December 21, 2012

Project Finance Client Alert

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MYANMAR'S NEW FOREIGN INVESTMENT REGIME: OPPORTUNITIES AMIDST CAUTIONARY REFORM

I. Introduction

With the easing of economic sanctions by the United States and Europe, Myanmar is now a prime target for foreign investors looking to gain a foothold in this resource-rich, strategically-located Southeast Asian nation. Eager to harness the potential of newly accessible foreign capital, Myanmar is now endeavoring to establish a legal framework necessary for effective integration into the world economy. At the center of the debate is Myanmar's recently promulgated Foreign Investment Law (the "**FIL**"), which replaces legislation enacted in 1988. Early last month Myanmar's parliament passed the updated Foreign Investment Law, which was signed into law by President U Thein Sein on November 3, 2012.

This Client Alert briefly outlines recent trends in foreign investment laws and Myanmar's bold initiative to reform its legal framework to attract greatly needed foreign capital.

II. "New Generation" Investment Policies

Myanmar's FIL joins the ranks of what the U.N. Conference on Trade and Development dubs a "new generation" of foreign investment policies. These investment policies have emerged against the backdrop of the recent global financial crisis, and in response to the success of emerging Asian economies that have rejected unfettered markets in favor of greater state involvement.[1] Such policies promote an integrated development approach to incentivize foreign investment while ensuring that growth inures to the benefit of local stakeholders. Common features include promoting / restricting investment in targeted sectors, securing a place for local companies in global value chains, establishing environmental safeguards, and promoting self-regulating enterprises through information-sharing and corporate social responsibility.

In its "Investing Across Borders" ("**IAB**") series, the World Bank Group uses four major indicators when evaluating a jurisdiction's attractiveness to foreign investors. These categories track the key provisions found in a typical foreign investment law and offer a useful benchmark for evaluating proposed legislation. IAB indicators include (a) sectoral restrictions that limit foreign investment in areas of strategic importance, (b) start-up restrictions such as the "time, procedures, and regulations involved in establishing a local subsidiary of a foreign company", (c) access to industrial land and (d) the legal frameworks for alternative dispute resolution and arbitration.[2]

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1. Source: United Nations Conference on Trade and Development, *World Investment Report 2012: Towards a New Generation of Investment Policies*. New York and Geneva: United Nations.
2. Investing Across Borders 2010: Indicators of Foreign Direct Investment Regulation in 87 Economies, online: The World Bank Group, <http://iab.worldbank.org>.

These "best practices" echo much of the conventional wisdom on investor friendly regulatory regimes, and underscore the overwhelming global trend towards liberalization of foreign investment policy. This trend is most pronounced in Asia, which, according to a 2012 U.N. report on foreign direct investment, has seen "by far the highest concentration of measures liberalizing entry and establishment conditions for foreign investors" and where a number of countries "pursued privatization policies, particularly in airport and telecommunications services." However, amidst the general trend of liberalization in Asia – including special incentives to foreign investors, decreased discrimination against non-state actors and streamlined entry procedures – one sees a concomitant rise in regulation of strategic sectors including the extractive industries, agriculture and financial industries. It is somewhat paradoxical that in Asia, the world's fastest growing economic region, we see, notwithstanding certain liberalization, "more restrictions on foreign equity ownership in all sectors than any other region."[3]

III. Myanmar's New Foreign Investment Regime

Myanmar is taking major steps towards liberalization, including working with the IMF to float the exchange rate of its currency, the Kyat, downsizing an overextended bureaucracy, and passing a series of opening-up reforms as part of an ongoing action-for-action dialogue with the United States and other nations. At the same time, Myanmar is understandably wary of ceding too much too soon in sectors bearing on national sovereignty and natural resources. The potentially competing objectives of these new generation investment policies are evident in some of the more contentious (or omitted) provisions of Myanmar's FIL.

On the one hand, the FIL reflects a clear desire by policy makers to make the law more investor friendly. Would-be investors are given a high degree of visibility in respect of (a) land use rights, (b) the applicable taxation regime, (c) foreign exchange and (d) protection against expropriation and moratorium. The newly enacted FIL provides investors with the right to lease land for a term of up to 50 years, with the possibility of two further ten year extensions.[4] From a tax perspective, the FIL provides a five year suspension of corporate income tax for foreign investors as well as relief (or possible exemption) on the taxation of machinery and other equipment imported to Myanmar for the construction of the relevant foreign invested business. Under the new FIL, foreign investors can open foreign currency or Kyat accounts at state-approved financial institutions and are guaranteed remittance of foreign capital investments in the original foreign currency.[5] Finally, the FIL provides foreign investors with guarantees against expropriation and moratorium and confirms support for any contractually agreed form of dispute resolution (which would include arbitration).[6] Notwithstanding this progress, there are a number of nuanced ambiguities and open points in the FIL that will need to be addressed by Myanmar's government in the near term in order to provide foreign investors with additional clarity on their rights in this potentially dynamic market. These include the following key points.

Restricted Industries

Like its 1988 predecessor, the FIL allows 100% foreign investment in certain sectors, but caps foreign participation in 11 restricted sectors. Significant debate exists as to precisely which activities fall within the ambit of ill-defined categories such as businesses "which can cause damage to the natural environment and ecosystem" and businesses "which use hazardous chemicals under international agreements." In addition, the FIL effectively fails to address or "kicks the can down the road" in determining the percentage of foreign ownership permitted in a joint venture operating in these sectors. We understand that this issue will be addressed in the foreign investment rules to be issued before February 2013 by the Ministry of National Planning and Economic Development.[7]

Investment Structures

Foreign investment in Myanmar can be by way of either a joint venture, where a foreign firm and its local partner establish a Myanmar-based foreign invested company, or through a local branch of a foreign firm in the case where the foreign investor is acting unilaterally. Any investment in a restricted industry must be done by way of a joint venture establishing a foreign invested company given the yet to be determined local ownership requirements for such

3. United Nations Conference on Trade and Development, *World Investment Report 2012: Towards a New Generation of Investment Policies*. New York and Geneva: United Nations.
4. Tangentially, we note that it will be important that the Myanmar government also provide foreign investor land lessees with the right to assign their land use rights in connection with any financing.
5. Source: http://www.dica.gov.mm/includes/NEW%20FIL%20english+myanmar.pdf.
6. Source: http://www.dica.gov.mm/includes/NEW%20FIL%20english+myanmar.pdf.
7. Source: http://www.dica.gov.mm/includes/NEW%20FIL%20english+myanmar.pdf.

investments. We understand that the minimum capital investment requirements for foreign invested companies across all industries will be addressed in the foreign investment rules to be issued before February 2013 by the Ministry of National Planning and Economic Development.[8]

Pursuant to the FIL, the Myanmar Investment Commission will also require a consent right where a foreign firm that has been granted a license to invest in Myanmar seeks to transfer either any of its shares or its shares in its Myanmar-based foreign invested company. Further, the Myanmar Investment Commission requires termination of any investment license where a foreign firm previously granted such a license sells all of its shares to a third party.[9] Clarification of these rules will be necessary for project financing and private equity investments to grow in the country since sponsors and lenders / investors will require the ability to assign and enforce security interests in project companies established in Myanmar.

Labor Issues

The FIL proscribes fairly aggressive local workforce requirements for foreign invested businesses. From day one all unskilled workers employed by a foreign invested company are required to be Myanmar nationals, and the skilled workforce requirements are scaled such that (a) in the first two years of the life of a foreign invested company, 25% of the skilled workforce must be Myanmar nationals, (b) in years three and four of the life of a foreign invested company, 50% of the skilled workforce must be Myanmar nationals and (c) thereafter, 75% of the skilled workforce must be Myanmar nationals. While the legislation indicates that exceptions to this policy may be made for a "business based on knowledge", given the current state of the Myanmar education system and the unskilled nature of much of the local workforce, meeting these thresholds is likely to be burdensome to any foreign investor.[10]

IV. What it all Means

The FIL provides for significant, yet incomplete, improvement to the Myanmar foreign investment regime. In the industries in which we most heavily focus, project financing and private equity, project sponsors and lenders / investors favorably view the changes made to the land use, taxation, foreign exchange and dispute resolution regimes. In addition, continuance of the Myanmar government's guarantee against expropriation is an important and visible acknowledgment of the need for government support in the nascent stages of foreign investment in Myanmar.

Concerns remain, however, with respect to the permitted percentage of foreign ownership that will be allowed in the so-called "restricted industries", as well as the parameters of this set of protected activities. Similar to Mongolia's Strategic Foreign Investment Law enacted earlier this year, imprecise and unclear drafting creates significant uncertainty for foreign investors and, in turn, affords significant discretion to implementing authorities. Both of these trends are, undoubtedly, viewed unfavorably by foreign investors. In addition, the minimum capital requirements for foreign investments in the restricted industries may prove to be problematic given that sources of financing available to domestic players (i.e., the coveted local partner) seeking to fund their stake in any associated joint venture are extremely limited. Lastly, from a collateral or security perspective, it is important that lenders / investors are able to take security over land use rights and governmental permits, and also have the right to foreclose on the shares of a project company in the case of a default without risking loss of any required government licenses.

In massaging these aspects of the foreign investment regime, the Myanmar government should strive to give a meaningful say to local stakeholders in the development of their country while at the same time harmonizing these interests with the governance, financial and collateral-related demands of foreign investors as well as with lessons learned from peer emerging markets such as Mongolia. Striking this balance will be integral to Myanmar's continued growth and development.

8. Source: http://www.dica.gov.mm/includes/NEW%20FIL%20english+myanmar.pdf.
9. Source: http://www.dica.gov.mm/includes/NEW%20FIL%20english+myanmar.pdf.
10. Source: http://www.dica.gov.mm/includes/NEW%20FIL%20english+myanmar.pdf.

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