

## MYANMAR IPPS IN SEARCH OF TERRA FIRMA

SINCE THE ENACTMENT OF THE NEW FOREIGN INVESTMENT LAW (FIL) IN MYANMAR IN LATE 2012, A NUMBER OF FOREIGN-INVESTED POWER PROJECTS HAVE BEEN LICENSED. WHILE PROGRESS TO-DATE HAS BEEN SLOW, THERE ARE STRONG REASONS TO EXPECT AN INCREASE IN MOMENTUM ON THESE PROJECTS. BY **STEPHEN MCWILLIAMS** AND **JOHN MACKAY**, LATHAM & WATKINS LLP, AND **EDWIN VANDERBRUGGEN**, VDB LOI.

Myanmar's existing licensing and security regimes, largely untested in the context of international financings, are generally suitable for international independent power producers (IPPs) seeking to develop and finance projects in Myanmar. Recent advances in Myanmar's environmental regulation will also impact positively on the ability of international developers and lenders to move forward with major power projects.

However, a remaining challenge for Myanmar, and a necessary component for a successful IPP programme, is the development of a model power purchase agreement (PPA) that will be deemed bankable by international lenders, particularly those lending on a project-finance basis.

Although the Myanmar Government is presently working with international organisations to prepare a model PPA (in connection with the current tender of the Myingyan gas-fired power project), that form is not yet publicly available and it is unclear if such a model of PPA will be phased in for other projects or to what extent it will be made generally available to prospective developers and lenders. The Government is also simultaneously preparing a much-needed update to the country's Electricity Law, although this is expected to require extensive implementing regulations that will take some time to draft and put into effect.

Notwithstanding uncertainties regarding the development of a model PPA and the status of Electricity Law updates, positive developments are occurring within Myanmar's IPP regime. The state-owned electricity distributor, Myanmar Electricity Production Enterprise (MEPE), has recently entered into a number of PPAs, all of which are understood to be a significant departure from its pre-2012 "unofficial model PPA".

These new PPAs have attempted to address some key bankability issues for the first time and the willingness of the Government to engage on these commercial and legal issues is an encouraging development. While challenges remain, revisions to the form of PPA, and the recent Myingyan tender exercise, provide good reasons to review the state of the commercial and legal terms of Myanmar's PPAs as we look ahead to a period of significant acceleration of foreign investment in Myanmar's power sector.

With these developments in mind, this article provides an overview of some of the key aspects of the current legal regime in Myanmar, as relevant to the development of a successful IPP regime capable of attracting international developers and financiers, and provides our views on some areas where further changes are required in order to encourage participation of international investors and lenders in Myanmar IPPs.

### Licensing power projects

Under the current framework, a foreign investor in the power sector must secure a concession by concluding a series of contracts with the Government addressing the construction and operation of a facility and the sale of electric power. In practice, a foreign investor will also require an investment licence from the Myanmar Investment Commission (MIC) and a locally registered company must be established with the Directorate of Investment and Company Administration. Although 100% foreign ownership is permissible, as in many other regional jurisdictions foreign investors will in practice often involve local partners.

Projects over 30MW (categorised as large-scale projects) are typically initiated by foreign investors through the submission of an expression of interest to the Ministry of Electric Power (MOEP). This may be prompted by a publicly announced invitation, such as the current Myingyan tender, or it may be unsolicited.

At this point, the MOEP may invite the foreign investor to sign a non-binding memorandum of understanding (MoU) for a fixed period during which the foreign investor will be required to conduct technical and financial feasibility studies. If the project is deemed to be feasible, a private award may be negotiated, though recently awards have tended to be made through an open and competitive bidding process, representing some risk to the party initially carrying out the feasibility study.

Typically, a successful bidder will agree the concession framework through a memorandum of agreement (MoA) that incorporates build, operate, transfer (BOT) terms (entered into with the Department of Electrical Power for gas-fired projects or the Department of Hydropower Planning for hydro and coal). Subsequently, a PPA (entered into with MEPE for a gas-fired project or

the Hydropower Generation Enterprise for hydro and coal) would be concluded.

The MoA also serves as a framework for a number of other supporting agreements, including a fuel supply agreement, a land lease and a joint venture agreement (as applicable), which are subsequently executed. Although the process described above has been used up to 2014, it is now being updated and streamlined by removing the requirement to enter into an MoA and moving straight to negotiation and execution of the BOT, PPA and other agreements. Cabinet approval is usually required for the grant of the concession.

### Secured lending framework

A clear and workable security regime is a cornerstone to any successful IPP programme that seeks to attract international project finance. Myanmar's security regime has a strong existing foundation, as it retains many elements of English common law as a legacy of the nation's colonial past. Accordingly, the types of security available in Myanmar will be familiar to lenders, with some minor differences reflecting local practice.

Thus, an IPP may provide its lenders with a mortgage or a fixed charge over a land lease (including the facilities on the land). Full diligence and appropriate local legal advice must be taken as there are some restrictions on which land can be mortgaged (eg, for land designated as farmland, certain further approvals are required). Myanmar law also allows a company to provide a fixed charge on its contractual rights (including a PPA) and book debts (eg, receivables under a contract).

A floating charge may be created on any other property, including bank accounts in Myanmar (although most lenders will insist on an account structure that keeps the majority of revenue offshore). A shareholder in a Myanmar company may also provide a guarantee in respect of a loan made to its subsidiary or create a hypothecation or a pledge on its shares in a project company.

Most charges and mortgages must be registered by the Company Registrar in accordance with the Myanmar Companies Act. In addition, charges and mortgages on immovable property must be registered with the Deed Registration Office (DRO) (at the time of writing, applications for the registration of charges and mortgages in connection with site leases for foreign invested projects have only just begun to be submitted to the DRO, which appears to be processing these initial applications).

Mortgages on immovable property must have the consent of the MIC, which requires a number of potentially subjective conditions to be met (which can be loosely summarised to include positive confirmation of legitimate reasons for the mortgage, a requirement that it not be detrimental to the interests of the state, and the ability of the mortgagee to carry on the mortgagor's activities associated with mortgaged land and buildings).

The MIC's requirement that the mortgagee be able to carry on any aspect of a mortgagor's activities may be of concern to project finance lenders, who would typically expect either to sell a foreclosed project or appoint a third party to develop or operate it on their behalf rather than taking it on themselves. In any event, some comfort may be taken from the fact that MIC approval is required at the time the security is created and lenders should therefore simply ensure that the relevant approval is a condition precedent to the advance of funds.

A final consideration for international lenders is that many Myanmar security mechanisms remain largely untested, which is of particular concern when aspects of the existing security regime apparently clash with elements of Myanmar's more recent commercial law framework. One glaring example is the conflict between existing prohibitions under Myanmar's Transfer of Immovable Property Restriction Act against a foreigner's ability to "acquire immovable property by way of purchase, gift, mortgage, exchange or transfer" and the more recent 2012 FIL, which clearly allows mortgages to foreign lenders.

It should also be noted that enforcement of any share security would require approval from the MIC, and lenders are generally averse to accepting a share pledge that would require further consent for enforcement (particularly for a project-financed IPP). Accordingly, it may be prudent for lenders to a major IPP to seek comfort by way of direct assurances from the Government with respect to the enforceability of the security package (and there is regional precedent for seeking such direct comfort).

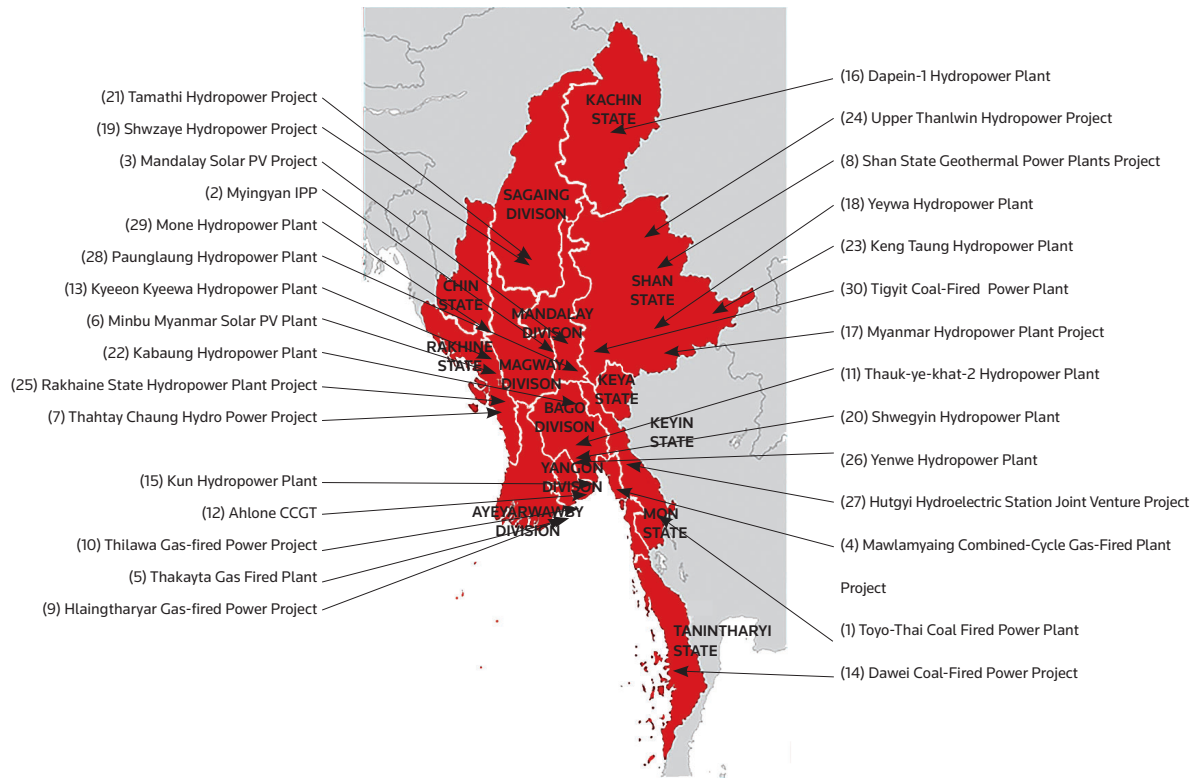
Ultimately, the increased level of foreign investment will also increase the frequency of security being granted to foreign financial institutions (which should in turn contribute to the development of a track record with respect to the enforcement of such security). This momentum should gradually provide greater clarity on the practical aspects of the security regime and lessen the requirement for direct comfort from the Government.

### Environmental law issues

Environmental issues have rapidly come to the forefront of Myanmar policy in recent years. Myanmar's environmental regulations cannot be ignored, as power projects can only receive their foreign investment licence once the necessary approvals have been obtained from the environmental regulator, the Ministry of Environmental Conservation and Forestry.

In the wake of the 2012 FIL, the environmental aspects of a proposed project have featured more prominently in the Government's investment regulations and in its assessment of projects, and although implementing regulations for Myanmar's new Environmental Conservation Act have not yet been issued, regulators are already referring to publicised drafts of the regulation.

**MYANMAR POWER PROJECTS, AS REPORTED 2004 – 2014**



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Project name	Capacity (MW)	Project capex (US\$m)	Project stage	Type	Sponsor(s)
(1) Toyo-Thai Coal Fired Power Plant	1,280	2,500	In Development	Coal-fired	Toyo Thai Power Holdings
(2) Myingyan IPP	250	1,880	Pre Development	Gas-Fired	Myanmar Government
(3) Mandalay Solar PV Project	300	480	Announced	Solar	ACO Investment Group
(4) Mawlamyaing CC Gas Fired Plant Project	230	170	Feasibility Study	Gas-Fired	Toyo Thai Corp PCL
(5) Thakayta Gas Fired Plant	500	700	Announced	Gas-Fired	Myanmar Government
(6) Minbu Myanmar Solar PV Plant	210	275	Pre Development	Solar	Green Earth Power (GEP)
(7) Thahtay Chaung Hydropower Project	100	Unknown	Execution	Hydro	Myanmar Government
(8) Shan State Geothermal Power Plants Project	TBD	Unknown	Feasibility Study	Geothermal	Emerging Markets Energy Pte
(9) Hlaingtharyar Gas-fired Power Project	500	Unknown	Announced	Gas-Fired	Myanmar Government
(10) Thilawa Gas-fired Power Project	500	900	Announced	Gas-Fired	Myanmar Government
(11) Thauk-ye-khat -2 Hydropower Plant	120	Unknown	Operational	Hydro	Myanmar Government
(12) Ahlone CCGT	120	170	Construction	Gas-Fired	Toyo Thai Power Holdings
(13) Kyeoon Kyeewa Hydropower Plant	74	Unknown	Operational	Hydro	Myanmar Government
(14) Dawei Coal-Fired Power Project	4,000	Unknown	Announced	Coal-fired	Italian-Thai Development PCL
(15) Kun Hydropower Plant	60	Unknown	Operational	Hydro	Myanmar Government
(16) Dapein-1 Hydropower Plant	240	Unknown	Operational	Hydro	Myanmar Government
(17) Myanmar Hydropower Plant Project	7,000	10,000	Feasibility Study	Hydro	Myanmar Government
(18) Yeywa Hydropower Plant	790	Unknown	Operational	Hydro	Myanmar Government
(19) Shwzaye Hydropower Project	600	Unknown	Announced	Hydro	Myanmar Government
(20) Shwegyin Hydropower Plant	75	Unknown	Operational	Hydro	Myanmar Government
(21) Tamathi Hydropower Project	1,200	Unknown	Announced	Hydro	Myanmar Government
(22) Kabaung Hydropower Plant	30	Unknown	Operational	Hydro	Myanmar Government
(23) Keng Taung Hydropower Plant	54	Unknown	Operational	Hydro	Myanmar Government
(24) Upper Thanlwin Hydropower Project	2,400	Unknown	Announced	Hydro	Hanergy, Asia World, Myanmar Government
(25) Rakhaine State Hydropower Plant Project	600	Unknown	Announced	Hydro	Myanmar Government
(26) Yenwe Hydropower Plant	25	Unknown	Operational	Hydro	Myanmar Government
(27) Hutgyi Hydroelectric Station Project	600	1,200	Announced	Hydro	EGAT, Sinohydro Grp, Myanmar Government
(28) Paunglaung Hydropower Plant	280	170	Operational	Hydro	Myanmar Government
(29) Mone Hydropower Plant	75	Unknown	Operational	Hydro	Myanmar Government
(30) Tigiyit Coal-Fired Power Plant	120	Unknown	Operational	Coal-Fired	Myanmar Government

Source: Thomson Reuters, PFI, MOEP, IJ Global, Dealogic, JICA

As with other regional jurisdictions, all large-scale projects now require an Environmental Impact Assessment and an Environmental Management Plan as part of the investment licensing application process. Also of particular note is the recent trend to insert comprehensive provisions on environmental standards into project documentation.

The progressive codification and publication of clear environmental standards should contribute positively to the growth of foreign investment in the Myanmar power sector and will provide greater certainty as to the environmental requirements on major IPPs.

#### **Towards a bankable model PPA**

- *Current status* – Prior to 2012, power projects in Myanmar were required to enter into a suite of what were generally standard form agreements consisting of an initial MoU and subsequently an MoA (incorporating BOT concession terms) and a PPA (we will jointly refer to those for convenience as the Pre-2012 Model). More recently, more detailed PPAs have been used for a number of gas-fired power projects, some of which have already gone into commercial operation. These more recent PPAs, although based on the same template as the Pre-2012 Model, clearly have some significant differences in their commercial and legal terms when compared with their predecessors.

These differences include a number of terms that are key to a bankable PPA, including a take-or-pay offtake commitment, force majeure provisions, tariff adjustments and termination payments. While the approach to these key terms is not yet sufficiently consistent to be properly described as representing a Model PPA, in the most recent Myanmar PPAs consistent approaches have become evident.

This emerging uniformity is consistent with the Government's objective to minimise variations across contracts on similar transactions, which is likely driven by a desire to increase transparency while also limiting the need for renegotiations. However, the drive towards consistency can be a double-edged sword, and it is hoped that as IPPs continue to negotiate PPAs on a case-by-case basis, the eventual outcome will be a model PPA with entrenched terms that are bankable for international lenders in the context of a developing economy at the early stages of developing an IPP programme. The next section summarises the treatment of some of the key terms in recent Myanmar PPAs.

- *Take-or-pay commitment* – The Pre-2012 Model historically adopted different approaches to the power purchaser's take-or-pay commitment, particularly in circumstances where an event of force majeure had occurred.

Many recent PPAs, including those executed in 2013 and 2014, favour an approach under which MEPE commits to purchase a guaranteed minimum output at an agreed tariff. This commitment commonly applies on both an

annual basis and in each month (based on a percentage of the power plant's contracted capacity), although the precise payment arrangements still differ significantly from one PPA to the next.

For example, some PPAs provide for regular payment of invoices based on the guaranteed monthly kilowatt hours only, with an annual balancing payment to compensate for any excess amounts dispatched, while other PPAs provide for regular payments based on the higher of the guaranteed monthly kilowatt hours and the actual monthly output. Notwithstanding these inconsistencies, the most recent PPAs at least provide for a regular minimum payment. This simplifies the financial modelling exercise for prospective lenders.

A remaining area of concern with respect to take-or-pay terms is the absence of a deemed availability concept. Instead of adopting a conventional approach based on payment for actual or deemed capacity (and actual or deemed availability), past Myanmar PPAs tended to guarantee payment for actual output, which still leaves potential gaps if the plant is available and capable of generating electricity, but there is nevertheless no actual output or generation by the seller due to circumstances beyond its control (eg, due to a government force majeure event affecting the power purchaser or its ability to deliver electricity).

It will be essential for successful large-scale project financing that any gaps in the take-or-pay commitment are properly identified and addressed. Gaps in at least some recent PPAs due to unclear and ambiguous drafting have left uncertainty as to whether or not the take-or-pay commitment applies in circumstances where it would commonly be expected. Assuming these ambiguities are unintentional, they should be easily remedied with more careful drafting in the future.

There is cause for optimism, as the approach to force majeure risk already appears to be increasingly detailed and sophisticated with each new PPA, including with respect to the distinctions drawn between natural force majeure events (earthquakes, floods, typhoons, etc), governmental/regulatory force majeure events (change in law, non-renewal of permits and expropriation) and other force majeure events (strikes, acts of terrorism and sabotage) and the consequences thereof.

In the most recent PPAs, governmental/regulatory force majeure events and other non-natural force majeure events affecting the seller or the power purchaser result in an MEPE obligation to make payments at least sufficient to cover the seller's debt service obligations and operating costs. It appears that MEPE is reviewing regional examples and this is helping move the Myanmar PPAs towards a more bankable approach on take-or-pay and force majeure.

- *Tariff adjustment* – Tariff adjustment arrangements are a significant concern for the Government and sellers alike and have, in practice, been one of

the more challenging areas upon which to reach agreement. PPAs in the Pre-2012 Model featured a diverse approach to tariff adjustment formulas. These ranged from a straightforward escalation of the tariff in line with Myanmar inflation to more sophisticated arrangements taking into account both local and foreign components of operation and maintenance costs, and allowing tariff adjustment by reference to consumer price indices in both Myanmar and relevant foreign jurisdictions.

The Government has generally resisted tariff adjustment structures that could allow significant tariff increases due to factors outside Myanmar or outside the Government's control. A number of the Pre-2012 Model PPAs consequently provide for tariff adjustment on the basis of tariff renegotiation and more recent PPAs have included strict limits on the maximum possible tariff escalation in each contract year.

In addition, the Government has successfully been implementing measures to harmonise tariffs across power projects based on the type of power generation (eg, hydroelectric or gas-fired), making it more challenging for individual project developers to negotiate bespoke tariff adjustment provisions. Although these arrangements are generally an improvement on the uncertainty of the "renegotiation" approach in the Pre-2012 Model, the more recent formulations are not without risk and international project developers and lenders should ensure that tariff adjustment formulas are carefully reviewed in any future PPAs very early in the negotiation process.

- *Termination payments* – Myanmar's PPAs vary widely in the consequences of a party's default in the performance of its obligations and the seller's entitlement to compensation in the event of termination due to a party's default or a prolonged force majeure event.

Under the most recent Myanmar PPAs, the events of default and other circumstances that can give rise to termination are fairly conventional and are broadly consistent with common market practice in the region. However, the circumstances in which the power purchaser (or the Government) is obliged to purchase the project upon a termination event are much more limited.

As an example, under the most recent PPAs, termination after commercial operation due to an MEPE default results in an option, but not an obligation, for MEPE to purchase the project (and even if it agrees to do so, the price is subject to further agreement). If MEPE does not exercise its option to purchase, or an acceptable price cannot be mutually agreed, the seller's only remedy is to claim general damages in accordance with Myanmar law (and export whatever parts of the plant and equipment it is able to dismantle).

This current termination treatment does not provide the level of certainty and protection required by international project developers and lenders, which would commonly expect to see an express and unequivocal obligation for the power purchaser to buy out the seller with

a termination payment expressly covering the full amount of the actual outstanding debt (plus accrued unpaid interest and certain breakage costs and prepayment fees) and the seller's loss of profit as a result of the early termination of the PPA.

Termination payments are obviously a key area of concern for international lenders as the lack of a termination payment under certain circumstances could lead to the failure of a borrower to repay its loans and result in an underlying power asset with no value. Lenders require a very clear understanding on how outstanding project debt will be repaid in different termination scenarios, both before and after commercial operation has commenced.

### **Conclusion – In search of terra firma**

The regulatory framework for investment in the Myanmar power sector is in rapid development. The new FIL has supplemented existing commercial security laws and licensing provisions, which should set the necessary foundation for IPPs to be developed on a project-finance basis similar to successful IPP programmes elsewhere in the region.

Key milestones for project finance are being met within this framework, such as recent successful perfections of asset security by way of registration. On the back of the recent regulatory changes, the Government has also concluded a number of new and comprehensive PPAs that address vital issues including take-or-pay, force majeure, tariff adjustment, termination payments, security rights and environmental compliance, all of which are of key importance to international investors and lenders.

While these developments should rightly be viewed as material progress for the IPP regime in Myanmar, if the sector is to attract significant international project finance, it will have to address a number of critical bankability issues in the approach taken on these issues. This is particularly so with respect to potential gaps in the take-or-pay provisions, substantial limitations on the seller's entitlement to claim tariff adjustments and inadequate termination payment regimes.

Such growing pains are not unusual in the development of any IPP regime and it is hoped that the creation of a model PPA (which is understood to be in preparation for the current tender of the Myingyan IPP) may serve to harmonise the past commercial variations into a bankable form of PPA.

In any event, we would expect that Myanmar's IPP regime will stabilise as the Government's experience and comfort with international investors grows. While the most recent 2013-2014 PPAs do not represent a fully bankable form, they do at least represent an incremental step in the right direction and should encourage more international investors and lenders to consider participating in the growth of Myanmar's IPP regime. ■