PRIVATE SECTOR PERSPECTIVES ON PUBLIC-PRIVATE PARTNERSHIPS IN VIETNAM

Hanoi, April 2020
PREFACE

Vietnam ranked No. 79 out of 137 countries in the world in infrastructure quality in the World Economic Forum’s Global Competitiveness Report 2017-2018. Only 20% of Vietnam’s roads are asphalted, much lower than other countries such as Malaysia, India and Indonesia. The Asian Development Bank (ADB) estimated that Vietnam will need US$480 billion for infrastructure investment in 2017-2030. This is a huge investment value and a ‘financial burden’ for Vietnam. Therefore, private investment is needed to bridge this funding gap. Expanding public-private partnership (PPP) also helps the Government to capitalize on private sector expertise and technology to improve infrastructure and service delivery in terms of better quality and cost which will boost economic growth and generate various opportunities.

While the world is being reshaped, Vietnam has plenty of opportunities to attract foreign investment. The legal system for PPP is a prerequisite and must be built with a stable regulatory framework in a transparent and predictable business investment environment, and follow international standards.

Representing the Vietnamese business community and acting as a bridge between the Government and the business community, the Vietnam Chamber of Commerce and Industry (VCCI) has shown its important role of listening and integrating opinions of the business community and stakeholders raising the opinions of the business community on policies in general and on the draft PPP Law in particular.

After the Prime Minister established the Public Private Partnership Committee under the National Council for Sustainable Development and Competitiveness Improvement, the President of VCCI was assigned to chair the PPP Committee and holds the vice chairmanship of the National Council. Since then, VCCI has become increasingly involved in policy advocacy and PPP promotion with such specific activities as establishing the Project on Enhancing Private Participation in Public-Private Partnership in Vietnam, making research reports, and holding workshops on topics concerning the draft PPP Law. Opinions collected at the workshops are useful and timely for drafting and appraising agencies to review the bill.

In order to report multidimensional information on stakeholder views on public-private partnership in Vietnam, VCCI cooperated with USAID to compile the report titled “Private perspectives of public-private partnership in Vietnam”. The information provided in this document is based on domestic and international researches, authors’ expert views and opinions of interviewees.

Vietnam Chamber of Commerce and Industry
Public Private Partnership Committee - National Council for Sustainable Development and Competitiveness Improvement
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Disclaimer: The views expressed in this material are those of the authors and the interviewees and does not necessarily reflect the views of the Viet Nam Chamber of Commerce and Industry, USAID or US Government.
### ACRONYMS

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<tr>
<th>Acronym</th>
<th>Definition</th>
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<tbody>
<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
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<td>ASA</td>
<td>Authorized State Agency</td>
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<td>BLT</td>
<td>Build-Lease-Transfer</td>
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<td>BOO</td>
<td>Build-Own-Operation</td>
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<tr>
<td>BOT</td>
<td>Build Operate Transfer</td>
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<tr>
<td>BT</td>
<td>Build-Transfer</td>
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<tr>
<td>EIA</td>
<td>Environment Impact Assessment</td>
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<td>EVN</td>
<td>Vietnam Electricity Group</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>HCMC PPC</td>
<td>Ho Chi Minh City People’s Committee</td>
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<td>IPP</td>
<td>Independent Power Plants</td>
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<td>JCCI</td>
<td>Japan Chamber of Commerce and Industry</td>
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<td>MOF</td>
<td>Ministry of Finance</td>
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<td>MOIT</td>
<td>Ministry of Industry and Trade (MOIT)</td>
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<tr>
<td>MOT</td>
<td>Ministry of Transportation</td>
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<tr>
<td>MTIP</td>
<td>Mid Term Investment Plan</td>
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<td>MPI</td>
<td>Ministry of Planning and Investment</td>
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<td>NCSDCI</td>
<td>National Council on Sustainable Development and Competitiveness Improvement</td>
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<td>PDF</td>
<td>Project Development Fund</td>
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<td>PPP</td>
<td>Public-Private Partnerships</td>
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<td>PIP</td>
<td>Public Investment Planning</td>
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<tr>
<td>SPC</td>
<td>Special Purpose Company</td>
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<tr>
<td>VBF</td>
<td>Vietnamese Business Forum</td>
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<tr>
<td>USAID</td>
<td>US Agency for International Development</td>
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<tr>
<td>VARISSI</td>
<td>Vietnam Association of Road System Investors</td>
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<tr>
<td>VCCI</td>
<td>Vietnam Chamber of Commerce and Industry</td>
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<tr>
<td>VGF</td>
<td>Viability Gap Funding</td>
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<tr>
<td>VND</td>
<td>Vietnamese Dong</td>
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EXECUTIVE SUMMARY

According to the Global Infrastructure Outlook, Vietnam will need over $600 billion to reach its infrastructure goals by 2040. Given current public budget constraints, it is estimated that over 50 percent of the funding required will need to come from the private sector. Only 10 percent of Vietnam’s infrastructure is funded by the private sector, far lower than in many other middle-income countries in Asia. Incentivizing private sector participation requires a favorable investment climate, as well as market-based risk adjusted returns for investors. This in turn requires policy and legal reforms to create a consistent and sustainable platform for partnership between the public and private sectors.

Public-Private Partnerships (PPPs) are one mechanism for increasing the involvement of the private sector in infrastructure development. According to official government statistics, as of 2019 there have been 336 PPP projects in Vietnam, with a total investment capital of approximately US$70 billion, with most of the projects in the transportation sector in the forms of Build-Transfer (BT) or Build-Operate-Transfer (BOT). Around two-thirds of PPPs are in the transportation sector, but additional projects include resettlement housing, office buildings, energy infrastructure, as well as water supply and sewerage.

THE OPPORTUNITY IS NOW FOR PPPS IN VIETNAM

As demonstrated in the 2019 Global Infrastructure Investor Survey by EDHEC Infrastructure Institute of Singapore, Vietnam is among the top five emerging infrastructure markets with the most potential in the next five years, alongside India, China, Brazil, and Indonesia. Various expressway projects are planned and underway to improve connectivity within major cities in Vietnam, with a total investment value worth up to US$120 billion.

According to an international consulting firm, which has long history of providing advisory services in infrastructure, health care, and government services, there is high level of interest in investing in infrastructure in under PPP as Vietnam has a stable political environment, high level of public security and no risk of terrorism. However, they have not been able to invest in Vietnam due to regulatory and implementation challenges that cannot be overcome under the current regulations and institutional arrangement. Japanese investors who have been actively investing in power sector, confirmed the large potential for PPPs in Vietnam in many other sectors such as health care, airport and road construction and they are ready to expand provided that better risk sharing is provided to enable them to raise financing from financial institutions.

In order to promote PPPs, the Government of Vietnam (GVN) is currently working to develop a new law on PPPs. After several rounds of review and consultations, the Law is currently under consideration by the National Assembly.

MOBILIZING THE VOICE OF THE PRIVATE SECTOR

In 2018, the Prime Minister established the National Committee on PPPs as a professional body under the National Council on Sustainable Development and Competitiveness Improvement. The Committee on PPPs is charged with 1) Developing policies and PPP projects/programs for sustainable development and long-term national competitiveness enhancement; 2) Mobilizing both domestic and foreign resources; and 3) Encouraging
businesses to present ideas and build PPP models/projects in a sustainable way. The Chairman of the Vietnam Chamber of Commerce and Industry (VCCI) serves as the Chairman of the National Committee on PPPs, providing the Committee with an ideal role in mobilizing the voice of the private sector, both domestically and internationally.

In support of its mandate, the Committee on PPPs, in collaboration with USAID, has collected feedback from the business community and consolidated the recommendations into this Green Book, presenting the current situation, potential opportunities, and constraints to greater private sector participation in PPPs. **The goal of this report is to ensure that the Law captures the essential elements needed by the private sector to effectively maximize the potential of PPPs in Vietnam.**

**PRIVATE SECTOR-DRIVEN RECOMMENDATIONS FOR THE PPP LAW**

In light of the above issues faced by investors during implementation of PPP projects, and after analysis of the draft PPP Law, the following table represents a summary of key private sector recommendations on amending the draft Law. The recommendations are based on recommendations from the private sector and good practices in both the domestic and international market for PPPs, which will remove barriers to private sector investment in PPP projects in Vietnam.

**Figure 1: Summary of Recommendations**

<table>
<thead>
<tr>
<th>PPP Sectors (Article 5)</th>
<th>In consideration of the need to focus limited resources on key sectors, while being open to new sectors, the private sector supports the view that the Law should focus on a few sectors and allow the Prime Minister to add new sectors when needed. More clarity is needed regarding the type of infrastructure assets in the power sector, and in particular energy efficiency, renewable energy, and street lighting projects should be included.</th>
</tr>
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<tbody>
<tr>
<td>Revenue Risk Sharing Mechanism (Article 83)</td>
<td>It is recommended that revenue risk sharing mechanism be included. The level of revenue sharing thresholds should be decided on a project by project basis, as different projects have different risk profile. Revenue risk sharing is a very effective manner to encourage foreign investments. Furthermore, the private sector views that the threshold should not be fixed, as is set out in the current draft. Instead, it should be allowed to be set for each project, supported by an effective and transparent mechanism to control for contingent liabilities and ceiling for public debt.</td>
</tr>
<tr>
<td>State Capital in PPP (Article 70)</td>
<td>In addition to state capital participation during construction, it is necessary to be able to mobilize state capital for maintenance and operations to address new challenges that need government supports. Consultation with banks is during the development of feasibility study is critical to ensure the bankability of the project.</td>
</tr>
<tr>
<td>Guarantee of the obligations of ministries and State-owned Enterprise PPP Counterparties (Article 98)</td>
<td>It is recommended that the GVN should guarantee the obligations of relevant ministries, Vietnam state bodies, and state-owned enterprises under PPP contracts. Contract modification must be done through negotiation to ensure the interest of all parties. Cooperation of state agencies with ASA is key to the success of PPP projects.</td>
</tr>
<tr>
<td>Guarantee on Foreign Currency Conversion (Article 82)</td>
<td>It is recommended that the Government shall guarantee convertibility from Vietnam Dong payable under PPP contracts into foreign currencies to ensure the availabilities of foreign currencies for PPP contract implementation and</td>
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repayment of debts. The availability of foreign currencies should not be capped at 30 percent of revenue, instead it should be flexible.

<table>
<thead>
<tr>
<th><strong>Time-limit for Financial Arrangement (Article 77)</strong></th>
<th>The draft law should specify what kind of “financial arrangement” should be completed within the time frame specified in the draft Law.</th>
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<tbody>
<tr>
<td><strong>Early Termination Payments (Article 55 and 70)</strong></td>
<td>It is recommended that the draft Law specify the key principles for termination payment in all termination scenarios allowed in the draft Law. Compensation should be sufficient to pay at least remaining debt amount and relevant termination costs.</td>
</tr>
<tr>
<td><strong>Allow Some Room for Foreign Laws to Govern (Article 57)</strong></td>
<td>It was adamantly stated that if the governing laws are exclusively Vietnamese laws, and foreign laws are not allowed in some way (at the very least the financing documents), the projects will not be bankable and foreign financiers will shy away from the project. For the benefit of both Vietnamese and foreign investors, the Law should leave room for foreign law to be applicable to project-related contracts, depending on negotiations between Government agencies and investors.</td>
</tr>
<tr>
<td><strong>Institute a Project Development Fund (PDF) for project preparation</strong></td>
<td>The private sector believes that a dedicated PDF would allow more flexibility and certainty for preparation and implementation (or disbursement) of the state capital for each project.</td>
</tr>
<tr>
<td><strong>Step-in Rights of Lenders (Article 55)</strong></td>
<td>Lenders should have the right to enter into agreements with the parties to a PPP contract. This will enable lenders to exercise step-in rights and cure defaults under a PPP contract on behalf of the project company and investors in certain circumstances as prescribed in such agreements.</td>
</tr>
<tr>
<td><strong>Selection of domestic Contractors (Article 60)</strong></td>
<td>The draft PPP law should not contain requirements that force investors to select domestic contractors in preference to foreign contractors, even though domestic contractors may be capable of performing the relevant work. A legal requirement to select domestic Vietnamese contractors over foreign contractors will significantly deter international investors from participating in Vietnamese PPP projects.</td>
</tr>
<tr>
<td><strong>Land Clearance</strong></td>
<td>The draft law should clarify the support measures by the State in land clearance so that the Special Purpose Vehicle would have the required land to start construction on time. This land availability issue is paramount to international investors as this is one of the most important risk elements that is more properly allocated to the State rather than private investors.</td>
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I. INTRODUCTION

Over the last decade, private financing through public-private partnerships (PPPs) has become increasingly popular around the world as a way of procuring and maintaining infrastructure such as transportation, public utilities, social infrastructure, and other specialized services. According to the Global Infrastructure Outlook, Vietnam will need over $600 billion to reach its infrastructure goals by 2040. In the context of public debt reaching the statutory cap set by the National Assembly at 65 percent of gross domestic product (GDP), the limited viability of loans from multinational development banks, the government will need to mobilize new streams of investment.

Given current public budget constraints, it is estimated that over 50 percent of the funding required will need to come from the private sector. Incentivizing private sector participation requires a favorable investment climate, as well as market-based risk adjusted returns for investors. This in turn requires policy and legal reforms to create a consistent and sustainable platform for partnership between the public and private sectors. PPPs are one mechanism for increasing the involvement of the private sector in infrastructure development.

In order to boost PPPs in Vietnam, the government is developing a new law on PPPs. The draft PPP Law was composed by the Ministry of Planning and Investment (MPI) after several rounds of feedback from various stakeholders, including government ministries, provincial governments, the international community, private organizations, and international consultants. The draft Law is currently under consideration by the National Assembly.

In 2018, the Prime Minister established the National Committee on PPPs as a professional body under the National Council on Sustainable Development and Competitiveness Improvement. The Committee on PPPs is charged with 1) Developing policies and PPP projects/programs for sustainable development and long-term national competitiveness enhancement; 2) Mobilizing both domestic and foreign resources; and 3) Encouraging businesses to present ideas and build PPP models/projects in a sustainable way. The Chairman of the Vietnam Chamber of Commerce and Industry (VCCI) serves as the Chairman of the National Committee on PPPs, providing the Committee with an ideal role in mobilizing the voice of the private sector, both domestically and internationally.

In support of this mandate, the National Committee on PPPs is collaborating with USAID to gather feedback from the business community and consolidate into a Green Book that presents the current situation, potential opportunities, and constraints greater private sector participation in PPPs. The Green Book provides the voice of private sector through desk research, in addition to interviews with domestic and foreign investors, as listed in the attached annex. It highlights the existing status quo on private sector participation in infrastructure development in Vietnam and provides recommendations to removing barriers to private sector participation in infrastructure.

In developing this Green Book, the team interviewed a number of local and international investors, financial institutions, and transaction advisors. The list of the interviewees is provided in Annex I. Prior to the interview, the PPP Committee distributed a questionnaire which formed the basis for the discussion. This methodology was used because PPP is a complicated topic and face to face interviews would allow for better exchange of information and focus on certain issues of interest.
2. OVERVIEW OF THE LEGAL AND REGULATORY FRAMEWORK ON PPPS

In Vietnam, PPP in the forms of BOT, BTO, BT contracts have been around since 1997 with the Government issuing Decree 77/ND-CP on BOT applicable to domestic investors and Decree 62/1998/ND-CP on BOT-BTO-BT applicable to foreign investors. Foreign and domestic investors were treated differently.

On May 11, 2007, the Government issued Decree 78/2007/ND-CP on BOT-BTO-BT forms applicable to all types of ownerships, foreign and domestic, in the economy. The Decree 78/2007/ND-CP was then replaced by Decree 108/2009/ND-CP and the Prime Minister issued Decision 71/2010/QD-TTg regulating on piloting PPP investment scheme, which prescribes the forms of public investment in PPP projects in a more comprehensive way. Moreover, the PPP concept has been recognized by legal documents with higher validity including Law on Tender 43/2013/QH13, Law on Public Investment 49/2014/QH13, Law on Construction 67/2014/QH13, and Law on Investment 67/2014/QH13.

The Government issued Decree 15/2015/ND-CP on PPPs, consolidating Decree 108/2006/ND-CP and Decision 71/2010/QD-TTg and issued Decree 30/2015/ND-CP providing detailed guidelines for implementing Law on Tender in selecting investors. In 2018, the Decree 15/2015/ND-CP was replaced by Decree 63/2018/ND-CP by the Government setting forth sectors, requirements, and procedures for investment in form of PPPs.

Current PPP regulations are inadequate and often inconsistent with other laws. The legal framework for PPPs has evolved over the last 30 years, but the current highest governing regulations are still at the decree level and often inconsistent with, and subservient to, other laws.
3. POTENTIAL OF PRIVATE SECTOR PARTICIPATION IN INFRASTRUCTURE IN VIETNAM

Governments around the world employ PPPs to meet the growing demand for new and better infrastructure services by leveraging private financial institutions and expertise. PPPs are able to provide better value for money over traditional public procurement. Value for money from PPPs is obtained through improving investment efficiency, better mitigating risks, and outputs-oriented performance. The following is a summary of existing private sector participation in infrastructure in Vietnam:

- According to government official statistics from 2019 the line ministries, agencies and provinces have signed and implemented 336 PPP projects, with a total investment capital of VND 1,609,335 billion (about US$ 70 billion).

- The dominant share of PPPs is in the field of transportation (220 projects); resettlement housing, dormitories, etc. (32 projects); office buildings (20 projects); energy (18 projects); as well as water supply, sewerage, environment (18 projects).

- Within the power sector, there are 18 projects under BOT forms in thermal power, with a total investment capital of US$ 41.743 billion. According to an international consulting firm, foreign investment in PPPs in Vietnam is realized only in the power sector, where the projects have a long maturity and often have a value of billions of dollars. In addition to PPP contracts, the power sector has attracted a large share on private investment inflows into independent power plants (IPP), including foreign investment.

- The agriculture sector is less attractive to PPP with only 23 projects. This is because agriculture is deemed riskier, traditionally has lower rate of returns, and suffers from a comparative under-investment by the State.

- For the healthcare sector, private participation is mainly through ‘socialization’ and not through PPP contracts. According to the World Bank Health Care Sector Specialist, there are 240 private hospitals in 50 provinces (accounting for 13 percent of total number of hospitals) and 35,000 private clinics, providing 31.2 percent of outpatients and 6.3 percent of inpatients services. Most projects are proposed and developed at the provincial level, especially in Ho Chi Minh City, and these projects are focused on heavy infrastructure development rather than preventive and primary health care services. The projects are concentrated in big cities and are perceived to provide better patient experiences.

- In terms of primary contract types, BOT and BT forms are dominant, comprising over 95 percent of PPPs. BOO and BLT are far less common. In discussing PPP contract types with a large domestic commercial bank, it was noted that they were only interested in financing BT projects, where there was land as collateral.

What is socialization?
Socialization is a Vietnamese term for the private delivery of public services or private participation in public services. The main difference between a PPP and a socialization project is that unlike a PPP, a socialization project does not have a firm contract from the Government.
The Asian Development Bank (ADB) principal private sector development specialist and PPP specialist noted in a blog post that only 10 percent of Vietnam’s infrastructure is funded by the private sector\(^1\), far lower than in many other middle-income countries in Asia. Yet, according to 2019 Global Infrastructure Investor Survey by EDHEC Infrastructure Institute-Singapore\(^2\), Vietnam is among the top five emerging infrastructure markets with the most potential in the next five years, together with India, China, Brazil, and Indonesia.

The Infrastructure Vietnam Conference 2019 reported that just 20 percent of the country’s national roads are paved. The rising population in major cities in recent years has strained and exceeded capacity of the existing connectivity networks and utilities systems. With 50 percent of Vietnam’s population expected to be living in cities, Hanoi and Ho Chi Minh are building rapid transit systems exceeding US$ 22 billion in the hope of reducing private vehicle ownership and improving air quality. The recently approved plan to build a 1,372km north-south highway by 2030 is estimated to cost US$ 14 billion, although that plan has hit some roadblocks.\(^3\)

Various other expressway projects are planned and underway to improve connectivity within these major cities. Similarly, development and upgrading of urban utilities are announced and there are 44 planned PPP projects with total investment value worth up to US$ 120 billion in the road and power sectors.

According to an international consulting firm which has advised foreign investors in infrastructure, health care, and government services, **there are many offshore funds which are interested and ready to invest in infrastructure development in Vietnam.** Investment in the country is attractive for offshore investment inflows thanks to its stable political environment, high level of public security and no risk of terrorism. However, when compared to countries in attracting foreign investment, those countries often do better than Vietnam in terms of legal and regulatory framework that is conducive for private investment.

**Among Japanese investors who were interviewed and who actively invest in power sector in Viet Nam, many said they were happy to expand to other sectors such as health care, airport and road construction as long as there is a good guarantee mechanism in place to offset the risks they faced.**

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4. CURRENT BARRIERS TO GREATER PRIVATE SECTOR PARTICIPATION IN PPP

Increased PPPs are expected to address constraints in public investment by mobilizing the private sector, with its capacity and resources, to play a vital role in financing public infrastructure. Despite this potential, the private sector has been faced with several barriers to participating in PPP projects. The key barriers raised by the private sector are described below.

4.1 LACK OF CAPACITY TO DEVELOP QUALITY PROJECTS

The ADB Senior Infrastructure Specialist pinpointed a lack of quality PPP projects when discussing why private sector participation in infrastructure has not developed commensurately with its potential. This can be attributed to weak capacity by Authorized State Agencies (ASAs), who often lack the ability to draft and negotiate PPP contracts - an important public sector capacity requirement, especially given the long-term nature and the large transaction costs associated with PPPs.

According to a representative from a Vietnamese law firm, the data collected through surveys for project development is problematic, which has resulted in many projects being subject to investment capital reduction, and thus requiring re-signing of financial plans and contracts. In addition to investment downward adjustment, many projects are faced with losses and bankruptcy threats due to inaccurate survey data in project documents.

The direct cause for the Phu My Bridge failure, for example, was due to HCMC People’s Committee (PPC) failing in its contractual obligation to build a ring road connecting to the bridge. But the root cause behind this failure was actually a poorly prepared financial plan. Even with the traffic volume as originally projected, the toll collections were not enough to pay back the loans.4

As noted by a consultant company, many transport projects fell short of expected quality and progress - 56 of 75 projects are brown field while only 19 or 75 are green field. In the healthcare sector, a World Bank Private Sector Specialist noted that of the 63 projects recently proposed, only 28 have completed pre-feasibility studies or feasibility studies, only eight projects have completed tendering documents, and only three contracts have been signed. Of these last three contracts, the Cam Pha General Hospital was cancelled after the contract had been concluded due to litigation from its staff. Clearly, time, efforts, and resources of both the private and public sectors were wasted on developing these projects.

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4 A study by Fulbright University pointed out that projected traffic was much lower than expected leading to the fact that the project could not collect enough revenue as project and even with the project revenue the project could not generate enough cash to pay back the loan.
which end up not being implemented. Market sounding needs to improve to gauge investor interest before conducting pre-feasibility studies.

Under the laws, pursuant to Article 8.7 of Decree 63/2018 / ND-CP, ASAs shall select independent consultant organizations to support the implementation of a number of duties. However, there is not much indicative practice in Vietnam for this selection process. The key issue is budget allocation for procuring and paying for advisers, and this often proves time consuming or beyond the capabilities of the government. In order for PPPs to be successful, the GVN will need to retain international and reputable financial, legal and technical advisors, and will need to ensure there will be an appropriate budget and political will for entering into these partnerships. Interviews noted these examples underscored the urgent need for developing a well-functioning, dedicated Project Development Fund (PDF).

4.2 LACK OF GUIDELINES FOR NEGOTIATING PROJECTS

As noted in discussions with representatives from the Vietnam Electricity Group (EVN), no clear and specific guidelines from the Government and the Ministry of Industry and Trade (MOIT) exist for negotiating BOT power contracts, including generation, offtake, tariffs, risk-sharing scheme. In contrast, domestic IPPs have guidelines for negotiating the tariffs with EVN. As most PPP projects in the power sector are large-scale, the negotiations for PPP project in the sector are arduously difficult.

4.3 HINDRANCES FROM OTHER LAWS AND REGULATIONS

According to the ADB representative, PPP projects are subject to multiple laws and there exist conflicts between the PPP regulatory framework and other laws, such as on tender, state budget, public investment, public debt, etc. For projects on waste treatment, for example, the Law on Environment Protection requires a detailed Environment Impact Assessment (EIA) report along with the feasibility study. At the feasibility study stage, however, the investor has not yet been selected and therefore the EIA cannot be completed because of the absence of funding.

Another issue is that PPP projects are exclusively subject to regulations on public investment projects. According to the Vietnam Association of Road System Investors, if projects are considered public investment, they are subject to public expenditure cost norms and public investment capital management. This is a deterrent to project implementation. Enterprises building roads in the Central provinces, for example, are faced with higher costs due to the harder terrain, as a result, these enterprises must apply for lengthy approval on budget increases.

In addition, a large number of power projects have not been implemented due to the lack of guidelines for implementing the Law on Planning, effective as of Jan 1, 2019. The Law on Planning has changed the planning process substantially for power projects. Where previously the power sector had many plans including those for energy, national electricity, provincial electricity, regional electricity, and plans for each power type such as wind and solar power, as per the Law on Planning, the power sector now has only a national electricity plan and an Electricity Masterplan that is integrated into the Socio-Economic Development Masterplan. According to the Law on Electricity, the projects must be in line with the masterplan yet there are no guidelines for implementing the law. Therefore, according to an EVN representative,
as many as 400 projects are waiting to be cleared for power planning changes in order to be eligible for preparation and development of projects.

PPPs are long term projects and regulatory changes may stop some projects. For example, the Trung Luong – My Thuan highway has suffered from great delay as a result of this:

- *Change of investors*: The project started under Decree 15/2015/ND-CP which did not prohibit the transfer of ownership after the signing of the BOT contract. However, Decree 63/2018/ND-CP reversed this and transfer of equity can only be done after the completion of construction. During the implementation of the above project, one investor, Yen Khanh, is under a criminal investigation and wanted to transfer its equity to the other investors in the project but the Ministry of Transportation (MOT) cited did not allow based on the Decree 63 which resulted in great delay in the implementation of the project.

- *Interest rate*: The interest rates in the approved financial plan is about 3-4% lower than the lending rates of commercial banks making it impossible to access bank loans. In 2018, the Ministry of Finance (MOF) issued a new Decree 08/2018/TT-BTC to allow market rates to be applied but this does not apply retroactively to this project making it impossible to progress.

- *State supports*: At the time of signing the contract, the PM and ministries agree to support the project with the right to collect toll on Ho Chi Minh – Trung Luong highway. However, this has been stopped and not possible since January 1, 2018 upon entry into force of the Law on Public Asset Management and Operations.

In order to address the above challenges, the MPI suggest (i) applying the transition provision under Decree 63 to the project to enable Yen Khanh to transfer its equity; (ii) Applying the rule of the MOF to the project and adjusting its financial plan; and (iii) most importantly providing viability gap funding with an obligation from the national budget instead of the right to collect toll on Ho Chi Minh – Trung Luong highway.

### 4.4 NON-COMPETITIVE TENDERING PROCESS TO SELECT INVESTORS

A competitive selection process ensures that the most competitive bid is procured, the risks are transferred effectively, and that optimal solutions are developed by the private sector. The tendering process for PPP bids should be competitive, otherwise the ASA runs the risk of ending up with incapable investor. According to MPI’s latest assessment, out of 71 PPP projects completing investor selection, 69 percent appointed investors directly. In discussions with a World Bank representative, it was revealed that in the transport sector, 74 of 75 projects were awarded by direct appointment of investors. For BT projects especially, the rate of investor direct appointment is as high as 94 percent (34 out of 36 BT projects were by direct investor appointment). It was noted that PPP was efficient, but in the absence of competitive bidding, PPP might be even more costly than the traditional public investment. Private investors with interest in PPPs do not trust the process of selecting investors due to

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5 The representative of EVN shared that this requirement has prevented some projects in the power sector from moving forward as the existing investors who do not want to implement the projects cannot transfer them to other investors.

lack of transparency. Representative from an international law firm noted that Vietnam does not have a good record in bidding out project, the preparation is poor and invitation for bids tends to be too difficult to comply with.

4.5 INADEQUATE RISK-SHARING MECHANISMS

The PPP investment form means investment is conducted based on long-term partnerships between the public and private sectors, whereby risks are allocated to the party that can handle them in the most effective and cost-efficient way. The essence of risk-sharing is the combination of "sticks and carrots" to create incentives through a contract mechanism to produce the desired outcome and prevent negative results. The objective is to achieve efficiency and optimal cost. Risk should be transferred to the party that can manage the risk most efficiently (mitigating the probability and/or consequences of the risk of transferring them to a third party at an efficient cost).

Risk allocation mechanisms must be included in project proposals and feasibility study reports. More specifically, if it's too burdensome for the private sector, then it is difficult for the private sector to secure bank financing. Most PPP projects are financed by bank borrowings and a one or two year delay as a result of land clearance would turn a profitable project into a loss-making one and a five year delay would push the business to bankruptcy.

As cited by the ADB Specialist interviewed, risk allocation is not optimal, often placing undue burden on one party or the other. There is no official standard or risk allocation template and risk allocation is negotiated with ASAs on a case-by-case basis. This negotiation process takes a long time and foreign investors often encounter difficulties in navigating the process. According to an international law firm, authorities have yet to clarify a risk-sharing mechanism in which the government guarantees a certain minimum revenue flow for the developer, agreeing to supplement revenue if this minimum is not met. This is especially important in the case of infrastructure, where projects can often carry significant risk.

Increased regulatory clarity would help investor confidence. The current model transfers most of the risk on to the private sector. To attract private sector investors and operators, a transparent policy framework and fair allocation of risk are key. Similarly, attractive deal structures with a clearly defined project scope and adequate guarantees on the expected financial return will help to encourage participation in PPP deals.

4.6 RISKS FROM CHANGES IN POLICY

In most cases, the PPP contract covers a long period of time, where investors are exposed to many risks. A representative from a credit institution, for example, cited policy change as a considerable risk, where a change in government can result in a change in policy that may impact project implementation. Recently, projects have been affected due to inconsistencies in policies and planning. With the Phu My Bridge, noted above, the HCMC PPC failed to fulfill the commitment of building the Ring road #2 in the East to connect Nguyen Van Linh to Hanoi Highway through Phu My Bridge and the actual traffic volume turned out to be much lower than projected (only about 53.7 percent of the projection). This has seriously impacted the project revenue.
In other cases, the contractual obligations are not strictly observed and investors are subject to discretionary acts by the state. One representative from a construction company commented that some projects were forced to exempt or reduce fees due to the resistance of the people, resulting in heavy impacts on the financial plan and a prolonged repayment period. Similarly, according to a consultant group on infrastructure solutions, the Vietnamese Government’s recent actions on some of the road BOT projects created negative perceptions about risk. For example, in the case of one current transportation project, because of Government’s effort to curb inflation under the Resolution 35 / NQ-CP, it has required additional works from the investor, suspended toll collection, reduced the toll area and shortened the term of the BOT agreement. Needless to say, this practice creates much uncertainty for both domestic and foreign investors and are generally perceived as increasing investor risk.

In addition to contract provisions, investors are also subject to discretionary administrative documents by the State agencies and in many cases, these administrative orders contradict with the contractual obligations negotiated and signed by the parties. During discussions of the uncertainties that impact the investors, a representative of Deo Ca Group made a frank remark:

“ASA and the investor are parties to the PPP contract who are equal partners and must honor the signed contract. If it is necessary to change the contract, the party must negotiate to ensure the interest of all parties. The investor should not be viewed as if it were the builder and instructions and orders from the state must be made in the form of a request to modify the contract”

In the Deo Ca Tunnel Project, for example, the Deo Ca Group prepared a financial plan with the State contributing equity, financing from Government bond proceeds, and including toll collection as a commitment in the contract. The State, however, did not fulfill the commitments. Specifically, $51.7 million from the total of $217.2 million in Government bonds was withdrawn following a decision of the National Assembly. This has impacted the investment capital for the project. Additionally, the MOT was asked to review toll collection stations at La Son – Tuy Loan for the new tunnel, as well as toll fees, and the MOT acted without consulting investors and developing plans for compensation. As a result, the removal of toll plazas has adversely impacted project revenue.

4.7 SEQUENCE OF COMPONENT PROJECTS, UNSECURED SUPPLY OF FUEL, AND MONOPOLY OF TRANSMISSION GRID IN POWER SECTOR

The representative from EVN cited that for PPP projects in the power sector, the project size is quite large, and there are many associated/component projects attached to the main PPP project that need to be appraised and approved. Many component projects, however, are not approved in sequence with the main PPP project, which causes further delay to the PPP project implementation. The transmission line project (Van Phong – Vinh Tan 500 KV line under Van Phong I project, Sumitomo BOT), for example, has been delayed in Government approval process.
Many PPP power plants use coal and gas to fuel power production. The sources of supply, however, cannot always be secured in both price and quantity. Vietnam National Coal-mineral Industries Holding Corporation Limited (Vina Comin), specifically, cannot guarantee the supply of coal. Domestic production is fraught with difficulties and importing these goods is also very volatile. Only PVN’s Thai Binh 2 Thermal power has been successful in supplying its three million tons of coal per year. Without a secured supply source of fuel, private investors will not invest in PPPs in power.

The EVN representative commented that the Law on Electricity stipulates that the State will hold a monopoly over the transmission grid. It is unclear from the law, however, whether this monopoly is limited to transmission management only, or also applied to investment in the transmission grid. In practice, there are investors who invest in the transmission grid, transfer to the State and has a share in the revenue that the Government collects on the transmission grid. Yet Trung Nam, an investor in solar power, planned to invest and transfer to the State their generation dispatch lines but faced protracted delays due to the article in the Law on Electricity mandating the State monopoly over the transmission grid.

A representative from EVN recommended that 1) project approval should be well coordinated and appraised in a holistic way to avoid undue delays, 2) the supply sources of fuel should be guaranteed by stakeholders such as TKV and PVN, and 3) there should be clear guidelines on the transmission grid state monopoly to incentivize the private investment in transmission grid with clear regulations on transfer and operation.
5. PRIVATE SECTOR COMMENTS ON DRAFT LAW ON PPP

Cognizant of the constraints faced by the private sector in participating in infrastructure through PPP projects, the Government has exerted efforts to improve the legal framework for PPP projects development and implementation through the draft Law on PPPs. However, many issues of potential concern to the private sector continue to exist within the latest draft. Based on our interviews, there are discussed below.

5.1 PPP SECTORS

The draft Law on PPP will impose limits on the sectors open to PPPs while authorizing the Prime Minister to add new sectors if needed. The areas for growth listed in the draft Law cover most of the sectors where PPP has taken place. However, as the situation changes quickly with technology and local and international development, sectors where PPPs are viable options may change from time to time.

Often, in one sector for example in power generation, there exist three kind of investment i.e. public investment (state power plants) private investment (IPPs); and PPPs (BOT power plants). In some projects, PPP is the only viable option to do this such public lighting or solar rooftop on government buildings. The notion that there is already private investment in certain sector and PPP is not needed will lead to missed opportunities for attracting productive investment in PPPs in Vietnam.

Investors from the United States recommend expanding areas in the power sector, including Liquid Natural Gas terminal projects, regasification projects and pipeline/gas transportation projects. Additionally, investors noted potential for PPPs in photovoltaic power stations (i.e. solar parks).

PPP projects in energy efficiency, solar rooftop, and street lighting areas should also be included as there is investor interest in these sectors and PPP is often the only viable option for growth. Some provinces have successfully conducted PPPs in street lighting, which can be scaled and repeated by other provinces.

5.2 REVENUE RISK SHARING

Private sector interviewees consistently noted the lack of government guarantees in PPP projects as a main reason why a number of PPP projects in the transport sector were put on hold (including Dầu Giây - Phan Thiết; Tân Vạn – Nhơn Trạch). Very few foreign investors are interested in PPP projects if there is no government guarantee for minimum revenue. This is the case of TKV’s Quynh Lap I thermal power project, where the TKV has not been able to secure financing from interested banker/financiers due to the absence of a government guarantee.

“We have contacted and pitched projects to Japanese and European investors, who said that they would be interested only if there were government guarantee mechanisms for minimum revenue and foreign exchange”.

- Deputy Director of Thang Long PMU
With vast experience in advising PPP projects, a representative from Vietnam’s leading financial law firm, mentioned that in many cases banks asked for guarantees beyond the limited liability with special purpose company assets, and recommended that the Government guarantee for the PPP projects be introduced to improve the security for private investors. Japanese investors have reiterated that although they have plans to expand investment to health care, airport and road construction, they would not finance PPP projects without a government guarantee. This view was also shared by the President of the Association of Foreign Direct Investment Enterprises who stressed the importance of revenue guarantees and risk sharing to entice foreign investors.

The Thang Long PMU, for example, has been assigned to the Ministry of Transport as the ASA to implement two of eight component projects in the North – South Expressway (Mai Son – Highway 45 and Highway 45 – Nghi Son). For this project, the Deputy Director noted that investors want guarantees that ensure their money is being well managed and that there are mechanisms in place to ensure the financial protection for all parties.

To improve security for private investors, the Government intends to introduce revenue risk sharing for PPP projects. According to the existing draft, the Government will share with investors 50 percent of the revenue shortfall between the actual revenue and revenue committed by the contract (not exceeding 75 percent of revenue set out in the financial plan). On the other end of the spectrum, the investors and/or special purpose company (SPCs) will share 50 percent of the revenue surplus will between the actual revenue and revenue committed by the contract (not exceeding 125 percent of revenue set out in the financial plan) with the Government. Every three years, the parties shall determine the differences between actual revenue and revenue committed by the contract. The financing for guarantee will be sourced from the contingency (or unallocated budget) from public investment planning (PIP).

Representatives of Japanese investors noted that revenue guarantees are a very effective way to encourage foreign investments, but that the threshold should not be fixed as it stands the current draft. They noted, however, that the ratio of revenue risk sharing should be decided on project by project basis because project viabilities are different for each project, and the set provisions in the Law risk constraining investment.

In finalizing the Green Book, PPP Committee, USAID, and Institute for Policy Studies and Media Development conducted a round table discussion on risk sharing in PPPs with several investors, financiers, and advisors. Annex II provides a summary of the discussion.

5.3 ACCESS TO FOREIGN CURRENCY

International investors and lenders want to assure that they can convert their revenue in local currency to hard currency to pay for 1) imported inputs; 2) service their loans; and 3) pay for other expenses as needed. Under normal conditions, they can buy hard currency from banks without any problem.

As PPP is a long-term commitment and often involves a lot of money, investors and lenders often require government to guarantee that in the worst case scenario they can access the national foreign exchange reserves for this above purposes. The draft Law on PPP stipulates that, for important projects approved by the National Assembly and Prime Minister, the GVN may provide a guarantee on access to foreign currency up to 30 percent of the net foreign
exchange need (i.e. local currency revenue minus expenses). This is the same as the current practice.

This may represent a missed opportunity. Japanese investors, in particular, stressed the need for this kind of guarantee, which is a pre-condition for their bank loans. They recommended that the ceiling limit on this guarantee should not be included in the law to enable the GVN to tailor their approach meet the need of different projects.

5.4 TIME-LIMIT FOR FINANCIAL ARRANGEMENT

The draft Law states that within 12 months from the contract signing date, the investor or SPC has to have completed their financial arrangement. According to the representative from multinational law firm, the Law should clarify what constitutes the financial arrangement and the requirements should align with implementation realities. In practice, if financial arrangement completion is defined as the process leading to the first drawdown, it normally takes 12-18 months to complete, and the requirement should adhere to this timeframe.

5.5 TERMINATION PAYMENT

In discussing the issue of termination payments with the Japan Bank for International Co-operation, and as suggested by other foreign lenders and donors, a termination payment clause should be stipulated under the following condition within the PPP law for the benefit of investors and/or lenders. Investors and/or lenders should be appropriately compensated when the termination is due to 1) government default, 2) borrower’s default, 3) political force majeure and 4) natural force majeure as stipulated in the approved project contract. In the case of the project company’s default, compensation should be payable if the relevant authority elects to purchase the project. Such compensation should be supported under Government Guarantee and Undertakings. Compensation should be sufficient to pay at least remaining debt amount and relevant termination costs in all cases.

The current draft has not specified the compensation arrangements but leaves room for the Government to specify in regulations. These key principles should be addressed in the new law.

5.6 GOVERNING LAW & APPLICABLE LAWS

Unfortunately, applicable laws and governing laws are understood differently by the Government and international lawyers, and indeed some international lawyers commented that governing law and applicable laws are two different concepts. The applicable law to PPPs in Vietnam is obviously Vietnamese law, however, the parties to a contract can use the laws of another country to interpret the terms of the contract. This is true when the law of the host country is less developed and does not have a rich body of cases to interpret the terms of the PPP contracts.

The draft Law requires the governing law of the PPP contract between the investors and Vietnamese state authorities to be Vietnamese law. This new condition will deter major international lenders from financing projects in Vietnam. International lenders have consistently required that most project documents (including concession contracts) be governed by a well-established legal system to avoid ambiguity and uncertainty in contract interpretation and implementation.
Most importantly, according to international financial advisory firm there are a number of contract law concepts which are not clearly defined or recognized under Vietnamese laws, but which are important to international lenders. Examples include liquidated damages, indemnity, reasonableness tests, waivers, and joinder of disputes. The application of Vietnamese laws to interpret those contract law concepts would result in significant unknowns, which lenders will not accept.

Japanese investors noted that, in order for the contract law to be complete and effective, there must not only be statutes such as the Civil Code or the Law on Contracts, but also a sufficient number of published precedent court cases on contracts, as well as a textbook on contract law on which judges and lawyers can rely (for example Hugh Beale’s Chitty on Contracts, now in its 33rd edition). Those three legal sources are imperative for investors and bankers to predict how the contracts will be interpreted by the court when the parties have a dispute on the interpretation of the contract. In Vietnam, although the Civil Code was enacted, the number of precedent court cases published by the Supreme People’s Court is limited (20 cases and not all relate to PPP contracts), and there is also no authoritative textbook on contract law, which can be relied upon judges and lawyers.

As noted by the Head of the Infrastructure Working Group of the Vietnamese Business Forum (VBF), the requirement that Vietnamese law must be the governing law of the concession contract will result in a standstill for the draft Law if the goal is to attract internationally funded PPP. Particularly, overseas bankers will not provide large loans which enable PPP investors to invest in large-scale PPP projects.

As suggested by an international consulting firm, based on the past experiences in Vietnam BOT projects by international investors, there should be space for flexibility in the applicable law under the new PPP law. It is critical for the PPP law to leave the governing law for negotiation between the parties. That would mean that Vietnamese law is still a possibility if the government insists on it in a particular case and the sponsor decides that it is bankable. But it would not be mandatory as it would kill the financial feasibility of a deal.

5.7 STATE CAPITAL TO SUPPORT PROJECT INFRASTRUCTURE FACILITIES

According to Japanese investors, the draft law stipulates that state capital in PPP project shall be public investment capital and shall follow the public investment laws. However, the public investment capital in PPP projects depends on the financial structure and risk allocation of the project and would only be finalized after the investor has been selected. Therefore, if the Government wishes to secure the PPP budget in the Mid-Term Investment Plan (MTIP) and annual plan on an individual project basis, it would take long time (estimated at more than a year) and will lack the flexibility of budget adjustment.

Should PPP projects follow current budgeting norms, they will not be attractive to private investors, as the system may not be able to anticipate the evolving needs of the projects. While the previous draft described the establishment of a dedicated fund for PPP projects, this was discarded in the latest draft. However, investors believe a dedicated PDF would allow for more flexibility and certainty for actual implementation (or disbursement) of state capital for each project. Hence, this Green Book strongly argues for conversations regarding the establishment of a dedicated source of funding for PPP projects at the PPP Law discussion in the National Assembly.
should be secured on a long-term basis and the process should be efficient to avoid unnecessary delays in implementation. In addition, state audit should be restricted to the public finance and assets used in PPP projects to support construction of auxiliary works, and compensation, site clearance, and/or resettlement.

State capital during operations: After construction, there are challenges resulting from regulatory changes such as tariff adjustment, exemptions that contradicts the original BOT contracts undermining the financial plans and special purpose companies/investors cannot honor the loans contracts. There are many cases where financial plans are not realized because of the changes in underlining assumptions. For example, La Son Tuy Loan toll station which was used to support Deo Ca tunnel project was removed. One toll station has also been removed in Bac Giang – Lang Son highway. Currently investors of these two projects are negotiating with ASA to provide budgetary supports to comply with the financial plan. However, the current rules only allow the Government to provide supports during the construction of the projects not during operations. Negotiations with ASA and banks run into many difficulties.

5.8 EXPENDITURES FOR PROJECT PREPARATION

Similarly, the expenditures of the competent agencies and the contract signing agencies, the project preparation units, the procuring entities, the Appraisal Council of the PPP project, the unit assigned to appraise PPP project will be covered by public investment capital and accrued to the total investment of the project. Investors noted that it will be most efficient if the costs for project preparation, appraisal and investor selection is covered by a dedicated PDP to ensure flexibility and timeliness. The public investment capital and following public investment law have led to poor quality, inconsistencies and delays in project implementation due to insufficient or untimely funding.

5.9 STEP-IN RIGHTS OF LENDERS

The draft Law stipulates the step-in rights of lenders. According to the Japanese investors, lender step-in rights to cure defaults are a common practice in PPP projects internationally. Lenders should have the right to enter into agreements with the parties to a PPP contract. This will enable lenders to exercise step-in rights and cure defaults under a PPP contract on behalf of the project company and investors in certain circumstances as prescribed in such agreements.

5.10 SELECTION OF DOMESTIC CONTRACTORS

The draft PPP Law requires that domestic contractors be selected for the works that domestic contractors have capability to perform. In case domestic contractors are unable to perform the work, leading to the compulsory use of foreign contractors, foreign contractors must associate with domestic contractors or use domestic subcontractors.

A legal requirement to select domestic Vietnamese contractors over foreign contractors will significantly deter international investors from participating in Vietnamese PPP projects. International investors and lenders often have specific technical and policy requirements such that, although works may be capable of being performed by local Vietnamese contractors, a PPP project is only attractive for international investors to the extent foreign contractors may be used. Under such circumstances where the use of foreign contractors is desirable, it is
mutually beneficial to both foreign investors and Vietnamese state bodies participating in a PPP that Vietnamese law to permit the use of foreign contractors.

Investors from Japan recommended that the law should not contain requirements that require investors to select domestic contractors in preference to foreign contractors in the cases domestic contractors are capable of performing the relevant work.

5.11 LAND CLEARANCE

According to provisions on the Preparation of Construction Site, the provincial-level People’s Committee is responsible for organizing land clearance and completing procedures for land allocation or lease of land to implement the project in accordance with the laws on land, PPP contract and other relevant contracts.

The President of the Association of FDI Enterprises raised the concern that in many projects that needs land clearance, the conflict between the government and local residents will cause inevitable delays to project implementation. The draft Law should clarify the support measures by the State in land clearance so that the SPC would have the required land to start construction on time. This land availability issue is paramount to International Investors as this is one of the most important risk elements and international investors and lenders are reluctant not in a position to bear risks associated with land clearance.
6. CONCLUSION

Serious investors, including international investors, interviewed have a lot of hope that the PPP Law will ease some of the challenges that have prevented them from investing in Vietnam, most notably transparent competition in selecting investors and improvements in government guarantees to help raise financing. If the purpose of the Law is to mobilize private sector investment and expertise, it needs to make it easier private investors to invest under PPP.

The PPP Law represents a step forward in legal terms as PPP is elevated to a Law and should help to address some legal conflicts with other laws. The draft Law mandates competition for investor selection and introduces a new mechanism to share revenue risk. The draft also, however, contains some significant setbacks compared to the current regime, which may undermine the overarching purpose of this Law i.e. attracting private investment. Some of these concerns have been shared and presented in this report and

In order to promote PPPs, we see the need for new institutions to support the Law, such as a market oriented, well-functioning project development facility and PPP guarantee funds. These institutions, with the right incentives and design, will help realize PPPs true potential in Vietnam.

The PPP Committee will continue to work with the business community to provide policy makers with the direct views of investors who support a good PPP law.
### ANNEX I: LIST OF COMPANIES AND ORGANIZATIONS INTERVIEWED

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ANNEX II: RISK SHARING MECHANISM

This annex summarizes a round table discussion conducted on April 16, 2020 by VCCI, PPP Committee - National Council on Sustainable Development and Competitiveness Improvement, USAID, and IPS which was attended by representatives from the Office of the National Assembly, Ministry of Planning and Investment, Vietnam Association of Road System Investors (VARSI), Deo Ca Group, experts, consultants and some of press agencies.

1. Why risk sharing is necessary in PPP projects

PPPs represent long term contracts between the public and the private sectors Public-private partnership. The private and the public sectors work together to share risk and responsibilities in implementing the project. In essence, PPPs are meant to provide public services with investment/operations from the private sector. If the government wants to mobilize the private investment, it needs to ensure that the project is feasible by providing supports, guarantees, undertakings and it should not pass all the risks to the private sector as if it were a private investment. Therefore, the essence of risk-sharing in PPP is that risks are allocated to the party that can handle them in the most effective and cost-efficient way and is best able to absorb risks.

If all the risks are passed to the private sector, the profit opportunity must be significant and this mean higher cost for consumers and vice versa. From a market perspective, when the government share the risk, it accepts that risk with the lower cost. This is because if the Government were to undertake the project for public purpose, it would have to bear all the risks. If all the risks are passed to the private sector, the private sector will need to price this which will result in higher overall cost. Therefore, the participation of the government in sharing some of the risks in PPPs is a way to help reduce the overall investment cost and benefit both the government and users.

An example to illustrate this is Project N105 - four lane expressway way in Bangladesh. This was designed in 2019 with a total investment cost of 340 million USD, with viability gap funding (VGF) of 111 million USD without minimum revenue guarantee. After the government offered the minimum revenue guarantee, the winning bidder/investor accepted to invest in this project with USD27 million in VGF and thus the government saved 84 million USD from reduction of VGF due to the minimum revenue guarantee.³

PPPs are implemented to provide public goods and services (public purposes) through investment cooperation (private capital) and/or private management. The State wants to attract financial resources, take advantage of expertise and management capacity of private sector to offset the budget deficit, so the State should have the responsibilities and obligations in ensuring the feasibility of the project through support, guarantee tools. In addition, the

³ Information on this project is available at https://tinyurl.com/ycnbvrlr
State should not push all responsibilities, risks of PPP project to the private sector as other commercial projects.

Therefore, the essence of risk-sharing in PPP is that risks are allocated to the party that can handle them in the most effective and cost-efficient way and is best able to absorb risks.

If all risks are transferred to the private sector, “the profit” must be very high and make the cost to end users will be high and vice versa. From a market perspective, the public sector’s risk sharing means that the State can accept that risk at the lowest cost, because if the State operates that project, the risks still exist and the State must accept all. If all the risks are transferred to the private sector, they will include risks in the cost.

The State’s risk sharing in PPP project will reduce project costs and create benefits for the State and users.

For example, the N105 four lane expressway project in Bangladesh signed a contract in 2019 with a total investment of 340 million USD, initially the government expected to support 111 million USD for the construction of the roads without minimum revenue guarantee. Minimum collection. After the government committed to sharing revenue risks through the minimum revenue guarantee mechanism, the winning investor contributed 27 million USD to the VGF and thus the government saved 84 million USD from reduction of VGF due to participation in revenue risk sharing with investors.

The PPP project is not only involving the investors but also the banks that lend up to 70-80% of the overall investment. If a project is too risky, lenders will not lend and the project will fail. Therefore, it is necessary to create a mechanism to ensure the risk is best managed, especially in the beginning of project.

2. Types of risk in PPP projects

- Risks due to early termination of the contract;
- Risks due to land clearance;
- Construction (quality, time and cost overruns);
- Financing
- Demand/Revenue
- Risks from changes in policies/plans/regulations;
- Foreign currency convertibility
- Exchange rate risk;
- Force majeure (natural disaster, epidemic, war...).

3. Comments on risk sharing mechanism in the Draft Law on PPP
There are many articles on risk sharing in the draft PPP Law. The Draft Law for the first time introduces a revenue risk sharing mechanism which attracts the attention of many domestic and foreign investors. At the round table discussion, the following points were shared:

a. The revenue risk sharing mechanism should be transparent and fair

The revenue sharing should be based on the same basis either the committed revenue or in financial plan not both committed revenue and financial plan as it is currently in the draft PPP Law. The committed revenue in the contract should be set at 75% of the one in the financial plan instead of “no lower than” 75% because the current language will create rent seeking opportunities.

Fairness in revenue risk sharing. When revenue increases due to the increase in traffic and demand compared, investors will share revenue increase with the State, but when revenue decreases due to the decrease in traffic and demand, the State only shares revenue shortfall in cases:

- When the decline is due to the fault of the state (changes in policies and plans);
- After reviewing the performance for 3 years;
- Do not use the State VGF.

With this mechanism, when the revenue increase (for any reason), investors will share the excess revenue with the government. When the revenue decreases, the government will only share the shortfall when it is due to the fault of the State. It is not easy to proof that if the decline in revenue is due to policy changes or other reasons.

VGF is meant to increase the viability of a project, especially in the beginning of the project. Revenue sharing is during operations if the actual revenue falls below committed one. They are different and for different purposes. They should not be considered as mutually exclusive though different projects may need different kind and level of supports.

The reviewing period of three years will impact the cash flow of the project and the survival of the special purpose vehicles. When a shortfall in revenue occurs, the special purpose company needs cash to service its debt and having to wait for three year would lead to dishonoring the loan agreements which will result in serious consequences for the investors and the special purpose companies.

The current draft PPP Law requires that this the application of mechanism must be decided at the stage of investment decision i.e. new projects after the promulgation of this Law not to existing projects.

b) Revenue sharing thresholds

Different projects have different risk profiles and need different kind of support to manage the risks. The Law should provide for the kinds and principles of risk sharing. The implementing regulations should spell out which agency will give this guarantee, sectors that can qualify, and fiscal risk management. The details on threshold and ratio of coverage should
be subject to negotiation to tailor this to each project. Revenue collection needs to be transparent and subject to oversight.

When

Demonstrating the causality between revenue reduction and the State policy changes is not simple and not practically feasible, creating a gap for the “ask and give” mechanism. When revenue decreases, investors need money to pay off debt to avoid being squeezed, but investors have to wait for 3 years to receive this money and at that time the project is likely to have been squeezed. The financial support mechanism in the construction process and the revenue risk sharing mechanism are completely different and have different ways of handling risks, therefore, it is advisable not to set the condition not to use the State capital during construction process as a condition to apply the revenue risk sharing mechanism.

- Recommend that payment conditions for revenue decrease are the same as for sharing the revenue increase and removing the above 3 conditions to ensure a transparent and fair risk sharing mechanism and avoid “ask and give” mechanism.

c. Experience of Indonesia in fiscal risk management, project development and PPP project guarantee

In 2009, in order to provide guarantee for PPP projects, the government established Indonesian Infrastructure Guarantee Fund (IIGF), a state-owned enterprise under the Ministry of Finance in charge of providing guarantees for PPP projects. The establishment and operation of IIGF in the beginning was difficult because the ministries did not agree. Investors did not trust IIGF. With a strong and transparent governance structure and appropriate incentives to staff, IIGF has produced the outstanding as follows.

- Provided guarantees for 21 PPP projects with a total value of USD14.7 billion (one USD in state capital in the Corporation attracts 26 USD in private investment);
- Fiscal risk management is centralized at the Corporation which provides guarantees and collect guarantee fees for each project and the Corporation has been profitable. In 2018, the company earned over USD30 million in net profit.
- In 2018, the state equity in the Corporation was around USD670 million of which 37.5% is retained earnings.

The centralization of risk management in one agency that ensures the best risk management. IIGF is commercially driven and price the risk according to the market. The exposure of the national budget is not significant and limited to the equity of IIGF. IIGF works with other financial institutions to provide guarantees if the exposure is greater than its capital base. This financial institutions is essential and complements credit institutions that will not be able to provide long term guarantees against government obligations because of their capital adequacy requirement.
REFERENCES


