

POSITION PAPER OF INFRASTRUCTURE WORKING GROUP

A NEW PPP LAW – THE TOP 10 NEW HOPES

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Numbers – a fundamental biblical exegesis

According to the draft report of Ministry of Planning and Investment on implementation of the PPP program, in the last 20 years around 200 projects have been licensed under the public-private partnership (**PPP**) scheme:

- 158 BOT and BT projects in the transport sector;
- 9 BOT projects in power sector;
- 5 waste water treatment projects.

We are not sure how many of these licensed projects are in operation. In the BOT power sector, we believe it is 4.

There have been hardly any projects complying with the PPP scheme under Decree 15 and Decree 63 (the **PPP Regulations**).

- Our best information suggests that there have been no PPP projects involving foreign banks that comply with the PPP Regulations¹ (**Genuine PPP Projects**).
- We do not have the statistics to be able to evaluate whether there have been any Genuine PPP Projects which have been completed by private sponsors which have been project financed by private Vietnamese banks. If there have been any, we would welcome receipt of the details.

Purpose of PPP – the meaning of life

The purpose of the PPP Regulations is for the State to shift infrastructure expense from the State, which is running up against a debt ceiling, to the private sector.

But infrastructure projects tend to be expensive. Most companies cannot do many projects using just their own balance sheet. So they need to borrow. But this involves several factors:

- Borrowing from a State-owned bank is sub-optimal given the purpose of the PPP Regulations mentioned above.
- Financing should ideally be on a non-recourse basis, so that experienced sponsors do not have to use their own balance sheets and can go back for more financing for future projects. This will enable rapid roll-out of projects and scale.
- Ideally projects would find private sector bank financing.

Background to the new PPP Law – old hat

¹ We use this terminology as there is a lot of public confusion involving so-called PPPs which are indeed public-private partnerships but not under the PPP Regulations. These include the “Japanese PPPs” that involved Japanese ODA combined with private merchant projects such as the Lach Huyen port project, as well as, even more loosely, projects done under standard Investment Law principles and benefiting from support from Governmental entities or State-owned companies.

The regulations underpinning BOT and PPP projects in Vietnam have a venerable history. Some have unkindly suggested that there have been more words than projects.

- The PPP program of Vietnam started in 1997 with Decree 77 on domestic build-operate-transfer (**BOT**) projects.
- Decree 62 on foreign-invested BOT projects was issued in 1998.
- Landmark foreign-invested BOT power projects followed: BP/Sembcorp/Kyushu's Phu My 3 and EDF/Sumitomo's Phu My 2-2.
- Decree 78 on BOT projects was issued 10 years later combining the two regimes into one BOT scheme applicable to both domestic and foreign sponsors.
- Two years later, the Government promulgated Decree 108. This replaced Decree 78. This was the last and most comprehensive Decree on BOT before the PPP program was launched two years thereafter.
- The famous 1,200MW Mong Duong 2 BOT power project of AES marked the most significant success of Decree 108.
- In December 2010, the Prime Minister of Vietnam signed Decision 71 launching the pilot PPP program in Vietnam.
- For 5 years, between 2011 and 2015, PPPs under Decision 71 and BOTs under Decree 108 co-existed, consubstantial but not co-eternal, to the confusion of many.
- Decree 15 effective on 10 April 2015 replaced both Decision 71 and Decree 108. BOTs became a form of PPP. Other new, unprecedented forms of PPP concession contracts were permitted. It was an upgraded and permanent version of the Decision 71 pilot PPP program and was designed to facilitate private and foreign investment in Vietnam's challenging infrastructure development world.
- The Ministry of Industry and Trade (**MOIT**) issued Circular 23 on procedures for developing BOT thermal power projects (**Circular 23**) on 13 July 2015. Under Circular 23, direct appointment of investors was permitted both for BOT projects that were in the Power Master Plan and for ones not covered in the Master Plan but approved by the Prime Minister. With Circular 23, PPP power projects could continue to follow the tried and tested BOT regime, which was useful as the former BOT regime had been solidly developed in the power sector, and a certain predictability on risk allocations had developed.
- On 31 December 2015, the Ministry of Transport (**MOT**) issued Circular 86 on the formulation of feasibility study reports of PPP projects in the transport sector.
- In 2016, the Ministry of Planning and Investment (**MPI**) issued two Circulars implementing Decree 15:
 - Circular 02, effective on 18 April 2016, set out criteria and procedures for project screening and formulation of feasibility study reports.
 - Circular 06, effective on 20 September 2016, provided guidance on licensing procedures for PPP projects. Circular 06 also contained a generic model PPP contract setting out the key provisions that would need to be included in a project contract.
- On 23 March 2016, the Ministry of Finance (**MOF**) issued Circular 55 on financial management of PPP projects. Circular 55 regulated the costs and spending of authorised state agencies (**ASAs**) in preparing and developing PPP projects.
- Earlier in 2018, the Prime Minister signed Decree 63. This became effective in June 2018 and replaced the former Decree 15. It is the third effort of the Government in less than 10 years to provide a workable basis for PPPs in Vietnam.

The new PPP Law – hope springs eternal

The Government is now working on a plan to develop a new PPP Law. The hope is that the new PPP Law will lead to privately-financeable projects rather than more words. The additional hope

is that it retains the positive momentum of the past and at the same time solves the problems of the past.

Momentum – mass for good

1. *Established BOT mechanism in power sector:*

The power sector has been the most successful sector at attracting foreign investment in BOT projects, with various multi-billion dollar projects under construction, at pre-financial closing stage or in operation. The fine work of the MOIT and the Government over the years has established a moving, but reasonably accepted risk allocation mechanism and practice for power projects, providing reasonable clarity to international sponsors and financiers.

2. *Steps forwards:*

The Government has step-by-step pulled together a legal framework to facilitate PPP developments. This did not exist 10 years ago. It has also made welcome progress in providing guidance to the State agencies on how to participate in this new investment modality.

- The MPI has set up a website dedicated to the PPP program. The website provides updates about the legal framework for PPP and potential PPP projects in different sectors and provinces.
- The MPI has worked with the ASAs to compile lists of potential PPP projects.
- On 19 April 2017, the Ministry of Planning and Investment (*MPI*) issued 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*). This enables ASAs, which assume significant burdens in project preparation, particularly the preparation of feasibility study report to the international standards for tendering projects, to obtain some financial support to meet such burdens.

3. *Changing perspectives:*

The PPP program and the government's efforts to educate related authorities and stakeholders about PPP have started to gradually shift the view of the many State authorities, whose historical role was to spend State budget funds in the manner permitted by the Public Investment Law and other relevant public expenditure laws. Now there is a greater understanding that the State's role should be that of a business partner with some understanding of the commercial requirements for a successful project.

Current problems – a new hope for solutions

1. *PPP Regulations are prescriptive not outcome-oriented*

Prescriptive: the parties have to follow the method or rules laid down, even if they are sub-optimal.

Outcome-oriented: the result is more important than the method by which the result is reached.

Example:

In order to develop a PPP project that an ASA can put out for tender, that ASA has to formulate and approve the following as part of the feasibility study (*FS*):

- the environment impact assessment report under the Environment Protection Law;
- the basic design of the project under the Construction Law;

- the technology used by the project under the Law on Technology Transfer.

Unfortunately, at the FS stage of a PPP project, there is no clarity on the detailed elements of the project, which will vary depending on the results of the later bidding process. ASAs have encountered difficulties in addressing these requirements, resulting in significant delays to project preparations.

Hope for new PPP Law: The new PPP Law could take a different approach. The new PPP Law could view PPP projects from a commercial and market standpoint instead of traditional public or private investment project standpoint. It could require ASAs to set out the outcomes desired and the support that will be provided by the State. The bidders would have the flexibility to structure projects in a manner that best achieves the outcome desired and that complies with applicable laws.

2. *Inconsistent laws*

All projects in Vietnam have to comply with applicable laws. One of the problems for PPPs is that requirements primarily intended to regulate a non-PPP project have crept into the PPP Regulations. This is because of two things – the PPP Regulations refer to such other laws; and a Law in any sector has a higher legal rank than the Decrees that govern the PPP Regulations.

Hope for new PPP Law: As a Law is superior to a Decree, the new PPP Law should supersede provisions in other Laws which are not consistent with the requirements of a PPP project. By way of example, if the new PPP Law were to allow PPP land to be mortgaged to Vietnamese agents of foreign banks, that would prevail over the provisions of the Land Law that are currently interpreted to preclude this.

3. *Provide clarity on PPP*

One of the reasons the term PPP is used to apply to projects that are not done under the PPP Regulations is that the Government provides various incentives to projects done under the Investment Law. Tax and land incentives abound under the Investment Law. Furthermore, bigger projects, such as the Nghi Son Refinery Project, can obtain Government Guarantees and Undertakings Agreement relating to performance of obligations of offtakers, foreign currency availability and so on.

Hope for new PPP Law: The new PPP Law should clarify the dividing line between the PPP Law and the Investment Law. It is of course important that infrastructure projects 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 PPP is not seen as the exclusive means of developing infrastructure. 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.

4. *Viability gap funding*

One of the underlying sources of difficulty for the PPP sector has been the difficulty of determining what viability gap funding is available for a PPP project. The expense of preparing PPP project proposals without having guidelines on what support is available tends to make such preparation unattractive.

Hope for new PPP Law: The scope of available guarantees and further visibility into viability gap funding principles are among the main gaps that could be filled in the new PPP Law.

5. *Investment registration certificate*

According to Decree 63, after the official decision to appoint the sponsors (including foreign entities) of a project, the sponsors can incorporate the project company to implement the project. There is no requirement for the sponsors to apply for an investment registration certificate (*IRC*). The purpose was to help sponsors avoid “double licensing”. But without the IRC, sponsors and project companies may encounter difficulties in obtaining other key licenses for their projects and in other daily operations of the project. Various other laws including the Law on Enterprises and Law on Land, which are of higher effect than Decree 63, require foreign investors to submit the IRC to obtain the enterprise registration certificate and land use right certificate. Also, project companies (especially foreign-invested ones) need to show evidence to banks or third parties for various purposes, such as to transfer funds across borders. It is not commercially practical for the project companies to present to these third parties the entire concession contract to demonstrate its rights in the projects.

Hope for new PPP Law: The VBF Infrastructure Working Group would suggest that the new PPP Law should provide that the sponsors be automatically issued with an IRC after finalising and initialing the concession agreement. The IRC is a necessary document recording the rights of the sponsors in the Project.

6. *Restriction on transfer*

Decree 63 provides that sponsors of a project can transfer part or all of their rights and obligations under the executed project contracts to the financing parties or other sponsors only after the completion of construction or (if the project has no construction element) the commercial operation date. Decree 63 does not provide any exception to this restriction.

There are concerns about this provision. As a transfer would anyway be subject to the consent of the ASAs, which can review and approve the new sponsors, a hard restriction on transfer appears to be unnecessary. A restriction on transfer to financing parties prior to the completion of construction or the commercial operation date, as the case may be, is unlikely to be acceptable to lenders. The result may be to curtail construction financing.

Hope for new PPP Law: The VBF Infrastructure Working Group would suggest that the new PPP Law should permit a transfer to financing parties prior to the completion of construction if the consent of the ASA is obtained.

7. *Publication of contracts*

Decree 63 requires that the ASAs must publish the key contents of executed concession contracts on the national procurement portal. These contents include, amongst other things, basic information about the location, technology, investment capital, sponsors’ equity and State participation in the project. In particular, the information required for publication also contains the prices and fees of the relevant project. While the VBF Infrastructure Working Group always promotes transparency, prices and fees tend to be sensitive issues for companies. There may also be concerns from a competition law standpoint when competing sponsors have access to each other’s price information.

Hope for new PPP Law: The VBF Infrastructure Working Group would suggest that while the basic parameters of projects should be published, publication of specific prices should be removed. Instead, the ASAs should only publish pricing formula or cost elements being factored into the pricing to provide the market with precedents on how prices are generally established.

8. *Financing issues – old chestnuts*

A number of financing issues remain unresolved both in the legal framework and in the actual implementation of projects causing concerns for potential project lenders. Examples of these issues include restrictions on the mortgage of land use rights to foreign lenders, narrowing government guarantees on foreign exchange risks and offtaker risks, and taxes on interest on foreign loans. All of these issues have been debated at length during the process of developing the drafts of the PPP Decree and previous VBF dialogues.

Hope for new PPP Law: The VBF Infrastructure Group would suggest that the new PPP Law establish the Government's position on these fundamental issues, as well as whether exemptions from particular policies can be obtained and how.

9. *Financing issues – castles in the air*

Apart from traditional project financing, sponsors of infrastructure projects in Vietnam have few options to raise capital. The regulations on project bonds or trading equity are either not accommodating to the nature of an infrastructure project company (e.g. the law requires that the bond issuer must be profitable for at least a year in order to be eligible to issue bonds), or not available at all (e.g. strict requirements on transfer of project equity preventing project companies from raising funds on the capital markets).

Hope for new PPP Law: The VBF Infrastructure Working Group would suggest that the new PPP Law provide financing flexibility by exempting PPP projects from the bond issuance principles under certain circumstances and subject to adequate investor safeguards (particularly the requirement that bond purchasers be limited to qualified institutions).

10. *Sector-specific issues*

- *Financially unviable service price for PPP waste treatment projects:*

Waste treatment is a prioritised sector for PPP. It was expected to set an example for the implementation of the PPP program - projects in this sector are of a manageable size, and there is an urgent need for urban waste treatment in major provinces in Vietnam. However, the sector as a whole has run up against Circular 07/2017/TT-BXD (**Circular 07**) on waste treatment service fees. Circular 07 does not set out a pricing mechanism that is workable for PPP projects. Circular 07 limits the profit of the project to 5% of the project costs, affecting the financial viability of the projects.

Hope for new PPP Law: The new PPP Law should have an override clause that allows flexibility to the parties to negotiate the most commercial and efficient service fees for a given project, regardless of regulations relating to fees applicable to non-PPP projects.

- *Financial support to PPP projects in transport and other challenging sectors:*

To date there is still no clarity on the mechanism for the State to provide financial viability gap fillers to PPP projects in high risk sectors where there is often no offtake agreement to guarantee the revenue stream of the project, such as transport. Without a guaranteed revenue stream,

investors and lenders will have no means to assess and manage risks of these projects and will be deterred from participating in PPP projects in these challenging sectors.

Hope for new PPP Law: The new PPP Law should authorize mechanisms – with details to be elaborated - whose purpose is to provide certainty to investors and lenders in these projects. Of course, this will have to be combined with preservation of the State’s interest through penalties if the project delivers quality at less than the agreed parameters.

- *Generally:*

To date, apart from the power sector, there is no specific guidance on PPP risk allocation in any infrastructure sector.

Hope for new PPP Law: The new PPP Law should focus on building up dedicated governmental bodies in charge of each infrastructure sector, with best practices being spread through a coordinating body at, say, the MPI.

Final remarks – the end of the beginning

There is no doubt that a good PPP program must first start from a strong legal framework. But the new PPP Law will take time to get right. In the meantime it is important that the ongoing momentum is not lost.

Private investment in the power sector has been successful because a model has been developed over time, including detailed risk-allocation mechanisms. There are departments at the MOIT and Electricity of Vietnam who are deeply experienced and can apply the details to future projects. But, because of the prescriptive nature of the PPP Regulations, it has proved more difficult to achieve this in other sectors.

The VBF Infrastructure Working Group would suggest that the Government take robust actions, including creating ad-hoc or special mechanisms - as was attempted with the Phan Thiet – Dau Giay expressway some years ago - to pilot a successful PPP project in each needed sector, such as waste treatment, roads and railways. These would provide helpful precedents that would both inform the crafting of the new PPP Law and also, possibly, enable a roll-out of projects in that sector.