Client Alert

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VIETNAM INTERNATIONAL LAW FIRM

Vietnam has long struggled to attract foreign investment into its power and infrastructure sectors. The Government hopes that a major overhaul of its investment policies will provide much needed stimulus.

On 14 February 2015, the Government issued Decree 15/2015/ND-CP on Investment in the Form of Public Private Partnership ("Decree 15") for investment in infrastructure and public services sector, which took effect as from 10 April 2015. Decree 15 seeks to combine the 5-year old pilot public private partnership ("PPP") framework with its much older cousin, the build-operate-transfer ("BOT") framework, which has existed in various forms for more than two decades. The Government also issued Decree 30/2015/ND-CP on 17 March 2015 providing guidance on bidding requirements for selection of investors for PPP projects ("Decree 30"), which took effect as from 5 May 2015 (as part of the implementing regulations of the Law on Bidding enacted on 26 November 2013 and effective on 1 July 2014). The new PPP framework is also supported by the new Law on Investment, which was enacted on 26 November 2014 and took effect from 1 July 2015.

Previous BOT Regime

The older BOT regime has been viewed as being narrowly applied to foreign invested power projects and domestically invested road projects. The BOT regime has not covered a wider range of infrastructure projects, particularly for those projects which need viability gap funding. At the same time, the Vietnamese government considers narrowing the scope of government guarantee for BOT projects. However, proponents of the BOT regime cite its history of guiding the development of various foreign invested BOT power and other infrastructure projects implemented to date which meet international lending requirements, although the number of such projects has been few (only 5 foreign invested BOT power projects licensed, of which 4 were financed).

Pilot PPP

The introduction of the pilot PPP legislation, Decision 71, in 2010 was intended to provide a better framework for developing infrastructure projects. It was implemented in parallel with changes to the BOT regime, which were introduced only 1 year prior in 2009 (Decree 108/2009/ND-CP dated 27 November 2009).

However, in the 5 years the pilot PPP legislation has been in place, not one project was developed following its guidelines. Investors were discouraged from developing projects due to a number of shortcomings in the pilot PPP legislation.

Controversy

There are contrasting views as to whether the combination of the BOT and PPP regimes is a good idea. The BOT regime has been in place for many years and is considered workable despite its flaws. Meanwhile the PPP regime is untested and has failed to gain any traction with investors. It is likely that the Government intends the modifications to the PPP regime set out in Decree 15 will resolve these issues. However, it is arguable whether it would have been wiser to keep the BOT regime in place, at least temporarily, to ensure that the new PPP regime will operate as expected. In light of this, critical consideration should be taken to address the financing aspects of PPP projects.

Deficiencies with Pilot PPP Regime

The most significant deficiencies in the pilot PPP regime can be summarised as follows:

• Provisions in Decision 71 on pilot PPP legislation conflicted with provisions in Decree 108 on the BOT regime;

• The State participation portion was capped at 30%;

• There was no clear regime for funding the State participation portion;

• There was a minimum investor equity contribution of 30%;

• There was no clear risk allocation for project structure and financing; and

• The roles of various State bodies were not clear.

Merger of BOT and PPP Regimes

Decree 15

Decree 15 addresses the issue of conflicting provisions between the former BOT regime and the pilot PPP legislation, by merging the two regimes in Decree 15. This is reflected in the implementation of the new Law on Investment, which was adopted on 26 November 2014 and will take effect from 1 July 2015.

Decree 15 covers all the current BOT forms under Decree 108 and extends to additional contract forms as follows:

• Build-Operate-Transfer (BOT) Contract;
• Build-Transfer-Operate (BTO) Contract;
• Build-Transfer (BT) Contract;
• Build-Own-Operate (BOO) Contract;
• Build-Transfer-Lease (BTL) Contract;
• Build-Lease-Transfer (BLT) Contract; and
• Operation and Management (O&M) Contract.

State participation portion

Cap abolished

Decree 15 no longer caps the State's equity participation (now called "State investment capital"), thereby abolishing the previous caps – 30% under the pilot PPP legislation and 49%, including any investment participation by State owned enterprises ("SOEs"), under the former BOT regime.

State investment capital shall only be available for projects that are proposed by a relevant State body or eligible under official development assitance ("ODA") or preferential loans with foreign lenders.

State investment capital can be used for a variety of purposes, namely, to provide:

• Capital support for projects involving public toll fees, where the fees collected are not sufficient to cover the investors' investment return plus profit margin – in effect, viability gap funding;

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• Payment support for investors to operate and provide services under BTL, BLT or similar contracts; or

• Capital support for supporting construction work or for site clearance, compensation and resettlement.

State investment capital will be funded from the State budget, Government bonds, ODA and preferential foreign loans.

Minimum investor equity

As a carry-over from the merger of the two regimes, the 30% minimum investor equity required under the pilot PPP legislation has been replaced with the more manageable requirements under the former BOT regime. As such, the minimum equity amount depends on the size of the project. Under Decree 15, for a project with total investment below or equal to VND 1,500 billion (about USD 70.4 million), the investor(s) must contribute at least 15% as equity. For larger projects, the equity contribution must comprise 15% of VND 1,500 billion plus 10% of the amount in excess of VND 1,500 billion.

Any State investment capital is deducted from the total investment capital of the project in order to determine the equity ratio.

Participation by State owned enterprises

Decree 15 clarifies that investment and participation by SOEs in PPP projects are not counted as State investment capital. Furthermore, SOEs are not allowed to invest in PPP projects other than in a joint venture with one or more private investors.

As with the new Law on Investment, an SOE is defined under Decree 15 as a 100% State owned company.

Unsolicited proposals

Decree 15 provides a framework to encourage investors to make proposals for projects which are not included in the lists proposed by the Authorised State Body. This is done by submitting an application (including investment project report) to the Authorised State Body for appraisal and approval.

If approved, the Authorised State Body will publish the project proposal to allow other investors to attend a public tender of the project at a later stage. The Authorised State Body can require the original investor to prepare a feasibility study report (if applicable) and agree on the incurrence and settlement of project preparation costs in case another investor is selected in the public tender. Pursuant to Decree 30, the original investor which has proposed the project and prepared the feasibility study (if applicable) shall be entitled to the following preferred treatments in a public tender as the case may be against other bidding investors:

• In case of bidding on price, the other bidding investors shall be considered as if bidding 5% higher than the price bid by the original investor;
• In case of bidding on support of State investment capital, the other bidding investors shall be considered as if bidding 5% higher than the amount of State investment capital bid by the original investor;

• In case of bidding on socio-economic benefits, the original investor shall be considered as if bidding 5% higher than the amount of State budget contribution bid by itself;

• In case of bidding on a combination of the above criteria, the original investor shall be entitled to the maximum 5% for each criterion.

Roles of Authorised State Bodies

Decree 15 has changed little regarding the roles of Authorised State Bodies. As such, this fails to clarify the confusion resulting from the overlapping authority of various authorities. For example, the Ministry of Industry and Trade has authority over power projects and the Ministry of Transportation has authority over road projects, but in each case the Ministry of Planning and Investment is responsible for coordinating foreign investment in such projects.

However, an area which has been clarified is the role of the Prime Minister, who retains significant discretion in relation to certain key decisions. Notably, the Prime Minister (as opposed to the Government, under the former BOT regime) now has the power to appoint the Authorised State Body to provide Government guarantees on behalf of the Government on certain aspects of the projects, in favour of a project company and its investors. This means that the authority to issue such guarantee is much clearer and reliable, thus alleviating potential lender concerns.

New licensing procedures

Under the former BOT regime and the pilot PPP legislation, investors were required to apply for an investment certificate. This concurrently served as the licensing certificate for the project and the business registration certificate for the project company. The Law on Investment 2014 and Decree 15 now introduce two licensing steps. The investor must first apply for an investment registration certificate for the project; and then apply for a business registration certificate for establishment of the project company. Though subject to further guidance, it has been proposed that implementing legislation supporting the new Law on Investment will be drafted to include a sequenced licensing process, in which the business registration certificate will be issued within 30 days of the issuance of the investment registration certificate.

Change-in-law events

The new Law on Investment narrows the scope of a change-in-law event, whereby only changes to legal documents will be considered a change-in-law and trigger the right of investors to claim for remedy. As such, the new Law on Investment differs from the Law on Investment 2005 in that changes in policies will no longer be considered a change-in-law event. The new Law on Investment also provides exceptions where investment guarantees will not apply. This includes change-in-law events due to national defence and security, social order and safety, social morals, community health or environmental protection. This is an unfavorable change which may affect an investor's ability to claim for remedy if a change-in-law event has occurs.

Project term

The new Law on Investment extends the maximum operational term of projects in economic zones to 70 years (as opposed to the standard 50 years under the Law on Investment 2005, or the exceptional 70 years if so decided by the Government). In addition, now any delay in handing over the project land by the State to the investors will not be included in the project term.

Governing law

Decree 15 clarifies the rules regarding the choice of a foreign governing law. A chosen foreign governing law will be applied as long as the choice of governing law does not contradict Vietnamese conflict of law rules. Under the former BOT regime and the Law on Investment 2005, such a choice would only be valid if it did not contradict all regulations under the laws of Vietnam.

Limited scope of legal opinion

The legal opinion of the Ministry of Justice ("MOJ") is now only limited to the project contract, Government guarantees and other project documents which are entered into by a State body. This means that the MOJ legal opinion would no longer cover the project contracts entered into by State-owned enterprises, such as supply agreements and off-take agreements, etc. It remains to be seen whether this will prove to be an issue for lenders.

Security over Land

Under the former BOT regime and the pilot PPP legislation, the project company would be exempt from land use fees/rental in accordance with Vietnam's land laws, which prevent the project company from mortgaging such land use rights under the land laws because the land use fees/rental are exempt and not fully paid. Furthermore, the current laws restrict any mortgaging to onshore banking institutions, thus requiring a more complicated onshore security agent arrangement in order to provide foreign lenders with security. Now, both Decree 15 and the new Law on Investment offer a new mechanism for reduction of land use fees/rental (or certain lump sum payment). This allows the project company to mortgage the land use right by way of applying for reduction of land use fees/rental which have been paid by lump sum payment. This favourable change in the law should be further explored with the Authorised State Body while negotiating the project documents in respect to a land use right mortgage. However, there has not been any improvement on the need of onshore security agent.

Lenders' position in the projects

During the application of the former BOT regime, the Authorised State Bodies took the view that lenders are not parties to the project contract. This meant that Authorised State Bodies were under no obligation to accommodate the lenders' views and comments during the negotiation of the project contract and other relevant project documents. However, under Decree 15, lenders for the first time are considered parties in PPP projects. This provides a legal basis to argue that the lenders' positions should be reflected in the project documents.

Investment Agreement

Upon conclusion of the project contract, the parties (i.e. Authorised State Body and investors) must enter into an investment agreement to acknowledge certain project contents (such as draft contents of the project contract, rights and obligations of parties and other agreements between the parties). Under the former BOT regime, the parties were only required to initial the project contract. The impact of this provision remains to be seen and will depend on the content of further guidance on the specific conditions and procedures.

Foreign currency guarantee

Under Decree 15, the Prime Minister shall have power to grant a government guarantee on foreign currency (as opposed to a performance guarantee) for important projects, and appoint a State body to act on behalf of the Government in this regard. The

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detail of a foreign currency guarantee will depend on the national socio-economic development strategy, the foreign exchange policy and the balance of foreign currency from time to time and the need of each specific project as proposed by the relevant ministry or province. It is expected that the Government may consider and introduce different foreign currency guarantees for each sector.

Issues not addressed in Decree 15

Decree 15 includes the original BOT scheme provision for providing a government guarantee. This is despite investor concerns that the availability and extent of this guarantee are being diluted with respect to covering performance and other obligations of State bodies that are contracting parties to the project. Recent rulings and considerations also show a pattern towards limiting the coverage of such guarantees. For example, the Prime Minister's Official Letter 1604 dated 12 September 2011 limited foreign exchange guarantees to only 30% of revenues. The Letter also provided for a term limit on the Government guarantee of project contracts and power purchase agreements of 25 years and 18 years, respectively, for gas and coal fired projects (reduced term for other projects). These and other limitations have not been addressed in Decree 15.

Conclusion

There are still many concerns about Decree 15 and whether it will provide a workable and bankable framework for PPP project development in Vietnam. Nonetheless, investors may take some comfort in the fact that some provisions of the former BOT regime have been adopted in order to resolve the inadequacies of the pilot PPP legislation. This comfort will of course be subject to the implementation of the scheme being handled correctly. Both the Government and investors will need this to work if Vietnam is to satisfy its increasing demand for additional power and infrastructure.

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