

POWERING AHEAD: CHALLENGES FOR MYANMAR

Nathan Dodd, Ben Thompson and Rohan Bilimoria at Mayer Brown JSM examine the key challenges faced by prospective investors in Myanmar's Power Sector.



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INTRODUCTION

Myanmar's future economic growth will largely depend on the ability of its Government and power infrastructure to keep pace with its plans for rapid economic development. However, the harsh reality is that about 94% of Myanmar's rural population does not have access to electricity and a substantial level of foreign investment is required to upgrade the nation's existing power infrastructure. As the Government's finances are overstretched, international project finance will play a vital role as a source of funding for the power sector.

What many people do not know is that there are already success stories in Myanmar. For example, Toyo Thai Power Corporation's 121MW Ahlone gas-fired power project, which is already operating at 80MW, getting dispatched (and paid) and is likely to close a US\$100 million project financing in the coming weeks. We have been advising on this project since 2012 and it demonstrates what dedicated sponsors can achieve. In addition, the Government has made a significant step with the tender process for the Myingyan 250MW gas-fired power project. These are encouraging developments for the nation and the international project finance community.

However, it is fair to say that project finance in Myanmar is still at an early stage and potential investors face a number of significant challenges.

OUTDATED LEGAL FRAMEWORK

Myanmar's current legal framework remains a challenge for foreign investment. An extensive upgrade of Myanmar's legal system and legislation is required to strengthen investor confidence and attract significant foreign funds. The legal framework is based on a combination of laws from different periods of its history (including many colonial-era laws held over from British rule) which exist alongside a common-law style judicial system. Many laws are outdated or untested.

However, the Government has shown a willingness for

reform. The Foreign Investment Law in November 2012 introduced a number of welcome changes including preserving the right of foreigners to wholly own investment vehicles, relaxing rules around joint ventures with local partners, extending the tax holiday for foreign investors and allowing foreigners to lease land for 50 years plus two extensions of 10 years.

For the power sector, the Electricity Law of 1984 still forms the basis of the legislative framework but does not provide for power generation by independent producers. Fortunately, this law is under review by the Myanmar parliament. The Government released an advance draft of the new Electricity Law in December 2013 in consultation with the Asian Development Bank and a further interim draft earlier this year.

UNDERDEVELOPED FINANCIAL SYSTEM

Myanmar's financial system is one of the least developed in the world, with less than 10% of the population holding a bank account. This is inevitably a concern for international investors and lenders.

The Government has identified the development of the financial system as one of its key priorities and has sought advice from the World Bank. The granting of independence to the Myanmar Central Bank in July 2013, the World Bank's active involvement and the current plan to grant up to 10 foreign banks with limited operating licences later this year are all positive signs likely to increase international transparency and improve investor outlook.

However, despite the current state of the financial system, it is worth remembering that there are independent power projects already operating in Myanmar, with producers receiving payments into their designated accounts.

UNCLEAR PROJECT STRUCTURE

A further challenge is the lack of precedent transactions in Myanmar. With no significant track record of power purchase agreements (PPAs) and

no standard build-operate transfer (BOT) contract, investors in the power sector have so far been negotiating projects on an ad hoc, bilateral basis.

However, there are independent power projects in Myanmar with signed PPAs. The Ahlone power project mentioned above has a signed PPA with the state-owned power utility Myanmar Electric Power Enterprise (MEPE), with 80MW already being dispatched.

Further, the International Finance Corporation (IFC), with Mott MacDonald as their technical adviser, are advising the Government on the

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Myingyan power project tender process, which should also help to establish a standard PPA for future projects.

Another issue is the apparent unwillingness by the Government to provide sovereign guarantees on power projects which are commonplace in other Asian jurisdictions such as Vietnam and Bangladesh.

Unusual features for power projects in Myanmar include the "free power" and "free equity" requirements. The Government recently announced that independent power producers would be required to grant up to 15% of free equity in the project and up to 15% of free power to MEPE. This was also reflected in the tender documents in the first round of Myingyan. However, these requirements would artificially inflate the tariff for the remaining power generated, and the variability would make project comparisons more difficult. It is our hope that these requirements will not be a part of the final Myingyan tender, and it can be noted that they do not feature in every negotiated power project.

LACK OF SECURITY OF OFF-TAKE

Investors and lenders for emerging markets often take comfort from the track record of previous projects. Unfortunately, MEPE as offtaker has not had the opportunity to demonstrate a reliable track-record of off-take payments which investors or their lenders

can take comfort from (unlike, for example, EGAT in Thailand). Furthermore, MEPE is highly dependent on a government subsidy as its payments for power generation are greater than its selling price for that power to its end-consumers. A subsidised power utility is not unusual in the Asian region, but structuring projects to provide comfort to lenders on MEPE credit risk through extended political risk insurance will be a key requirement for commercial lender participation in the sector.

In an encouraging move, Myanmar officially became a member of the Multilateral Investment Guarantee Agency (MIGA) on 17 December 2013 which means that foreign direct investment into Myanmar's power sector will be eligible for MIGA's political risk guarantees and support (which can include MIGA coverage for breach of contract by MEPE).

UNCERTAIN COLLATERAL PACKAGES

Many international lenders will be reluctant to lend to projects in countries where lender-security is difficult to enforce.

A lack of market-tested collateral packages for international lenders is a key concern on current power projects in Myanmar. Although existing legislation provides for a range of lender-security interests, there are limited examples of these being used in practice. Importantly, Myanmar law does not allow foreign lenders to take security over immovable property. As a result, experienced international and local counsel are essential to provide combined advice on a robust lender-security structure for the benefit of international lenders. The role of international institutions such as the World Bank in advising the Government will be vital to ensure the transition of the power sector to a model which is bankable.

LACK OF FUEL

Outside of the renewables sector, any successful power project will of course require a reliable source of fuel.

Myanmar enjoys significant gas reserves, but most of the country's gas has already been committed to China and Thailand under long-term sales contracts. This shortage of gas will remain a significant issue until new gas fields

come on-stream (estimated to be 2018 at the earliest).

Whilst Myanmar also has substantial coal reserves, these are primarily located in remote areas and are generally less suitable for power

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generation given their grades and calorific values. However, the Government is prepared to allow importation of coal to satisfy domestic needs. This will be accompanied by public environmental concerns, but modern coal-fired technology and imported coal are likely to be the key to meeting the power demand in Myanmar.

CONCLUSION

Myanmar and the investors looking to develop power generation in Myanmar face some undeniable challenges, and a degree of initial market "froth" is being replaced with an increasingly realistic view. However, this is positive as investors and their lenders begin to develop serious market entry strategies and sponsors such as Toyo Thai have already demonstrated that successful independent power projects can be developed in this growing market. With continued and strong international support, we believe the outlook for the power sector in Myanmar remains positive.

ABOUT THE TEAM AT MAYER BROWN JSM:

Nathan Dodd and Ben Thompson have a combined experience of more than 25 years on the development and financing of Asian power projects. Their team at Mayer Brown JSM is currently advising the sponsors on two projects in Myanmar - the development of a 1,320MW super-critical coal-fired power project and the US\$170 million development and financing of the Ahlone 121MW gas-fired power project which is likely to be the first project financing in Myanmar. In 2013, their team advised an international bidder with respect to the initial tender for the Myingyan IPP 250MW gas-fired power project in Myanmar.