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ASEAN PATH

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2015 ASEAN FDI FRAMEWORK THE KEY ASPECTS INVESTORS NEED TO KNOW *FROM A PRACTITIONER'S VIEWPOINT*

ASEAN PATH is a series of white papers prepared by DFDL's experts aiming to assess, in more depth, compelling issues arising from the regional economic integration under the auspices of the Association of Southeast Asian Nations ("ASEAN") Economic Community Blueprint. The articles are based on an in-depth legal analysis of the local and ASEAN legal framework from the perspective of a practitioner assisting foreign and ASEAN investors in their investments and operations throughout various ASEAN Member States. All articles will be accessible on our website: www.dfdl.com.

2015 ASEAN FDI FRAMEWORK

THE KEY ASPECTS INVESTORS NEED TO KNOW

FROM A PRACTITIONER'S VIEWPOINT

THIS PAPER FOCUSES ON ASEAN FOREIGN DIRECT INVESTMENT ("FDI"), BUT WILL FIRST GIVE SOME BACKGROUND ON THE ASEAN COMMUNITY WITH AN OVERVIEW OF TREATIES AND AGREEMENTS MOST RELEVANT TO FDI AS WELL AS A BASIC OUTLINE OF THE CURRENT STATE OF ASEAN FDI.

THE PAPER WILL THEN BRIEFLY OUTLINE HOW THE DEVELOPMENT OF THE ASEAN ECONOMIC COMMUNITY ("AEC") HAS AFFECTED, AND WILL LIKELY AFFECT, THE LEGAL AND ECONOMIC INFRASTRUCTURE FOR FDI.

LASTLY IT WILL ADDRESS SOME OF THE IMPACTS ON POTENTIAL INVESTORS, REGARDLESS OF WHETHER SUCH INVESTORS ORIGINATE FROM INSIDE OR OUTSIDE ASEAN.

ASEAN TRADE AGREEMENTS

A CONFUSING PICTURE FOR INVESTORS

ASEAN was formed on August 8 1967 under the auspices of the ASEAN Declaration signed by Indonesia, Malaysia, the Philippines, Singapore and Thailand. Brunei joined in 1984, and the remaining ASEAN members (Vietnam, Lao PDR, Myanmar and Cambodia) joined in the mid to late 1990s. The ASEAN Declaration sets out the objectives of ASEAN, which include the acceleration of economic growth.

There are a large number of treaties, agreements, initiatives, etc. that make an intricate web of relations between ASEAN members. For ease of reference, we organize them into four different categories:

- I. **Intra-ASEAN Agreements** of which, for our purposes, the three most important are set out in Table 3.
- II. **Free Trade Agreements (ASEAN + Agreements)** that will have a significant impact on FDI.
- III. **Broader regional economic cooperation agreements involving ASEAN** that are currently in various stages of negotiation [1].
- IV. Finally, there are a number of FTAs and other economic co-operation agreements that involve some, but not all, ASEAN Member States and third parties. In terms of broader economic agreements, two of particular note are the **Trans-Pacific Partnership** and **APEC's proposed Free Trade Area of the Asia-Pacific**. This category would also include more focused agreements such as the recently signed economic liberalization agreement between Singapore and Taiwan, and the **EU-Cambodia Framework Cooperation Agreement**.

Table 1: FDI Flow in ASEAN – Significant Growth Story

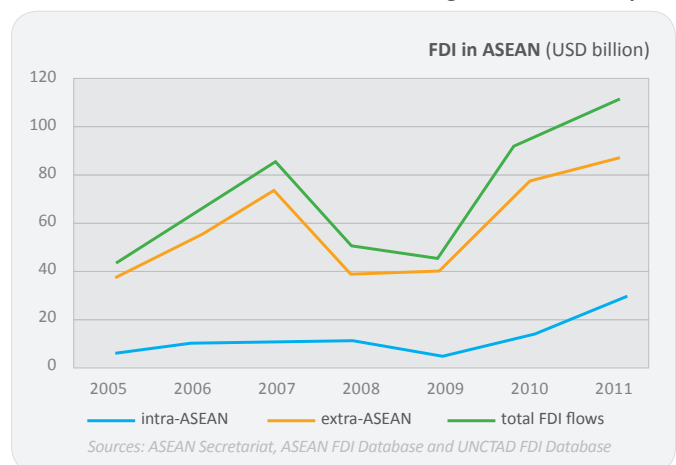
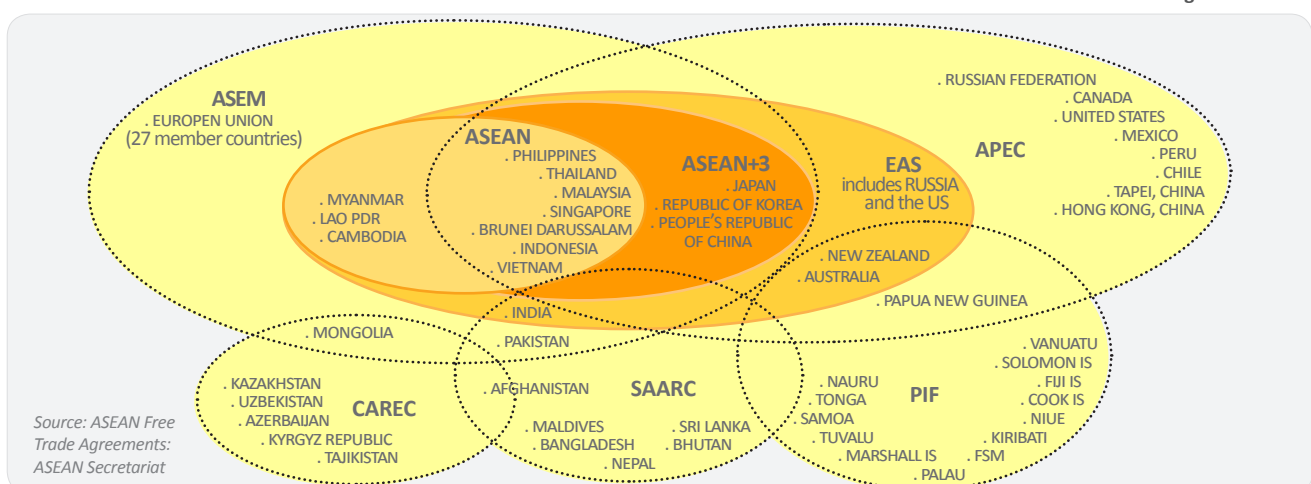


Table 2 sets out the myriad Asian-related trade agreements in force or being negotiated, showing how overwhelming it may appear for investors who are forced to navigate through these legal instruments when evaluating a potential investment. Even within ASEAN, it appears that many businesses do not focus on ASEAN economic integration, despite its importance to FDI, as compared to more specific ASEAN +1 FTAs [2].

Table 2: Constellation of Asian Trade Agreements



THE FDI FOCUS

INVESTMENT/ GOODS/ SERVICES

It was decided by the Member States in 2003 to create an ASEAN Community by 2020 with three basic pillars:

- I the AEC
- II the ASEAN Security Community
- III the ASEAN Socio-Cultural Community

Each community would have a blueprint for implementation. The 2007 signing of the Cebu Declaration on the Acceleration of the Establishment of an ASEAN Community by 2015 aggressively pushed the initial plan forward by five years. The ASEAN Member States acknowledged the importance of integrating the ASEAN Community as quickly as possible to promote, among other matters, ASEAN's role in regional economic development. The Cebu Declaration also restates ASEAN's commitment to expand its engagement with its Dialogue Partners (which include China, India, Japan, Korea, Australia and New Zealand).

For the purposes of this Paper, we will concentrate on the three most important intra-ASEAN agreements for FDI, as detailed in the table below. Future DFDL Papers will cover the various ASEAN+ FTAs. Although other trade and broader economic agreements should not be discarded in any analysis when investing or operating businesses in ASEAN, the scope and effect of these first two groups of agreements should be examined in detail by ASEAN and foreign investors as an essential element in any investment assessment.

The intra-ASEAN agreement that has arguably done the most to improve trade within ASEAN is the **ASEAN Trade in Goods Agreement ("ATIGA")**. ATIGA aims to lower customs duties throughout ASEAN with the objective of having tariffs between 0% and 5% for the vast majority of goods by 2010 for Singapore, Indonesia, Thailand, Brunei, the Philippines and Malaysia, and by 2018 for Cambodia, Laos, Myanmar and Vietnam (together "CLMV").

The **ASEAN Framework Agreement on Services ("AFAS")** provides the legal framework to enable Member States to lower restrictions on, and enhance liberalization of services within ASEAN. The AFAS framework was designed to require Member States to provide commitments or to liberalize new sectors beyond that which had been provided for under GATS. In the context of the AEC, going forward, AFAS liberalization commitments are intended to be based on the AEC Blueprint.

In the mid and long term, the **ASEAN Comprehensive Investment Agreement ("ACIA")** will, most probably, have the biggest impact on FDI and foreign investors. Indeed, the objectives and the scope of the ACIA, if fully developed and implemented, would drive the ASEAN investment framework integration to a new level by liberalizing and integrating further each ASEAN Member State's investment framework, as well as offering strong protection to foreign investors, both from within and outside ASEAN.

Table 3: ASEAN Main Framework Agreements – A Simplified Picture

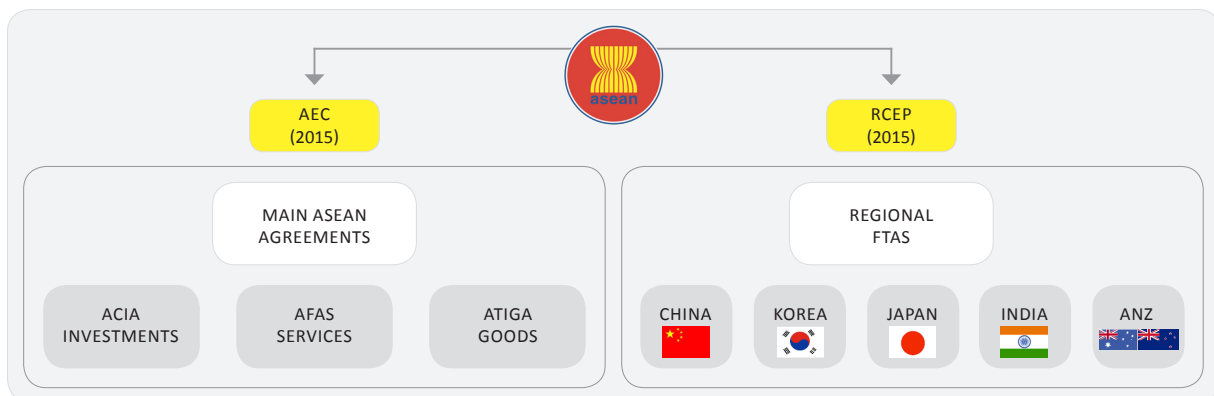


Table 4: Main Terms of ACIA, ATIGA & AFAS – Broad Coverage

ASEAN COMPREHENSIVE INVESTMENT AGREEMENT ("ACIA")	ASEAN TRADE IN GOODS AGREEMENT ("ATIGA")	ASEAN FRAMEWORK AGREEMENT ON SERVICES ("AFAS")
SIGNED FEBRUARY 26, 2009	SIGNED FEBRUARY 26, 2009	SIGNED DECEMBER 15, 1995
REPLACED THE ASEAN INVESTMENT GUARANTEE AGREEMENT, AND THE ASEAN INVESTMENT AREA FRAMEWORK AGREEMENT.	REPLACED THE COMMON EFFECTIVE PREFERENTIAL TARIFF SCHEME, THE MAIN IMPLEMENTING MECHANISM FOR THE ASEAN FREE TRADE AREA WHICH WAS MEANT TO SUBSTANTIALLY ELIMINATE TARIFF AND NON-TARIFF BARRIERS BETWEEN ASEAN MEMBER STATES.	GOAL OF ELIMINATING RESTRICTIONS ON TRADE IN SERVICES AMONG ASEAN MEMBER STATES AND ENHANCING COOPERATION IN SERVICES.
ACIA WAS INTENDED TO BE MORE COMPREHENSIVE THAN ITS PREDECESSORS AND INCORPORATES FOUR PILLARS: LIBERALIZATION, PROTECTION FACILITATION AND PROMOTION.	ATIGA CONSOLIDATES AND ENHANCES VARIOUS AGREEMENTS AND INSTRUMENTS WITH A GOAL OF DRASTICALLY LIMITING PERMITTED TARIFFS COMMENCING 2010 (WITH A MORE FLEXIBLE SCHEDULE FOR CAMBODIA, LAO, MYANMAR AND VIETNAM. WITH A MORE FLEXIBLE SCHEDULE FOR CLMV)	BASED ON THE WORLD TRADE ORGANIZATION'S GENERAL AGREEMENT ON TRADE IN SERVICES. VARIOUS COMMITMENT PACKAGES (INCLUDING SOME INDUSTRY-SPECIFIC COMMITMENTS) HAVE BEEN SIGNED UNDER AFAS, AND A NUMBER OF MUTUAL RECOGNITION AGREEMENTS HAVE BEEN EXECUTED.

LEGAL FRAMEWORK FOR INVESTMENT IN ASEAN

A DEVELOPING STORY

As noted above, the principal legal instrument governing FDI in ASEAN is ACIA which was signed in 2009, and which came into effect on March 29, 2012. ACIA replaced a number of existing agreements and instruments to create a comprehensive agreement based on international standards. ACIA is meant to govern measures of ASEAN Member States relating to investors from different Member States or investments of such investors existing as of the effective date or later.

Article 1 of ACIA sets out its principal objective of creating “a free and open investment regime in ASEAN in order to achieve the end goal of economic integration” through:

1. **Progressive liberalization of the investment regimes of Member States.**
2. **Provision of enhanced protection to investors of all Member States and their investments.**
3. **Improvement of transparency and predictability of investment rules, regulations and procedures conducive to increasing investment among Member States.**
4. **Joint promotion of the region as an integrated investment area.**
5. **Cooperation to create favorable conditions for investment by investors of a Member State in the territory of other Member States.**

To whom do ACIA's benefits apply? ACIA's benefits are applied to investments made by “investors” of other Member States. Investors are defined to include both natural (including both citizens and permanent residents) or juridical persons (whether owned by ASEAN natural persons or by investors from outside ASEAN) from ASEAN Member States.

To which investments does ACIA apply? An investment for purposes of ACIA includes every kind of asset owned or controlled by an investor. Claims to money arising solely from commercial contracts of sale or extensions of credit in conjunction with such contracts are explicitly excluded from the definition of investments.

To which sectors does ACIA apply? Unfortunately, ACIA's express language is somewhat unclear – however Article 3(3), states that for the purposes of liberalization, ACIA is applicable, subject to Member States' reservations, to the following sectors: manufacturing, agriculture, fishery, forestry, mining and quarrying. This also applies to services incidental to such sectors and will apply to any other sectors as agreed by all Member States.

Liberalization is not defined in ACIA; however it is stated in Article 30 of the ASEAN Economic Community Blueprint to incorporate the following actions:

1. **Extend non-discriminatory treatment, including national treatment and most-favored nation treatment, to investors in ASEAN with limited exceptions; minimize and, where possible, eliminate such exceptions.**
2. **Reduce and, where possible, eliminate restrictions to entry for investments in the Priority Integration Sectors covering goods.**
3. **Reduce and, where possible, eliminate restrictive investment measures and other impediments, including performance requirements.**

The language used appears to be a compromise to carve out these sectors so that the rest of ACIA, including the protection provisions, would logically then apply to all sectors^[3]. While not determinative, the ASEAN Secretariat has noted that protection provided under ACIA includes:

1. **Fair and Equitable Treatment (Article 11);**
2. **Full Protection and Security (Article 11);**
3. **Rules on Expropriations (Article 12);**
4. **Compensation in the event of strife (Article 14);**
5. **Protecting Insurers' right to recover (Article 15);**
6. **Promoting Freedom for the Entry of Key Personnel (Article 22);**
7. **Transfer of Funds (Article 13)^[4].**

ACIA sets out a number of significant protections for covered investments noted in Table 5 below.

ACIA also sets out a framework for the future development of FDI by providing that Member States should cooperate to increase awareness of economic integration and to develop ASEAN SMEs and MNCs. As suggested by the Business Survey cited in Endnote 2, there is clearly additional work required in this regard. In addition, Member States are to cooperate to facilitate ASEAN FDI through such means as establishing one-stop investment centers, streamlining investment procedures, and consulting with business communities about investment issues. One additional consideration is that CLMV Member States are granted greater flexibility in their commitments depending on their level of development.

A final, and quite interesting, feature of significant relevance to investors is the dispute resolution system developed for situations where a foreign ASEAN investor has suffered losses based on a breach of its rights under ACIA by a Member State. While encouraging resolution through conciliations and consultations, if a dispute is not resolved within 180 days of a request for consultations, the investor may submit a claim either to domestic courts or to arbitration under various permitted rules.

Table 5: ACIA – Enhanced Protections for FDI

ARTICLES 5 & 6	THAT MEMBER STATES MUST TREAT INVESTORS AND INVESTMENTS FROM OTHER MEMBER STATES NO LESS FAVORABLY THAN DOMESTIC INVESTORS AND INVESTMENTS (ARTICLE 5) FROM ANY OTHER MEMBER STATE OR NON-MEMBER STATE (ARTICLE 6) – I.E. GRANTING NATIONAL TREATMENT AND MOST FAVORED NATION TREATMENT TO ASEAN INVESTORS AND INVESTMENTS.	ARTICLE 11	THAT EACH MEMBER STATE MUST PROVIDE FAIR AND EQUITABLE TREATMENT AND FULL PROTECTION AND SECURITY FOR ASEAN INVESTMENTS.
ARTICLE 7	THAT MEMBER STATES MAY NOT IMPOSE PERFORMANCE REQUIREMENTS (SUCH AS PRODUCTION QUOTAS) ON ASEAN INVESTORS OR INVESTMENTS.	ARTICLE 13	THAT CAPITAL, PROFITS, DIVIDENDS, AND OTHER TRANSFERS RELATED TO A COVERED INVESTMENT CAN BE FREELY MOVED INTO AND OUT OF EACH MEMBER STATE.
ARTICLE 8	THAT JURIDICAL PERSONS MAY NOT BE REQUIRED TO APPOINT SENIOR MANAGEMENT OF A PARTICULAR NATIONALITY; ALTHOUGH A MEMBER STATE IS GENERALLY FREE TO IMPOSE SUCH REQUIREMENTS ON A MAJORITY OF THE BOARD OF DIRECTORS.	ARTICLE 14	THAT A COVERED INVESTMENT SHALL NOT BE DIRECTLY OR INDIRECTLY NATIONALIZED OR EXPROPRIATED WITHOUT FAIR MARKET VALUE COMPENSATION AND DUE PROCESS.
		ARTICLE 21	THAT EACH MEMBER STATE MAKE RELEVANT LAWS, REGULATIONS AND GUIDELINES PUBLICLY AVAILABLE AND TAKE OTHER MEASURES TO ENHANCE TRANSPARENCY OF ITS INVESTMENT REGIME.



CURRENT ASEAN FDI

A DEFINITIVE GROWTH STORY

H.E. Lim Hong Hin, Deputy Secretary-General of ASEAN, noted that the free flow of investments was one of the most critical goals of regional integration and that accomplishing the AEC by 2015 would depend on “the extent by which we remove impediments to investment, by making our investment regime open and transparent, in order to attract more trade in goods and services, and capital” [5]. Conversely, the 2012 ASEAN Investment Report noted that, “economic integration of the region has become an increasingly important determinant for FDI in ASEAN”.

This is further supported by an economic analysis of ASEAN FDI, which concluded that, while regional economic integration (i.e. the creation of a larger market) is an important determinant for both intra- and externally-originating ASEAN FDI, this effect was larger for external sources [6].

In 2002, FDI into ASEAN was at its lowest point in years; the contrast in recent years as set out in Table 1 above is quite startling: with an increase of almost 150% in FDI in ASEAN from 2009, at around USD47 billion, to 2011, at around USD114 billion. It is important to note that the growth of intra-ASEAN FDI has outpaced externally sourced ASEAN FDI, which suggests that ASEAN businesses are investing aggressively in other ASEAN Member States.

A number of factors have been identified as a source of the substantial increase in FDI including new investments and expansion of existing investments by trans-national corporations, strong ASEAN M&A, record levels

of intra-ASEAN investments, and an increase in investment from emerging sources such as China [7]. Other important factors include legal and structural issues relating to the AEC and other integration efforts; external factors such as rising production costs in China, and the attributes of the ASEAN Member States’ economies, which may include access to resources, low-cost skilled and unskilled labor, and opportunities for market and infrastructure development.

Within ASEAN, there are some clear distinctions between Member States’ ability to attract FDI. From 2005-2011, Singapore has attracted, with the exception of 2008, over 50% of ASEAN FDI in each year. Indonesia and Malaysia have also done well over this period. Recently, Brunei has begun to attract significantly greater levels of FDI although not approaching the levels of the top five Member States. Myanmar appears to be experiencing a surge with recent reports suggesting that from April 1, 2013 to the end of August 2013, over USD1.8 billion in FDI had been approved, with one official stating the principal source was Malaysia [8]. However, there still appears to be a large gap between FDI into Singapore, Indonesia, Malaysia, Thailand, and Vietnam and the relatively low levels of FDI in Brunei, Cambodia, Lao, Myanmar and the Philippines [9]. Again, such numbers would need to be analyzed in more depth taking into account the relative size of each ASEAN economy.

HOW SHOULD INVESTORS APPROACH THE ASEAN MARKET ?

A PRACTITIONER'S PERSPECTIVE

The ASEAN Economic Blueprint identifies five core elements of the AEC's single market and production base:

- I free flow of goods;
- II free flow of services;
- III free flow of investment;
- IV free flow of capital; and
- V free flow of skilled labor.

The AEC will allow investors to access a potential consumer market of 600 million while structuring their production and distribution systems in the most efficient means possible to access ASEAN and other markets^[10].

The establishment of the AEC is starting to have a transformational effect on the foreign invested companies investing in the ASEAN market and on ASEAN companies investing (together, "ASEAN Investors") in other ASEAN countries over the last two years. Based on our experience in advising ASEAN investors, we have noticed a move towards an investment approach that is less country-centric and much more regionally minded. This new approach is especially noticeable for ASEAN investors looking to develop a Production Chain or Supply Chain within ASEAN Member States. This is only the beginning of such a shift, and with the implementation of the various intra-ASEAN Agreements and FTAs, we expect regionalization of investment decisions will accelerate as ASEAN investors will be forced to start with an analysis of the ASEAN and regional investment framework before focusing on more local legal, regulatory and taxation issues.

We recommend the Seven Steps approach to ASEAN investment detailed in Table 6 below. We advise that investors first analyze the various ASEAN agreements to establish the potential jurisdictions for investment before digging deeper into that particular country's legal, regulatory and

taxation framework. Such an approach would be particularly relevant to ASEAN investors looking to develop a Production Chain or Supply Chain within ASEAN countries.

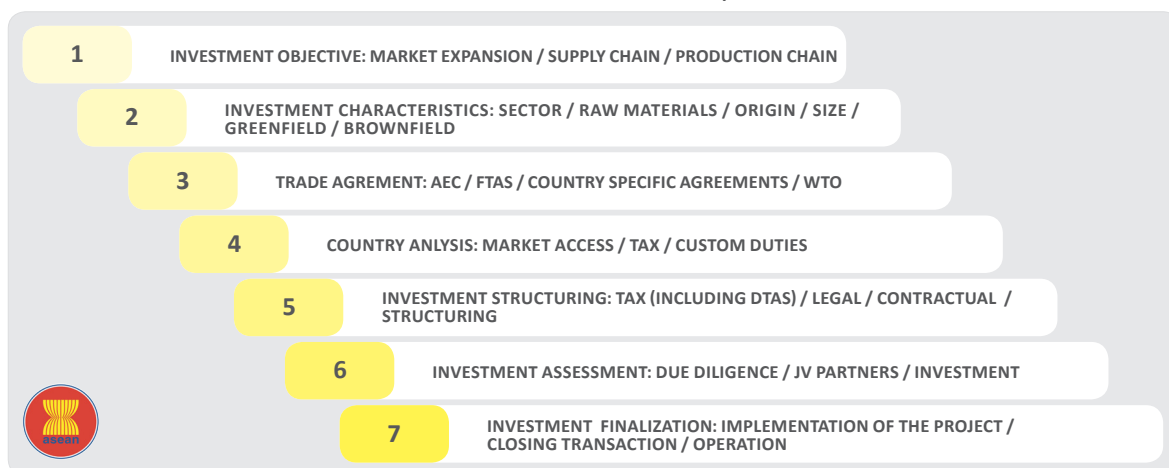
We also expect that the development of the AEC and more effective implementation of ACIA and the various FTAs will continue to accelerate investments by ASEAN investors. However, in order to access the benefits and realize the protections and liberalization under ACIA, investors from non-Member States will have to invest in or create juridical persons within an ASEAN Member State. Despite recent initiatives, it can still be challenging, relatively expensive and time-consuming to establish a foreign-owned company in many ASEAN Member States.

In addition to considering legal and procedural issues, there may be considerable local challenges within individual Member States as regards obtaining suitable skilled or unskilled labor, access to essential infrastructure, supply and distribution logistics, resources, or even local political or market issues that an investor will need to consider. Local due diligence will likely be a significant concern depending on the nature of the investment, and this may be complicated if there are local partners or shareholders.

In summary, a potential ASEAN investor will have to consider a number of issues that we have described in Table 6 below as the seven steps for successful ASEAN investment. We will continue to develop this analytical framework as the AEC develops, and suggest that potential ASEAN investors seek advisors with a strong local presence who are knowledgeable on issues specific to individual Member States as well as being able to provide advice with respect to issues pertaining to the nature of the investment more generally including, when necessary, the ASEAN agreements.

David Fruitman & L-Martin Desautels
DFDL

Table 6: Seven Steps for a Successful ASEAN Investment



REFERENCES:

1 - As examples: Comprehensive Economic Partnership for East Asia –ASEAN +6 (Japan, China, South Korea, India, Australia, New Zealand); Regional Comprehensive Economic Partnership –ASEAN +6.
2 - Please refer to ASEAN Economic Community: Business Survey by Albert Hu, in ASEAN ECONOMIC COMMUNITY: A Work in Progress (2013: Institute of Southeast Asian Studies) Table 10.9.
3 - Source: ASEAN Comprehensive Investment Agreement – An Introduction: ASEAN Secretariat.

4 - Source: ASEAN Comprehensive Investment Agreement – A Guidebook for Businesses and Investors: ASEAN Secretariat.
5 - Opening Remarks at Forum on the ASEAN Comprehensive Investment Agreement (ACIA), Kuala Lumpur, Malaysia, 21/3/2013.
6 - Regional Integration and Foreign Investment: The Case of ASEAN Countries, E. Nwosu, A. Orji, N. Urama, J. Amuka, published in ASIAN Economic and Financial Review, 2013, 3(12):1670-1680 (accessed online).

7 - Source: ASEAN Investment Report 2012.
8 - Source: International Business Times: Myanmar Sees Huge Foreign Direct Investment (FDI), but American Companies Still Lag Behind, by Sophie Song (20/09/2013) accessed online.
9 - Source: ASEAN Investment Report 2012.
10 - Source: ASEAN Economic Community Blueprint.



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He has been counseling a diversified group of foreign investors, including investments funds, international banks and large Asian investors, on their investment in the ASEAN Region. Martin has also advised various governmental entities under technical assistance projects (notably for the World Bank, Asian Development Bank and European Union) on various aspects of the development of investment, regulatory and legal frameworks.

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