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New Law on Public-Private Partnerships (PPP) in Vietnam

8 September 2020

Speed read

On 1 January 2021, Vietnam's long awaited Law on PPP (the **PPP Law**) will come into effect. The PPP Law establishes an umbrella legal framework for all PPP projects and aims to attract more private investment to the development of Vietnam's infrastructure. This note looks at some of the key changes under the PPP Law, some positive and some less so, with respect to making the PPP framework more appealing to private sector developers, investors and lenders.

On 18 June 2020, the National Assembly of Vietnam passed the long awaited PPP Law which establishes an umbrella legal framework for all PPP projects and aims to attract more private investment to the development of Vietnam's infrastructure. The PPP Law will take effect from 1 January 2021 and will replace the previously issued PPP regulations under Decree No. 63/2018/ND-CP dated 4 May 2018 (**Decree 63**).

Although it was hoped that the PPP Law would usher in a legal framework on PPP more in line with international practice and address the shortcomings of Decree 63, the PPP Law does not go as far as many market commentators had anticipated, and may not drive private sector developers, investors and lenders to support PPP to the extent that Vietnam's authorities had intended. Time will tell. This note looks at some of the key changes brought about by the PPP Law.

PPP projects

Permitted sectors

The PPP Law has narrowed the sectors eligible for PPP projects (**Permitted Sectors**) and, notably, the Prime Minister no longer has the discretion to permit any additional sectors for PPP investment. The regulated sectors are now as follows:

(i) transportation;

(ii) power plants and power transmission lines, except for hydropower plants and monopoly cases of the State under the Law on Electricity;

(iii) irrigation works, clean water supply, water drainage and waste water treatment, and waste treatment;

(iv) healthcare, education and training; and

(v) information technology infrastructure.

Like its predecessor, the PPP Law does not expressly include other projects of interest to potential investors in Vietnam, such as those relating to upstream oil and gas, mining, petroleum refineries and plants, steel mills and aluminium refineries. However, while Decree 63 left the door open for the Prime Minister to allow such projects to go ahead under a PPP framework pursuant to his authority, the PPP Law provides no such discretion. The Ministry of Planning and Investment (**MPI**) has explained that the purpose behind limiting the sectors for development by PPP was to focus on those sectors most suitable or attractive for private sector development, avoiding focus on sectors with national security issues or which the private sector realistically may find less attractive and to support and promote socio-economic development.

Minimum investment requirements

The PPP Law imposes the following minimum investment capital requirements for PPP projects, with the MPI noting in forums the preference for larger scale projects:

(i) VND100 billion (approximately USD4.35 million equivalent) for PPP projects in health, education and training;

(ii) VND200bn (approximately USD8.7m equivalent) in other Permitted Sectors, but VND100bn if the PPP projects are located in difficult socio-economic areas and extremely difficult socio-economic areas (as defined in the Investment Law); and

(iii) no minimum investment capital is required for PPP projects implemented in the form of O&M contracts.

While Decree 63 categorises PPP projects by way of national importance, the PPP Law aligns with the approach adopted by the Investment Law and classifies PPP projects by the governmental authority charged with approval power over the project: (i) the National Assembly, (ii) the Prime Minister, (iii) the relevant Ministries and other central agencies, or (iv) the Provincial People's Council. Such appropriate approval authority is determined based on PPP project factors such as size of capital investment, potential environmental impact, location, sources of the investment capital, likely impact on the surrounding community and the specific industry sector into which the project falls.

PPP investment models

In line with international practice, the PPP Law no longer recognises the build-transfer model (**BT**) of PPP investment under which investors could recover their investment by exchanging the BT project for land use rights to be used for other projects. All BT projects that have not been approved and issued with an approval in-principle of the investment plan (the **AIP**) shall be stopped as from 15 August 2020 and no new BT project shall be considered going forward.

As a result, there are now seven types of permitted PPP investment models:

(i) Build – Operate – Transfer (BOT);

(ii) Build – Transfer – Operate (BTO);

(iii) Build – Own – Operate (BOO);

(iv) Operate – Manage (O&M);

(v) Build – Transfer – Lease (BTL);

(vi) Build – Lease – Transfer (BLT); and

(vii) mixed contracts combining (a) BOT, BTO, BOO or O&M and (b) BTL or BLT.

The process for implementing PPP projects

The PPP Law sets out the following steps, including detailed guidance in relation to each, for the implementation of a PPP project.

1. Formulation, evaluation of the pre-feasibility study report, and AIP.
2. Formulation, evaluation and approval of the feasibility study report, approval of the PPP project and announcement of the PPP project.
3. Selection of investor(s).
4. Establishment of the project company and signing of the PPP contract.
5. Commencement of implementation of the PPP contract (including both construction and operation).

Note that for PPP projects using high tech (per the list of high tech prioritised for investment and development under the regulations on high tech[1]) or new technology, the implementation process varies slightly in that the investor shall be selected before formulation, evaluation and approval of the feasibility study report, and approval of the PPP project.

PPP contract template

Similar to Decree 63, the new PPP Law requires that a PPP contract must have certain fundamental terms and conditions in accordance with a standard form contract to be provided by the Government for each PPP investment model (**Template Contracts**). Template Contracts are expected to be provided under a separate implementing decree. To date, the only official template contracts which exist are the power purchase agreements for renewable energy projects which are regarded by many industry commentators as vague in their terms and not bankable. Hence, it remains to be seen how well developed the Template Contracts will be and the extent to which their content will be negotiable.

Private sector investment capital

Under the PPP Law, the equity capital contribution of the private investors in a PPP project must be at least 15% of total investment capital. Any capital contribution from the State is not counted toward investment capital for the purpose of determining the equity capital to be contributed by private investors. These requirements are more relaxed than those under Decree 63 which required an equity capital contribution of at least 20% of total investment capital for PPP projects with investment capital of up to VND1,500bn (USD64.7m equivalent) plus at least 10% of the portion of any investment capital exceeding VND1,500bn.

Unlike its predecessor, the PPP Law provides a timeframe for capital contribution to a project company. The investor(s) and the project company shall be responsible for contributing equity and raising loans and other capital sources to implement the PPP project within 12 months from the signing of the PPP contract. This period can be extended to a maximum of 18 months for projects with an AIP issued by the National Assembly or the Prime Minister. However, the PPP Law is still silent on whether the required equity capital can be contributed in stages or in an agreed debt to equity ratio with loans over the construction period. This aspect is expected to be addressed in the forthcoming implementing and guiding regulations on the PPP Law.

Similar to Decree 63, the PPP Law is also silent on the use of sponsor subordinated loans or equity bridge loans as well as raising financing through the issuance of preference or other types of shares. Thus, questions in relation to their use remain unanswered, although they have been widely used for the funding of Vietnamese projects (particularly for power and major plant projects). Nonetheless, it is now expressly permitted for a project company to issue corporate bonds (excluding convertible bonds and bonds with warrants) in accordance with the following conditions:

(i) the bond proceeds shall not exceed the loan capital stipulated in the PPP contract;

(ii) the bond proceeds shall only be used to (a) implement the PPP project or (b) restructure the existing loans of the project company; and

(iii) the project company must open an escrow account to receive the bond proceeds and disbursement of the bond proceeds shall only be for the permitted uses in item (ii) above.

Government support

As with Decree 63, Government support can come in many forms and the PPP Law sets out the following permitted uses for State capital contribution to a PPP project:

(i) support for the construction of works and infrastructure systems for a PPP project;

(ii) payment for land clearance, compensation and resettlement, and support of the construction of temporary works;

(iii) payment to the project company for providing public products and services (eg, by way of a tariff payment under a PPP concession contract);

(iv) payment for revenue support in the event of revenue reduction;

(v) expenses of the different State authorities in signing the project contracts, preparing, pre-feasibility study report and feasibility study report, and their other obligations in implementing a PPP project (i.e., those obligations stemming from the "process to implementing a PPP project"); and

(vi) expenses of the appraisal committee for evaluating the pre-feasibility study report and feasibility study report.

State capital contribution is limited to no more than 50% of the total investment capital for permitted uses (i) and (ii) above. For projects with multiple component projects, including PPP component projects, the State capital contribution ratio will be determined on the total investment of such components.

Investment incentives and guarantees

General incentives

Broadly speaking, investment incentives under the PPP Law include tax incentives, rights to mortgage project assets, rights to use land, rights relating to the purchase of foreign currency and foreign currency balancing, rights to utilise public services, and rights relating to ownership of assets.

Government guarantees

Nonetheless, the significant deviation from Decree 63 is that the PPA Law does not expressly include the grant of a Government guarantee (**GGU**) to investors to a PPP project to guarantee the performance or payment obligations of State counterparties (eg, to supply fuel or to purchase electricity

from BOT or renewables power plants). It remains to be seen whether the Government will nevertheless continue to provide GGUs where it considers appropriate or whether lenders and investors will simply have to accept that there will no longer be a GGU in place for any PPP project.

Foreign currency availability guarantee

Although modified from Decree 63 and subject to certain regulatory criteria, the PPP Law continues to allow foreign currency guarantees and the Government will decide whether to apply policies ensuring the availability of foreign currency of up to 30% of the revenue in VND (after payment of operating costs in VND) of projects approved by the National Assembly and Prime Minister. This is effectively the same as what has been achieved in recent BOT power projects in Vietnam, although it remains to be seen whether the PPP Law or its implementing regulations will change how this 30% rule is applied.

Revenue sharing and support schemes

The PPP Law marks the first time a law in Vietnam allows the State to commit to revenue sharing and revenue support mechanisms with private investors. This could offer a major boost to PPP projects where the project is taking market or usership risk (eg, toll road or rail projects).

When actual annual project revenues reach more than 125% of the projected revenue in the base case financial plan set out in the PPP contract (the **Financial Plan**), the investors and project company shall share with the State half of the project revenues over and above the 125% level. Such revenue sharing shall be applied after the project company has adjusted the price, the usership or tolling fee and the term of the PPP contract, and the State Audit Office has audited the revenue amount subject to the revenue sharing mechanism.

When actual annual project revenues fall below 75% of projected revenue in the Financial Plan, subject to certain regulatory conditions, the State shall support the project by making up half of the revenue shortfall below the 75% level.

If applied, the revenue support mechanism shall be set out and approved under the AIP at the outset. While it is not clear how the project company will be entitled to adjust the price, fees and PPP contract term unilaterally, the concept of revenue support mechanisms should be seen as a significant positive step.

Selection of investors

The PPP Law now integrates the process for investor selection whereas previously, the investor selection options were addressed under Vietnam's Law on Bidding. The PPP Law provides three methods of investor selection for PPP projects.

(i) open tender.

(ii) competitive negotiation – if there are no more than three investors satisfying conditions for participating in the open tender; and

(iii) direct appointment – this is only permitted in limited cases: (a) projects falling in a Permitted Sector but which have elements relating to national defence, national security or which involve protection of State secrets, or (b) upon early termination of the relevant PPP contract, the State authority signing the PPP contract may work with lenders to the PPP project to find a replacement investor.

For projects in category (a) above, the relevant approving authority must obtain prior consent from the Prime Minister, having consulted with the Ministry of Defence and the Ministry of Public Security.

If there are special conditions relating to a particular PPP project, as a result of which the competent authorities are unable to select a suitable investor using the above methods, the Prime Minister may consider and decide another method for selection of investors.

It is now clear that even for a PPP project proposed by a developer, the selection process must be made either by way of open tender or competitive negotiation. Notably, if a developer proposes a PPP project, the developer must at least, among other things, prepare a pre-feasibility study report, obtain an AIP and prepare a feasibility study report before it can be considered as a potential investor of such project during the selection process which must follow. The PPP Law states that a developer having an approved proposal will have preferential treatment during the selection process, but it is unclear what type of preferential treatment will be available or how such preference will be applied. In the event that the proposing developer is not successful, its costs of preparing the pre-feasibility and feasibility study reports will be reimbursed by the selected investor.

Transfer of interests in a project company

Similar to Decree 63, the PPP Law also imposes restrictions on the transfer of equity interest in the project company to third party investors prior to completion of construction of the PPP project.

The PPP Law nevertheless now allows that if the project company was established by a consortium, the investors may transfer their stakes in the project company among themselves; provided that, the owners' equity ratio is maintained such that the lead investor must contribute at least 30% and each remaining investor in the consortium must contribute at least 15% of the total owners' equity (or the equity capital contribution of the private investors) in the PPP project.

Lenders' security and step-in rights

Lenders' security

The PPP Law provides that a project company may grant security over its (i) assets, (ii) physical assets, (iii) rights under the PPP and other contracts for the development and operation of the project, and (iv) statutory land interests to the lending banks in accordance with regulations on land and civil matters. However, while it provides for the procedure to grant security over items (i) – (iii), it is silent on the process to grant security over statutory land interests. As a result, security over land use rights will continue to be regulated by the Land Law of Vietnam which continues to impose restrictions on foreign lenders taking security over land use rights and immovable assets.

Lenders' step-in rights

The PPP Law removes reference to a step-in rights mechanism which allowed lending banks to preserve essential contracts entered into by the project company in the event of a default by such project company. Instead, the PPP Law stipulates that in the event of enforcement by lenders, the State authorities and lending banks may work together to select a new investor by direct appointment. However, the PPP Law does not legislate as to the time at which such agreement can be made (i.e., whether such agreement can be executed when the lending banks enter into loan and security documentation or whether they need to wait until the occurrence of an enforcement event to enter into an agreement with the governmental authority to select a new investor). This new mechanism represents an unwelcome departure from what Decree 63 allowed and, if applied strictly, may affect the ability of developers to raise limited recourse funding for a PPP project. In practice, we expect that international project lenders will continue to require direct agreements allowing for lenders' step-in and transfers to proposed replacement project companies and sponsors to be negotiated with key State counterparties, as has been done in the thermal power and other sectors.

Amendments to a PPP contract

Under the PPP Law, a PPP contract can only be amended in those circumstances specifically contemplated and provided for in advance in the PPP contract itself and be considered by the contracting parties upon the occurrence of any of the following events:

(a) force majeure or fundamental change in circumstances, change in relevant planning, policies or laws that 'seriously affect' the technical or financial plans of the project, prices and charges of public products and services supplied by the project company;

(b) change in a contracting party to the PPP contract;

(c) change in the term of the PPP contract; and

(d) circumstances which fall within the authority of the contracting authority provided that such amendment does not result in any amendment to the AIP, which will bring more effective financial and/or socio-economic benefits to the project.

It is not clear whether the events above create a specific right for the investor to amend a PPP contract, or whether any amendment remains subject to further consent between the contracting parties. Force majeure and change in law events are usually specifically provided for in a standard and internationally bankable PPP contract. Hopefully, this uncertainty will be resolved in the Template Contracts or further guiding decree. It also remains to be seen whether the guiding decree will provide any further clarification on the flexibility of the parties in amending the PPP contract in other events.

Early termination rights

The PPP Law provides that a PPP project contract can only be terminated early in certain circumstances (including extended force majeure, national defence or national security reasons, insolvency, material breach by a party, or where there is a fundamental change in circumstances as provided under the Civil Code). The PPP Law does not seem to provide for any flexibility for the parties to agree on any other termination events in the PPP contract, although this may be managed to the extent that the parties are able to negotiate what is defined as a material breach.

Early termination payments to investors are allowed only if such payments are due to national defence or national security reasons or if the contracting authority materially breaches the PPP contract. However, there is no further detail on how such early termination payments might be calculated. This will be a significant issue if early termination payments are not allowed for prolonged natural and political force majeure events, as they have been in the past in BOT power concession contracts in Vietnam. This will need to be addressed in the Template Contracts and negotiation on individual PPP projects.

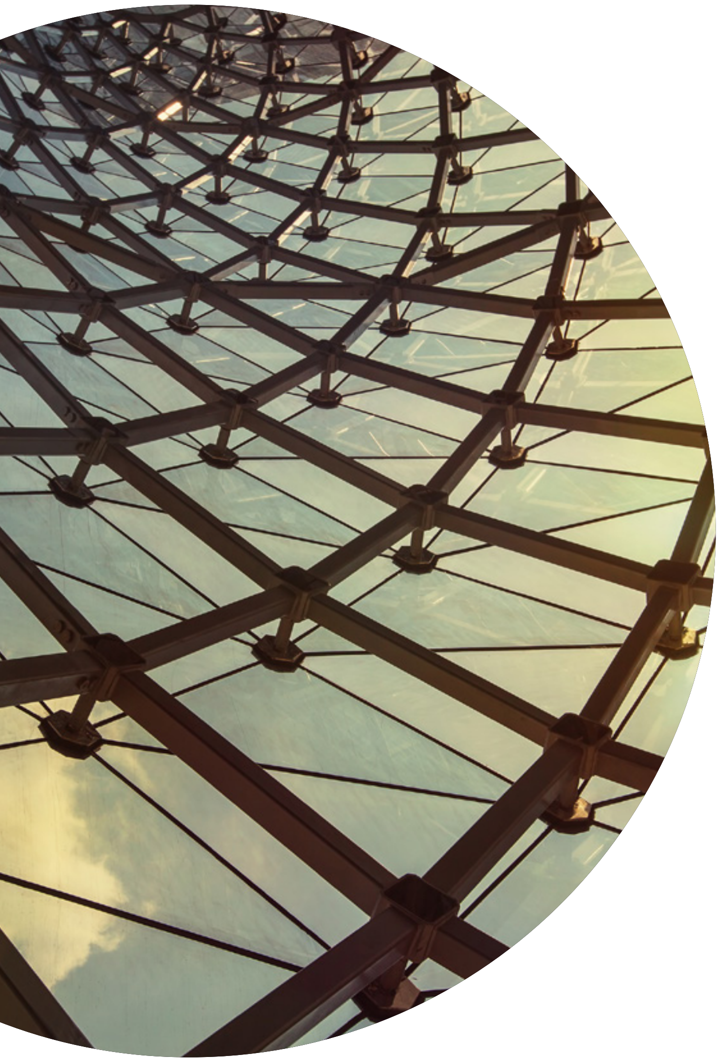
The choice of foreign governing law for concession contracts is no longer permitted

The choice of foreign law as the governing law in PPP project contracts and documents to which the State is a party is no longer permitted under the PPP Law. If there is any provision in the PPP contract relating to matters that have not been regulated by Vietnamese law, the parties may agree that foreign law will govern those specific terms and conditions, provided that such agreement shall not contradict the basic principles of Vietnamese law. At this time, the 'basic principles of Vietnamese law' are not clearly defined and it is very difficult to determine what may constitute 'basic principles of Vietnamese law'.

Transitional provisions

Project contracts executed prior to 1 January 2021 will continue to be performed in accordance with their terms. For projects with project contracts currently under review or negotiation, including, for example, wind and solar power projects trying to sign a PPA and other concession contracts, the PPP Law makes significant changes to their implementation. Generally, the implementation of such projects going forward is based on whether they fall within the Permitted Sectors and satisfy the minimum capital requirements under the PPP Law and where they fall in the investor selection and implementation process.

Specifically, for those investors who are looking to develop projects in Vietnam, if the investors of a project of a nature which is covered by the new PPP Law have been officially selected, the investors may continue to negotiate the project contracts in accordance with the requirements of the PPP Law (which requirements will be heavily dependent upon whether the project contracts can be executed before the implementing regulations publish the Template Contracts) without the selection process being reopened. Where the project investor has not been officially selected, the PPP Law investor selection and project approval requirements and processes will need to be followed.



Conclusion

The PPP Law has made some significant changes to the implementation of PPP projects in Vietnam, including existing PPP projects without signed contracts. The clarification of the investment procedures for PPP projects, especially the investor selection process, relaxation of private sector equity capital contribution requirements and introduction of revenue sharing and revenue support mechanisms will be seen favourably by the private developer, investor and lending communities.

However, the introduction of minimum investment requirements and the removal of step-in rights for lending banks, investor's rights to transfer its rights and/or obligations under a project contract and the choice of foreign law as the governing law in PPP project contracts may affect the ability of investors to raise funds for a PPP project in private and international lending markets. Some developers might also see the removal of the Prime Minister's discretion to approve projects outside the specifically stated Permitted Sectors for implementation on a PPP basis as being a loss of flexibility.

The passage of the PPP Law was only the first step in moving Vietnam's PPP regime forward. Among other things, the Government will need to issue additional guidance and regulations for the PPP Law's implementation and application of various new mechanisms in practice. Arguably, most highly anticipated will be the standard form project contracts to be issued by the Government for each PPP investment model. It is suggested that investors and developers closely consult and liaise with the relevant State authorities for further guidance on how their PPP project(s) may be affected.

Contact information

Adam Moncrieff
Managing Partner, Vietnam
Tel +84 28 6288 4811
adam.moncrieff@allenovery.com

Duc Tran
Partner, Vietnam
Tel +84 28 6288 4949
duc.tran@allenovery.com