

Client Alert

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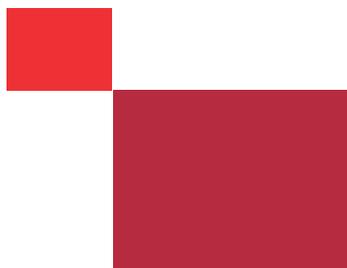
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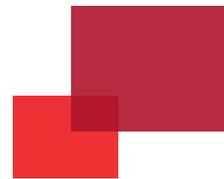
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Vietnam Public-Private Partnership (PPP) Law passed and draft implementing decrees released: impacts on large-scale energy and infrastructure projects

In-depth

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Overview of Vietnam's PPP investment market

According to the government's Report No. 25/BC-CP in 2019:¹

- Vietnam had 336 PPP projects for which PPP contracts have been signed (including 140 projects under BOT contracts, 188 projects under BT contracts and 8 projects under other types of PPP contracts).
- For those projects, a total amount of approximately VND 1,609,295 billion (approximately USD 70 billion) has been mobilized and utilized for investment and development of infrastructure projects in Vietnam.

According to the government's Proposal No. 354/TTr-CP dated 27 August 2019 to the National Assembly on the PPP Law, PPP projects have been implemented in the following sectors:

- transportation (with a total of 220 projects, accounting for 65.47%)
- power and energy (with a total of 18 projects, accounting for 5.35%)
- water supply, sewerage and environment (with a total of 18 projects, accounting for 5.35%)
- other sectors (with a total of 80 projects, accounting for 23.83%).

Vietnam has been looking for the best approach to promote more private sector capital and participation in the infrastructure sector since as far back as 1991, when the first "Build - Operate - Transfer" (BOT) rules were adopted. More recently, multiple regulations relating to PPP projects have been developed in order to promote private investments for infrastructure enhancement.

The need to adopt the PPP Law

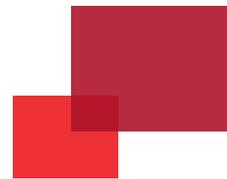
According to the government, it is necessary to adopt a separate law to regulate PPP investment activities and avoid the current situation of utilizing non-PPP specific regulations from other laws during the application process, in order to set up a stable and sustainable legal framework for PPP investments.

The role of PPP project contracts

The PPP Law distinguishes between: (i) state-authorized agencies (including those agencies issuing Investment Policy Decisions and other permits and licenses to PPP projects); and (ii) agencies signing PPP project contracts (i.e., the public sector's contracting parties). The PPP Law also provides that agencies signing PPP project contracts will be state-authorized agencies or other units under such state-authorized agencies' management and authorized by such state-authorized agencies.

However, the PPP Law does not clarify the legal relationship between the negotiated PPP project contract (as the contractual agreement of the public sector's contracting party and private sector investors) and discretionary permits and administrative documents issued by state-authorized agencies.

¹ Government's Report No. 25/BC-CP dated 30 January 2019 on the status of implementation of PPP projects in Vietnam; and government's Proposal No. 354/TTr-CP dated 27 August 2019 to the National Assembly on the proposed PPP Law.



For example, the PPP Law does not clarify how to deal with cases where existing or future discretionary permits and administrative documents issued by state-authorized agencies contradict contractual agreements with investors under PPP project contracts, nor whether investors would be protected from risks and liabilities due to changes in laws, policies and permits.

PPP investment eligible sectors and scale

Under the PPP Law, the list of projects eligible for PPP investment forms is more restricted compared to the current regulations. The PPP Law also introduces a new criterion to determine PPP-eligible projects as well as thresholds of total investment scale/capital to be eligible for investments in the PPP form.

The PPP Law narrows down the list of PPP investment sectors to only include:

- Transportation
- Power grids, power plants (except for hydropower plants and the cases of State's monopoly, according to the Electricity Law)
- Irrigation, water supply, drainage and wastewater treatment, and waste treatment
- Healthcare, education and training infrastructure
- Information technology infrastructure.

The government has explained that the reduced scope of PPP investment sectors under the PPP Law has been designed to eliminate those sectors that have not been implemented under PPP arrangements, those that have been implemented but have been ineffective or unattractive to the private sector, or those that have been sufficiently implemented under other modes of investment (e.g., socialization or private investment)².

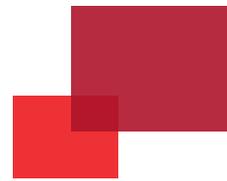
In addition, while Decree No. 63 had previously authorized the Prime Minister to decide on other sectors apart from those specifically mentioned in the Decree No. 63 on a case-by-case basis, the PPP Law removes this possibility.

In terms of the investment scale for the purpose of eligibility for PPP investments, PPP projects (other than O&M contracts) must meet the following minimum total investment capital threshold:

- No less than VND 100 billion (approx. USD 4.3 million) for projects in the health, education and training sectors and in areas with difficult or special difficult socio-economic conditions
- No less than VND 200 billion (approx. USD 8.6 million) for projects of other investment sectors and in other geographic areas.

Further, a current draft decree guiding the implementation of the PPP Law provides even more stringent investment capital scale thresholds in certain investment sectors. For example, infrastructure sector projects (i.e., roads,

² National Assembly's Report No. 538/BC-UBTVQH14 dated 16 May 2020 on the proposed PPP Law.



railways, airports and seaports) must have a minimum investment capital of VND 1,500 billion (approx. USD 65 million). An investment threshold of VND 2,300 billion (approx. USD 100 million) will apply to a PPP project investing in a power grid or power plant.

Therefore, to assess the project's viability for using a PPP investment form, investors should carefully consider their project's sector and investment scale to ensure that their projects belong to an eligible sector and meet the relevant minimum investment capital threshold as specified in the PPP Law. For sectors such as infrastructure and power, investors should follow up on the finalization of the draft decree guiding the implementation of the PPP Law, since this will likely specify a higher threshold than that provided under the PPP Law

Classification of project schemes

The PPP Law inherits most of the types of basic project contracts from Decree No. 63, which are divided into two main groups:

- Projects that collect fees from end users (i.e., BOT, BTO, BOO, O&M)
- Projects that collect payments from the state based on the quality of public products and services provided (i.e., BLT and BTL).

The primary change is that the PPP Law abolishes the PPP project scheme of Build-Transfer (BT). From a previous explanatory report for the PPP Law's submission to the National Assembly, the BT form was removed due to government's concerns over the lack of administrative supervision and legal issues in relation to land transfer and land price evaluation in exchange for the BT project's investment.

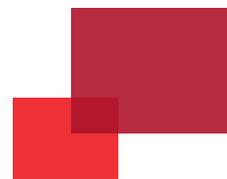
Certain investors that currently own and follow a BT investment project form should review the transitional process and provisions under the PPP Law until it takes effect on 1 January 2021 to determine the relevant legal implications for their projects.

Capitalization for PPP projects

Investors and PPP project companies are responsible for contributing equity capital as well as mobilizing loan capital and other lawful sources of capital to implement the PPP project.

Under the PPP Law, within 12 months from the signing date of the PPP project contract, investors and PPP project companies are required to complete the financing arrangements relating to the project. For projects whose Investment Policy Decisions are under the approval authority of the National Assembly or the Prime Minister, the completion period must not exceed 18 months. However, the PPP Law is not entirely clear as to whether "financing arrangements" refers to the financial close date (i.e., the date on which all the debt financing documents have been signed and all conditions precedent to initial drawdown of initial loans have been satisfied or have been waived by the financing parties), or otherwise.

For equity capital that needs to be injected by project sponsors/investors, the investors must contribute equity capital of at least 15% of the total project investment capital (excluding any state capital portion).



The PPP Law introduces a new limit that the State's capital contribution may not exceed half of the total investment amount into a PPP project in the form of supporting construction, infrastructure and land clearance and compensation. For a project consisting of multiple component projects of which there is a component project in the PPP form, the State's portion threshold shall be 50% of the total investment of such PPP component project.

Government assurances and guarantees

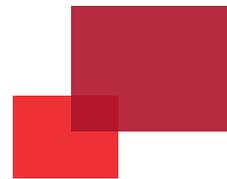
According to the government's proposal and explanations, a PPP project is a project implemented to provide public products and services (for public purposes) through private investment (private capital) and/or private management. Under the PPP framework, the government of Vietnam aims to call for private sector participation in contributing financial resources, and use intellectual and management capability from all economic private sectors to make up for the state budget shortage. Therefore, the government should take certain responsibilities and obligations in ensuring the feasibility of the projects by providing certain support, assurances and guarantees (rather than pushing the entire responsibility and risks for implementing projects to the private sector as for normal private investment trade and commerce projects).³

However, the PPP Law does not fully settle some of the key issues that affected bankability under the Current Regulations on PPP. Specifically, the proposed mechanism for sharing revenue increase and decrease may not be equivalent to government guarantees on minimum revenue (for Stand-Alone Projects). The reason is that the proposed mechanism for sharing revenue increase or decrease is subject to strict limitations and conditions, which remain favorable to the public sector (rather than the private sector of investors and lenders). The PPP Law also provides fixed thresholds for minimum revenue guarantees, which may create concerns over financial feasibility for certain projects and flexibilities in terms of implementation, given that the level of guarantees may vary in different sectors and projects in different scales. In particular, if the project's actual revenue is higher than 125% of the level set out in the financial plan, the investors shall share with the State 50% of the difference between the actual and the anticipated revenue. On the other hand, when the actual revenue is lower than 75% of the level set out in the financial plan, the State shall share 50% of such difference with the private parties.

Amid concerns over sources of foreign currency at the national reserve, the "guarantee" for the balance of foreign currency can only be granted to certain limited important projects, with guarantees for foreign currency balances limited to no more than 30% of the project revenue in Vietnamese dong after subtracting expenditures to all PPP projects. Overall, as the PPP Law sets such a threshold for all PPP projects in Vietnam, it creates concerns over both uncertainties and the lack of flexibility. This may not align with the proposed law's set objectives of attracting foreign investors with strong financial capacity in PPP investments to large-scale projects or of increasing the attractiveness of PPP projects. This also directly impacts the bankability of projects.

In addition, the Current Regulations on PPP under Decree No. 63 provide for government guarantees for obligations of state-owned enterprises. Specifically, under Decree No. 63, depending on the nature and requirements for the implementation of the projects, the guaranteed obligations can include: (i) the supply of raw materials, the sale/consumption of products and services, and

³ The government's Proposal No. 449/TTr-CP dated 7 October 2019 on the Draft PPP Law.



other contractual obligations to the investor, the project company and other enterprises participating in the project's implementation; and (ii) the obligations of state-owned enterprises, which sell fuel and raw materials to, or purchase products and services from, the investor and the project company. For example, in the case of power generation businesses with the national electricity company (EVN) being the off-taker, the government guarantee can cover EVN's energy payment obligations under the power purchase agreement, or the fuel supplier's obligations to provide the fuel under the fuel supply agreement. However, the PPP Law has removed this clear basis for the mechanism of government guarantees for obligations of state-owned enterprises. Instead, the PPP Law refers to "investment assurance mechanisms" as available to be determined under the Investment Policy Decision, feasibility study report, and/or PPP project contracts, with a general reference to the Investment Law. Such vague references may not be interpreted as a sufficiently certain obligation the relevant state-authorized agencies to agree on the necessary government guarantees and understandings (GGU), and as a result, it may be more difficult to negotiate a GGU on a project-by-project basis.

Under the PPP Law, the land use purpose of the project remains unchanged in the entire implementation term of the PPP project contract, including where the lenders exercise their step-in rights. However, this level of assurance of rights of access to land may not be sufficient to address practical issues on land clearance delays for certain projects and locations without stronger support, assurances and implementation mechanisms from the local governmental authorities.

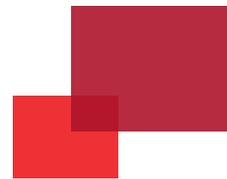
In terms of assurance of the right of mortgage of assets and the rights to commercially operate infrastructure facilities and systems, while a mortgage of the project development company's right to business in favor of lenders is expected to enhance the lender's control over the projects and function of the lender's step-in right, we note that in Vietnam, a mortgage over land-use rights in favor of foreign banks is still restricted under the Land Law. Therefore, certain arrangements such as those involving a domestic security agent and bank account mortgage over sale proceeds are necessary in order to include land-use rights into the security package for foreign banks — although the validity and permissibility of such arrangements have not fully been tested or guaranteed. As the legal basis is uncertain and there remains a risk that the State Bank of Vietnam can challenge such arrangements, the PPP Law does not fully resolve this issue or clarify whether an offshore lender can take a security interest over land and buildings if an onshore security agent is appointed.

Project step-in rights of lenders

The PPP Law removes the specific provision regarding the lender's step-in rights as stipulated in Decree No. 63.

Decree No. 63 specifically stipulated that lenders have rights to step in and take over the whole or a part of assets of investors and/or the PPP project company ("project step-in rights") that have been set up under their contracts if the investors or the PPP project company fail to perform their obligations under the project contract or the financing/loan agreement.

The PPP Law provides for general provision on lender's rights in the relevant contracts. Specifically, during the PPP contract's implementation, lender's



rights, including step-in rights, are subject to PPP project contracts and financing contracts and relevant laws.

In addition, the PPP Law provides for a new guidance on replacement of investors in case a PPP project contract is terminated early, in which case the lender may coordinate with the relevant State agency in charge of signing the PPP project contract to select such a replacing investor. The agreement on the selection of a new investor must be made in writing between the relevant State agency, the lender and investor(s) and/or PPP project company. The PPP Law is not entirely clear whether the written agreement must be entered by the replacing investor, the replaced investor or both of the investors.

As such, these scenarios should be effectively negotiated and clarified in the relevant project contracts, from a sponsor's perspective or from a lender's perspective, to ensure that an appropriate risk and responsibility allocation will be reflected in the relevant contracts.

Termination of PPP project contracts

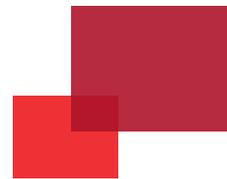
Termination events and compensation payments upon termination, also known as “buy out” payments, are of essential concern to developers (and lenders) in reviewing PPP project contracts. It is critical for both sponsors and lenders because in the event that the PPP project contracts are terminated, they do not want to be left with a stranded project without a contractual revenue stream.

Hence, the termination events and compensation payments upon termination should be reviewed and managed thoroughly by PPP investors and lenders. In most Asian markets, this compensation amount in termination cases is determined following complex formulae subject to the nature of the termination event. At the core of the formulae is the fundamental concept that the amount must include, in every termination scenario where such amounts are payable, the total amount owed to the project's lenders.

The PPP Law provides that in general, the contractual termination shall be in accordance with the agreed PPP project contracts. Parties to a PPP contract may negotiate with the relevant State agency on a project-by-project basis to mitigate the termination risks. However, such negotiation must be in compliance with provisions on termination events and compensation regime under the PPP Law.

More specifically, the PPP Law allows for agreement on an early termination of the PPP project contract in limited cases, which can be categorized into three scenarios as follows:

- Termination events due to governmental events or defaults of the public sector/relevant State agency: These include material breaches of their contractual obligations, or terminations for the purposes of protecting the national interests, or national defense, security and State secrets
- Termination events due to investor's/project company's defaults: These include investor's/project company's material breaches of their contractual obligations, or the investor's/project company's falling into insolvency under the Bankruptcy Law
- Terminations due to force majeure events or objective events: These include force majeure events, or basic changes to circumstances.



For the first scenario of termination events due to governmental events or defaults, the PPP Law mentions a "buy-out" arrangement by providing for the financial arrangement for acquiring the PPP project company or for compensating for termination of the contract, which shall be allocated from the State's capital. However, the PPP law remains unclear as to whether such "buy-out" payment sufficiently covers outstanding debts, equity capital investments and investment returns/profits, and how effectively such payments will be made through State's capital.

In this respect, under the recent draft of the new Decree guiding the implementation of the PPP Law, PPP project contracts will need to stipulate the termination compensation amount, which consists of the reasonable value of the works executed under the PPP contract, the expenses and losses incurred by the investor, and loss of profits (if any). However, given that there is no clarification on how to determine the "reasonable value" of the executed works, details of these payments will need to be negotiated on a project-by-project basis.

For the second scenario of termination due to the investor's / project company's defaults or events, the PPP Law requires the investor to transfer its shares or capital contribution portion to a new investor.

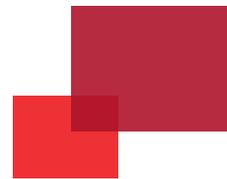
Given the general wording of the PPP Law, further details on termination events and compensation payments will need to be more clearly guided in the upcoming new Decrees to create more certainties in terms of payment protections.

In this respect, regarding a compensation amount upon termination events, Article 42 of the draft guiding Decree refers to a similar principle for both the first scenario (i.e., termination events due to governmental events or defaults) and the second scenario (i.e., termination due to investor's defaults or events). Accordingly, the draft Decree further clarifies that the PPP project contract can include more details on compensation payments to be determined by either party to the PPP contract, which may include: compensations for worked performed under the PPP contract, expenses incurred and loss of profits (if any). However, specific determination of the amount and components of compensation payments will need to be negotiated on a project-by-project basis.

Transfer or assignment of PPP project sponsors' rights and obligations

The PPP Law provides for certain conditions for an investor to assign its shareholding or capital contribution in a PPP project company to another investor.

If the PPP project company is established by a consortium of multiple investors, then each membership investor has the right to transfer its shares to another membership investor in the consortium only if the capital contribution among them ensures the required minimum equity ratio of each member in the consortium. Under the PPP Law, the lead investor in the consortium must contribute a minimum 30% of the total equity contribution to the project company, and each membership investor must contribute a minimum 15% of the total equity contribution to the project company.



In addition, the PPP Law stipulates that in case the transfer is from an existing investor to a new investor out of the consortium of existing investors, then such transfer can only be carried out after the project's construction has been completed or the project has commenced its operation phase (if the project has no construction work element).

In addition, in both of the above-mentioned cases, the relevant investors must also satisfy the general conditions of a permitted transfer in a PPP project, including: (i) the proposed transfer must not change the implementation of the signed PPP project contract; (ii) the transfer must be conducted in compliance with the relevant laws; (iii) the transfer must have been agreed by the relevant State agency entering into the PPP contract; and (iv) the transfer must have been agreed by the lender(s) and the other membership investors in the consortium (in case of a consortium of multiple investors).

Given that the PPP Law restricts transfers or assignments of a PPP project company's rights with specified limitations and conditions, under the PPP Law, relevant investors in a PPP project may need to take these conditions into account in the investment's early stage to properly design relevant legal, corporate and project structures for project development and financing in compliance with the PPP Law's requirements.

Governing law of PPP project contracts

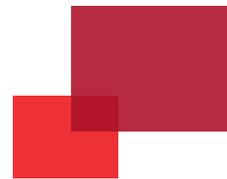
Under the PPP Law, the PPP project contract, its appendices and other relevant documents signed between the Vietnam state agencies and the investors/PPP project company are governed by Vietnamese laws. The PPP Law has added that "for matters for which Vietnamese laws do not regulate, the parties may agree in detail in the PPP Project Contract on the basis of being not contrary to the fundamental principles of Vietnamese laws."

However, the added wording of the PPP Law does not make any reference to "foreign law," and so the applicability of foreign law as the governing law of PPP project contracts remain uncertain.

In addition, as the PPP Law imposes a qualification regarding matters that Vietnamese laws do not regulate, the agreement on governing law for those issues must not be contrary to the fundamental principles of Vietnamese laws. This raises another enforcement issue that those rules practically allow a Vietnamese court to refuse the application of foreign law in cases where it is inconsistent with the fundamental principles of Vietnamese law.

Unlike the "applicable laws" concept, the concept of "governing law" of a contract refers to parties' choice of a specific law to interpret concepts and terms of the contract. It is impractical and unenforceable for parties to specify in the PPP project contract/concession agreement, "matters for which Vietnamese laws do not regulate" and which are "not contrary to the fundamental principles of Vietnamese laws."

As this clause applies to all PPP projects setting a compulsory and non-negotiable rule, it continues to raise concerns for foreign investors and financiers over parties' flexibility to negotiate the governing law of PPP contracts on a project-by-project basis, as well as the lack of predictability in terms of the interpretation of concepts and enforcement of obligations of the parties involved. This clause may also not be aligned with the proposed law's set objectives of attracting foreign investors with strong financial capacity in



PPP investment to large-scale projects, or of increasing the attractiveness of PPP projects. Having said that, governing law may not always be a stand-alone bankability issue for many projects, and certain measures can be made to improve drafting and predictability of relevant project contracts on a project-by-project basis. For this purpose, among other things, an offshore arbitration can be considered to be negotiated for large-scale foreign-invested projects on the basis discussed further below.

Resolution of disputes

Under the PPP Law, disputes between the competent agency, the contract signing agency and a foreign investor or a PPP project company established by a foreign investor are resolved by: (i) Vietnamese arbitration; or (ii) a Vietnamese court, **unless agreed otherwise in the PPP project contract or provided otherwise under an international treaty to which Vietnam is a member**. In this case, the PPP Law does not specifically refer to "foreign arbitration" or "international arbitration." However, based on the underlined wordings, foreign investors will need to negotiate for "foreign arbitration" or "international arbitration" on a project-by-project basis.

Transitional process until the effectiveness of the PPP Law

The PPP Law takes effect from 1 January 2021. Given that there are substantial changes in comparison to the current PPP regulations, the PPP Law stipulates a transitional process for the implementation of certain changes. Investors are recommended to review the notable transitional points below and consider their impacts on a project-by-project basis.

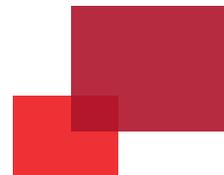
For PPP projects that satisfy the PPP sectors and minimum investment scales required:

- If a project has its investment policy decision/approval issued by the relevant investment authority before 1 January 2021, the next steps of such project will be implemented according to the PPP Law.
- If a project has its feasibility study report (FS report) approved by the relevant authority before 1 January 2021, then the investor of such project can carry out the next steps following the FS report approval in accordance with the PPP Law, except when the investor selection has not been completed. If the investor selection has not been completed, then the additional remaining steps for the selection of the investor for that PPP project will need to be approved.

In the above cases, if the State's capital contribution exceeds 50% of the total investment amount (i.e., the ceiling ratio threshold newly required under the PPP Law), it is not required for the relevant investors or the State to amend the State's capital ratio in such projects.

Otherwise, for a PPP project that is not in the eligible PPP sectors or does not meet the applicable minimum investment scale:

- If the PPP project does not have pre-qualification investor selection or has not been issued the tender invitation dossier or set of requirements, the project's implementation will be stopped.
- For a PPP project that has been under the investor selecting process:



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- If that project has its pre-qualification investor selection approved, then it will proceed with the next step of its implementation under the PPP Law.
- If that project has been issued a tender invitation dossier and set of requirements before 1 January 2021 but its tender close is later than 31 December 2020, the party inviting tender will have to extend the tender close period in order to amend the tender invitation documents or set of requirements in accordance with the PPP Law without amending the approved investment policy decision and FS report.
- If that project has its investor selection but the PPP contractual negotiation is carried out after 1 January 2021, then the relevant authorities will organize negotiation and execution of the contracts subject to the results of investor selection, tender proposals, and tender invitation documents under the PPP Law, without amending the approved investment policy decision and FS report.

PPP project contracts signed before 1 January 2021 will remain effective under their agreed terms.

As for the removal of BT projects from 1 January 2021:

- BT projects for which the tender invitation documents or set of requirements have not yet been issued shall be stopped.
- The BT projects for which the tender invitation documents or set of requirements have been issued shall continue, subject to the law at the time of issuance of the tender invitation documents or set of requirements.
- BT projects whose investor selection results are expected before 1 January 2021 shall continue on the basis of the law at the time of issuance of the tender invitation documents or set of requirements.
- For BT projects for which contracts are signed before 1 January 2021, the relevant investors shall continue the contractual implementation and payment according to the executed contract and the laws at the date of signing.
- BT projects without investment policy decision approval shall be stopped from 15 August 2020.
- Newly proposed BT projects will be stopped from 1 January 2021.

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If you would like to further discuss details of the PPP Law or long or short-term priorities of the energy sector in Vietnam, please do not hesitate to contact us.