

INFRASTRUCTURE DEVELOPMENT IN A DARK GREEN WORLD

*Prepared by
Tony Foster, Nguyen Ngoc and Tran Tuan Phong
Infrastructure Working Group*

BACKGROUND

On 14 February 2015, the Vietnamese Government issued Decree 15 regulating investment in public-private partnerships (the **PPP Decree**). The PPP Decree took effect on 10 April 2015. It replaced Decision 71 on the pilot PPP programme and Decree 108 on the BOT scheme. It was expected to resolve the problems of the two former regimes and facilitate private and foreign investment in infrastructure development.

The PPP Decree and a number of its progressive provisions indicate that the Vietnamese Government is committed to efficiency. As anyone who sits in a traffic jam knows, efficiency and the avoidance of waste is one of the keys to a sustainable future.

Implementation of the PPP Decree over the last 18 months has shown that a lot of work still needs to be done to achieve the goals.

STEPS FORWARD UNDER NEW PPP DECREE

- **Contract forms:** The PPP Decree covers both availability-payment type contracts and user-fee type contracts. It expands the BOT Decree by covering also Build-Own-Operate; Build-Transfer-Lease; Build-Lease-Transfer; and 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.
- **Sectors:** The list of sectors available for PPP investment enumerated under the PPP Decree is broader than that contained in Decision 71 and the BOT Decree.
- **State support or participation:** State support or participation can take various forms, including support for capital expenditures 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).
- **Project development steps:** The PPP Decree sets out a clear process for project development.
- **Tender requirement:** The PPP Decree emphasises the requirement for public bidding for investor selection.

IMPLEMENTING REGULATIONS

Following the promulgation of the PPP Decree, the relevant Ministries have issued a number of Circulars providing guidance on PPP projects in their respective sectors.

1. Project development procedures

In 2016, the Ministry of Planning and Investment (**MPI**) issued two Circulars implementing the PPP Decree:

- Circular 02, effective on 18 April 2016, sets out criteria and procedures for project screening and formulation of feasibility study reports.
- Circular 06, effective on 20 September 2016, provides guidance on licensing procedures for PPP projects. Circular 06 also contains a generic model PPP contract setting out the key provisions that would need to be included in a project contract.

The PPP model is relatively new to many authorised state agencies (*ASAs*), especially municipal authorities. These two Circulars of the MPI are important guidelines for the ASAs in developing projects. They are also helpful in promoting transparency in project selection and preparation.

2. Financial management

On 23 March 2016, the Ministry of Finance (*MOF*) issued Circular 55 on financial management of PPP projects. Circular 55 was effective on 5 May 2016. Circular 55 mainly regulates the costs and spending of the ASAs in preparing and developing PPP projects.

3. Power and energy sector

- The Ministry of Industry and Trade (*MOIT*) issued Circular 23 on procedures for developing BOT thermal power projects (*Circular 23*) on 13 July 2015. Circular 23 was effective on 1 September 2015. Under Circular 23, direct appointment of investors will be permitted for BOT projects that are in the Master Plan for National Power Development and ones that are not covered in the Master Plan but approved by the Prime Minister for direct appointment of the investors.
- In parallel with Circular 23, the MOIT issued Circular 38 on implementing PPP projects in sectors under the management of MOIT that was effective on 15 December 2015 (*Circular 38*). Circular 38, which is not applicable to BOT thermal power projects, follows the PPP Decree.

The former BOT regime has been solidly developed in the power sector and there is a certain predictability on risk allocations. With Circular 23, PPP power projects will continue to follow the tried and tested BOT regime.

4. Transport

On 31 December 2015, the Ministry of Transport (*MOT*) issued Circular 86 on the formulation of the feasibility study reports of PPP projects in transport sectors. Circular 86 complies with the procedures set out under the PPP Decree.

UNRESOLVED LEGAL HURDLES UNDER THE PPP DECREE

The PPP Decree and its implementing regulation still contain a number of key legal gaps that impair the bankability of projects.

1. Viability gap funding and project development fund

The two key elements of PPP legislation that are still missing include guidance on viability gap funding (*VGF*) and the project development fund (*PDF*). The PDF will provide resources for the ASAs to prepare projects while the VGF will be crucial to support the financial and economic viability of projects. These two facilities are the elements that will differentiate the PPP scheme from many other investments in Vietnam and from the previous BOT scheme. They will also help centralise the implementation of the PPP scheme.

The VBF Infrastructure Group would suggest the Government promptly issue the guidance on VGF and PDF.

2. Attractiveness of the PPP program

Events during the past 18 months 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 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 banks. The lack of strong and attractive PPP investment incentives to motivate non-State banks (local and foreign) to lend would cast doubt on the practicality of the program.

The VBF Infrastructure Group would suggest that the PPP program be strengthened to provide these clear and favourable investment conditions that will attract the financing that the country so needs for its effective development.

3. Double licensing

The double licensing process under the former BOT regime remains unresolved under the PPP Decree. The selected investors will have to qualify at investor selection stage. They will then have to go through the full licensing procedures and lengthy appraisal of both the project and their own capacity again.

The VBF Infrastructure Group proposes that a simplified licensing procedure should be adopted.

4. 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. No changes have been reflected in the implementing regulations.

The VBF Infrastructure Group would suggest that greater communication about the government's position would be useful.

a. Land

A mortgage of land use rights is only possible if all land rent has been paid. A bizarre problem arose in the context of BOT projects, where land was granted to the project for free. The Government took the position that no mortgage is therefore possible because no rent has been paid (rather than the philosophically equally possible position that all rent has been paid). The PPP Decree now appears to allow for nominal rent to be paid for land by way of an entitlement to a "reduced land rental". However, even this does not solve the mortgage problem, because the land law does not allow foreign lenders to take mortgages over land use rights.

Clarity requested: A workaround to this problem is urgently needed. Onshore security agents have been used in practice on an ad hoc basis in BOT projects. However, the legal basis 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 VND income. Without it, some PPP projects may not be bankable. Current practice in BOT projects in the power sector is to provide some level of guarantee of exchange rates, although sponsors are now often left with some 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)?

IMPLEMENTATION STATUS

a. What has been done

Following the PPP Decree, the Government has taken a number of actions to translate the regulations into projects.

- The MPI has set up a helpful 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 been working with the ASAs to compile a recommended list of PPP projects. Last month a list of 68 projects with total capital of 15 billion USD was submitted to the Government for approval.
- The ASAs in major sectors including transport and water and waste treatment and in major provinces of Hanoi, Ho Chi Minh City and Danang, have also actively worked toward their own list of projects.

b. Work remaining

Despite these efforts, there remains significant work that need to be done to achieve a successful PPP program and to promote infrastructure development in Vietnam.

- **Freedom to choose between PPP Decree and Investment Law:** The PPP Decree suggests 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.
- **Need for pipeline projects:** There should also be a pipeline of attractive and feasible PPP projects for the infrastructure that Vietnam visibly needs and that also attract investors. Renewable energy and transport should be included and prioritized in addition to the more traditional thermal power projects. The MPI has to date had difficulty

obtaining workable project proposals from ASAs. Many proposals that have apparently been submitted are either unrealistic in any meaningful timeframe or too 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).

- **Support to financial viability of projects:** The scope of available guarantees and further visibility into viability gap funding principles are among the main gaps that should 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.
- **Coal-fired power projects – effect of the Paris Agreement:** The power sector was the leader in the PPP market for foreign investment since the 1990s. There is now a relatively predictable risk allocation, and the parameters of government support and guarantees are known. Given a significant demand for more power, some coal-fired power projects under negotiation should be put into operation to fill the need while renewable power is developed on the scale and at the price needed. However, most traditional sources of private sector financing for these projects will dry up in light of the Paris Agreement on the climate change. Longer term, there will need to be a rethink about financing in this sector, particularly improvements in the bond market to enable project bonds, and greater flexibility in pricing and government support.
- **Opening of the road sector:** A good road sector is also vital for the economy and the climate. Unfortunately, in this sector, the risk allocation and concession principles for PPPs are still evolving, the bidding process is not certain, centralised procurement is dominant and offshore financing is limited. These hurdles should be assessed and resolved to secure foreign lending to finance the urgent need of transport infrastructure.