



SOME ISSUES TO CONSIDER FOR TOLL ROAD PPP PROJECTS IN MYANMAR

15 June 2018

MYANMAR PRACTICE OVERVIEW

We are known for providing the ultimate in ground connectivity to our clients. We believe that specialization, along with tenacity, is necessary to achieve this. Therefore, in 2017, we ramped up our headcount and the number of our senior advisors, and we converted to a system of exclusively dedicated practice teams in Myanmar.

We have created 4 general practice teams (Corporate M&A, Banking and Finance, Licensing and Disputes) and 3 specialized teams (Energy and Infrastructure, Telecommunications and Taxation).

Each practice team comprises a team leader, who assists a partner to manage the team, and minimum 4 to maximum 10 advisers who are exclusively dedicated to only one team. All team members are, just like partners Edwin Vanderbruggen and Jean Loi, residents of Myanmar.

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SOME ISSUES TO CONSIDER FOR TOLL ROAD PPP PROJECTS IN MYANMAR

The Union Ministry of Construction, in coordination with the Union Ministry of Transport and Communication, and the Yangon Regional Government seeks to implement its first ever elevated expressway, the Yangon Elevated Expressway. The Government is planning to invite tender bidders this year.

The elevated expressway will run 40 km start from Strand Road in Down Town to Mingalardon Industrial Zone at the outskirts of Yangon, east of Yangon's Inner Ring Road, and 15 km from No.3 Road of Mingalardon Industrial Zone, connecting to Yangon-Mandalay Highway, and further to Hantharwady International Airport which is in the implemented plan.

Against this backdrop we have provided this preliminary issues memo to highlight some of the key legal and practical issues to consider for sponsors, lenders and Government stakeholders.

Situation of existing toll roads in Myanmar

Myanmar has an exceptionally high percentage of toll roads among developing countries, 22,000 km of road in total are tolled in one way or another with private sector involvement. On most trunk roads in Myanmar users have to pay some kind of toll. There are also 170 tolled bridges. The first BOT contracts for toll roads were signed in 1996 (the AH14 Mandalay-Lashio-Muse). Approximately 90% of the roads with

more than 1,000 vehicles per day, not including the expressways, are under BOT contracts. BOT roads are 14% of the total trunk road network and 31% of the national highway network.

There are two types of toll roads in Myanmar: BOT roads and "auction roads". In a BOT road project, the private sector contractor invests in road improvement and repair. With auction roads, there is some type of a tax farming structure, where the private contractor just operates the toll booth in return for an advance payment to the Government. Under this regime, the operation of the toll gates is auctioned off to interested bidders at 80% of the estimated traffic volume multiplied by the toll rates for the different vehicle types. Once the revenue exceeds the 80%, the private sector partner realizes a profit. There is no real bidding, but rather a lottery process.

Toll rates are determined by the Department of Highways' (formerly the Public Works Department) ("DOH") Production Section, and are reviewed every 2 to 4 years, or are set by the BOT contract on a "to be negotiated" basis. BOT toll rates are currently between 0.03US\$ (e.g. for saloon type cars) to 0.22US\$ (e.g. for very large trucks) per km, depending on the vehicle type, with rates for "auction roads" at one third or one fifth of BOT toll rates.

A thorough ADB study published in 2016 has observed that while user payments in

Myanmar are large (estimated at 120M\$ per year), users are not getting value for money (ADB, Myanmar Transport Sector Policy Note Trunk Roads, 2016 p. 90). Most BOT roads are in poor or bad condition, sometimes making it necessary for users to slow down to as much as 20 km/hour. Improvements such as road widening, while agreed in the BOT contract, are not always implemented or enforced although tolls are still collected, the ADB study noted. Most revenue is concentrated on 20%-25% of the road network with significant traffic.

Myanmar has a lot of experience with toll road bot contracts, but not the right kind

The template BOT contract used by the DOH has been described by the ADB as being "deeply flawed" and "often far removed from best practice". This is the case both from a legal and a commercial perspective. Some examples:

- The BOT contract requires the contractor to repair and widen the road in return for collecting toll for 40 year, which can be extended with three periods of 5 year.
- The contractor is required to maintain the road for the entire contract term, and to widen the road again in case the traffic reaches certain thresholds. However, the ADB estimates that the profitability for contractors is for most roads very



low. The economics are not viable, which is probably the main reason for the lack of investments;

- The contractor provides a performance guarantee of 1% of the estimated investment cost;
- The Government receives a share in the gross toll receipts (between 5 to 20%, depending on the years of the contract);
- The Government is entitled to terminate the contract without compensation in case the contract defaults on the construction or maintenance obligations;
- There is a flawed termination payment framework; and
- Disputes are settled through negotiation or, failing agreement, by arbitration in Myanmar.

The legacy experience with domestic BOTs is not helpful to the socialization of a new PPP document in accordance with international best practices. We have extensive experience in explaining complex project documents to Government officials and persuading them of the benefits of an international standard document. These exercises generally take much longer than stakeholders expect.

Flexibility will be needed in the project structure

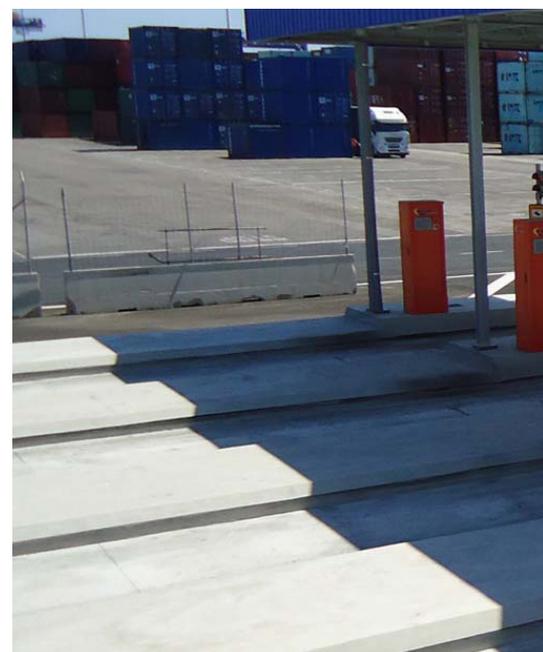
There are no specific laws on PPP or other laws or regulations imposing any particular structure for the Project in Myanmar. The Government is to a large

degree free to decide how to structure the Project. For the IFC's project on creating a Model Toll Road PPP Document, a very typical structure for toll-road PPP projects was assumed and proposed. It includes the formation of a Concessionaire SPV project company concluding a concession agreement with the Ministry of Construction, Government support and a separate O&M provider. In the structure, the SPV will collect toll fees from users and, potentially, an availability payment from the MOC.

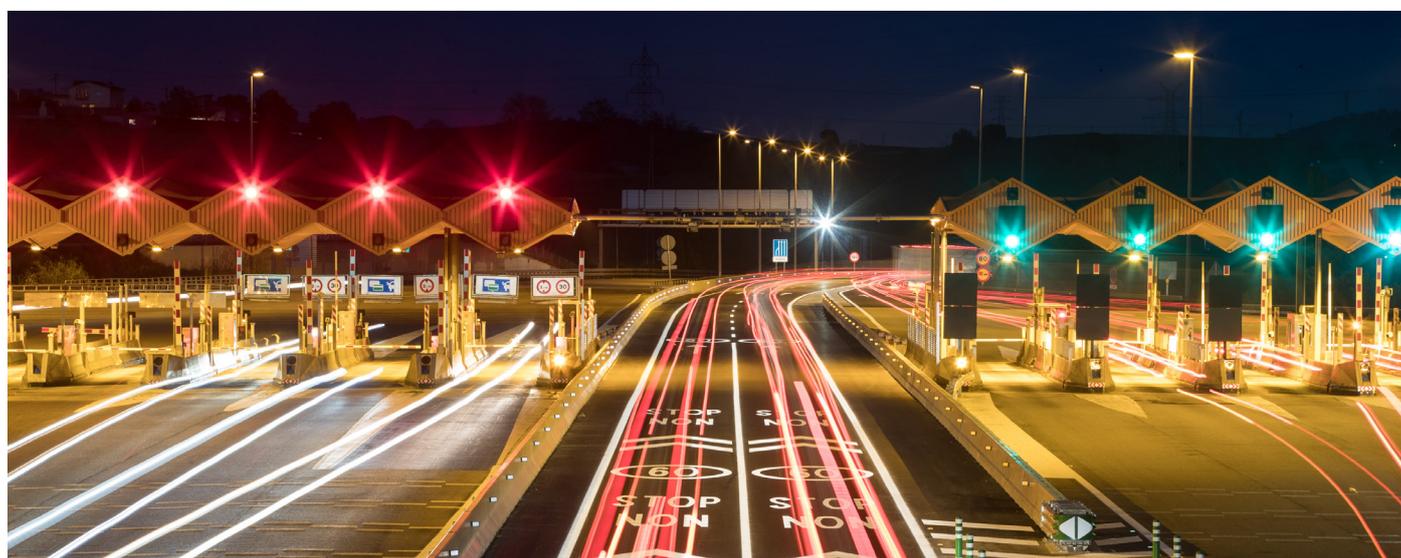
Based on our experience we believe it is entirely possible, even likely, that the MOC will consider several different structuring options before settling on a final solution. As you know, the MOC itself is still considering different options of implementing public infrastructure projects, such as through ODA loans in combination with operating concessions. Furthermore, other Government stakeholders will weigh in on the documents and the structure, such as the MOPF and the Attorney General Office. We have had experience on projects where this happened in relatively late stages, after documents have already been issued in the context of a tender.

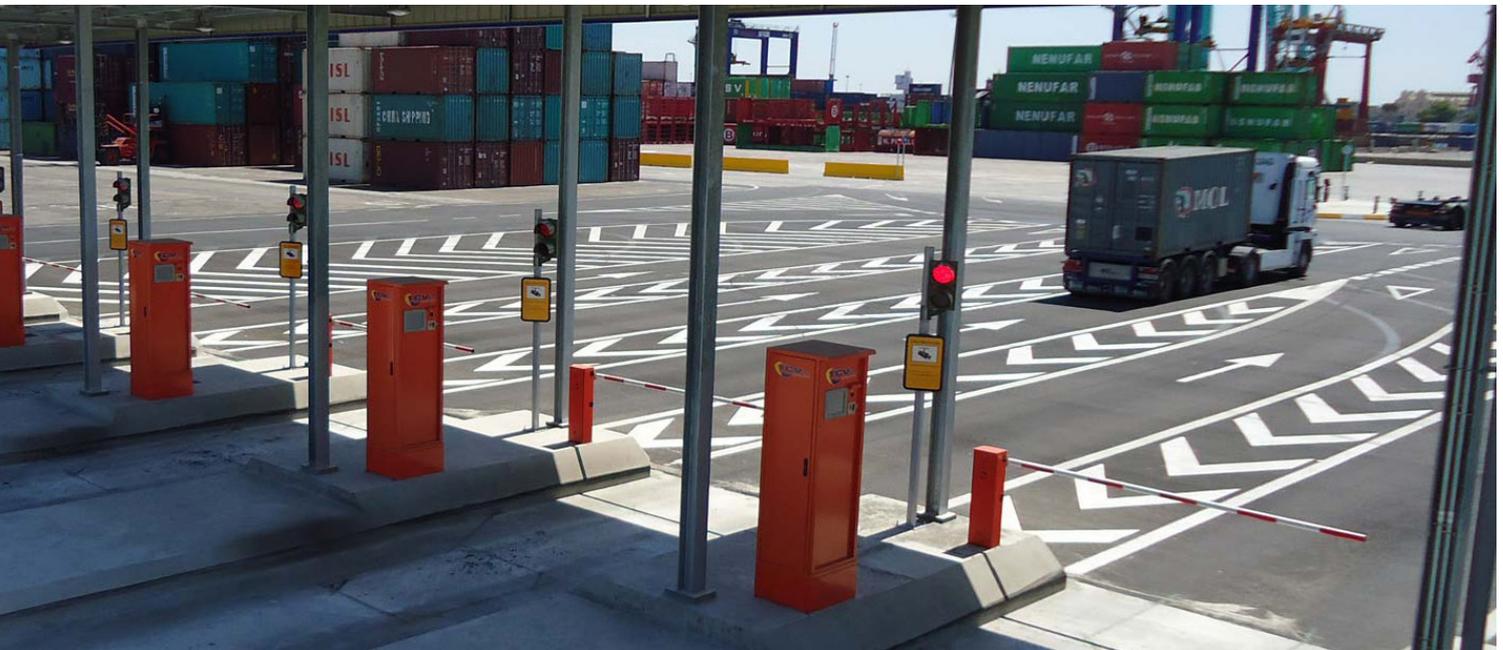
How are government counterparts likely to perceive certain key commercial terms?

Many of the key factors of the Project have come up in prior infrastructure projects with private sector investment. Our experience in negotiating, explaining and documenting these will be a valuable asset to the Project, such as:



- **Availability payments versus use payments?** It is generally difficult to understand for Government officials that they might have to pay for something even if it is not being used. This principle was accepted, for example, in only 1 out of 5 PPAs signed in 2016 (we worked on 5 out of 5; 4 times for the sponsors, 1 for the lenders). But to some degree this is about semantics, and on how the matter is explained. On the PPAs without capacity payments, for example, instead a "minimum guaranteed offtake" was agreed, which was to some degree the same in combination with a comprehensive FM framework.
- **Foreign currency tariff?** This issue is closely watched by the Ministry of Planning and Finance (MOPF), and the Central Bank of Myanmar, which are concerned about further decline





of the MMK. A new Directive of the Central Bank in December 2016 has put more pressure on Government departments and State-Owned Enterprises to pay only in MMK. But, in our recent negotiations with the MOPF in connection with a number of projects have resulted in a more pragmatic “multi-currency approach” (MMK and USD).

- **Foreign currency-linked toll fees?** Given the sensitivities associated with increasing toll rates for Myanmar users, it may be politically difficult to agree on formulas where

the toll fees get hiked based on exchange rates. Nevertheless, lenders will have to be reassured about the foreign currency debt service, probably through some sort of Government support mechanism.

- **Bankable termination payments?** On several infrastructure projects, even when we were acting for the Government, we encountered significant push-back on termination payments. On the Yangon and Mandalay Dry-Ports PPP, for example, we were unable

to get the Union Ministry to accept a bankable solution. On most of the energy deals we worked the Government did accept a bankable termination payment.

Land rights of the project

The land use rights of the projects, as an elevated expressway, can be structured in different ways under Myanmar law. Chiefly, a right of way (ROW) in Myanmar can be created through a contract of license (which is not an immovable property right), an easement (which is an immovable property right), a long term lease (which is also an immovable property right in Myanmar law) or a transfer of a land use right (which is an immovable property right). The practice to date for oil and gas pipelines in Myanmar, all of which are “owned” by the MOGE, has been to create a ROW through a transfer of land use rights. In other fields such as for telecom towers, which are nearly all foreign owned companies, long term leases have been the standard, while for water pipelines and fiber optic cables owned by foreign owned companies, licenses have been used. To date, existing BOT contracts for toll roads, which are all agreements with local parties, do not provide in any separate right for the company to lease the land or own the construction on it.

One part of the problem is to establish in Myanmar which Government entity is the owner of a particular plot of land where one or more pillars will be erected. This should not be underestimated. In practice, there are rarely documents or



surveys available to identify which entity, union level, state/region level or municipal level, actually holds the authority to provide a right of use to the Project company.

If the Project wishes to create an immovable property right which is opposable to all third parties, a registered lease is the most practical solution. However, this is unprecedented in Myanmar for publicly used assets. A lessee may not be able to close the toll road for public use, even if that is a common right for lessees in general.

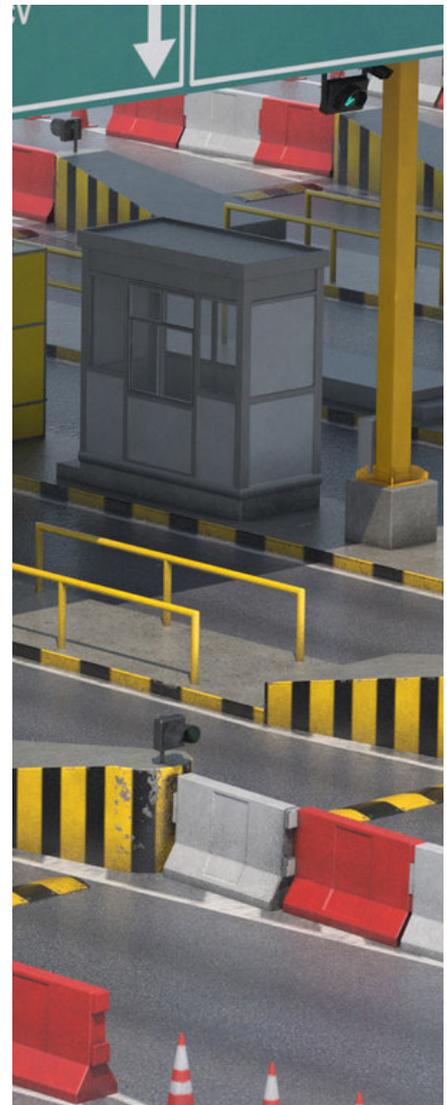
Instead, the (proper) Government land owner can create a contractual right (a license) for the Project company to erect buildings on the land of the owner. The Project company would have the contractual right to use the buildings for the duration of the contract. Such right can be assigned to a third party lender under the Transfer of Property Act.

Direct agreement with the lenders?

So far only 1 project, an IPP has managed to obtain a direct agreement between the lenders and the Government. The negotiation was extremely lengthy. This issue must be handled differently on other projects to avoid extreme delays. Furthermore, there is some uncertainty as to the boundaries in the scope of application of the Public Debt Management Law 2016 for “guarantees”, which require approval from the National Assembly. Although we think it is likely that a document establishing a contingent liability towards the project company does not fall into the scope of application, there is always the chance that there are different views on this.

Progress on the documentation

On some deals, such as Hanthawaddy International Airport, the parties were unable to move the documentation forward fast enough. Delays, indecision and a number of tactical errors at the side of the sponsors resulted in a near termination of the deal. On more recent projects we mitigate this issue by preparing documents way in advance, by simplifying international precedents and by drafting Myanmar-language summaries and term sheets.



Overview of Tax and Other Aspects		
1	Corporate Income Tax rate	25%
2	Corporate Income Tax holiday	3, 5 or 7 years depending on the location of the project in Myanmar
3	Import of capital goods, plant	Exempt from import taxes and customs duty during the construction period
4	Indirect tax on service provided by the project company to its customers	5% Commercial Tax, can offset input Commercial Tax on expenses
5	Additional income tax incentives	Reinvested profit, accelerated depreciation, profit from export
6	Dividend distribution	No withholding tax, no restrictions to dividend distribution
7	Tax on interest paid to lenders	Interest paid on cross border loans 15% withholding tax, reduced to 10% or 8% under some tax treaties. No withholding tax on local loans.
8	Foreign ownership restriction	No requirement for a local partner on most infrastructure activities
9	Debt to equity ratio	Generally 70/30 to 80/20 debt/equity permitted, special cases may be allowed
10	Foreign nationals as directors	Permitted. At least one director should be a resident of Myanmar, but no requirement for any Myanmar nationals on the board of directors
11	Local content requirement	Generally not applicable
12	Loss carry forward	3 year. Losses during tax holiday cannot be carried forward

Table: Trunk Road Lengths by Surface Type and State and/or Region, 2014

State/ Region	Cement Concrete		Asphalt Concrete or Penetration Macadam		Water-Bound Macadam		Gravel		Earth		Track		Total	Of Which Paved
	km	%	km	%	km	%	km	%	km	%	km	%		
Kachin	25.3	1	587.9	16	541.9	14	970.7	26	967.4	26	693.4	18	3,786.8	16
Kayah	–	0	472.0	49	60.5	6	100.0	10	329.1	34	0.0	0	961.6	49
Kayin	–	0	831.8	46	87.6	5	176.2	10	723.5	40	0.0	0	1,819.2	46
Chin	–	0	555.6	28	528.3	27	–	0	861.6	44	26.6	1	1,972.0	28
Sagaing	32.2	1	2,091.5	47	519.9	12	716.0	16	1,124.2	25	0.0	0	4,483.8	47
Tanintharyi	–	0	744.7	55	323.3	24	206.6	15	81.9	6	0.0	0	1,356.5	55
Bago	263.2	12	1,467.8	66	199.6	9	122.3	6	158.1	7	0.0	0	2,211.0	78
Magway	–	0	2,586.3	73	341.4	10	352.3	10	260.7	7	0.0	0	3,540.7	73
Mandalay	203.0	9	1,861.6	85	98.8	4	12.2	1	23.1	1	0.0	0	2,198.7	94
Mon	–	0	729.8	83	2.4	0	65.4	7	82.3	9	0.0	0	879.9	83
Rakhine	36.4	2	991.4	53	439.3	24	182.3	10	215.9	12	0.6	0	1,865.8	55
Yangon	97.5	9	787.4	75	87.4	8	12.1	1	59.9	6	0.0	0	1,044.3	85
Shan (East)	2.2	0	2,116.3	55	336.2	9	799.3	21	563.0	15	0.0	0	3,817.0	56
Shan (South)	57.3	1	2,154.1	43	531.1	11	923.3	18	1,382.9	27	0.0	0	5,048.7	44
Shan (North)	6.4	0	632.6	30	368.9	18	419.7	20	660.4	32	0.0	0	2,088.1	31
Ayeyarwady	19.3	1	1,592.2	61	158.8	6	488.6	19	361.8	14	0.0	0	2,620.8	61
Naypyitaw	191.5	44	223.7	52	–	0	–	0	18.5	4	0.0	0	433.7	96
Total (2014)	934.4	2	20,426.8	51	4,625.3	12	5,547.0	14	7,874.4	20	720.6	2	40,128.6	53
Total (2011)	638.4	2	16,622.9	44	5,561.8	15	5,636.0	15	6,087.1	16	1,409.8	4	37,785.3	46

– = not available, km = kilometer.

Source: ADB estimates based on Ministry of Construction data.

The new landscape for the sovereign guarantee

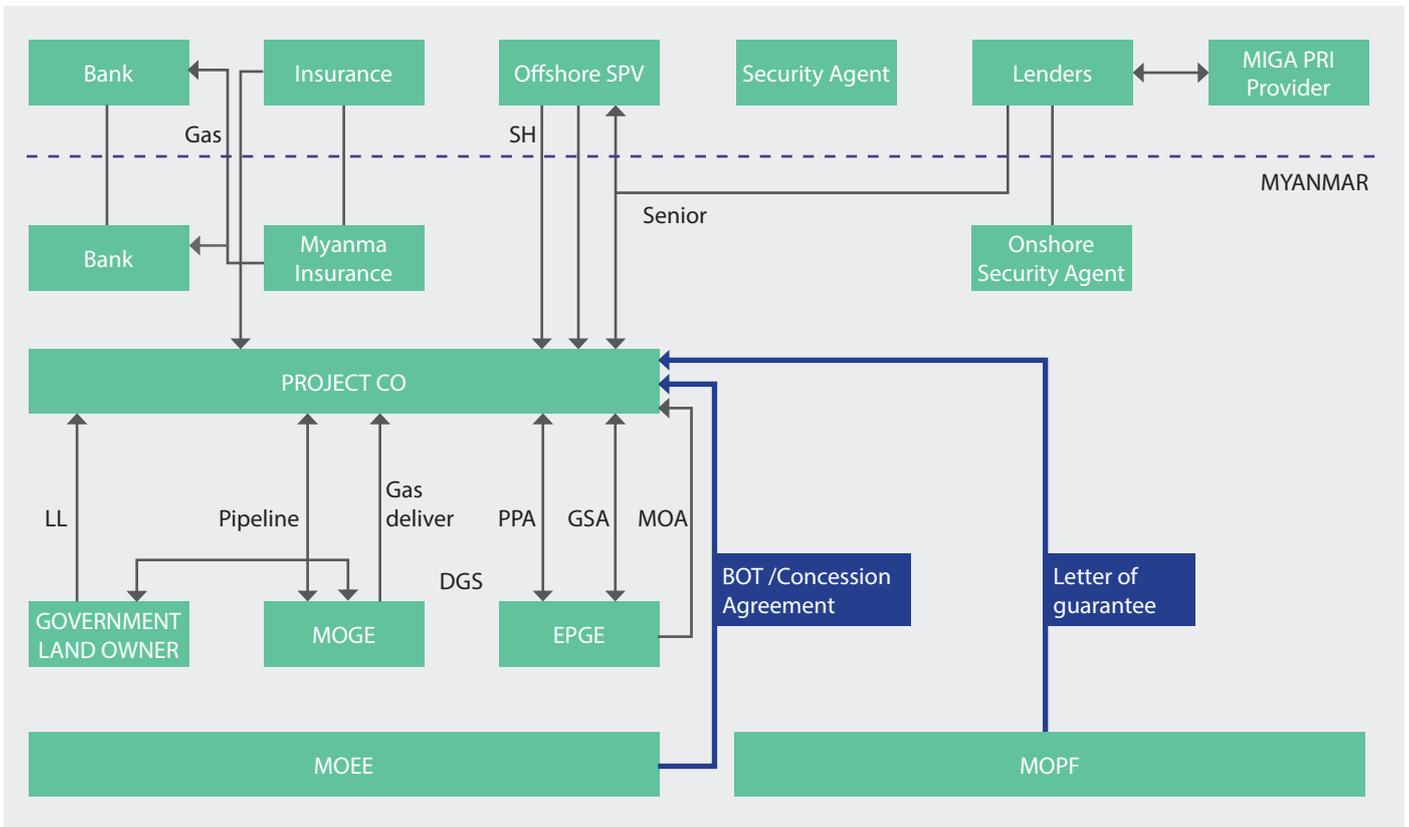
The legal framework of Sovereign Guarantees is in full development in Myanmar. In following of the Public Debt Management Law 2016, a wholly new legal context exists for such guarantees. Under this law, an actual sovereign guarantee in the sense of this law, can only be issued by the MOPF and within the terms and conditions set by the National Assembly.

In practice, line ministries including the MOEE have issued contractual commitments covering payment obligations of their SOEs in the guise of a Build-Operate-Transfer contract. Such a BOT has the effect of a guarantee. But, in

fact, this structure was only done for one particular power project, and not for any of the others. So far.

The MOPF is now in the late stages of considering an implementing regulation under the Public Debt Management Law 2016 for the financing of PPP projects. It contains a procedure, conditions and various other terms for issuing sovereign guarantees in Myanmar. The guarantee structure would use both contractual commitments (by the line ministry) and a letter of guarantee by MOPF, the letter acknowledging and confirming the contractual commitments of the line ministry (Note: VDB Loi drafted this regulation, and works with MOPF to finalize it).

In the below structure, it is illustrated how the Government guarantee would work in a power project setting. The obligations of the Government contract parties EPGE (the electricity utility) and the MOGE (Myanmar Oil and Gas Enterprise) are backed by the relevant Union Ministry, in this case the MOEE (Ministry of Electricity and Energy) and confirmed by the guarantee issued by the MOPF. In the case of a toll road project where the Ministry of Construction is the contract party providing the concession, and not a state-owned enterprise such as EPGE or MOGE, the structure used for power projects will have to be adjusted.



Based on the most recent insights, the Government guarantee structure would thus look as follows:

1. **A contractual commitment by MOEE to pay on behalf of EPGE** in a project document between the Sponsors/the Project Company and the MOEE, most likely a document called the Concession Agreement or Implementation Agreement or MOA; and
2. **A letter of guarantee issued by the MOPF** under the (now in draft) Regulation on the Financing of PPP Projects.

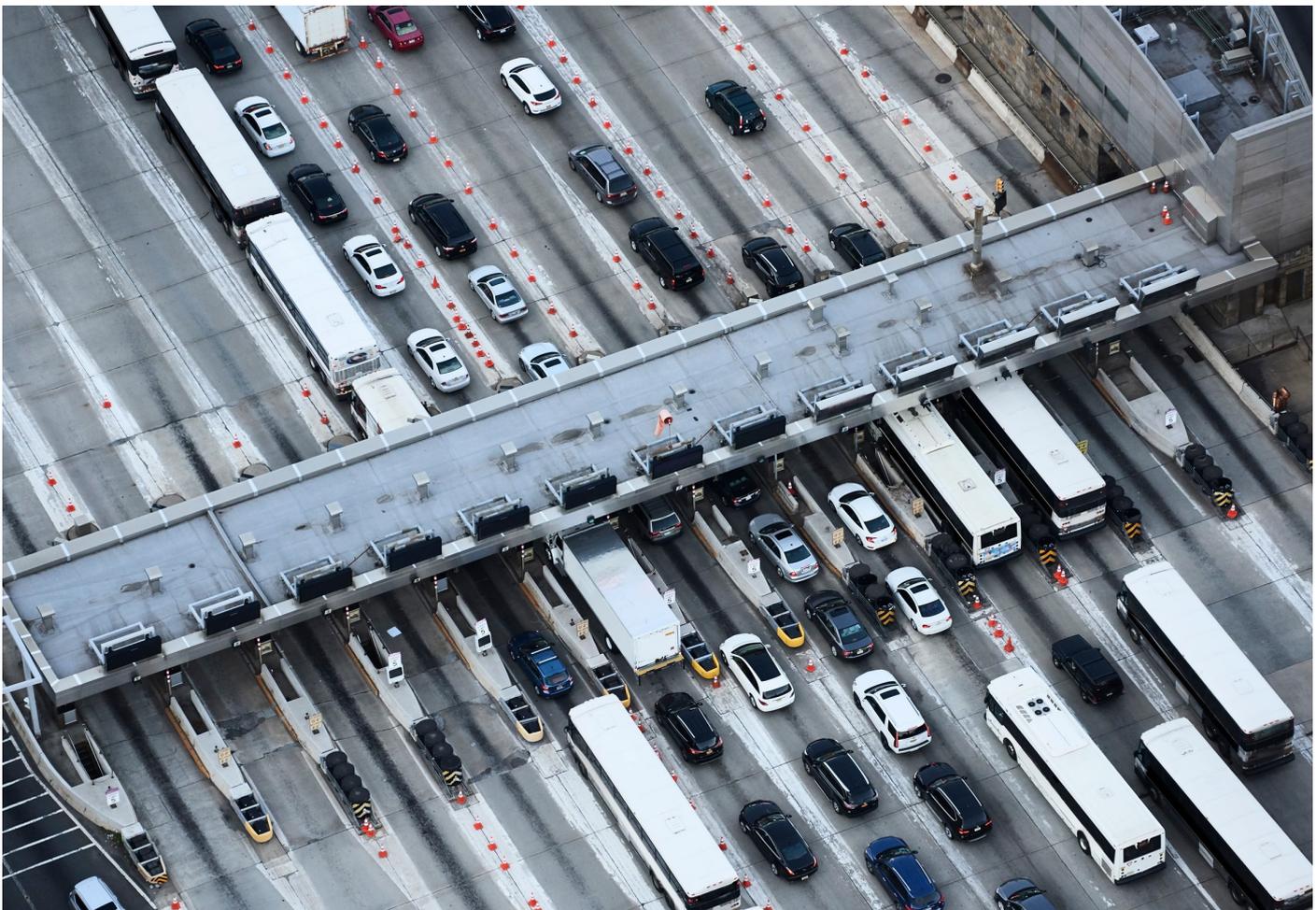


Figure: Highways Traffic Load, as of 2013 (Vehicles per day)



Source: ADB estimates based on Ministry of Construction highway traffic data.

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Table: Actual Truck Loading and Axle Damage Factors

Responsible Agency	Length (in km)	Responsible Agency
National Highways		Ownership: Central government management responsibility—Ministry of Construction
Expressway	590	Execution: Department of Highways (Public Works until 2015)
International communication roads	5,918	
Union roads	4,837	
Region and states connecting roads	4,595	
Total National Roads	15,940	
Region and State Roads		Ownership: Central government management responsibility—Region and state
District and township connecting roads	11,824	Execution: Department of Highways
Township and villages connecting roads	12,309	
Total Region and State Roads	24,113	
Major city roads	9,475	Yangon, Mandalay, and Naypyitaw City Development Committees
Army roads	10,426	Directorate or military engineers
Other roads	676	Ministry of Electrical Power
Rural Roads	Total 96,780	
	48,696	- Department of Rural Development (Ministry of Agriculture, Livestock and Irrigation)
	36,800	- Department of Progress of Border Areas and National Race Development (Ministry of Border Affairs)
	11,500	- Town development committees
Total	157,059	

km = kilometer.

Note: In this table, the national and region and/or state road length was computed based on the recorded length of each road as appearing in Ministry of Construction records. Figures obtained are different from aggregated Ministry of Construction records.

Source: ADB estimates based on Ministry of Construction data.

Investment incentives

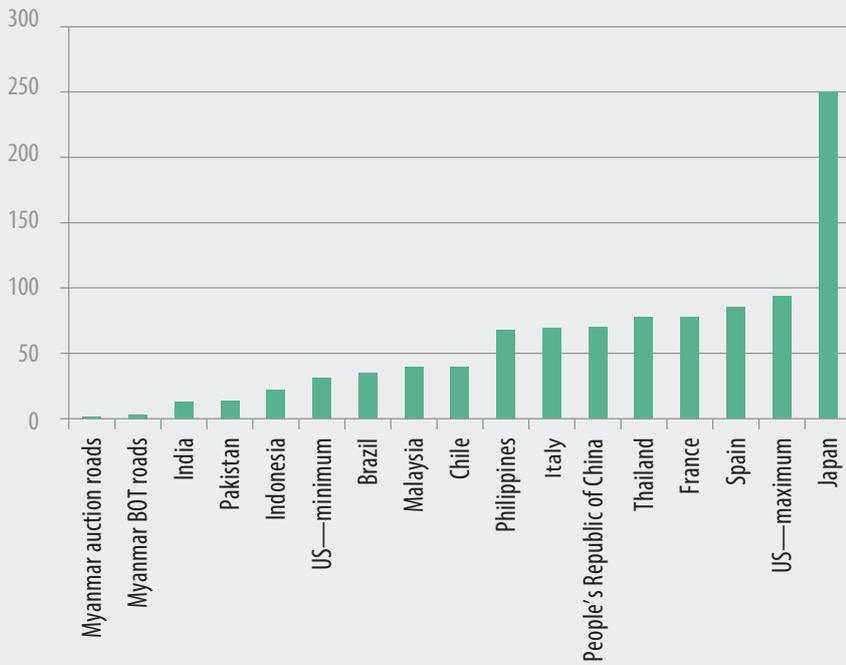
Foreign investment in Myanmar is governed by the Myanmar Investment Law, which requires large projects such as PPP Projects to obtain an investment license, known as a Myanmar Investment Commission (“MIC”) Permit. The MIC Permit is the key to investment incentives, including land use rights and tax benefits.

The MIC has issued a list of promoted investment activities which are eligible for tax incentives. The construction of new highways appears on the list, meaning investors can apply to the MIC to receive tax benefits including a corporate income tax holiday. The

duration of the tax holiday depends on the location of the project, with investments in less developed zones benefiting from a 7 year holiday, while investments in urban areas benefit from 3 years. This holiday is not triggered until the project company is earning an assessable income, so often the holiday period will start from the COD of the project. The second type of tax exemption is an entitlement for the project company to apply for customs duty, commercial tax and advanced income tax exemptions on its imported machines, equipment and materials during the construction period of a project.

To obtain an MIC Permit, a detailed proposal of the project as well as various government approvals must be submitted to the MIC for consideration. Once a proposal is submitted to the MIC, a decision is usually made within 60 days. The Permit will set out the construction time line, any extensions to which will require approval from the MIC. Once the Permit is issued, an application for the eligible tax incentives can be made.

Toll Rates for Cars (MK per km)



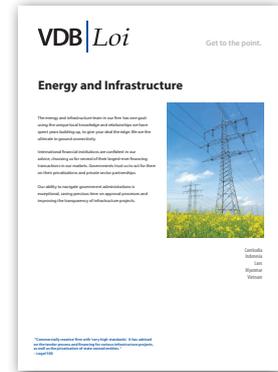
BOT = build–operate–transfer, km = kilometer, MK = Myanmar kyat, US = United States.

Source: ADB estimates compiled from various sources.

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The Energy and Infrastructure team is led by Philipp Troesch. Philipp is a Swiss qualified lawyer with 15 years of experience in corporate, commercial law and infrastructure. He leads our Energy and Infrastructure team assisting clients with joint ventures, acquisitions and large greenfield foreign investment. He will be in charge of the report and will liaise with other members of the team to ensure quality and consistency.

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