

VIETNAM APPROVES NEW PPP REGULATION

Introduction

On November 9, 2010, Vietnam's Prime Minister approved a new PPP regulation entitled "*Regulation on Public-Private Partnership Investment Piloting*" (the "**New Regulation**"), which provides an updated legal framework for the procurement of pilot PPP projects in certain key sectors, including transportation, water, power, healthcare, and waste treatment infrastructure. The New Regulation comes into effect on January 15, 2011.

The New Regulation succeeds Decree 108, Vietnam's predecessor BOT law from January 2010, and aims to provide a legal PPP framework that more closely adheres to international standards.

Adoption of the New Regulation is an important step toward achieving this goal, although the content of the New Regulation indicates that the work is not yet complete. In fact, the name of the New Regulation implies that this regulation applies to a "piloting" phase of PPP projects. The Ministry of Planning and Investment's (MPI) Vice Minister Dang Huy Dong indicated that feedback from international PPP players on pilot projects undertaken pursuant to the New Regulation will be incorporated into Vietnam's PPP model in furtherance of this goal, and the New Regulation assigns this task to a multi-sector task force to be established by MPI. The New Regulation also provides that it will be in effect from 3 to 5 years until a decree on PPP investment is issued by the government to replace the regulation, clearly anticipating such successor regulation.

Overview of New Regulation

The New Regulation sets out the general project selection, preparation and procurement process for the pilot projects. It creates a centralized process, with a task force



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drawn from various relevant ministries involved in the formulation and implementation of each project and MPI presiding over the overall coordination of the program. Under the New Regulation, the procurement process is to be conducted in accordance with international practices and customs, “ensuring competition, fairness, transparency and economic efficiency.”

While the approval of the New Regulation is an encouraging step, the New Regulation is drafted in relatively general terms, and therefore international players are likely to seek further clarification of the New Regulation before committing risk capital to these projects.

To highlight a few features of the New Regulation:

Competitive Bidding

Under the New Regulation, unlike its predecessor, every pilot project is subject to competitive bidding (although a private investor may propose a project for inclusion in the portfolio to be considered for selection under the pilot program). The request for proposals is required to include details of the evaluation criteria, bidding procedures, draft project contract, feasibility report, proposed State Contribution (discussed below) and proposed investment guaranty mechanism for the project.

The New Regulation attempts to incorporate an important feature found in current leading PPP models, by setting out tight timeframes within which certain stages of the procurement process must be completed. For example, finalization and initialling of the project contract must occur within 30 business days of the selection and approval of the sponsor (investor). However, this timeframe is ambitious for even the most commoditized jurisdictions and may risk deterring, rather than encouraging, the participation of international investors who may view the prescribed timeframe as unrealistic.

State Contribution

The New Regulation caps the “State Contribution” amount per project at 30%, except as otherwise decided by the government.

This is a reduction from the limit on state capital of 49% of total investment capital under Decree 108. State Contribution under the New Regulation can be in a wide range of forms, including state capital, and, together with any government guarantees, will be considered and determined on a case-by-case basis to ensure the financial viability of the project. The New Regulation expressly provides that State Contribution is not considered equity and does not have a right to dividends from revenue of the project.

Performance Security

Performance security of a minimum of 2% of the “total investment capital” of the project is required until the completion of construction. “Total investment capital” is not defined but appears to refer to the aggregate amount of private and public investment capital in the project.

The New Regulation does not specify whether the performance security must be granted in favour of the authorizing state body or whether, in common with practice in other jurisdictions such as Canada, the lenders can take the benefit of the security if they step in.

This is one of the areas of the New Regulation in respect of which further clarification would be helpful.

Equity

The New Regulation provides that Investor’s equity capital must account for at least 30% of the privately-owned investment in the project. The investor may obtain funding from commercial loans and other sources (without government guarantees) up to a maximum of 70% of the privately-owned investment in the project.

The prescribed equity to debt ratio is an increase from the minimum of 10% to 15% (depending on the total investment capital) equity capital required under Decree 108, and is closer to the minimum 20-30% required under Decree 108’s predecessor, Decree 78.

While it is understandable for Vietnam to require a certain level of “skin in the game”, generally speaking, mandating a high equity to debt ratio will result in making the project more expensive, given the comparative cost of equity over debt. In more developed markets, the ratio is closer to 10-15%. Nonetheless, a high equity to debt ratio may be necessary if lenders are not willing to lend a larger proportion of the private investment.

With respect to assignment, the New Regulation provides that the investor is permitted to assign its rights and obligations under the project contract, subject to the consent of the authorized state body and provided that such assignment will not “adversely affect the objectives, size, technical criteria and schedule for implementing the project and other conditions already agreed in the Project Contract”.

Investment Incentives

Investment incentives under the New Regulation include corporate income tax incentives, incentives on import and export duties and exemption from land use fees or land rent for the duration of the project. A foreign contractor participating in the project would be entitled to exemption or reduction of taxes in accordance with tax laws applicable to foreign contractors.

Contractors

The project company is responsible for selecting contractors to implement the project and, where selection of a contractor is within the governing scope of the Law on Procurement, such selection must be made in accordance with the laws on tendering. The project contractor must notify the authorized state body within 15 business days of the date of its decision to select the relevant contractor.

The provisions relating to the selection of contractors are drafted in general terms, and therefore a number of clarification questions arise: (1) whether the project company is required to notify the authorized state body of the selection of only its construction

contractor/service provider or of every contractor of each tier; (2) whether the notification requirement is purely a notification requirement or an approval right on the part of the authorized state body; and (3) the effect of Vietnam’s tendering laws on the ability of the investor to pre-select contractors and form a consortium at the bid phase.

Generally speaking, the more restrictions imposed on the ability of the investor/project contractor to select and appoint its subcontractors, the less attractive the project will be to the private sector.

Lender Step-in Rights

The New Regulation expressly permits the inclusion of lender step-in rights, provided that the lender discharges all of the corresponding obligations of the investor/project company, and the terms of such step-in rights must be specified in the loan, security agreement or other agreement between the investor/project company and the lender, and must be approved by the authorized state body (the counterparty to the project contract).

The proviso that the lender discharge the obligations of the investor/project company may be significant to lenders accustomed to the rules of jurisdictions such as the UK and Ontario, Canada, where they merely acquire the rights, benefits and entitlements of the project company upon step-in, and the public authority’s recourse lies in its ability to terminate if, after the lenders have stepped in, the project company continues to default in its performance.

Security

Project companies are permitted to pledge or mortgage assets and land use rights in accordance with Vietnam’s laws, subject to the consent of the authorized state body and provided that any such pledge or mortgage must not “adversely affect the objectives, implementation progress and operations of the Project as stipulated in the Project Contract”.

Foreign Currency Risk

During the construction and operation of the project, the investor/project company is permitted to buy foreign currency from authorized credit institutions in order to serve specified project-related activities, including repayment of foreign loans (principal and interest) and remittance abroad of capital and profit, in accordance with laws on foreign exchange control. For certain important projects in the energy, transportation construction and waste treatment sectors, the New Regulation permits the authorized state agency to propose, for the government's consideration, some form of government assurance or support with respect to the foreign currency balance.

The ability to convert project-related funds into US dollars or other liquid foreign currency and the government's willingness to provide adequate protection against foreign exchange fluctuations over the full terms of the projects will be critical to making the projects financeable. International investors will have very limited appetite to assume long-term foreign currency risk in the absence of relevant long-term currency hedging instruments.

Foreign Governing Law

Foreign law may govern the project contract as determined on a case-by-case basis and provided in the RFP.

Next Steps

While considerable work lies ahead, where political will is a key precondition to the successful establishment of an internationally bankable PPP market, Vietnam's most recent efforts to bring its PPP framework up to international, bankable standards is a positive sign for the international PPP community, and the approval of the New Regulation is a preliminary but important step in furthering this overall objective.

As an immediate next step, the multi-sector task force will be established, comprising representatives of MPI, the Ministry of Finance, the Ministry of Justice, the Ministry of Industry and Trade, the Ministry of Transport, the Ministry of Construction, the State Bank of Vietnam and other relevant agencies, to assist the respective ministries in the implementation of the pilot PPP projects. The selection process is currently underway, with an aim to have the task force in place by the end of this year.

Project Finance, Infrastructure and P3 Practice

Davis LLP's Project Finance, Infrastructure and P3 Group is comprised of over 20 lawyers who have successfully closed a wide range of complex Canadian and international infrastructure projects, for clients in the public sector, private consortia, and lending community, encompassing many asset classes. Projects that we have advised on include:

- Bermuda Hospitals Board Redevelopment Project (2010), Bermuda's first PPP project - special PPP counsel to the Bermuda Hospitals Board.
- Alberta Canada Schools P3 Project - counsel to sponsor (2008 - awarded "North American Social Infrastructure Deal of the Year" by Project Finance Magazine, NY).
- Anthony Henday Drive Northwest Leg Ring Road (Edmonton, Canada) - counsel to sponsor (2008 - awarded "PPP Deal of the Year - Americas" by PFI Magazine, UK).
- Golden Ears Bridge (British Columbia, Canada) - counsel to sponsor (2006 - awarded "N.American PPP Deal of the Year" by Project Finance Magazine, NY, and "North American Deal of the Year" by PFI Magazine, UK).
- Richmond-Airport-Vancouver (RAV) Line - counsel to sponsor (2005 - awarded "North American Transport Deal of the Year" by Project Finance Magazine, NY, and "Infrastructure Deal of the Year - Americas" by PFI Magazine, UK).

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