INVESTMENT IN INFRASTRUCTURE – THREE CRITICAL ISSUES IN IMPLEMENTATION

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I. BACKGROUND

According to the Ministry of Planning and Investment, about US$68 billion of foreign investment is needed in the infrastructure sector in the next five years.

The Vietnamese government knows that such sums do not flow just because they are needed. So it has improved the legal framework surrounding infrastructure development. Notable in this context are the laws around the privatization of the aviation and power and energy sectors and regulations on investment in public-private partnerships (***PPP***).

This paper looks at some of the main difficulties that have emerged in the implementation of these legal changes.

II. PRICE

The Government of Vietnam has issued a decision[1] indicating that it wishes to reduce its stakes in various companies involved in the infrastructure of Vietnam.

Accordingly, in 2016-2020, the State plans to reduce its stakes in SOEs as follows:
Companies involved in airport operation, and mining and crude oil exploration (state ownership above 65%). These SOEs include PetroVietnam Exploration Production Corp and Vinacomin.

- Companies involved in chemicals, airlines, SOEs with 30% market share or higher in petroleum product trading, telecoms (with infrastructure), and electricity retail (state ownership of 50% - 65%). These SOEs include: Mobifone, VNPT, Vinachem and EVN retailers.

- Companies involved in water supply and drainage, manufacturing, real estate, agriculture, forestry, electricity production, telecommunications, and construction (state ownership can fall below 50%, or full divestment is possible). These SOEs include Song Da Corporation, Vinapaper, VTC, VTVCab, PV Oil, Binh Son Refinery, PV Power, and Genco 1, 2, 3.

In addition, the Ministry of Transport has recently equitised major State-owned companies in the aviation sector, including Vietnam Airlines and ACV. But there is a major problem in the process which will prevent long-term foreign investment from coming into Vietnam on the backs of these equitisations. This is price. Normally, this would not be an implementation issue, but where the seller is the State it is.

The government is quite naturally taking the position that the price has to be the market price. The question is whether the listed price or Upcom price is really a market price for a long-term investor buying a large stake rather than a few shares. Where a small number shares of the

[1] Decision 58/2016/QD-TTg of the Prime Minister dated 28 December 2016 on classification of State-owned enterprises and list of State-owned enterprises to be restructured in 2016-2020.

equitised company have been registered for trading on the stock market, the assertion that market price is the Upcom market price is not only inconsistent with the relevant law, but also is unreasonable commercially and will preclude investment from industry. The main buyers will be financial institutions and speculators who cannot add the same value or provide the same long-term benefits. These implementation challenges have undermined the equitisation process, resulting in prolonged negotiations with unsatisfying outcome for the government.

- ***Requirement of equitisation laws***: According to the regulations on equitisation, particularly Decree 59/2011/ND-CP on equitisation of SOEs as amended by Decree 189/2011/ND-CP and Decree 116/2015/ND-CP (***Decree 59***) and its implementing regulations, in case of a sale of shares to a strategic equity investor (***SEP***) after the initial public offering (***IPO***), the price of the shares can be negotiated between the equitisation steering committee and the SEP provided that the price is not lower than the lowest successful price in the IPO. Accordingly, under the equitisation regulations, the lowest successful price in the IPO is the only restriction applicable to the price for the sale of shares to a SEP.

- ***Trading band does not apply to equitisation***: Another argument that is heard for using the Upcom price is that under Article 38.4(a) of Decree 91/2015/ND-CP dated 13 October 2015 of the Government on investment and management of state capital in enterprises (***Decree 91***), the negotiated price for the transfer of shares of joint stock companies whose shares have been listed on UpCom must be within the permitted trading band applicable to that company on the date of transfer.

However, this is not the case. The Law on Management of State Capital in Enterprises No. 69/2014/QH13 dated 26 November 2014 (***Law on Management of State Capital in Enterprises***) suggests that this provision of Decree 91 does not apply in the context of an equitisation. This Law on Management of State Capital in Enterprises envisages three forms of restructuring of state capital in a State-owned enterprise (***SOE***):

(i) "transformation of the ownership" of the SOE and reorganisation of the SOE;

(ii) "transfer of the right to represent the State owner of the capital" in the SOE; and

(iii) "transfer of the state capital" invested in joint stock companies.

Article 38.4(a) of Decree 91 applies to a transfer ((iii) above). By contrast, an equitisation falls within (i) above (the "transformation of the ownership of an SOE" can be conducted by "*(i) equitisation; (ii) sale of the entire company; or iii) sale of part of the State capital invested in the SOE to transform the SOE into a multi-member limited liability company*").[2]

- ***Unreasonableness from a commercial standpoint:*** The number of shares of the SOEs registered for trading on the stock market is often a tiny percentage of the total share capital of the company. Trading is not liquid and the price is correspondingly influenceable by trading rather than value factors. The listed price, therefore, should not represent the market value of a large number of shares in a liquid market. In addition, the nature of the investment by a SEP is distinct from that of the investment by financial investors on the stock market.

[2] This distinction between equitisation (including sales of shares held by the State to a SEP in an equitisation) and the normal transfer of State capital invested in joint stock companies is confirmed in Article 4.6 of Decision 41/2015/QD-TTg dated 15 September 2015 of the Prime Minister on selling shares held by the State in blocks (***Decision 41***): "*the sale of shares to a strategic shareholder under an approved equitisation plan within 12 months from the date the company is converted into a joint stock company shall comply with the approved equitisation plan or decision of the competent authority that approved the equitisation plan.*"

At law and commercially, the former requires a minimum 5 year lock-up period and more commitments from the SEP to support the company in operations and doing business, e.g. providing personnel, know-how and technical assistance, etc.

Recommendation

- The VBF Infrastructure Group believes that the equitisation process can only be fruitful if the share price is to be negotiated based on market value of the SOEs.

- The price for the sale of shares of SOEs to SEPs in the context of equitisation should not be based on the trading price on the stock market. Instead, the price should be determined based on the valuation of the company, taking into account all the rights and assets of the company, its future development and other market factors.

- In case of any doubt, the State Securities Committee should be requested to provide an exemption of the stock exchange restrictions by allowing the transfer of the shares off the market as has occurred on frequent occasions in Vietnam.

- Under Decree 59, SOEs are allowed to carry out a private sale to a strategic investor or a limited competitive bidding among candidate strategic investors as part of the IPO process, provided that the sale price must not be lower than the floor price approved by the competent authorities. However, this procedure has never been employed and approved in practice. These provisions of Decree 59 should be clarified to facilitate successful private sales of SOEs' shares, especially where a competitive bidding is not suitable due to the specific nature of the SOEs.

III. PPP

After two years of implementing Decree 15/2015/ND-CP on PPPs (***Decree 15***) with no significant project being successfully tendered, the government is again discussing PPP amendments. In addition to various legal hurdles that have been raised by investors and lenders in previous sessions of Vietnam Business Forum, there are some critical issues in implementation.

- ***Public investment mindset of the authorised state agencies*** (***ASAs***): The management of the State's investment and support in PPP projects is subject to public investment laws and regulations. The ASAs continue to view PPPs from this angle, resulting in bureaucratic procedures and reluctance in taking unprecedented actions in this relatively new investment scheme.

- ***Limited resources and motivation for incentivising ASAs to develop project***: The ASAs assume significant burden in project preparation, particularly the preparation of feasibility study report to the international standards for tendering projects. Meanwhile, the resources allocated to ASAs for PPPs continue to be limited. On 19 April 2017, the Ministry of Planning and Investment (***MPI***) issued the long-awaited Decision 522/QD-BKHDT on the management and use of the project development fund (***PDF***) sponsored by the Asia Development Bank and Agence Française de Développement (***AFD***). According to Decision 522, the ASAs may submit an application to the MPI for using the PDF for preparation of PPP projects. Unsolicited projects are not eligible to the PDF. Before signing the project contract, the selected investor will be required to reimburse to the ASA the amount of the PDF used for the project plus a PDF fee equal to 7% of the amount of the funds used by the project. It is expected that Decision 522 will provide supports to ASAs in project preparation.

- ***General attractiveness of the PPP scheme to investors***: Events during the past two years have demonstrated that infrastructure projects can still be implemented under the Investment Law without recourse to PPP, using such incentives as exist under that law. However, the purpose of the regime is to create highly-efficient projects that can attract non-recourse debt funding from banks and thereby take the financing burden off the State. This goal is not achieved if infrastructure investments are done by local companies using corporate debt financed by State-owned commercial banks. The lack of strong and attractive PPP investment incentives to motivate non-State commercial banks (local and foreign) to lend also casts doubt on the practicality of the program to develop and fund infrastructure projects.

- ***Support to financial viability of projects***: The scope of available sovereign guarantees and further visibility into viability gap funding principles are among the main gaps that need to 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 industry sector.

- ***Financing***: Bankability is a major hurdle to the successful implementation of the PPP scheme. Although some modest progress is being made in such areas as government support to cover currency availability and convertibility risks (though a partial coverage of foreign currency conversion is not sufficient for a large-scale infrastructure project to be financed from international lenders' perspective), a substantial amount of work still needs to be done to make PPP projects financeable. Key outstanding implementation issues include the statutory restriction on mortgaging land use rights to foreign lenders; complex regulatory approvals and processes for land acquisition and compensation; uncertainty in applicability of foreign laws in contracts where all parties are Vietnamese nationals; and the payment ability and creditworthiness of an SOE offtaker.

- ***Risk allocation between the Government and the private sector***: As value for money is one of key drivers of PPP procurement, the guiding principle is that risks should be allocated to the party best able to manage them. It is important to investors that Vietnam releases a robust and consistent risk allocation framework applying across industries which provides greater certainty on certain key risks that should be retained by the Government so that infrastructure PPP projects can be successfully delivered with minimum transaction costs incurred by investors.

  In the absence of clear risk allocation guidelines, commercial negotiations over contractual terms of project documents will inevitably be time-consuming and complicated to all parties.

<u>Recommendation</u>

- The legal framework for the PPP scheme has been in place for 10 years since the build-operate-transfer scheme set out in Decree 78/2007/ND-CP dated 11 May 2007. Despite tireless efforts from the government to improve the legal framework to promote this investment model and attract foreign investment, the results remain limited. The VBF Infrastructure Group believes that implementation is critical to translate the laws into projects.
- We suggest that the government should focus resources to deliver a few bankable flagship projects to prove the feasibility of this scheme. Only when there are certain records of success can the ASAs and investors be motivated to follow the PPP path. Carrying out some

bankable flagship projects will also provide the ASAs and the investors with practical experience and lessons learned from the hands-on implementation.

- Different sectors will require different viability gap funding regimes. The government should issue guidance on government support and viability gap funding regime in each infrastructure sector. This will allow the ASAs and the investors to align on the agenda, objectives and timing for the development and financing of projects.

- The government should clearly define its interests (which the ASAs are protecting) as including the successful implementation of PPP, which should require the ASAs to consider commercial aspects of projects. This would include a formulation of quality feasibility study reports to international standards that can put to tenders, transparency in selection of investors, and clear and transparent risk sharing mechanisms with the private counterparty. Without a fundamental change in the implementing agencies' view of PPP projects, they are unable to take the risks posed by such projects.

IV. POWER PROJECTS – NEW IMPLEMENTATION SCHEDULE

All private sector power projects have taken more than 5 years to negotiate. Some power projects that are still being negotiated (with numerous Vietnam project counterparties) have been on the table for close to 10 years now.

In the face of this, the Ministry of Industry and Trade (***MOIT***) issued Circular 43/2016/TT-BCT (***Circular 43***) dated 30 December 2016 on project development is a step in the wrong direction. Circular 43 applies to, amongst others, PPP power projects with the installed capacity of 30MW or more.

According to Circular 43, within 90 days from the date the Prime Minister decides to grant the right to develop a PPP project to the investor, the investor must sign a memorandum of understanding (***MOU***) to prepare for the development of the project. The MOU must set out, amongst others, the schedule for the implementation of the project. Any time the investor fails to meet the schedule set out in the MOU, it will have to apply to the MOIT for adjustments. The adjustments will only be granted if, in the view of the MOIT, the delay was due to (i) a force majeure event; (ii) the conduct of the ASAs; or (iii) the conduct of a third party. The MOIT can request the competent authorities to decide to terminate the right to develop the project of the investor if within one year from the date the MOIT notifies the investor of the failure to meet a milestone set out in the MOU, the investor has not satisfied that milestone and the overall schedule of the project is, therefore, delayed for an aggregate of 12 months compared to the milestone set out in the MOU.

These regulatory attempts of the MOIT to tighten the implementation of power projects are too arbitrary. Many of the prolonged project delays happen at the MOIT. Yet the MOIT is the one that will determine if it is the cause of the delay. There are numerous reasons to be concerned about whether it will reach a fair determination. This will deter many quality international investors from even starting to develop a project (while perhaps encouraging some companies with less need to hold to high standards).

If a project moves into development, the requirement to constantly document who is responsible for project delays may cause unnecessary administrative burden and disputes. It has been well-proven that in large-scale BOT power projects, the intended schedules agreed between the MOIT and the investors were rarely achievable in practice due to the complexity of the project preparation process with the involvement of various related government authorities and

stakeholders. The requirement for the investor applying for an adjustment every time there is a delay would result in significant administrative burdens on both the investor and the MOIT (for reviewing and making decision on the adjustment).

Recommendation

- Circular 43 should be reviewed and amended to avoid causing unnecessary administrative burdens on PPP power projects. The MOIT, as a counterparty to the project contract, always has the right to challenge the implementation schedule of a project even without Circular 43. We believe that instead of requiring the investor to apply for the adjustment of the project schedules, the MOIT may use this right to ask the project investor to explain the reason for the delay any time the MOIT believes that the delay is intentionally caused by the investors.

- The grounds and conditions for termination of the development rights of the investor should also be clarified. The investor should be given the statutory right to be heard and to discuss with the MOIT before any such decision is made unfavourably to the investor.