

## PUBLIC-PRIVATE PARTNERSHIPS IN VIETNAM

### Public-Private Partnerships in Vietnam

On 14 February 2015, the Government of Vietnam (**Government**) officially promulgated the long awaited Decree No. 15/2015/ND-CP (**Decree 15**) on public-private partnerships (**PPP**) in an attempt to address Vietnam's contemporary infrastructure challenges and provide an enabling business environment that promotes private sector participation in long-term strategic public infrastructure development. It came into force on 10 April 2015.

This legal update focuses on our review of the key provisions of Decree 15 and provides practical insights regarding certain PPP/project finance issues of particular interest to lenders, sponsors, contractors and public sector entities from a Vietnamese law perspective.

### Unified legislative framework

The PPP concept and the particular characteristics of its contracting structure are expressly recognised in a number of key pieces of legislation, including the Law on Investment enacted by the National Assembly of Vietnam on 26 November 2014 (**the 2014 Investment Law**), and Decree 15.

Decree 15 presents a unified legislative framework for the procurement of PPPs in Vietnam, as it repealed both of Decree 108/2009/ND-CP (**Decree 108**) (relating to the BOT regime) and Decision 71/2010/QD-TTg (**Decision 71**) (relating to the pilot PPP scheme).

As a consequence, project sponsors no longer have to consider whether a major project should be structured as a 'BOT' project vs a 'PPP' project, which was, as a technical matter, previously subject to separate sets of rules.

### Transactional structures

The term 'public-private partnerships' describes 'a form of investment conducted on the basis of a contract between an authorised State body and the investor [and/or] the project company in order to implement, manage and operate an infrastructure project [or] to provide public services'.

In the past, BOT and BT models under Decree 108 have been commonly adopted in procuring gas-fired/coal-fired power projects and toll road investments in Vietnam.

For the first time, Decree 15 introduces new types of PPPs delivery models such as Build-Own-Operate (**BOO**), Build-Transfer-Lease (**BTL**), Build-Lease-Transfer (**BLT**) and Operate and Manage (**O&M**). In addition, the Prime Minister has the discretion to approve other models.

As a general observation, numerous other transactional structures widely used in other developed jurisdictions such as design-build-finance-operate-maintain (**DBFOM**) and design-build-finance-maintain (**DBFM**) were not expressly covered by Decree 15. Indeed, DBFOM was initially included in the earlier drafts of Decree 15.

### **Payment models**

Remuneration of project sponsors varies from project to project and will depend on the nature of the infrastructure. A commercial infrastructure adopting the BOT model typically involves a demand-risk transfer 'user-pays' structure where revenues are derived directly from the users of the infrastructure rather than the Government.

By contrast, the new contracting models such as BTL/BLT are generally availability-based and reliant on regular service payments directly from the Government (i.e. a service charge structure based on an availability payments model) over the life of the long-term concession with deductions for failure to comply with agreed performance standards.

### **Eligible infrastructure sectors**

As compared to Decision 71, Decree 15 attempts to expand certain key sectors or types of public infrastructure in respect of which PPP concessions may be granted, including:

- transport;
- street lighting, water supply, wastewater treatment;
- power generation plants and transmission lines;
- agriculture;
- commercial infrastructure;
- social infrastructure; and
- other sectors for infrastructure development as decided by the Prime Minister.

All PPP projects will be categorised into projects of national importance and Group A, B and C projects, in accordance with the public investment legislation. The criteria for a project to be grouped A, B or C are currently regulated by Decree 12/2009/ND-CP (as amended) and its implementing regulations.

A PPP steering committee shall be established to supervise PPP projects on a national level. It appears that the MPI will maintain its authority by coordinating and assisting the PPP steering committee to manage the implementation of PPP policies. Decree 15 also proposes that PPP local level management agencies may be established to enforce the PPP regulations.

### **Phases of PPP delivery**

Decree 15 contemplates the key phases involved in PPP delivery in Vietnam, including:

- project identification and preparation;
- approval of project list and feasibility study report;
- procurement, including the selection of project sponsors by way of a competitive tender;
- negotiation and execution of a project agreement;
- issue of an investment registration certificate;
- incorporation of a project company;
- project implementation; and
- transfer of the project facility to the Government (if applicable).

### **Risk allocation in greenfield PPPs**

An 'unbalanced' risk profile in project structuring has been customarily highlighted as one of the primary impediments to greater private sector investment in Vietnam infrastructure, and results in lengthy and expensive negotiations by the parties over the terms of the project agreement.

Unfortunately, there is not much substance in Decree 15 on the risk allocation principles for PPPs to assist the project sponsors to understand better which risks are retained by the Government (e.g. change in law/political risk), which risks are transferred to the project sponsors, and which risks are shared by the parties (e.g. force majeure).

The general principle governing the optimal allocation of risk in PPPs (rather than maximising it) should seek to pass project risks to the party best able to manage the risks at the least cost, irrespective of whether it is the public or private sector. Also, the risk transfer should generate incentives for the private sector commensurate with the level of risk that they have borne to supply cost effective and higher quality services on time.

Therefore, it is recommended that the Government should take a more flexible approach to the allocation of risk to minimise both project costs and risks for greenfield infrastructure projects.

In project-financed PPPs, the project company will typically pass down most of the project risks and obligations under the project agreement to the construction and services subcontractors.

### **Selection of PPP projects**

Decree 15 requires that a proposed PPP project must meet all of the following eligibility requirements:

- conformity with approved development master plans;
- falling within the specified infrastructure sectors;
- ability to attract private investors' commercial funding, technology and management experience;
- ability to deliver products and services to quality satisfaction; and
- financial thresholds of minimum VND20 billion (approximately US\$920,000) total investment capital (subject to certain limited exceptions).

### **PPP procurement principles**

It is encouraging to note that Decree 15 affirms the Government's support of the underlying principles for public governance of PPPs for procurement of goods and services by subcontractors, including value for money, equal treatment and transparency, as PPPs will undoubtedly increasingly become a prominent method for delivering key public services in Vietnam.

### **Investor selection**

Decree 30/2015/ND-CP (**Decree 30**) (with effect from 5 May 2015) sets out a series of procedures applicable to the selection of project sponsors of PPP projects in Vietnam.

The general rule is that the selection of project sponsors must be undertaken through a competitive tender process on the basis of an approved feasibility study report. During a contracting process, the financial proposal will be opened and analysed only if the technical proposal complies with the requirements of the tender rules.

Alternatively, direct appointment is available in certain limited circumstances where:

- only one investor registers or satisfies the pre-qualification requirements;
- only one investor has the required capacity to implement the project; or
- an investor proposes a project and satisfies the project implementation requirements 'with the highest feasibility and efficiency' (approved by the Prime Minister), including (i) an approved feasibility study report, (ii) a reasonable service price and (iii) satisfaction of the 'protection of national sovereignty, national borders or islands' requirements.

### **Unsolicited proposals**

Competitive tender remains the general principle under Decree 30 to pursue public infrastructure projects involving the private sector in Vietnam.

Project sponsors may initiate unsolicited proposals for PPP projects (that are not submitted in response to a request or solicitation issued by the Government), provided that such proposals do not fall within the approved list of PPP projects for which selection procedures have been approved or announced.

However, unsolicited proposals, if approved by the procuring authorities, are still subject to competitive tender.

Vietnam uses a 'bonus system' to promote unsolicited proposals that awards a bonus in the tendering procedure to the original project proponent by 5% credited to the original proponent's bid in an open tender.

### **Viability gap funding**

Depending on the project specific economics, the Government may make a funding contribution towards the cost of a PPP project by way of 'State investment capital' in order to alleviate the private sector finance constraints and make the relevant project more financially viable.

The purposes for which 'State investment capital' is used are clearly set out in Decree 15 as follows:

- to contribute capital to support construction of the facility in the case of a project with commercial operation [and/or] with collection of user fees but revenue is insufficient to recover investment capital and generate profit;
- to make payment to project sponsors who are providing services under a BTL, BLT or other similar delivery models;
- to support construction of auxiliary works, and to arrange compensation, site clearance [and/or] resettlement.

'State investment capital' includes capital from the State budget, bonds issued by the Government and local authorities, ODA, and concessional loans of foreign donors.

Contrary to Decision 71 (setting out the previous pilot PPP scheme) which caps 'State investment capital' at 30% of the total investment of a PPP project, Decree 15 places no statutory limits on the Government contribution.

It contains vague language on factors determining the value of State investment capital for a particular PPP project, which includes the project's financial plan, the in-principle decision on use of State investment, and the ability to raise and balance State investment capital sources for that project.

Of particular note, it appears that PPP projects derived from unsolicited proposals initiated by the private sector are not eligible for such 'State investment capital' funding.

### **Minimum equity participation**

Large infrastructure projects (including projects undertaken on a BOT basis) in Vietnam are primarily funded by a mix of equity investment and debt finance.

Similar to Decree 108, Decree 15 establishes that a PPP project has a minimum equity component of 15% of the total investment capital expenditure up to VND1,500bn (approximately US\$68 million) and 10% for the investment capital which exceeds VND1,500bn. The remainder of the funding would usually be provided by senior debt finance from commercial banks through formal loan syndication and secured on project assets.

Financing IPP power projects on a limited recourse basis in Vietnam is typically anchored on a 80:20 to 70:30 debt-to-equity ratio.

### **Lender's step-in rights**

Lender's step-in rights are available under Decree 15, and must be documented to ensure the continuation of the underlying project agreement at the lender's option.

As a practical matter, lenders will typically enter into a tripartite agreement with the Government and the project company, which gives lenders the right to step-in and take over the PPP project if an event of default subsists for a period of time (irrespective of whether a default occurs under the project agreement or under the senior finance documents).

Decree 15 also recognises the assignment of rights of project sponsors under a project agreement to third parties (including senior lenders and other prospective developers). In this regard, it is also worth noting that an assignment by way of security over a borrower's choses in action is not a recognised type

of security interest under the laws of Vietnam.

### **Default and termination payments**

Project agreements typically specify contractual remedies available to a party on termination due to the other party's default.

In this regard, it would have been desirable if Decree 15 had provided specific guidelines on the Government's 'standard' approaches to the calculation of termination payments/compensation to be paid to the project sponsors for termination of the project agreement upon the default of the Government.

Under international project financing conventions, the general principle which should be adopted is that on early termination of the project agreement, except where the private party defaults, the Government must pay a termination payment to the private party which is sufficient to pay all outstanding senior debt and any other financing costs.

### **Government guarantees**

Broadly consistent with the corresponding provision of the 2014 Investment Law, Decree 15 expressly authorises 'the Prime Minister to appoint a State agency to act on behalf of the Government to provide a guarantee on the provision of raw materials, on consumption [sale] of products and services, and on other contractual obligations to the project sponsors, the project company or other enterprises participating in project implementation, and a guarantee for performance by State owned enterprises of the obligations to sell fuel and raw materials to, and to purchase products and services from the project sponsors [and] the project company'.

In practical terms, difficulties have been encountered by project sponsors to obtain a Government guarantee which covers the performance obligations of the Vietnam project counterparties.

Further, there is no detailed guidance in Decree 15 on the identity and powers of 'a State agency' (which is presumably a governmental ministry) authorised to act on behalf of the Government to issue sovereign guarantees for PPPs. This gives rise to an uncertainty in limited recourse financed power projects in Vietnam, requiring that the implementing legislation must deal more adequately with those issues.

### **Minimum revenue guarantees**

On a separate note, the earlier drafts of Decree 15 also attempted to include a statutory provision on minimum revenue guarantees for PPPs, but such provision has been resisted and finally excluded by the Government after rancorous debate.

### **Currency risk**

Vietnam's currency devaluations and currency inconvertibility remain areas of uncertainty for project sponsors and international lenders.

In this regard, Decree 15 contains some vague language on the Government's 'assurances for foreign currency balancing' in relation to 'projects falling within the National Assembly's in-principle decision-making authority, projects for construction of infrastructure falling within the Government's investment programmes, and other important projects pursuant to decisions of the Prime Minister'.

There is growing concern about the inadequacy of this statutory provision, as the primary risks are the ability of the project sponsors to convert the local currency of the project revenue into foreign currency (generally US dollars), and remittance of the foreign currency out of Vietnam.

These currency risks are typically mitigated by way of a combination of political risk insurance (PRI), currency swaps and a debt service reserve account located outside Vietnam.

### **Correspondence 1604**

In respect of coal-fired BOT power projects, it should be noted that the Prime Minister issued Official Correspondence No. 1604/TTg-KTN (**Correspondence 1604**) on 12 September 2011 to the effect that the Government, among other things, shall only guarantee the conversion of a maximum of 30% of local currency (VND) project revenues into USD after deducting VND expenditures.



Whilst Correspondence 1604 technically applies to power projects only, it leaves open the question as to the potential implications of Correspondence 1604 and the Government's consistently adopted policy approach to other (non-power) infrastructure projects considering the same issue.

From an international lender's perspective it is imperative that the availability of foreign exchange for the conversion of VND received under the Vietnam project documents must be 100% guaranteed.

### **MOJ Legal Opinion**

On 26 May 2015, the Government issued Decree No. 51/2015-ND-CP (**Decree 51**), which comes into effect on 15 July 2015, in relation to the provision of a legal opinion by the Ministry of Justice (**MOJ**), which is applicable to PPPs.

We note that the principles for issuance of a MOJ legal opinion are expressly set out as follows:

- a legal opinion is issued on the basis of and in conformity with the laws of Vietnam as at the time of issuance;
- a legal opinion is issued after the [project] documents to be opined have been duly signed, approved, ratified or promulgated in accordance with the laws of Vietnam; and
- a legal opinion does not increase, decrease or change the rights and obligations of the parties under the [project] documents to be opined or under applicable law at the time of issuance.

### **Project documents subject to a MOJ legal opinion**

In PPP projects, a MOJ legal opinion will cover the following [project] documents:

- a project agreement;
- a Government guarantee;
- a land lease agreement; and
- other [project] documents to which the State of Vietnam, the Government or a State body is a party.

A strict interpretation of this statutory provision is that a State-owned enterprise does not technically constitute a 'State body', and such provision may potentially exclude from the coverage of a MOJ legal opinion other key project documents (including a gas sales agreement and/or a power purchase agreement) to which a State-owned enterprise (e.g. PetroVietnam or EVN) is a party.

### **Scope of opinion**

Under Decree 51, the scope of a MOJ opinion may include the legal conclusions in relation to the following matters:

- the capacity of a Vietnam project counterparty to execute or issue a document;
- the authority of a Vietnam project counterparty to execute or issue a document;
- the compliance with the laws of Vietnam regarding procedures for negotiation, execution and issuance of a document; and
- other matters (as applicable).

In practical terms, international lenders will typically require the MOJ to opine, among other things, that the obligations of the relevant Vietnam project counterparties are legal, valid, binding and enforceable under the laws of Vietnam.

### **Transitional provisions**

The transitional provisions of Decree 15 provide protection for project sponsors of an infrastructure project that secured a project agreement which was approved by the Government and initialled by the parties prior to the effective date of Decree 15 (i.e. 10 April 2015). Failure to do so would give rise to the project sponsors being caught by numerous mandatory rules set out in Decree 15, and would be subject to renegotiation of the agreed commercial terms of the PPP project.

A summary of the transitional provisions is set out below:

- project lists announced prior to 10 April 2015 must be reviewed and re-approved, unless otherwise approved by the Prime Minister;
- feasibility study reports which have been approved prior to 10 April 2015 are not subject to re-approval;
- projects for which project sponsors have been selected prior to 10 April 2015 are not subject to re-selection;
- project agreements which have been initialled prior to 10 April 2015 are not subject to renegotiation; and
- projects for which an investment certificate was granted or a project agreement was signed prior to 10 April 2015 shall continue to operate in accordance with the terms of the investment certificate/project agreement.

### Conclusion

Our general observation is that Decree 15 fails to provide desirable substantial changes to the previous BOT or pilot PPP regimes as the business community would initially expect, as numerous bankability issues facing Vietnam's infrastructure development (e.g. viability gap funding, tariffs, land acquisition, lender security over land) are not addressed adequately. Additionally, there remains a considerable sensitivity at present for international lenders and project sponsors when it comes to sovereign guarantees over foreign currency conversion.

Whilst the Government's new emphasis on a variety of PPP delivery models for major infrastructure projects in Vietnam is encouraging, it remains to be seen what volume of projects adopting new models emerges, given the lack of legal and commercial certainty under Decree 15 around what each PPP model consists of, particularly in the absence of a robust and transparent pipeline of bankable infrastructure projects.

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