

The Lao PDR: PPP Maverick or Policy Innovator?

By Audray Souche and Rutherford Hubbard

Landlocked between China, Vietnam, Myanmar, Thailand, and Cambodia and blessed with the vast water resources of the Mekong basin, the Lao People's Democratic Republic (Lao PDR) is one of a number of emerging economies in Southeast Asia. A single-party socialist republic since 1975, the ruling Lao People's Revolutionary Party has been relatively proactive over recent decades in capitalizing on the nation's comparative advantages as both a transport corridor and net energy exporter to its much larger neighbors.

Regional economists acknowledge that the need for further private investment in the Lao PDR is vital to overcome the tension between the growing needs for infrastructure and public services against state budgetary limitations. With significant infrastructure and resource exploitation needs and only limited capital resources, the Government of the Lao PDR has had to turn to foreign private investment for both basic services and the economic mobilization of key resources. Various contractual solutions have been tested for such involvement of the private sector in the performance of the relevant traditional public service missions. However, at present, there is no dedicated PPP legislation in the Lao PDR to address these needs, although such a law is under consideration by the government.

In response to the acute need for formal public-private partnership (PPP) regulation, the government has established a concessionary investment framework that serves the needs of some PPP-type investments on an *ad hoc* direct negotiation basis. This concessionary framework is well developed in both law and practice and has allowed for projects with similar elements to PPPs to proceed in the Lao PDR.

This quasi-PPP concessionary investment structure has enjoyed its greatest success in the hydropower sector where the rapid development of dams since the 1990s has added substantial power generation capacity, the majority of which is exported to Thailand under take-or-pay power purchase agreements. This model has also been successfully applied to projects in sectors as diverse as telecommunications, beverage production, real estate development, plantations, and customs services.

Despite the success of this concessionary framework,

we have not yet seen the emergence of significant private investment into basic services, such as infrastructure, health care, and education. While resource-based PPPs are common, availability payment PPPs, in which all revenue from a project (if any) is retained by the state and payment is made to the operator based on performance, are practically nonexistent. A recent attempt to develop a highway on a PPP basis, for example, stalled due to a lack of agreement on charging service fees for brownfield projects.

In order to determine the best way forward for PPPs in an emerging economy such as the Lao PDR, it is necessary to outline the current and proposed PPP frameworks and assess their suitability for facilitating development, while also considering alternative models that have been used elsewhere in the region.

Legal Framework

The concessionary space is not devoid of regulation in the Lao PDR. The Law on Investment Promotion (Investment Law) (02-NA, 8 July 2009) and the Decree on Implementation of Investment Promotion Law (Investment Decree) (119-PM, 20 Apr. 2011) set out rules for concessionary businesses. Other regulations set the terms for concessions of state land, electricity public-private joint ventures, and mining concessions.

The Investment Law allows investors to invest in three types of ventures: (1) a general business, (2) a concession business, and (3) development of Special Economic Zones (SEZs). General business investments are outside the scope of this article.

Concession businesses, to date, have focused primarily on the development of state assets. The resulting revenue stream funds the project development and provides a basis for the project. Often, the government will take an equity stake in concessionary project companies. The Minerals Law mandates that equity be offered to the government for projects in the mining sector, and is generally demanded by the government during the concession agreement negotiation process in the electricity and telecommunications sectors. The percentage of government equity is subject to negotiation.

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SEZs are an alternative instrument used by the government to leverage foreign private investment to develop specific areas of the country or stimulate certain industries. They are regulated primarily by the Investment Law and by individual decrees exclusive to each particular SEZ. Under the Investment Promotion Law, an SEZ is defined as an investment area larger than one thousand hectares with a “special promotion incentive policy and an autonomous economic-financial system” and are authorized to provide streamlined regulatory processing to investors.

The Concession Process

The regulatory framework for concessions based in the laws of the Lao PDR is limited. In lieu, the concession process is established by precedent, practice, and negotiation. As a result, each concession agreement between the government and the respective investors serves to establish and clarify the rights, obligations, and regulations applying to the concession project. Concession projects are developed as follows:

Feasibility

The first step in project development is the preparation of a comprehensive feasibility study, to be submitted to the government. During this phase, the potential investor investigates the business climate, meets with potential partners and competitors, evaluates economic conditions, calculates costs, assesses the legal environment, and examines relevant infrastructure.

Incorporation and Approval

The Enterprise Law limits the ability of an investor to conduct business in the Lao PDR without first incorporating a legal entity. Specific investment approval is further required under the Investment Law in the case of concession-related activities (investments that require specific authorization for the use of government property). In this case, an investment application must be lodged with the Investment Promotion Department (IPD) or the provincial Division of Planning and Investment in order to obtain the concession registration certificate.

Regulatory Compliance

The investor also needs to reserve the name of the entity. The application for name reservation must be lodged with the Enterprise Registration Office under the Ministry of Industry and Commerce. The name of the entity must include the form of enterprise, such as limited, sole limited, public, or a representative office or a branch office. The registration should be followed by an application to the Tax Department, Ministry of Finance to obtain a Tax Identification Number.

While an investment application for a concession-related activity is being considered, it may be useful to meet officials of the IPD or other relevant ministerial offices of the province where the project is located in order to introduce the project and facilitate the approval process.

Investment Incentives

Investors under the concessionary framework may be entitled to tax incentives. Under the Investment Promotion Law and Decree, these tax incentives are awarded based on the sector and location of the investment.

The most preferential tax incentives by location are provided to investments in remote areas with no economic infrastructure to facilitate investment, classified as Zone 1. Zones with a moderate level of economic infrastructure to some extent are classified as Zone 2, and zones with good infrastructure to support investments are classified as Zone 3. Each investor is entitled to a profit tax exemption for a period determined by the relevant zone and sector, running from 3 to 15 years. A project in an SEZ is subject to its own regulations and does not have a zone designation.

In addition to the above, investors are also entitled to the following customs duty and other tax incentives:

1. Exemption from profit tax in the next accounting year for entities that spend their net profit in order to expand the business;
2. Exemption from import duty on raw materials, equipment, spares parts, and vehicles that are directly used for production. Any import tax exemption on these items must comply with specific regulations;
3. Exemption from export duty for exporting general products. The export of natural resources and products derived from natural resources must comply with the relevant laws and regulations; and
4. Investors can transfer annual losses to the following year to be deducted from profit within a three-year period; however, the losses shall be audited and certified by the tax officer.

In addition, investors in certain high-priority sectors are entitled to additional incentives. Despite this clear incentive framework, in practice the concession agreement may grant more or less preferable incentives to the investor.

SEZ framework

Each SEZ is subject to a specific decree that sets out the rules for its incorporation, administration, and operation. Each SEZ decree also sets out the specific incentives that enterprises within that SEZ are entitled to, such as tax relief and access to land. Concessions of land in SEZs are limited to 75 years, but, in practice, SEZ land concessions of 99 years are not uncommon. Entities within an SEZ are also entitled to the investment incentives available under the Investment Law and Investment Decree, as described above.

In addition, Article 33 of the Investment Law provides that entities located in SEZs “are entitled to receive special policies and are regulated under specific regulations in accordance with the Laws of Lao PDR.” In practice, this means that each SEZ may be able to negotiate tax incentives beyond what is permitted under the Investment Law, both for the developer and investors.

PPP Decree

The government has prepared a PPP Decree, which was expected to be issued in March 2016. Although it has since been delayed, and a new deadline has not yet been set. As a practical matter, however, new laws or regulations in the Lao PDR are generally not applied or implemented until such time as all implementing regulations have been issued, unless the new law or regulation states otherwise. As such, the government may not be prepared to move forward with the first PPP under the Decree until all implementing regulations have been issued. This analysis is based on the assumption that the PPP Decree will not be significantly amended between now and the promulgation date.

It is important to note that pursuant to the terms of the draft PPP Decree, the Government will set up a PPP Unit subject to a specific decree. The Government will also establish a project preparation facility to cover the costs associated with developing PPPs. Furthermore, the draft PPP Decree states that additional clarification regarding its implementation will be provided in the form of a Prime Ministerial Notification.

The PPP Decree will apply to all projects in the Lao PDR where the government grants private operators the right to develop a public service or infrastructure project, for which the relevant government agency remains accountable. The only exceptions are for projects related to defense or public security. The below table sets out the tendering process under the PPP Decree, where:

1. **Project Executing Authority** is the government authority at the ministerial level that will implement the PPP;
2. **PPP Unit** means the unit within the Ministry of Planning and Investment (MPI) to be established by separate decree, tasked with managing the PPP policy, implementation, and expertise;
3. **Investment Committee** means the committee already operating under the MPI, with the authority to approve concessionary projects, and pursuant to the PPP Decree, with the power to approve PPPs as well; and
4. **Bidding Document Package** means the package of documents pertaining to a specific PPP, including at a

minimum the tendering process, a pre-qualification document package (as described in the PPP Decree Annex), the request for proposals, the draft PPP contract, the feasibility study, the expectations of government support, and the relevant technical annexes.

Under the draft PPP Decree, it is possible to enter into direct negotiation without observing the formal tendering process upon the recommendation of the PPP Unit and approval by the Investment Committee, provided that certain conditions are met. Under direct negotiation, there is no need for a Bidding Document Package and tendering process. Barring exceptional circumstances, it is necessary to demonstrate “urgent need” in order to enter into direct negotiations.

It is also permitted for the Project Executing Authority to receive unsolicited proposals, provided that they are developed independently and are beneficial to the public. However, unsolicited proposals must be subject to the tendering process, unless they meet the conditions for direct negotiations.

Challenges of the Existing Structure

The current *ad hoc* regulatory approach to PPPs in the Lao PDR is not without issues. The lack of a transparent bidding or tendering process can discourage private investors and limit project bankability. It may also prohibit access to development bank funding.

From a policy perspective, the lack of a transparent bidding or tendering process can drive up costs and limit public returns on PPP investments, particularly if the project is based on an availability payment structure. Furthermore, without a clear legal framework, investors face a level of unpredictability that can discourage investment and drive up financing costs.

The current regulatory approach creates an incentive for (or mandates, in the case of mining) the government to take an equity stake in project companies. However, this can limit the flexibility of the project company and may discourage private/foreign investors concerned with reputational and political risk. In addition, government equity can undermine the risk allocation and flexibility that are key drivers of the PPP model.

There are policy challenges associated with the current approach as well. Under the current regulatory framework, institutional capacity is developed in an *ad hoc* manner. Although the MPI has played an important role in implementing concessionary

Step	Responsible Party
Initial project proposal	Project Executing Authority
Approval of the initial project proposal	PPP Unit
Feasibility study	Project Executing Authority
Approval of the feasibility study	Investment Committee
Preparation of the Bidding Document Package, including the draft PPP agreement	Project Executing Authority
Approval of the Preparation of the Bidding Document Package	Investment Committee
Execution of the tendering process in accordance with the Bidding Document Package, including separate sealed bids for technical and financial proposals	Project Executing Authority
Review of the selected proposal	PPP Unit
Final approval	Investment Committee

projects, there is no system to develop institutional capacity for the full spectrum of PPP development. As a result, it is difficult to implement PPPs that differ from existing projects, in either new sectors or as supported by new funding mechanisms.

Potential Challenges Under the Proposed PPP Decree

While the need for a coherent, effective regulatory framework for PPPs in the Lao PDR is clear, the proposed PPP Decree may not be a marked improvement over the current system.

Under the Decree, each PPP will be subject to five discrete approvals from three separate agencies. While oversight and transparency are crucial to a successful PPP regulatory system, the proposed process appears to be cumbersome and time consuming.

The MPI has significant experience and capacity in negotiating the terms of concession agreements. The Decree will create a PPP Unit with relevant expertise, but it will not have authority to command the drafting and negotiating of the PPP agreement. As a result, the collective experience of the PPP Unit will have only a tangential impact on each new PPP process.

The PPP Decree requires that the draft PPP agreement is prepared before opening the tendering process and is not made available to potential bidders until tendering has formally opened. As such, there is little space to subsequently amend the draft PPP agreement, and potential investors are effectively precluded from substantively changing the PPP agreement to include innovative cost-reduction or service-enhancement strategies.

The PPP Decree does include limited provision for direct negotiations and unsolicited bids. However, there is no clear process for how such projects will be developed and how to maintain transparency in these alternative PPP development processes. In short, PPPs developed under the Decree are likely to be either (1) transparent but rigid or (2) flexible but not transparent.

Regional Alternatives

While the current draft of the PPP Decree exhibits several issues, the experience with different models in neighboring countries has shown that there is no magic formula for the

development of a successful PPP regulatory framework. The process quite often struggles with procedural and practical challenges, and the setting out of legislative or regulatory conditions does not in itself necessarily improve the viability for PPPs.

In Vietnam, for example, the establishment of a PPP pilot program in 2011 and issuance of the PPP Decree in early 2015 has not yet seen additional foreign investment in PPP projects. Outcomes since the 2013 PPP legislation reforms in Thailand also remain to be seen. The experience in both countries demonstrates that underlying country-specific issues, such as lengthy government procedures or excessive tariffs, must be addressed in order to create a favorable PPP environment.

Conclusion

Despite the lack of a legal framework for PPPs, private investment to develop public assets in the Lao PDR has been remarkably successful. While the lack of transparency and legal certainty does increase the investment risk, a growing precedent of projects in the hydropower, mining, and real estate development sectors presents a strong argument in favor of this largely *ad hoc* regulatory framework.

However, the proposed PPP Decree creates a potentially cumbersome, time-consuming, and rigid PPP structure, which may actually limit both innovation and investment in public infrastructure and public resources. While designed to provide much-needed transparency and certainty to PPP investments, the draft PPP Decree does not draw on or learn from the institutional learning and capacity generated through the implementation of dozens of PPP-type projects in the Lao PDR.

Given the many risks associated with investments in emerging markets like Lao PDR, it may, in fact, be preferable to rely on “battle-tested” investment vehicles rather than newly promulgated regulations that call on the collaboration of multiple ministries and administrative units.

Alternatively, the government could consider models proscribed by international financial institutions or those implemented elsewhere in Southeast Asia. There is no guarantee, however, that these models would be any more suitable than the current framework. In any case, the government faces some difficult decisions in the coming period on how best to proceed with PPPs in order to maximize development outcomes. ♦