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PROGRESS REPORT 2016 MYANMAR



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MYANMAR KYAT OR US DOLLAR FOR POWER PURCHASE AGREEMENTS: WILL THE GOVERNMENT INSIST ON MYANMAR KYAT TARIFFS?

One of the many challenges facing private investors in public infrastructure in Myanmar is, increasingly, the currency issue. The Myanmar Kyat (MMK) has been in a slow but steady decline against the US\$ since 2014. The local currency was supported by FDI influx, but as this number was on the decrease in 2016, the negative trade balance was able to exert some pressure on the MMK, but it has since stabilized around the 1,350 MMK/1 US\$ mark. The outlook for the MMK is according to a number of experts not too bad at all, just unsure. There are few prognoses of the long term prospects of the MMK versus the US\$, and thus no long term hedging options.

Long term investors in infrastructure used for public purposes such as Independent Power Producers (IPPs) or investors in public transportation infrastructure or water treatment or supply would under the circumstances typically seek a tariff (the price paid by the Government partner in a Public Private Partnership or PPP) in a foreign currency, the same currency as their financing.

The previous Government has at least on some projects gone along with this request. A number of Power Purchase Agreements (PPA) are in US\$. One PPA,

Highlights of this note

- ▶ More pressure to accept MMK tariffs
- ▶ Tariff entirely in MMK
- ▶ Tariff in US\$ but payable in MMK
- ▶ Tariff in US\$, payable in MMK with fixed conversion rates
- ▶ Some of the tariff is paid in MMK
- ▶ Tariff in US\$, only payable in US\$
- ▶ A complex structure
- ▶ Where is this going?

kind of a particular legacy situation, is even in a major Asian currency.

More pressure to accept MMK tariffs

Having a PPA in US\$ does however in and of itself not set all foreign investors (or their lenders) at rest. It helps that the payment obligation is in US\$. However, there is always the possibility that the Government payer simply has no US\$ available to pay. The availability of foreign currency is a risk that lenders will often not want to assume. This risk may have to be addressed in the project or financing documentation, by having the Government provide special assurances

on this matter. The Government would have to give guarantees it will set aside enough US\$ to cover the foreign currency obligations in the PPP contract. You can ask yourself however if such assurances help in the real world. Meaning that, if the Government has no US\$, they have no US\$ and a piece of paper saying they should have US\$ will be of limited comfort. But it does help to lift a contractual commitment into a clear sovereign obligation.

But the decline of the MMK is not only of concern to sponsors and lenders. It may also be too costly for the Government to have to fork out more and more MMK to cover the same purchase of electricity. The state-owned generation and distribution companies such as the EPGE and the YESC do not sell to their customers at US\$-indexed tariffs. It seems to be this concern that has moved the present Government to be more reluctant to take on US\$ denominated long term obligations for public infrastructure. In negotiations we conduct or assist with, whether in connection with PPAs, BOTs or PPPs, there is more attention on this issue and pressure from the Ministry of Planning and Finance as well as the Central Bank of Myanmar. It is much too early to call say if the Government will refuse to sign anything in a foreign currency. But clearly, this issue is one of the Government's priorities.

As sponsors negotiate with the Government and possibly find a compromise, what are the options to consider?

Tariff entirely in MMK

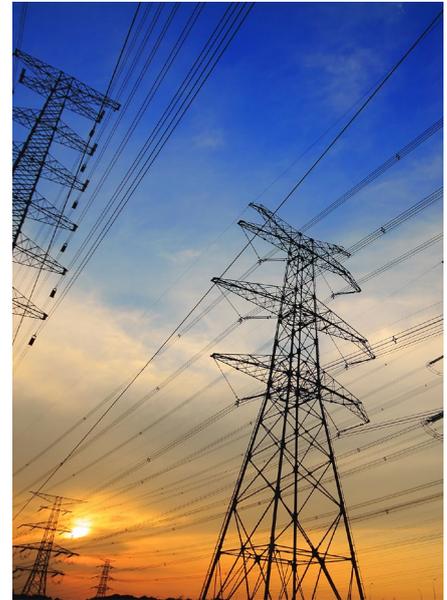
It sounds worse than it is. In Myanmar, at least as per present law, foreign investors may hold a US\$ bank account and are free to change whatever MMK they have or receive into US\$. Profit may be repatriated in US\$. Loan repayments and interest payments may, if the loan was approved by the Central Bank at the outset, be paid in foreign currency as well. Having MMK income will be scary to lenders in case the MMK keeps declining, but just in terms of the forex regulatory environment Myanmar is actually more liberal than Vietnam or China.

Tariff in US\$ but payable in MMK

A US\$ tariff, in theory, protects the sponsor and the lenders from MMK devaluation. The Government would be allowed to pay in US\$ or in MMK. But if paid in MMK, the Government would have to pay enough MMK to convert into the agreed amount of US\$, at any given time. The MMK goes down, the monthly bill for the Government goes up. Hence the Government's reluctance.

Tariff in US\$, payable in MMK with fixed conversion rates

In order to share the risk of currency fluctuations between the sponsor and the Government, the contract could provide that one or more fixed exchange rates are used when payment is received in MMK instead of US\$. For example, the deal might be structured in such a way that the sponsor will assume a small,



first part of currency changes, and the Government will assume all other risk. This protects one or the other party from excessive exchange rate changes. Pushing any risk to the sponsor may however be unrealistic.

Some of the tariff is paid in MMK

In many countries paying Governments try to save on foreign currency by paying at least some portion of the tariff in local currency. The project company often also needs at least some local currency for their operation and maintenance, so there is no need for 100% of the income to be in foreign currency. Pushing the local currency portion beyond 3% or 5% becomes a real currency risk for the sponsors and many of them will simply not do the project if they are asked to assume it.

Tariff in US\$, only payable in US\$

The best for sponsors and the cheapest for the cost of the project (all risks including currency risks get factored into the cost of the project in one way or another) is to have a US\$ tariff which the Government counterpart may only pay in US\$. Lenders may still require a sovereign guarantee on the availability of the foreign currency in Myanmar, as was noted above.

A complex structure

Parties could and probably should explore a hybrid combination of currency arrangements, where the obligations differ over time. For sponsors, there is a huge difference between the debt service period and afterwards.



Perhaps sponsors are willing to take a local currency risk, if there is sufficient upside, but there lenders will almost certainly not. So, you could structure an arrangement which provides one thing during the debt service period, and another thing afterwards. For example, you could agree to a US\$ tariff payable in US\$ during a say 10 year debt service period, followed by a partially US\$ and partially MMK tariff after that 10 year period.

Where is this going?

It is hard to predict where the Government's position will end up. Private sector involvement in financing public infrastructure, international financing, risk allocation in PPP projects are all very new concepts in Myanmar. Add to that the sheer number of projects, a number of painful legacy issues and a lack of Government resources and the result may be a stagnating deal flow. Sounds familiar? But on this issue, we

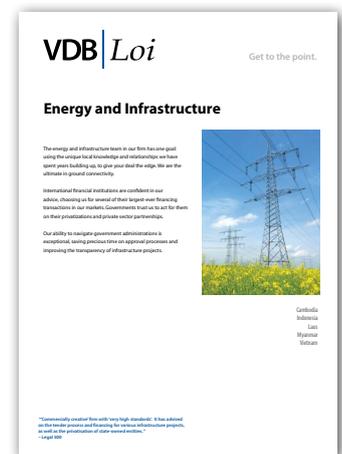
think the authorities will have to come around, at least in the short run. Yes, there is nothing wrong with being careful about escalating costs in case of a further MMK decline in US\$ terms. Whatever happens, though, as Myanmar increasingly turns to gas-fired power plants as a way to meet the lack of generation (instead of the unpopular coal or the protested hydro), the hard reality is that these fuel imports will have to be paid in US\$ anyway.

More importantly, the scale of infrastructure that needs to be built in Myanmar is so massive and its local financial sector so small that there really is no choice but to look to foreign lending. If you borrow money from overseas you can hardly expect those lenders to take the risk they will not be reimbursed in full because of currency fluctuations. If that is indeed a risk, they will of course not proceed with the loan or charge an exorbitant amount of interest, making your project uneconomical.

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Edwin Vanderbruggen is one of the most prominent foreign legal advisers in Myanmar, and he is widely recognized for his experience in the energy and infrastructure space in Myanmar. Edwin's experience working with the Myanmar Government is second to none, as he advises the Government on privatization transactions and PPPs in energy, transport and telecommunications. He and his team have uniquely extensive experience in electric power, and were involved in four out of five of the Myanmar gas and renewable projects concluded in March 2016, and he advised the Japanese Government on their investment in the Thilawa SEZ. Edwin worked on the planning, negotiation, documentation and financing for projects of all types of power generation, including gas, coal, hydro, solar, wind and W2E in Myanmar. He also advises four of the 'super majors' on oil and gas interests in Myanmar and on the first LNG terminal in the country. He lives in Yangon.

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The Energy team is led by Charles Magdelaine. Charles is a French lawyer qualified to practice in Paris educated in France, the United States and China. He has extensive experience in the documentation, financing and negotiation of energy projects in Southeast Asia, and Myanmar more in particular. Charles focuses on oil and gas, infrastructure, power and other natural resources projects.

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