

NEW PPP DECREE – PAVING THE WAY FOR ENHANCED COMPETITIVENESS?

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Good infrastructure in Vietnam is critical to economic growth. Vietnam's infrastructure spending has increased impressively over the last 10 years. But the challenges over the next 10 years are acute. According to a recent PwC survey, infrastructure spending will have to more than double to over \$50 billion a year by 2025 in order to remain competitive with the rest of South East Asia.

As government resources around the world are always limited, one way of enhancing the competitiveness of the economy is to involve the private sector more in providing infrastructure.

An important milestone in this process was reached on 14 February 2015. The Vietnamese Government issued a new decree regulating investment in public-private partnerships (the **PPP Decree**). The new PPP Decree will replace the current pilot PPP regulations in Decision 71 dated 9 November 2010 (**Decision 71**) as well as the BOT regulations in Decree 108, as amended (**BOT Decree**).

As the BOT Decree has been repealed, it is important that the PPP Decree is implemented quickly – both through the issuance of relevant implementing regulations and with some demonstrable early successes. The VBF Infrastructure Group believes that it is important for the success of the programme – and improvements to the competitiveness of the Vietnamese economy that will result – that these early projects are financed on a non-recourse basis.

INFRASTRUCTURE DEVELOPMENT BEFORE NEW PPP DECREE

Up until now, foreign investors in Vietnamese infrastructure projects have focused on four types of structures:

- BOT projects, such as AES's Mong Duong 2 project, the Phu My 2-2 project and the Phu My 3 project;
- BT projects, such as those attempted by some Korean investors, primarily in the road sector;
- "Japanese PPP" projects; which involve Japanese ODA being granted for a publicly-funded portion of a development together with a private commercial project that benefits from such public expenditure – Lach Huyen port being an example;
- Direct investments under the Investment Law, which can receive certain guarantees from the Government relating to foreign exchange, performance of State-owned companies and other risks to the financial returns expected from the project – the Nghi Son refinery project being the most recent example.

PPPs have been theoretically possible under Decision 71 for 4 years. But no foreign investment has been made under these regulations. There was an attempt to get one off the structuring blocks – the Dau Giay to Phan Thiet expressway project – but that does not appear to be happening.

STEPS FORWARD UNDER NEW PPP DECREE

1. Structures available for PPP

The PPP Decree covers both availability-payment type contracts and user-fee type contracts. It expands the BOT Decree by covering the following additional types of project:

- Build-Own-Operate
- Build-Transfer-Lease
- Build-Lease-Transfer
- Operate-Manage.

In addition the PPP Decree authorises “similar contracts” if they are approved by the Prime Minister. So there is room for discretionary variations on the theme. However, during the early implementation of the PPP Decree the authorized state agencies may be reluctant to offer “similar contract” forms outside of the main forms that are specifically named in the PPP Decree.

2. Sectors available for PPP

The list of sectors available for public-private investment enumerated under the PPP Decree is broader than that contained in Decision 71 and the BOT Decree. PPP investments are allowed in transportation, water supply and waste treatment, power plants and transmission, and infrastructure facilities for healthcare, education, culture, sport, industry and agriculture.

Other projects may also be done through PPP, as decided by the Prime Minister. Projects in the above sectors can still be implemented under the Investment Law without recourse to PPP and are entitled to such incentives as exist under that law. The VBF Infrastructure Group believes that it is important to the continued competitiveness of the economy that any doubts about this point are dispelled as soon as possible. Non-BOT infrastructure projects have been vital to the growth of the country to date, and it is important that non-PPP infrastructure projects continue to be possible if they do not need viability gap funding.

3. State participation in a PPP project

State capital can be used to fund gaps in the private sector viability of a project. This can take various forms, including capital expenditure support or payments for availability of the infrastructure that has been constructed.

There is no longer a cap on the State capital that can be used in a PPP project (previously 30% limit for pilot PPP projects and 49% limit via SOE participation for BOT projects).

The goal is for the State-owned capital to be determined according to the needs of the project. This will involve a proposal and approval process, which could of course be political in nature and which may prove cumbersome in practice. However, this is an area where substantial work is being done to build capacity and mechanisms to support appropriate determinations of when and how to fund viability gaps.

The VBF Infrastructure Group believes that appropriate decisions in this key area will be important in whether the PPP program is ultimately successful in enhancing the competitiveness of the Vietnamese economy. The VBF Infrastructure Group would welcome the opportunity to discuss the area in more detail with the Government when appropriate.

4. Incentives

In addition to, and overlapping with, viability gap support, the PPP Decree provides certain incentives to PPP projects. The table below illustrates the issues by comparing the incentives provided under the PPP Decree with those granted under the current BOT regime:

	BOT Decree	PPP Decree
Land	Exemption from rent or land use fees for the whole duration of the project.	Exemption or reduction from land use fees/rental in accordance with the land law.
Mortgage of land use rights	Land use rights can only be mortgaged to lenders, subject to an approval from the Prime Minister and a legal opinion of the Ministry of Justice.	Similar to BOT Decree. Land use rights, and other assets and rights, can be mortgaged in accordance with the land law and civil law. Mortgages of land use right to a foreign lender are not possible under current law, but approval of the Prime Minister might be obtained to use an onshore security agent.
Tax incentives	A BOT company is entitled to certain tax incentives.	In accordance with the tax laws. Similar to the BOT Decree.
Foreign exchange	In practice, the Government has guaranteed the convertibility, availability and remittability of foreign currency for some BOT projects.	Important infrastructure projects (which are included in the Government's programme or approved by the Prime Minister) can obtain FX availability guarantees. Exchange rate guarantees are not mentioned and the identity of the issuer of the guarantee is vague.
Government's support for use of public utilities	A BOT company is entitled to support from the Government for the use of public services. Accordingly, the Project Company is permitted to use land, roads and other support facilities to implement projects and has priority rights to use public facilities to implement the project where public services are scarce.	Similar to the BOT Decree.
Government Guarantee	Full guarantees have been provided by the Government for different aspects of a BOT project.	Performance guarantees of state-owned counterparties are possible; the entity acting as the guarantor on behalf of the Government will be appointed by the Prime Minister.

PROJECT DEVELOPMENT PROCESS

5. Development Steps

The PPP Decree sets out a set of steps that will have to be followed to develop a project:

- Projects can be (i) proposed by the Authorised State Authorities (**ASA**), or (ii) proposed by investors. Investors that propose projects or subsequently prepare the feasibility study of a project can be entitled to “incentives” during the tender process. These “incentives” could be a 5% preference in the tender process (whether bid on price, State capital funding, socio-economic benefits or combination of the above);
- Feasibility study to determine investment (including State contribution) and contract structure;
- Approval of State support;
- Approved PPP projects will be published in the tendering system;
- Bids by and selection of investor in compliance with the current tender law dated 26 November 2013 (the **Tender Law**) and Decree 30/2015/ND-CP of the Government dated 17 March 2015 on the bidding requirements for selection of investors for PPP projects;
- Signing of project contracts.

Vietnam has so far not shown great abilities in developing projects for foreign investors to bid on (Nghị Sơn 2 power project being an example of a testing case). The concern is that the PPP Decree is overly prescriptive and therefore it will be difficult to implement in practice. However, it may also be read as a reflection of current practice, and to the extent that such practice is well-accepted the steps in the PPP Decree may be viewed as pragmatic even if not ideal.

6. Project Contracts

The PPP Decree sets out the principal subjects to be covered in the project contract, including lender’s step-in rights, assignment rights and the right to amend the project contract (normally all subject to the approval of the ASA). There is no detail and all risk allocations remain to be determined. However, the VBF Infrastructure Group understands that significant support activities are being conducted by the Government’s development partners to develop standardised bidding documents, project contracts and sector-specific risk allocation models that may be drawn upon in tendering PPP projects. The VBF Infrastructure Group would welcome the opportunity to discuss these documents before they are promulgated.

7. Investment Certificate Process

The final step after concluding all the project discussions with the ASA is to obtain investment/business registration certificates. Under the PPP Decree, the parties will execute an “investment agreement”, instead of initialling the project contracts themselves.

8. Authority

The authority that is in charge of developing each kind of project depends on the sector involved. The final approval authority will rest as follows:

- (a)** The Ministry of Planning and Investment (**MPI**) will issue the investment/business registration certificates for:
 - (i) projects of national importance;
 - (ii) projects to which a Ministry is party to the project contract and
 - (iii) project to be implemented in two provinces or more.
- (b)** The provincial People’s Committee will issue the investment certificate for other projects (except very small ones).

9. Comment on Tenders

Tendering has not had a great track record for foreign infrastructure projects. Many investors will not prepare proposals that are then put out to tender (even if they do obtain a preference in the bidding). Furthermore, many issues have been pushed into the Tender Law. For example, the PPP Decree provides that the ASA and the investors may agree on the performance security in accordance with the Tender Law. Under this law, the performance security with respect to BOT contracts and “other contracts in accordance with investment law” will be between 1% - 3%. This is not only vague but means the security for a PPP project could be 3% - higher than under the BOT regime.

FINANCING ISSUES

The PPP Decree raises some concerns for project lenders. All of these issues have been debated at length during the process of developing the drafts of the PPP Decree, so the VBF Infrastructure Group assumes that no changes are likely in the implementing regulations. However, the VBF Infrastructure Group would suggest that greater communication about the government’s position would be useful

(a) Land

In addition to the exemption available to investors on land rent/land use fees in BOT projects, the PPP Decree contemplates a reduction in such rent or fees. The intention is to overcome the problem that arose in the context of a mortgage of land use rights, which is only possible if all land rent has been paid (the Government’s position in past deals has been that no mortgage is therefore possible because no rent is payable). However, even if this is the case, it does not solve the mortgage problem, because the land law does not allow foreign lenders to take mortgages over land use rights.

Clarity requested: There is a workaround to this problem, which has been used in practice in BOT projects, which is to use an onshore security agent. However, this is uncertain and the State Bank frowns on it. The VBF Infrastructure Group requests clarity on whether a foreign lender can take a security interest over land and buildings if an onshore security agent is appointed.

(b) Exchange rate guarantee

It is unclear to what extent under the PPP Decree the Government will guarantee the convertibility and remittability of foreign currency demands. If not, some PPP projects may not be bankable. Current practice in BOT projects is to provide guarantees of exchange rates, although sponsors are now often left with a small level of residual risk.

Clarity requested: to what extent does the Government contemplate providing guarantees of exchange rates for projects with VND revenues in different infrastructure fields, and what discussions are in progress with its development partners to provide foreign exchange comfort for project sponsors and lenders?

(c) Governing law

Foreign law may be used as the governing law for (i) project contracts where one party is a foreign investor; and (ii) contracts guaranteed by the competent authority, but only if the foreign law is not contrary to Vietnamese conflict of law rules. If a contract is between two Vietnamese entities, such as a power purchase agreement, it will need to be guaranteed in order to be subject to foreign governing law.

Clarity requested: As a foreign governing law is a requirement of international lenders at the current point in time in respect of non-recourse Vietnamese infrastructure projects, will the Government provide a guarantee for offtake/revenue contracts for PPP projects (i.e. contracts between the project company and the buyer of the infrastructure services that have been built)?

EFFECT ON EXISTING PROJECTS

A few projects have been implemented as BOTs (Phu My 2-2, Phu My 3 and Mong Duong 2 in particular). Numerous projects are being negotiated as BOTs under the existing BOT regulations, particularly in the power sector. The transition clause of the PPP Decree states that:

- Projects that were signed or licensed prior to 10 April 2015 will remain governed by their project documents and investment certificates.
- Project documents that have been initialled prior to the effective date of the PPP Decree are not subject to re-negotiation.
 - If a project contract has not yet been initialled the document should re-negotiated to be compliant with this PPP decree. This may result in another delay for developers.
- Projects that have been allocated to an investor prior to the effective date of the PPP Decree will remain so allocated.
- Feasibility study reports which have been approved prior to the effective date of the PPP Decree do not have to be re-approved.
 - It is unclear what will happen with feasibility studies that have been submitted but not yet been approved before 10 April 2014.

If any other transition issue arises it will be decided by the Prime Minister upon the proposal of the MPI.

As the existing BOT regime has been abolished, there is a lot of pressure on this untested PPP regime.

WORK REMAINING

The competitiveness of the Vietnamese economy depends on the PPP Decree working well. The PPP Decree manages to be prescriptive and vague at the same time and needs clarity on the specific issues, such as how specific risks are allocated and, at the end of the day, standard forms for each infrastructure sector. To avoid different interpretation from ministry to ministry, new implementing circulars will be needed. This is ultimately one aspect of the need for more institutional capacity. But it is also a function of the administrative system in Vietnam.

There should also be a pipeline of attractive and feasible PPP projects for the infrastructure that Vietnam visibly needs and that also attract investors. The MPI has to date had difficulty obtaining workable project proposals from ASAs. Many proposals have apparently been submitted that are small or otherwise not attractive (e.g. of a size that would not interest project financiers or where the role of the private sector is aspirational rather than real or the revenue stream is conjectural).

The scope of available guarantees and further visibility into viability gap funding principles are among the main gaps that ideally would be filled before starting bidding out a comprehensive PPP program. These gaps can be filled on a project by project basis, but the expense of preparing project proposals without having guidelines on what support is available will make such preparation unattractive. And even if the approach is successful in one case, the results are likely to provide little systemic encouragement outside a particular sector.

While the PPP Decree is a step in the right direction, there is more to be done. It will be important for the infrastructure of Vietnam, and hence of the economy and international integration in general, that the next steps are done well.