 718.7 million
Net Equity	Year 2005 S/. 1.9 million	Year 2005 S/. 595.0 million	Year 2006 US$ 166.3 million	N.A.	N.A.	Year 2006 US$ 166.0 million	N.A.	Year 2006 US$ 220.3 million

N.A. = Not Available.
Exchange rate for 2005 was S/. 3.3 per 1 US$.

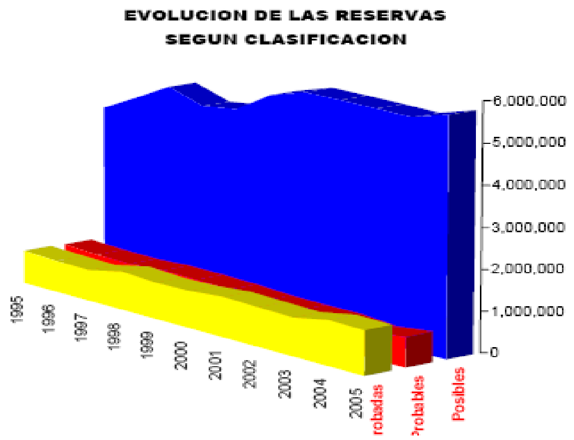
9.3 Liquid Hydrocarbons Reserves (1995–2005) (thousands of barrels)

RESERVAS PROBADAS

	COSTA NORTE	ZOCALO	SELVA NORTE	SELVA CENTRAL	SELVA SUR	SIERRA SUR	AREAS NO ASIGNADAS	TOTAL PAIS
1995	75,322	76,786	216,541	21,761	0	0	417,700	808,110
1996	77,072	67,487	197,371	14,591	417,000	0	0	773,521
1997	74,831	65,849	181,305	19,425	417,000	0	0	758,410
1998	144,454	66,807	143,085	16,517	0	0	566,520	937,383
1999	131,977	50,253	126,187	15,662	0	0	566,521	890,600
2000	143,787	51,107	127,267	16,938	566,521	0	0	905,620
2001	138,864	69,504	190,077	14,410	566,521	0	0	979,376
2002	121,813	67,812	183,314	13,431	566,521	0	0	952,891
2003	107,398	69,754	174,056	11,824	566,521	0	0	929,553
2004	123,560	72,545	181,830	10,454	708,914	0	0	1,097,303
2005	121,220	78,126	181,154	10,088	687,670	0	0	1,078,258

Northern Coast	Continental Shelf	Northern Jungle	Central Jungle	Southern Jungle	Southern Andes	Unassigned Areas	Total County

Evolution of Reserves by Category (1995–2005)



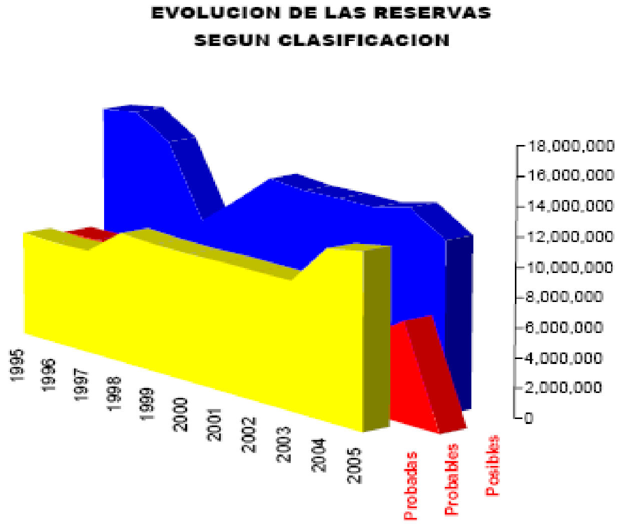
9.4 Natural Gas Reserves (1995–2005)

RESERVAS PROBADAS

	COSTA NORTE	ZOCALO	SELVA NORTE	SELVA CENTRAL	SELVA SUR	SIERRA SUR	AREAS NO ASIGNADAS	TOTAL PAIS
1995	69,555	202,290	26,681	255,660	0	0	6,470,000	7,024,186
1996	53,788	181,914	0	222,600	6,470,000	0	0	6,928,302
1997	56,300	170,700	0	301,800	6,470,000	0	0	6,998,800
1998	243,300	171,800	0	296,100	0	0	8,108,200	8,819,400
1999	158,900	136,800	0	289,800	0	0	8,108,100	8,693,600
2000	151,100	111,600	0	284,100	8,108,100	0	0	8,654,900
2001	167,100	173,000	0	276,300	8,108,100	0	0	8,724,500
2002	159,720	182,400	0	265,000	8,108,100	0	0	8,715,220
2003	186,817	174,500	0	252,700	8,108,000	0	0	8,722,017
2004	200,308	179,000	0	237,500	10,871,900	0	0	11,488,708
2005	212,960	293,700	0	221,000	11,200,000	0	0	11,927,660

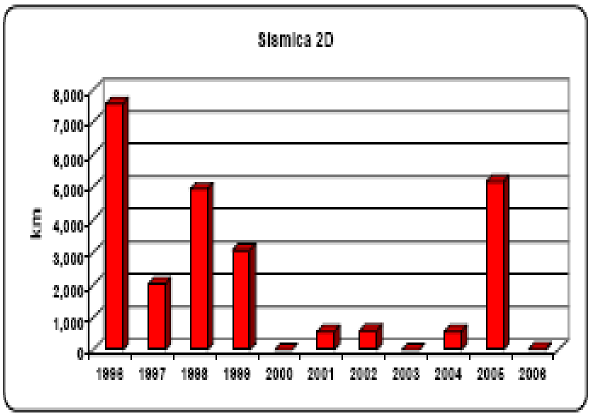
Northern Coast	Continental Shelf	Northern Jungle	Central Jungle	Southern Jungle	Southern Andes	Unassigned Areas	Total County

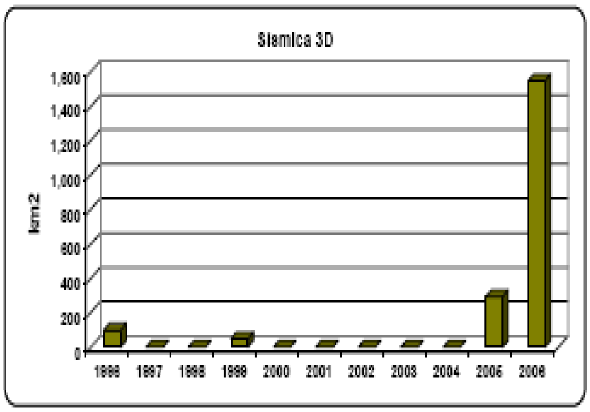
Evolution of Natural Gas Reserves by Category (1995–2005)



9.5 Exploration

2D and 3D Seismics Logged in Exploration Areas (1997–2006)





Exploratory Wells Drilled (1997–2006)

Source: *Anuario Estadístico de Hidrocarburos*. DGH–MEM. Year 2006

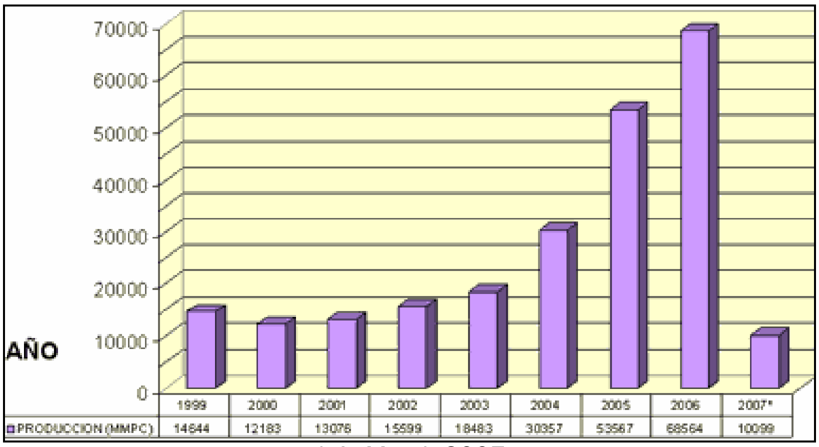
9.6 Audited Production of Liquid hydrocarbons, 1997–2006 (thousands of barrels)

ZONA	DEPARTAMENTO	COMPAÑIA	LOTE/AREA	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
COSTA NORTE	PIURA	CAVELCAS	I										
		GMP	I	258.9	230.0	252.4	272.2	240.6	229.4	238.7	234.6	276.1	282.942
		PET. MONTERRICO	II	340.9	261.9	277.2	274.1	246.4	230.2	206.2	193.7	203.6	209.461
		MERCANTILE	III	537.0	360.9	312.2	262.3	232.1	229.6	246.6	239.3	317.6	333.065
		RIO BRAVO	IV	208.0	177.2	193.6	202.9	196.7	201.5	210.7	226.3	305.2	414.081
		GMP	V	62.8	52.8	56.7	57.6	53.3	57.2	56.0	50.8	49.6	47.079
		PETROPERU	VI										
		SAPET	VI	1,328.4	1,151.2	1,087.7	1,492.0	1,557.2	1,264.4	1,203.0	1,323.3	1,214.8	1,113.818
		SAPET	VII	633.7	483.0	547.6							
		UNIPETRO	IX	153.2	134.2	130.7	123.1	128.9	115.6	112.8	113.1	105.2	101.690
		PETROPERU	NOR OESTE										
		PEREZ COMPANC / PETROBRAS (1)	X	5,288.6	4,874.3	4,679.5	4,455.2	4,206.2	4,104.7	4,207.9	4,144.3	4,590.8	4,648.288
		OXY-BRIDAS	XI										
		OLYMPIC	XIII									1.0	0.397
		PET. MONTERRICO	XV					12.5	10.3	8.0	7.6	7.1	6.998
	TUMBES	GMP	XIV (2)					0.6					
TOTAL COSTA				8,811.500	7,725.500	7,537.553	7,139.409	6,873.887	6,442.849	6,489.987	6,533.003	7,071.074	7,157.819
ZOCALO NORTE	PIURA (3)	PETROTECH	Z-2B	6,322.6	5,750.9	5,147.2	4,873.7	4,777.3	4,526.2	4,238.3	3,930.2	3,921.6	4,555.777
TOTAL ZOCALO				6,322.6	5,750.9	5,147.2	4,873.7	4,777.3	4,526.2	4,238.3	3,930.2	3,921.6	4,555.777
SELVA NORTE	LORETO	OCCIDENTAL	1-AB	18,071.2	17,593.0	14,772.1	4,638.0						
		PLUSPETROL	1-AB				8,725.1	12,918.8	13,665.8	13,211.8	11,576.6	10,020.3	10,219.179
		PETROPERU	SELVA NORTE										
		PLUSPETROL	8	9,741.2	10,173.0	9,788.9	9,330.9	9,260.5	9,075.3	7,796.8	7,080.9	6,382.3	6,207.286
SELVA CENTRAL	LORETO/HUANUCO	PETROPERU	SELVA CENTRAL										
	LORETO/HUANUCO	MAPLE	31 B / D	210.7	174.7	174.8	184.3	162.3	152.2	135.7	122.3	145.5	174.154
	LORETO	MAPLE	31-E (5)								0.9		
	UCAYALI	AGUAYTIA	31 C (4)		774.2	1,242.7	1,421.9	1,447.1	1,493.4	1,470.0	1,428.4	1,350.5	1,213.770
SELVA SUR	CUZCO	PLUSPETROL	88								3,776.2	11,731.2	12,659.101
TOTAL SELVA				28,023.0	28,714.9	25,978.5	24,300.2	23,788.7	24,386.7	22,614.3	23,984.8	29,629.9	30,473.5
TOTAL PAIS				43,157.1	42,191.3	38,663.3	36,313.3	35,439.9	35,355.8	33,342.6	34,448.0	40,622.6	42,187.1
TOTAL PAIS - PETROLEO				43,157.2	41,417.1	37,420.6	34,891.4	33,992.8	33,862.3	31,872.6	29,243.4	27,540.9	28,314.2
TOTAL PAIS -LGN				0.0	774.2	1,242.7	1,421.9	1,447.1	1,493.4	1,470.0	5,204.6	13,081.7	13,872.9

ZONE	DEPARTMENT	COMPANY	BLOCK / AREA
NORTHERN COAST			NORTHWESTERN
TOTAL COAST			
NORTHERN CONTINENTAL SHELF			
TOTAL CONTINENTAL SHELF			

NORTHERN JUNGLE			NORTHERN JUNGLE
CENTRAL JUNGLE			CENTRAL JUNGLE
SOUTHERN JUNGLE			
TOTAL JUNGLE			
TOTAL COUNTRY – OIL			
TOTAL COUNTRY – NGL			

9.7 Audited Production of Natural Gas (1997– March 2007)



* At March 2007

9.8 Transportation. Crude Oil Volumes Transported via the *Oleoducto Norperuano* in MBDC (2001–2005)

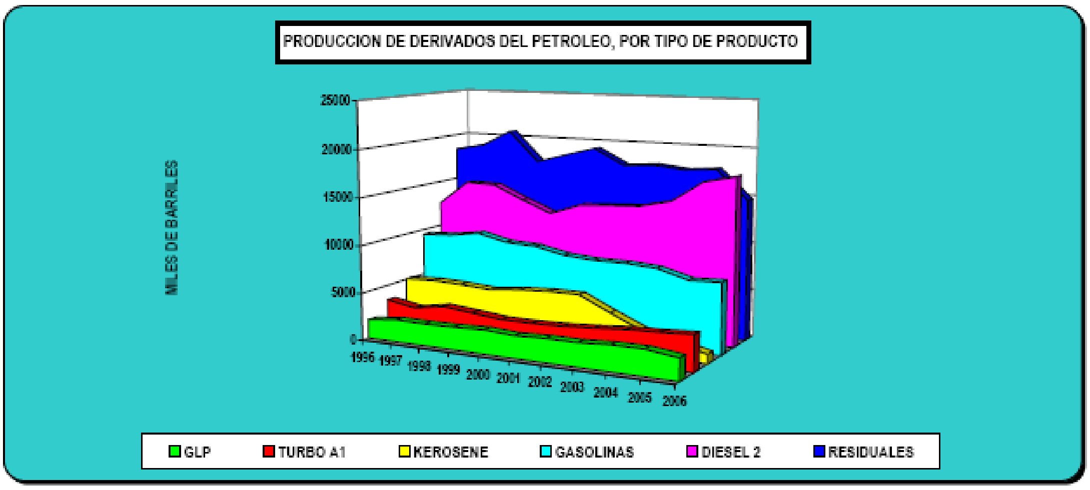
Transporte de petróleo crudo (MB/DC)

Tramo	2001	2002	2003	2004	2005
Andoas-Estación Nº 5	35,6	37,7	36,4	31,9	27,2
Estación Nº 1-Estación Nº 5	20,0	20,6	17,1	14,0	12,1
Estación Nº 5-Bayóvar	55,6	58,0	53,4	45,5	39,4

Source: PETROPERU. *Memoria Anual* 2005.

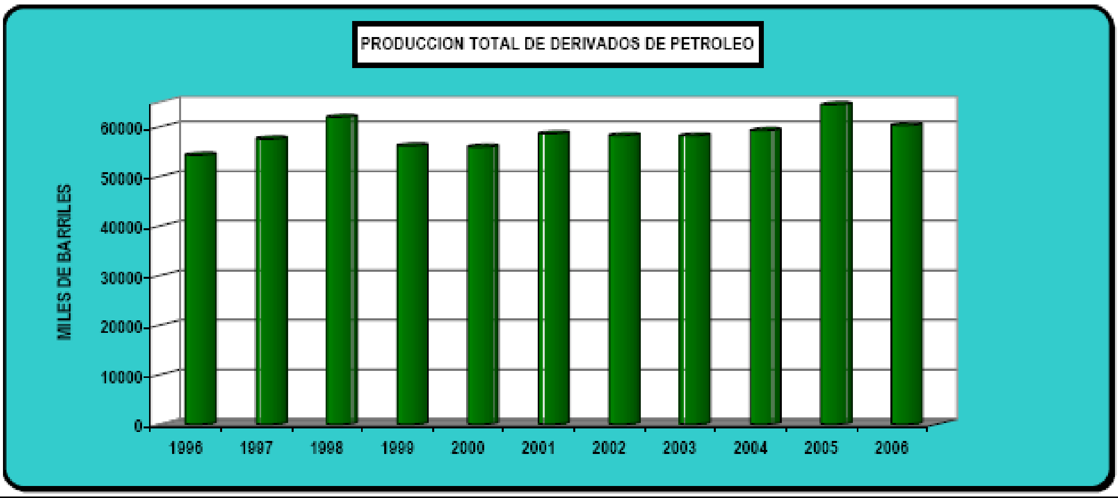
Crude Oil Transportation (MB / DC)					
Stretch	2001	2002	2003	2004	2005
Andoas – Station No. 5					
Station No. 1 – Station No. 5					
Station No. 5 – Bayóvar					

9.9 Refining.– Production of Oil Products by Product Type (thousands of barrels)



PRODUCTION OF OIL PRODUCTS, BY PRODUCT TYPE					
THOUSANDS OF BARRELS					
LPG	TURBO A1	KEROSENE	GASOLINES	DIESEL 2	RESIDUUM

Total Production of Oil Products (1996–2006) in thousands of barrels.



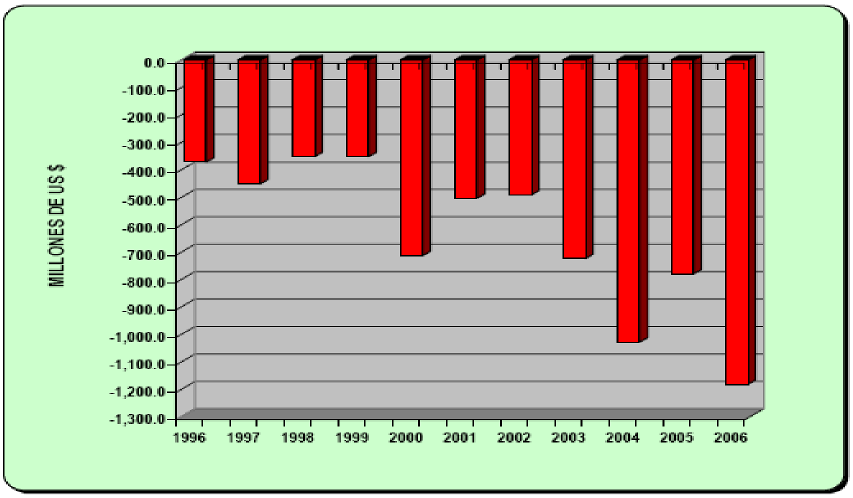
YEAR	BALANCE		EXPORTS		IMPORTS	
	THOUSANDS OF US$	THOUSANDS OF BLS.	THOUSANDS OF US$	THOUSANDS OF BLS.	THOUSANDS OF US$	THOUSANDS OF BLS.

9.10 Trade Balance for Hydrocarbons. Volumetric and Economic (1996–2006)

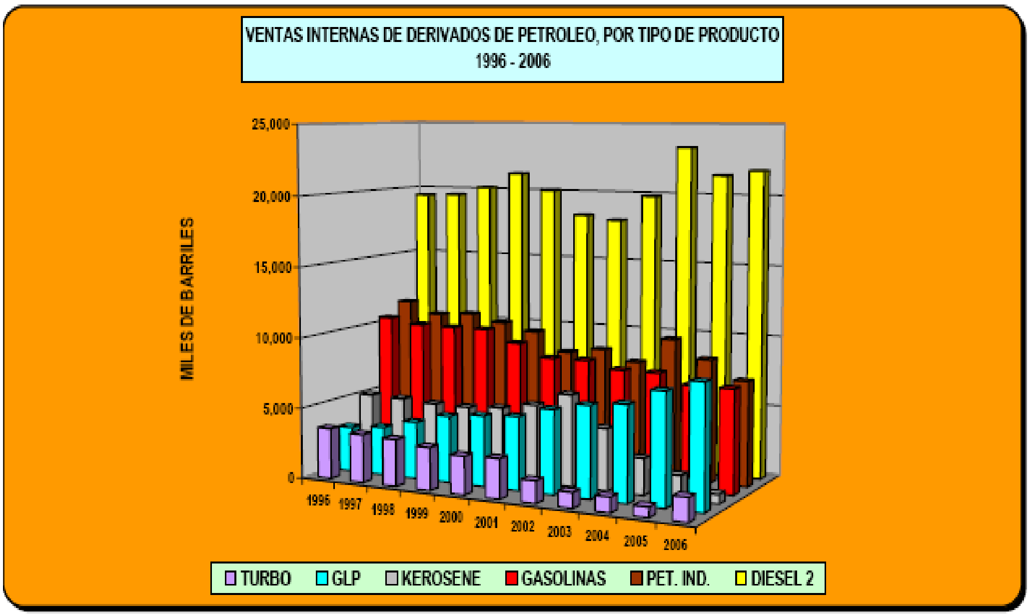
AÑO	SALDO		EXPORTACIONES		IMPORTACIONES	
	MILES DE US $	MILES DE BLS.	MILES DE US $	MILES DE BLS.	MILES DE US $	MILES DE BLS.
1996	-372,160.8	-10,781.9	347,984.2	20,315.4	720,145.0	31,097.3
1997	-451,505.9	-14,771.3	381,383.6	25,027.4	832,889.5	39,798.7
1998	-352,507.9	-17,182.9	250,794.5	27,126.9	603,302.4	44,309.8
1999	-352,562.6	-13,790.7	238,612.4	17,413.6	591,175.0	31,204.3
2000	-713,198.7	-20,520.8	380,306.5	14,946.9	1,093,505.2	35,467.7
2001	-503,841.0	-16,585.4	402,473.6	20,251.1	906,314.6	36,836.6
2002	-491,929.7	-16,894.7	471,073.7	20,856.7	963,003.4	37,751.3
2003	-723,815.6	-19,919.4	662,644.1	24,637.9	1,386,459.7	44,557.3
2004	-1,028,751.2	-21,978.5	685,696.6	21,881.1	1,714,447.8	43,859.6
2005	-779,785.7	-15,070.2	1,488,065.2	28,542.7	2,267,850.9	43,612.9
2006	-1,181,889.9	-18,437.2	1,602,694.4	25,874.6	2,784,584.4	44,311.8

Source: MEM, DGH

Trade balance of Hydrocarbons (1996–2006)

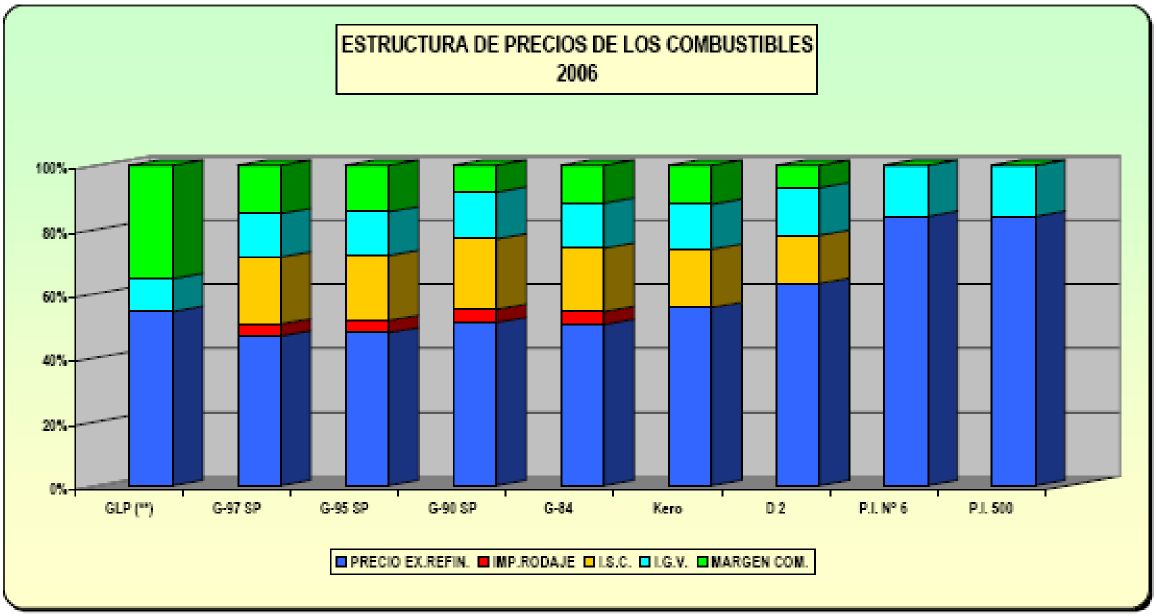


9.11 **Domestic Sales of Oil Products by Product Type (1996–2006).** Sales on the domestic market reached 134 000 BPD and are distributed by products as shown in Graph 28.



DOMESTIC SALES OF OIL PRODUCTS BY PRODUCT TYPE 1996–2006					
THOUSANDS OF BARRELS					
TURBO	LPG	KEROSENE	GASOLINES	INDUSTRIAL OIL	DIESEL 2

Fuel price structure including applicable taxes.



PRECIOS EXPRESADOS EN NUEVOS SOLES POR GALÓN

1.- Los margenes comerciales son libres, sus valores son estimados (DGH). Incluye el I.G.V. sobre el margen.

(2) El Impuesto Selectivo al Consumo, por medio del D.S.N° 025-97-EF, publicado el 12 de Marzo de 1997, establece montos fijos para cada tipo de combustible. El 17 de Agosto del 2004 mediante D.S. N° 112-2004-EF, se modifican el ISC del kerosene, Diesel 2 y GLP. Mediante D.S.N° 099-2005-EF, de fecha 1 de Agosto del 2005 se modifican los valores del ISC aplicable a gasolinas para motores y gasoils. El 10 de Setiembre de 2005 mediante D.S. N° 115-2005-EF, modifican Impuesto Selectivo al Consumo aplicable a gasolinas para motores, kerosene, carboreductores y gasoils. El 13 de Abril de 2006 mediante D.S. N° 044-2006-EF, modifican ISC aplicable a gasolinas para motores . Mediante D.S. N° 051-2006-EF, modifican el ISC aplicable a las gasolinas para motores, kerosene y gasoil. El 14 de agosto de 2006 mediante D.S. N° 135-2006-EF se modifican el ISC aplicable a los bienes contenidos en el Nuevo Apéndice III del TUO de la Ley General a las Ventas e ISC (gasolinas motor, gasoil y kerosene).

FUEL PRICE STRUCTURE 2006			
Ex-Refinery Price Trade Margin	Road Tax	Selective Consumption Tax	General Sales Tax
Prices given in new sols per gallon			
1. Trade margins are free, and their values are estimated (*Dirección General de Hidrocarburos*). Include the general sales tax over the margin.			
(2) Superior Decree No. 025-97-EF, published on March 12, 1997, established fixed Selective Consumption Tax amounts for each fuel type. On August 17, 2004, Superior Decree No. 112-2004-EF, amended the Selective Consumption Tax for kerosene, diesel 2 and LPG. Superior Decree No. 099-2005-EF, dated August 1, 2005, changed the Selective Consumption Tax amounts that are applicable to motor gasolines and gas oils. On September 10, 2005, Superior Decree No. 115-2005-EF changed the Selective Consumption Tax applicable to motor gasolines, carbo-reducers and gas oils. On April 13, 2006, Superior Decree No. 044-2006-EF changed the Selective Consumption Tax applicable to motor gasolines. Superior Decree No. 135-2006-EF changed the Selective Consumption Tax applicable to the assets contained in New Appendix III of the TUO of the General Sales and Selective Consumption Tax Act (motor gasolines, gas oil and kerosene).			

(*) Source: INEI
(**) Price given in sols per kilogram.

10. LESSONS LEARNED, COMMENTS AND SUGGESTIONS

1. In no case should private capital intervention be discarded in any and/or all of a country's oil & gas activities, whether in part or in whole. What should be kept in mind is that the contracts that are negotiated and signed should be fair and equitable for all parties and be based on clear, stable rules, with an inspection entity that performs its duties conscientiously. However, stability is relative since an oil contract, for example, is entered into for a fairly long duration of 20, 30 or 40 years, when those signing do not even believe that the assumptions on which it was negotiated will remain without change for that long. There are several intervening factors and some are extremely volatile, as in the case of oil & gas prices. This volatility is not only for market reasons, as these in turn are affected by political, social, religious, ethnic, environmental, and other factors.

The reasonable thing is for the companies to discuss the need for change and the possibilities for achieving it. This does not mean that the State cannot impose its conditions, especially when the companies go against the country's best interest. In the final analysis, countries are sovereign to renew or cancel contracts, provided the causes motivating them are fair. World history supports this position.

States and companies are aware of the need for regulatory reforms, for technical, environmental, social and other reasons, and also to keep a country competitive on the capital market.

In the case of Peru, although privatization could never be applied exactly as it was conceived, its partial practice has been positive, primarily with regard to up stream activities. It made it possible to increase the reserves of both liquid hydrocarbons and natural gas, build pipelines for liquids and natural gas and put especially natural gas at service of the people, modernize the *La Pampilla* refinery, improve storage and sales plants, create distribution networks down to the final consumer level with suitable service, and enhance and enforce safety and environment mechanisms and standards.

However, there was a price to be paid for this: the "truthing" of fuel prices. This action was taken at the right moment and with the people's consent, due to the political circumstances of the time and the people's hope for change under the new regime (August 1990).

2. State–owned oil companies, in the case of Peru, suffer much State interference in their administration. Often management is forced to take into account what it would mean for the regime in power if an action or direction to be taken might increase or decrease its acceptance or popularity with the people, or worse yet, if it would generate more or less votes during an election period, that is, bow to what in politics is known as populism.

3. The first thing that should be done in a State–owned oil company, regardless of whether it carries out all or some of oil & gas activities, is to maintain qualified human resources. This requires offering professional education and promotion opportunities that do not depend on which regime is in power, and assigning staff and wages according to current practices in the industry and ongoing training.

In the case of being in production or having areas that may contain hydrocarbons, State–owned companies should maintain an exploration program that will enable them to increase their reserves or at least replace those that are extracted.

The above two considerations are mentioned because, as in the case of Peruvian, although there may be regulations for naming company executives, whose terms may be scheduled to coincide with those of the administration, when governmental changes occur, these regulations are forgotten and the officers are changed. Likewise, when State–owned PETROPERU had problems covering its budget, the immediate response was to cut the items under training and exploration. This was a serious mistake, as it meant setting aside the company's future.

4. In general terms, States are bad entrepreneurs, and their errors may be glossed over when production gives them the luxury of making mistakes, even committing overindulgences that escape being noticed. One example are fuel subsidies, which once granted are almost impossible to eliminate, even when a country's oil scenario changes. This is what happened in Peru in the early '70s, when the military government, in a "patriotic act", dropped the gallon of 84 octane gasoline from S/. 10 to S/. 0.09 per gallon. Later on (in 1978), when Peru became a crude oil exporter, which lasted until 1989, it was impossible to raise the price even though the country changed to being a partial importer to meet its domestic demand, with the additional complication that prices began to shoot upwards, which caused serious damage to the country's economy. It was not until the early '90s that it was possible to adjust fuel prices to reality.

In the case of refining, although PETROPERU is playing the important role of fuel price regulator, it urgently needs to update its refineries. This is very difficult, and it needs to find a way to expedite procedures in order achieve this mandate. Economic or political concerns often to not prioritize these matters appropriately, but rather, in an effort to make them more transparent and economical, make them more cumbersome. The opposite occurs with those operated by private companies such as the *La Pampilla* refinery, which has been and continues to be kept up to date.

5. Privatization of oil & gas activities should go hand–in–hand with a legal and practical framework to facilitate real, effective competition. If not, in the consumers' defense, the State should intervene through a company or *ad hoc* agency, in order to prevent private company abuse of dominant position or monopolies.

6. In the case of Peru, State–owned companies should not perform high–risk exploration activities, as the cost is too high and negative results would affect the economy not only of the companies, but also that of the country. When a company decides to enter the exploration / exploration business, exploration activities are essential to maintain reserves, but in the Peruvian case it is impossible for a State–owned company to carry out sustained exploration programs, as history has shown. This, then, should be done by private companies. However, since the latter treat exploration as inherent in exploitation, it is necessary to contract out both activities. Oil contracts between the State and private companies will be beneficial for this purpose, as long as there are clear, stable rules, in addition to having good negotiation, supervision and inspection agencies. PETROPERU should continue its role of regulating fuel prices, but without going to extremes.

7. In the case of oil contracting, the rules of a country should not be fixed but should adjust to what is needed in order to achieve investment market competitiveness. This is not contrary to stability, as this is a relative concept and should be applied with full transparency and in conversation with the industry. As mentioned above, it is impossible for a contract with a 30 or 40 year duration to remain as signed, and even private companies are aware of this. It is normal for contracts to be accommodated to changes in the industry, always within the rule that they be fair for all parties.

8. With regard to communities in the surroundings of oil & gas activities, although there is oil revenue distribution, it should be legislated down to the community level. Presently, distribution is legislated as far as the local government level (regions and municipalities), and communities are forced to accept what these authorities decide they should give them. This has caused numerous conflicts and is one reason why oil & gas activities are rejected, as only negative impacts are felt, with little or no benefits.

With this in mind, communities should be informed of the oil & gas activities to be carried out in their areas, and not just of their obligations towards them but especially of their rights and the benefits they will bring.

9. The benefits granted to communities, taking into consideration location of resources within their territories, should be contained in laws that are previously analyzed, studied and proposed for their approval. They should not be subject to last–minute political concerns, much less to demands by the communities involved, no matter how right they are, as such decisions only create unrealistic obligations. Furthermore, these benefits should not only be for the region or district where the resource is located, but a fund should be set aside for those regions or municipalities that are less favored with natural resources.

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