The new PPP Decree – Vietnam's solution for infrastructure development

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The new PPP Decree – Vietnam's solution for infrastructure development

Introduction

On 14 February 2015, the Government of Vietnam promulgated the long-expected Decree 15 on PPPs (the "**New PPP Decree**"), which took effect on 10 April 2015. The New PPP Decree, together with the new Decree 30 on tendering for investors for PPP projects (the "**Decree on Investor Selection**"), effective on 5 May 2015, swept away the previous regulatory framework relating to BOT projects and pilot PPPs[1].

Although there has been significant spending on infrastructure projects in Vietnam over the past 20 years, the vast majority of the funding has been supported by Official Development Aid ("**ODA**"), the State budget and State guarantees of external debt provided by the Ministry of Finance ("**MOF**"). This is recognised as not being sustainable in the mid- to long term, particularly as Vietnam achieves middle income status with the consequent reduction of available ODA funding. In addition, the Government appears to be intent on mobilizing funds other than State (including State-owned enterprise ("**SOE**")) funds and limiting exposure to foreign creditors under MOF guarantees.

Other than some notable examples in power sector, most recently the AES Mong Duong 2 power project which reached financial close in 2011, very few projects have been implemented as true BOT projects or PPPs with private sponsors and international financing.

Instead, the trend has been for sponsors to approach infrastructure projects as (i) pure investment projects under the Law of Investment with incentives – including tax incentives and exemptions from land rents – stipulated in the laws applicable to the project depending on the relevant sector, category, scale or geographic location of the project; or (ii) as BT projects, prevalent in the roads sector, where the investor receives land for developing a separate commercial project in return for developing the infrastructure specified by the Government.

There is a clear realization that a more robust regulatory environment for PPPs is needed to encourage private, and specifically foreign private, investment in infrastructure in Vietnam in order to meet the nation's infrastructure funding requirements off the State's balance sheet. According to the Ministry of Planning and Investment ("**MPI**"), Vietnam needs about US$16 billion per year for infrastructure development, of which the State budget can only cover 50%. The adoption of the New PPP Decree and the Decree on Investor Selection is intended to be a step in that direction.

This client note highlights the key developments under the New PPP Decree and the Decree on Investor Selection and concludes with some observations on recent developments and trends.

A consolidated code for infrastructure projects in Vietnam

The New PPP Decree consolidates and replaces both Decree 108[2] on BOT, BTO and BT projects and Decision 71 on pilot PPP projects, which co-existed for more than 4 years to this April. This consolidation ends the past confusion in the market as to how BOT projects were distinguished from PPPs by clarifying that a BOT project is a form of PPP project.

Investors should note, however, that it remains possible to invest in infrastructure projects outside the framework of the New PPP Decree – although its investment advantages (and notably the possibility of obtaining viability gap funding ("**VGF**") from the State to render a project bankable) would of course not be available. Nonetheless, going outside the PPP framework might be the most appropriate option in certain cases, particularly where limited public benefit from the infrastructure project is envisaged.

Broader application

Under the New PPP Decree, more sectors are open to PPP investments. In addition to transport infrastructure,

[1] Hogan Lovells LLP advised the Ministry of Planning and Investment on the development of the New PPP Decree and the Decree on the Selection of Investors under a project funded by the Asian Development Bank.

[2] Please refer to the Glossary for definitions.

power plants, hospitals and waste treatment plants as were provided under Decree 108 and Decision 71, the New PPP Decree allows PPP investments in agriculture, education, culture, sports, construction of Government workplaces, social housing and cemeteries, science and technology facilities and economic and industrial zones. Investments in providing public services may also be carried out in PPP form.

Notwithstanding this breadth of application, it is expected that three first PPPs to be developed under the new regulatory framework (other than power projects) will be in the more traditional road or water sectors.

Project cycle

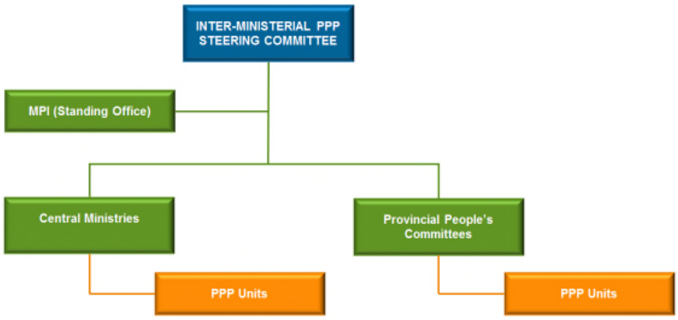
In a significant departure from the prior regulatory framework, where procedures for implementing a PPP project were scattered across various laws and regulations, resulting in uncertainty, delay and investor confusion, the New PPP Decree, together with the Decree on Investor Selection, sets out a relatively prescriptive step-by-step project cycle, providing useful guidance for both the Government and investors in implementing projects. All PPP projects, except for smaller Group C projects (as defined below), must follow the following stages:

A simplified process exists for smaller "Group C" projects (with a total investment capital of up to VND120 billion (approximately US$6 million)). Group C projects are not required to have a feasibility study report or to be conducted by a specially incorporated project company.

Institutional structure for administration of PPP projects

The New PPP Decree clarifies the institutional structure and the roles of various Government authorities in the PPP legal framework. At the central Government level is the Inter-Ministerial Steering Committee for PPP investments, established by the Prime Minister in 2012 and led by Deputy Prime Minister Hoang Trung Hai. The Steering Committee advises and assists the Prime Minister and the Government in making policies, and in the planning and strategy for implementing the PPP program. It also acts as a coordinator amongst the various Ministries and provincial People's Committees involved in PPP projects. The Deputy Minister of Planning and Investment is the deputy head of the Steering Committee, and the MPI also hosts its standing office, meaning that the MPI could centrally monitor the PPP program in Vietnam.

Depending on the location, scale and importance of each project, the relevant Ministry or provincial People's Committee (the "**authorised State agency**") will formulate its own projects and act as the representative of the State to negotiate and sign project contracts with the investors. The authorised State agency may also establish a special PPP Unit under its supervision to be the focal contact in implementing the PPP projects under its authority.



To date, only the MPI and the Ministry of Transport have established PPP Units. The Ministry of Industry and Trade intends to utilise the existing BOT unit under the General Directorate of Energy as its PPP Unit to leverage the unit's expertise with BOT power projects. In 2013, the Hanoi People's Committee also established a PPP Unit led by a deputy chairman.

Project screening and approval

Authorised State agencies formulate potential projects in compliance with procedures under the laws and regulations on public investment. Details regarding potential projects are published on the national public procurement website (http://muasamcong.mpi.gov.vn/) managed by the Public Procurement Agency under the MPI.

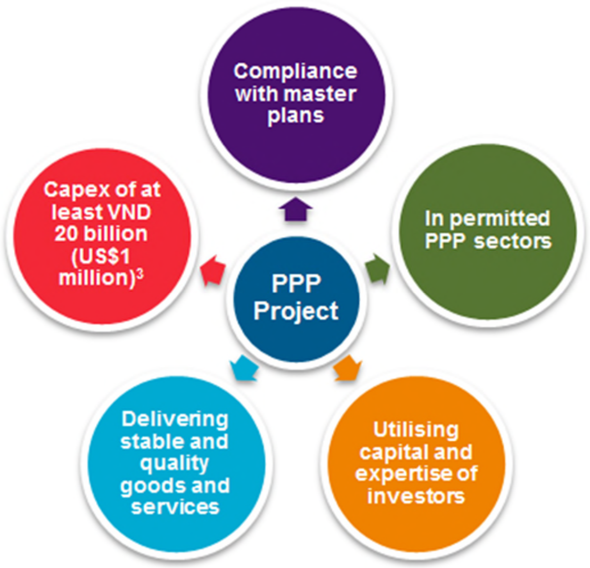
In April 2014, the Prime Minister approved a list of 127 projects calling for foreign investment to 2020, the majority of which are to be conducted in PPP or BOT forms. The listed projects are located across the country with four major sectors (construction of technical and social infrastructure, agriculture, manufacturing and services), ranging in size from US$3.5 million to US$5.6 billion, including the US$5.6 billion Long Thanh Airport PPP project in Dong Nai Province, the US$4 billion Binh Dinh Electricity Center PPP project in Binh Dinh Province; and the US$3.5 billion Dau Giay – Lien Khuong Expressway PPP project in Lam Dong Province.

In April 2015, Ministry of Transport announced that it was studying more than 50 projects with aggregate investment capital of VND160,000 billion (approximately

US$8 billion) for implementation in PPP form. Eligibility Projects approved for PPP investment must:

- be of sufficient scale;
- serve the public interest; and
- be commercially viable.

More specific eligibility criteria include all of the aspects below:



Funding for project preparation

Project preparation costs of the State include costs for formulation of project proposals and feasibility study reports, tendering costs, operating costs of the authorised State agencies and costs for engaging counsel and advisors.

Funding for project preparation may be sourced from (i) investment budgets allocated annually to the authorised State agencies; (ii) the project development facility described in more detail below; (iii) earnings from the fees for requests for proposals; and (iv) capital reimbursed to the State by the selected investors to cover prior preparation costs (for other projects).

*Project development facility ("**PDF**")*

The PDF is a fund contemplated to assist the State in the preparation of PPPs. It will mainly be sponsored by ODA and preferential loans from foreign donors. Since 2013, Asia Development Bank, Agence Française de Développement and the Australian Agency for International Development have committed to provide Vietnamese Government with a total loan of US$30 million for this purpose. The PDF will be administered by the MPI in cooperation with MOF.

Selected investors in a PPP project will be required to refund the preparation costs for their projects to the State, who will repay them to the PDF.

Contract forms

In addition to the BOT, BTO and BT contract forms previously envisaged by the former Decree 108, the New PPP Decree introduces Operation and Maintenance (O&M), Build – Lease - Transfer (BLT), Build – Transfer − Lease (BTL) and Build – Own – Operate (BOO) contract forms.

The introduction of the O&M model is a key development, which is expected to allow the State to auction or sells concession rights to already existing operating projects. There is no requirement for the investor to contribute capex.

BLT and BTL contract forms allow the State to pay fees directly to the project company in return for the use of an infrastructure facility, as opposed to requiring the project company to recover its profits from the end users of the facility. This model may be adopted where it is not desirable or practical for the foreign investor to assume the collection of revenues (and associated risks). It is also envisaged to be a method by which the State can contribute capital to a project to ensure its viability (see below).

Although previously not recognised as a legal concept, BOO projects (where there is no obligation to return the infrastructure back to the State) were in practice implemented as private investment projects under the generally applicable Law on Investment (without the support to the investor envisaged by the then existing BOT regime). The inclusion of BOO as a PPP contract form in the New PPP Decree will allow BOO projects to benefit from the PPP investment regime.

The New PPP Decree also attempts to address a past inefficiency in BT projects, by providing that BT investors may only implement their ancillary side projects after, or simultaneously with, the relevant BT project required by the State. This is intended to put an end to incidents where investors, who constructed their side project before commencing the attached BT project, then had insufficient capital to complete the BT project.

Beside the above contract forms, the Prime Minister may approve other contract forms upon request from

[3] PPP projects under O&M contracts and in agriculture sector can have capex of less than VND20 billion (approximately US$1 million).

the authorised State agency. In practice, it is unlikely that this provision will be relied upon.

No limit on State investment capital in support of a project's financeability

State investment capital can take three forms: (i) capital support for the construction of project facilities, payable to the investors or the project company after the completion of construction; (ii) payment by the State to the project company or investors in BLT and BTL contracts, payable on periodical basis based on defined deliverables; and (iii) support for the construction of side projects (e.g. in BT projects as discussed above) or land clearance and resettlement.

The New PPP Decree removes the 30% limit on the State contribution provided under the former Decision 71 relating to pilot PPP projects. Instead, the State investment capital is determined based on the financial need of each specific project. The form and the amount of the contribution are to be approved by the Prime Minister or the head of the authorised State agency (depending on the importance and scale of the project) in the feasibility study report for the relevant project.

This allows investors and the authorised State agencies the flexibility to structure the State contribution to the project in the optimal way to ensure its financeability, including by way of VGF, and has been welcomed by investors.

Selection of investors

Requirement for competitive bidding

Although Decree 108 provided for competitive bidding, in practice, very few BOT projects in Vietnam have been put to tender. Most BOT investors have been directly appointed, one notable exception being the investors in the prospective Nghi Son 2 power project.

The New PPP Decree, coupled with the Decree on Investor Selection, limits the possibility for direct contracting by stating that the selection of investors for PPP projects must be conducted by way of international competitive bidding, i.e. open to both domestic and foreign investors, subject to certain restricted cases.

Domestic bidding is only permitted where:

- Vietnamese laws or Vietnam's international treaties prohibit the participation of foreign investors in the relevant investment sectors;
- no foreign investors are selected in pre-qualification stage; or
- the project belongs to Group C, i.e. projects with capex of up to VND120 billion (approximately US$6 million).

Direct contracting is only permitted where:

- there is only one investor participating and qualified in the pre-qualification stage;
- only one investor has sufficient capacity to implement the project; and
- the investor proposing an unsolicited project is approved by the Prime Minister to implement the project based on the proposed service fees of the investor and the satisfaction of the demand for protection of national sovereignty or security.

The draft project contract to be included in tender package

The New PPP Decree is silent on many of the key terms of the concession or project contract. It is expected that a standard will be developed as the contracts for the first projects in each sector are prepared for tender.

The Decree on Investor Selection requires that the draft project contract must be included in the request for proposals to potential investors (i.e. it must be included as part of the tender package).

Interested bidders must submit their proposals in line with such draft contracts, although there is some room for negotiation with selected investors. The Decree on Investor Selection, however, does not provide for guidance on the extent of deviations that are permitted from the draft project contracts.

The requirement for draft contracts is intended to reduce the contract negotiation period as many large-scale BOT projects in Vietnam have historically taken 3-5 years to conclude, leading to significant costs for both public and private parties. However, the time it will take to develop standard documentation for inclusion in tender packages could lead to delays in putting currently envisaged projects to market.

Unsolicited projects

Investors may propose projects that are not listed on the list of projects announced by the authorised State agencies, as long as they satisfy all the eligibility conditions of PPP projects. An SOE (defined as an enterprise with 100% State capital) may only propose a project in consortium with other private enterprise(s). Companies partially owned by the State can independently submit project proposals.

Unsolicited project proposals must be approved by the relevant authorised State agency. If approved, the authorised State agency may then assign the project proponent to carry out the feasibility study for the project. Following the completion of the feasibility study, the project must be put to tender. The project proponent conducting the feasibility study will be entitled to bidding incentives, including an increase of the price proposed by other bidders by an additional 5% when evaluated against that of the project proponent.

Unsolicited projects cannot benefit from the PDF and are only entitled to State capital investment if such State capital is funded by ODA or preferential loans of foreign donors.

Incentives for projects

The incentives under the New PPP Decree are similar to those that existed previously. Depending on the nature and needs of each specific project, PPP investors and project companies may be entitled to the following incentives:

- the tax exemptions and reductions provided under tax regulations of Vietnam[4];
- State guarantee of the obligations of SOEs to supply fuel and raw materials to the project and to purchase products or services from the project. It should be noted that SOEs under Vietnamese law only means wholly State-owned enterprises, therefore, it is uncertain whether such State guarantees will be available where the Vietnamese parties are partially State-owned enterprises or privatised SOEs;
- the legal right to mortgage moveable assets, land and assets attached to the land in accordance with Vietnamese land laws, together with the right to operate the project, to its lenders within the concession term of the project (see "Step-in rights of lenders" below);
- State assurance of the project company's unchanged land use right purpose;
- the right to purchase foreign currency from licensed credit institutions; and a guarantee of currency convertibility for projects of "national importance";
- State assurances in respect of the provision of public services to the project; and
- State assurances in respect of the PPP investors' ownership of the project's moveable and immoveable assets and property.

Step-in rights of lenders

Lenders' "step-in-right" is a right for lenders to a project, or a party appointed by the lenders, to take over the contractual rights and obligations of the project company in certain default scenarios and to "step-in" to keep the project operating. This right was clearly recognised under the previous BOT and pilot PPP regulations and is reinforced in the New PPP Decree. In practice, most BOT contracts in Vietnam provide for lenders' step-in rights.

The New PPP Decree expressly recognises the concept of consent or direct agreements between the lenders and parties to project contracts (including authorised State agencies). These direct agreements ensure all relevant parties recognise the step-in rights, and are key to their perfection.

Application of foreign laws to project contracts and dispute resolution

Continuing the approach of previous regulations, the New PPP Decree provides that foreign laws may be selected to apply to project contracts with foreign investors, as well as the other contracts whose performance is guaranteed by the Government (such as supply or offtake). Generally, for larger BOT projects, authorised State agencies have accepted the application of foreign law to the application and interpretation of the contract.

The resolution of disputes between an authorised State agency and foreign investors or foreign invested project companies may be submitted to foreign arbitral tribunals. This provision is viewed as key by foreign investors, although to date we are not aware of any dispute under a BOT or BT contract having been actually instigated before a tribunal (please refer to our publication entitled *Arbitration*).

Transition provisions

The transition provisions in the New PPP Decree attempt to minimize the impact of the new regulatory framework on those projects that have already reached key stages of development as at the time it comes into effect.

Accordingly, it stipulates that:

[4] Depending on the investment sector or the geological location of the project, the project company can be entitled to exemption or reduction of the corporate income tax during a certain period of time from the year the company has taxable income. Import of machinery and equipment as fixed assets of the project may not be subject to import duties.

- there will be no re-approval of the feasibility study reports of projects whose feasibility study reports have been approved prior to 10 April 2015, the effective date of the New PPP Decree; and
- there will be no re-selection process for projects where the investors have been selected and approved prior to 10 April 2015 and there will be no re-negotiation of project contracts that have been initialled at that date.

Notwithstanding these provisions, some projects have in practice been delayed due to the implementation of the New PPP Decree and the consideration by the relevant authorities of the transition provisions and the application of the new Decree to on-going projects. It is reported that the Ministry of Industry and Trade is undertaking a formal review of the project contracts of a number of power projects including Vung Ang 2, Vinh Tan 1, Van Phong 1 and Nghi Son 2. Some authorised State agencies may be awaiting the adoption of further regulations implementing the New PPP Decree before taking any action.

Concluding remarks

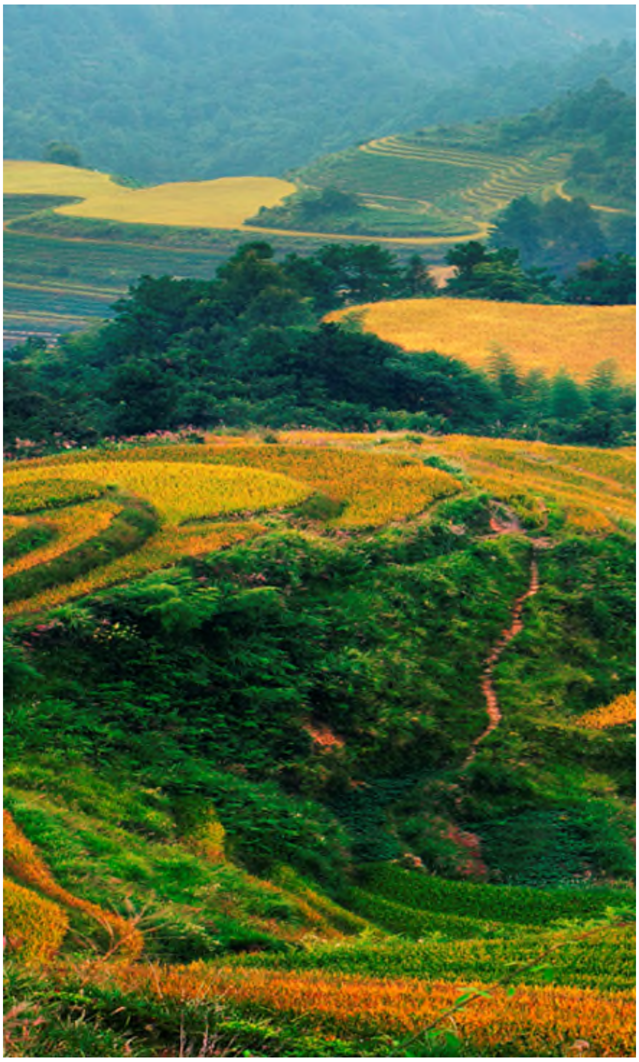
The New PPP Decree has clarified a number of issues that have historically been of concern to foreign investors looking to invest in infrastructure projects in Vietnam.

Of specific importance is the possibility for unlimited State contribution to PPP projects in a context where limited user revenue from public infrastructure and utilities compromises their financeability on a PPP basis. The New PPP Decree does, however, stop short of providing for minimum revenue guarantees to investors. It also does not clearly address the availability of State guarantees of currency convertibility, a key issue in the context of projects whose revenues are in Vietnamese Dong. Further regulations on this issue are expected in the near future.

The clarification of the process elements relating to project approvals and the promotion of competitive bidding under the Decree on Investor Selection also brings Vietnamese practice closer to international norms. In view of the limited regulatory stipulations relating to project contract content, it is however expected that it will take some time for the initial draft contracts to be finalised for tender. We understand that there are advisory projects under way to ensure that the risk allocation mechanisms of those contracts will be acceptable to the international market.

Finally, the ability of private entities to participate in existing infrastructure asset operation and management is also a key development. The Government is reportedly looking at structures to privatise constructed infrastructure in the airport, port and expressway sectors through the auctioning of O&M rights or the privatizing or selling down of the companies currently operating those assets, providing opportunities for investors.

The New PPP Decree is expected to mark a new chapter of Vietnam's infrastructure development. When taken together with newly effective amendments to the Law on Investment, the Law on Real Estate and the Law on Residential Housing, as well as other secondary legislation (such as Decree 60/2015/ND-CP relaxing foreign shareholding caps in public companies), there appears to be a regulatory shift towards encouraging foreign investment. As always, issues of capacity building and practical implementation will be critical in determining the success of the texts.



Glossary

BLT	: Build – Lease – Transfer
BOT	: Build – Operate – Transfer
BT	: Build – Transfer
BTL	: Build – Transfer – Lease
BTO	: Build – Transfer – Operate
Capex	: Capital expenditures or investment costs
Decision 71	: Decision 71/2010/ND-CP dated 9 November 2010 of the Prime Minister on pilot program for investment in PPP form
Decree 108	: Decree 1082009/ND-CP dated 27 November 2009 of the Government on investments in BOT, BTO and BT models
Decree on Investor Selection	: Decree 30/2015/ND-CP dated 17 March 2015 of the Government providing guidance on implementation of a number of articles of Law on Public Procurement relating to selection of investors
Law on Enterprises	: Law No. 68/2014/QH13 dated 26 November 2014 of the National Assembly on Enterprises
Law on Investment	: Law No. 67/2014/QH13 dated 26 November 2014 of the National Assembly on Investment
New PPP Decree	: Decree 15/2015/ND-CP dated 14 February 2015 of the Government on PPP investment form
O&M	: Operation and Maintenance
PDF	: Project Development Facility
PPP	: Public – Private – Partnership

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