

# The Brief

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## South-East Asia

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### Editorial

As the first signs of global economic recovery begin to appear, Vietnam is closely monitoring the positive signals its economy is sending out.

Indeed, the situation on the securities market has improved notably. Vietnam's stock market has gained nearly 35% since the beginning of 2009, recovering from its 2008 plunge. The volume of cash invested into the market has even exceeded the most optimistic forecasts. At the end of May, the VN Index had increased by around 34.5% since the beginning of the year. That performance puts Vietnam in fourth position among Asian countries, behind Indonesia (nearly 40%), India (nearly 42%), and China (more than 42%). Reports released by the HCM City Stock Exchange and Hanoi Securities Trading Center showed that foreign investors only began to make important purchases in mid-March, after the VN Index had started to rise again, proving the important role of domestic investment in the current recovery.



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Thus, despite the crisis, Vietnam remains attractive - more so than many other investment destinations. Investors continue to see value in Vietnam and its private equity market,<sup>1</sup> and the country is now expected to be the first Asian nation to overcome the global economic crisis.

Real estate has also shown good resilience to the crisis in the first half of 2009, and property prices have been rising significantly since the beginning of May. Prices in many districts in Ho Chi Minh City have risen by 20 to 40%, even doubling in some places from late last year. Despite global and national economic difficulties, Savills Vietnam, the leading real estate service provider in Vietnam, has recently announced the recruitment of 400 new employees.

It is, nevertheless, too early to be overly optimistic. While improvements have been backed up by strong efforts from the government through its economic stimulus program, there are now increasing vulnerabilities resulting from the large fiscal deficit used to finance the stimulus program.<sup>2</sup> Personal income tax exemptions were supposed to be extended for the end of the year, but the National Assembly has recently shown concerns about the limited benefits to the poor of such a measure, pointing out that it would primarily benefit high-income earners, while weakening the State budget. Finally, after long debates, the National Assembly ratified, on 19 June 2009, the exemption for the deferred PIT for the period from 1 January 2009 to 31 June 2009; but for the last six months of 2009, the PIT exemption will only be applicable to income arising from (i) capital investment, (ii) capital transfer, and (iii) franchising (excluding employment income). Royalties shall also benefit from such an exemption.

Reputed Vietnamese economist, Dr. Le Dang Doanh, sees a “W-shaped” scenario for Vietnam’s economic recovery, insisting on the unstable economic management of Vietnam. He believes Vietnam is benefiting from a very competitive agricultural sector, with exports all over the world and sustained sales in the context of the recession. The “L-shaped” scenario, i.e. the economy flattening out for a sustained period is, therefore, unlikely to happen.<sup>3</sup>

At the same time, legal reforms are going ahead and the Vietnamese statutory framework is being constantly updated. Measures include the new Law on VAT (effective as of 1 January 2009, but partly postponed due to the fiscal stimulus package) as part of a significant general reform of the taxation regime, and the much-welcomed first ever case decision of the Vietnamese Competition Council (VCC), dated 14 April 2009.

The VCC was established in 2006 (by Decree 05/2006/ND-CP) and had not yet rendered any judgment on a contentious matter until its decision of April 14. In this, the VCC found Vietnam Air Petrol Co. (better known as Vinapco) guilty of abuse of its monopoly position and in breach of the Law of Competition, articles 2 and 3. Vinapco has consequently been fined VND 3 billion (USD 168,300) for cutting off supplies to Jetstar Airlines (formerly Pacific Airlines), and imposing unfavorable business conditions on its customer by taking advantage of its impossibility to turn to another source of supply in the country. The penalty must be considered as only a warning for Vinapco (such a violation could be subject to a hefty fine of VND 70 billion (nearly USD 4 million), or 10% of Vinapco’s total revenue of the former year).

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<sup>1</sup> A Grant Thornton International survey in April this year showed that more than half of investors surveyed stated that Vietnam would be more attractive than other destinations in 2009. The survey has also shown that 67% of 169 domestic and foreign businesses were optimistic about their investments in Vietnam, particularly in unlisted companies.

<sup>2</sup> Ayumi Konishi, Asian Development Bank (ADB), Country Director for Vietnam, *Thanh Nien*, “Too soon for too much optimism”, 10 June 2009. To address the economic downturn, the Government is also allowing small and medium enterprises to enjoy a 30% CIT reduction in Quarter 4 of 2008 and for all of 2009. In addition, an enterprise satisfying certain specific criteria may enjoy CIT deferment of nine months of its quarterly CIT payment for 2009. Meanwhile, under recent regulations, a number of certain goods and products are entitled to VAT reduction of 50% (see below our article “VAT reform in time of financial crisis”).

<sup>3</sup> *VietNamNet*, 11 June 2009, “Signs of economic recovery remain a muddle”, online article.



## VIETNAM

### IMPLEMENTING FRANCHISING ACTIVITIES IN VIETNAM

While 2009 was supposed to see the opening up of the distribution sector in Vietnam to 100% participation by foreign entities, reality has been disappointing. In practice, the relevant authorities have been reluctant to license 100% foreign distribution companies; while the specter of the ambiguous Economic Needs Test, a test which has yet to be properly defined under Vietnamese law, hangs over established foreign-invested distribution companies wishing to open further retail outlets.

In order to circumnavigate the *de facto* restrictions placed on foreign involvement in the distribution sector, some international brands have opted to franchise their business systems to Vietnamese companies rather than attempt to establish fully owned or joint venture distribution companies in Vietnam for the purpose of distributing their brand bearing in mind the authorities' reluctance to open this sector entirely to foreign investors despite Vietnam's commitment to open it based on its WTO commitments.

The following is a short discussion of the legal framework for franchising in Vietnam:

#### Legal framework for franchising

Franchising activities in Vietnam are regulated by the 2005 Commercial Law, and further detailed in the 2006 Decree 35 Implementing the Commercial Law with respect to Franchising Activities and the 2006 Circular 9 Providing Guidelines on Procedures of Franchising Activities. The competent authority in charge of regulating franchising activities in Vietnam is the Ministry of Trade (on the national level), and the local People's Committee (on a local level). Because franchising involves the licensing of intellectual property rights, Vietnamese intellectual property regulations apply as well, for which the Ministry of Science and Technology is competent.

The Commercial Law provides that franchising is the commercial activity whereby a franchisor authorizes and requires a franchisee to conduct on its own behalf the purchase and sale of goods, or provision of services, in accordance with an established franchising system, and be associated with related intellectual property; and where the franchisor has the right to control and offer assistance to the franchisee in the conduct of its business. It should be noted that this is distinguished from distribution, whereby a company established in Vietnam imports products and distributes them to a wholesaler or directly to consumers in Vietnam, without licensing a third party.

#### Conditions on parties:

##### The franchisor

A franchisor is a business entity granting a franchise and the associated rights, to another business entity, the franchisee.

In order to grant a franchise to a business entity in Vietnam, the franchise granted must have been in operation for at least one year prior to registration in Vietnam, must have been registered with the competent authorities (Ministry of Trade), and may not deal in services or goods prohibited in Vietnam.

##### Rights and obligations of the franchisor:

A franchisor has the right to: (i) receive royalties; (ii) organize the advertising of the franchising system; and (iii) conduct regular and random inspections of the operations of the franchisee to ensure quality.

Unless otherwise agreed in the franchising contract, the franchisor has the following obligations to:

- provide the franchisee with disclosure documentation on the franchise system;
- provide the franchisee with initial training and ongoing technical assistance for the operation of the franchise system;
- design and layout the outward physical appearance of the franchise at the cost of the franchisee;
- ensure the intellectual property rights in respect of the objects set out in the franchise contract through proper registration in Vietnam as the case may be.
- provide equal treatment to franchisees in the franchise system.

##### The franchisee

One of the benefits of opting for franchising of a business system, rather than establishing a distribution entity in Vietnam, is the shift of most of the local licensing obligations to the local franchisee: The franchisee must be licensed to conduct franchising activities in Vietnam in order to perform a franchising contract. This would be evidenced in the business registration of the franchisee which must list the appropriate specific business line associated with the franchise, (e.g. distribution of chocolate). If the proposed franchisee is not licensed to perform the given franchising activities, it will have to modify its business line in order to carry on franchising activities.



### **Rights and obligations of the franchisee:**

Unless otherwise agreed, the franchisee has the right to (i) require the franchisor to provide all technical assistance related to the franchise system; and (ii) require the franchisor to accord equal treatment to franchisees in the franchise system.

Unless otherwise agreed, the franchisee has the following obligations to:

- pay royalties and other fees as defined in the franchise contract;
- invest in adequate infrastructure, finance, and human resources for the purpose of receiving the appropriate business know-how transferred by the franchisor;
- submit to the control and supervision of the franchisor, and to comply with the requirements of the franchisor regarding designs and layout of the sales or service outlet.
- keep relevant confidential information indefinitely;
- cease use of any trademark, trade name, business slogan, business logo and other intellectual property rights of the franchisor upon expiry or termination of the franchise contract;
- operate in accordance with the franchise system;
- not sub-franchise without the consent of the franchisor.

### **Steps prior to entering into the franchise contract**

#### **Registration of franchising activities**

Prior to entering into the franchising contract, the franchisor must register its franchising activities with the relevant trade authorities. Franchising activities from offshore to Vietnam, or vice versa, must be registered with the Ministry of Trade, while local franchising may be registered with the local department of trade.

The application file for registration consists of documents confirming the legal status of the franchisor, as well as documents providing information on the activities of franchising and the franchisor itself, evidence of ownership of intellectual property used within the franchising system, and details of the network of franchises.

The cost of registration is VND 16.5 million (under USD 1,000), and the timing pursuant to Decree 35 is five working days from the date of submission. In practice, the actual timing of registration may be longer.

### **Trademark registration**

It should be noted that intellectual property owned by the franchisor must be registered in Vietnam so that the franchisor may enjoy the benefit of protecting its rights against third party violations. Even worldwide registration falling under the Madrid Treaty, WIPO, or a bilateral agreement, must also be registered in Vietnam with the National Office of Industrial Property as evidenced by a title of protection. Furthermore, this title of protection is a mandatory document required by the Ministry of Trade at the point of registration of the franchising activities.

### **Obligation to provide franchisee information**

In addition to the registration obligations listed above, the franchisor has further obligations to the future franchisee prior to entering into a franchise contract. Unless otherwise agreed by the parties, the franchisor must provide the franchisee, at least fifteen days prior to the date of entry into the franchise contract, with a copy of both the franchise contract form, and the franchise description document. This legal requirement is presumably to provide the franchisee ample time to review and understand the requirements associated with the franchising system.

The franchise description document will include much of the information to be provided in the franchise contract such as general corporate information about the franchisor, information regarding the intellectual property rights associated with the franchise, and information pertaining to the general obligations of the franchisee.

Please note that a Vietnamese version of this franchise description document must be submitted to the Ministry of Trade for the purpose of registration of the franchise activity prior to signing of the franchise contract.

### **The franchise contract**

While a franchise contract may be drafted in both a foreign language and Vietnamese, the Vietnamese version is required by law and will prevail in the event of dispute.

The franchise contract must include the following particulars:

- details of the franchise and corresponding rights;
- rights and obligations of the franchisor and franchisee respectively;
- the term of the franchise contract;
- renewal policies and payment policies;
- termination; and
- dispute resolution mechanisms.



### Assignment of a franchise contract

The Vietnamese franchising regulations provide that a franchisee must meet two conditions prior to the assignment of a franchise contract: (i) the franchisor approves the assignment; and (ii) the intended successor franchisee is licensed to conduct the activities of the franchise operation.

While the above provides that the franchisor's approval must first be met prior to an assignment, the law does not give the franchisor *carte blanche* to decide against a transfer. Indeed, after receiving a request for such assignment, the franchisor must reply in writing within fifteen days and may only refuse assignment for the following reasons:

- the proposed assignee would not be able to take on the financial obligations under the franchise contract;
- the proposed assignee does not meet the selection criteria of the franchisor;
- the assignment would adversely impact the existing franchising system;
- the successor assignee does not agree in writing to comply with the franchise contract;
- the franchisee has not satisfied, nor has a plan to satisfy obligations found under the franchise contract.

When drafting the franchise contract, the franchisor should take the above conditions into consideration to adequately protect against an undesired assignment of the franchise contract.

### Termination of the franchise contract

The franchising regulations provide for unilateral termination of the franchise contract in certain instances.

Unless otherwise agreed in the franchise contract, the franchisee may terminate the franchise contract unilaterally if the franchisor breaches its obligations as discussed above. However, because of the ambiguous nature of such stipulations, it may be best to redefine the terms by which the franchisee may terminate the franchise contract.

The franchisor has the right to unilaterally terminate a contract in the following situations:

- the franchisee is no longer licensed to carry on the franchise business as required by law;
- the franchisee becomes bankrupt or is dissolved;
- the franchisee commits a serious breach of the law which may damage the reputation of the franchise system;

- the franchisee fails to remedy a non-fundamental breach of the franchise contract within a reasonable time after the franchisee has received written notice from the franchisor to remedy such a breach.

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### VAT REFORM IN TIME OF FINANCIAL CRISIS

A new law on VAT took effect on 1 January 2009 as part of a significant general reform of the taxation regime introduced by the Vietnamese government. The new law increases the number of goods and services subject to a 10% rate. Nonetheless, in order to mitigate the effects of the current global economic crisis, the government has also issued a series of temporary measures in order to ease the tax burden for enterprises.

#### Scope of the new law

The new law has notably widened the scope of organizations and individuals subject to VAT.

Value added tax payers shall be organizations and individuals (i) producing and trading taxable goods and services; (ii) importing taxable goods; and (iii) purchasing services from foreign organizations having no permanent establishment in Vietnam, or from individuals who are non-residents of Vietnam.

#### VAT rates – introduction of the “elimination method”

The new law retains the three applicable VAT rates at 0%, 5%, and 10%, but introduces some adjustments in the goods and services falling within each of the VAT bands in comparison with the previous law. Under the new VAT law, there is no longer a list of goods and services falling into the 10% band. Instead, the new VAT law introduces the “elimination method” according to which a VAT rate of 10% will be applied to goods and services which are not subject to the two other rates (i.e. 0% and 5%).

Therefore, the number of goods and services which will be subject to a 10% rate has significantly increased and, consequently, the list of exempted goods and the list of supplies subject to 5% VAT rate have been reduced. These changes will significantly affect the costs of relevant activities.



<b>KEY POINTS OF THE VAT REFORM</b>		
10% rate	Supplies previously exempt from VAT now subject to a 10% rate	Machinery, equipment, construction materials and specialized transportation vehicles that cannot be produced domestically, and which are imported to form fixed assets of the importer...
	Goods subject to a tax increase from 5% to 10%	Coal, newsprint, computers and printers, automobiles not subject to special consumption tax, ships, transportation services...
5% rate	Goods now subject to a 5% rate	Goods and services in agriculture and agricultural production, goods used for education, cultural and sports activities, medical equipment and instruments, artistic performances, film production and import, publication and screening of film footage...
0% rate	Goods previously exempt and now subject to a 0% rate	International transportation previously VAT exempt is now zero-rated (if the transportation covers both international and domestic transportation, the zero-rate applies to both)
		Exported goods and services <sup>(*)</sup> are eligible to zero-rated VAT when (i) there is a supporting contract, (ii) payments are made via banks (payments by offsetting exports against imports are also recognized for this purpose), and (iii) goods exported to foreign countries, duty-free zones, and deemed exports are supported by customs declaration.

(\*) The VAT law specifies that zero-rated exported services are those provided directly to: (i) organizations in foreign countries or in duty-free zones which do not have a permanent establishment and are not VAT tax payers in Vietnam; or (ii) individuals in foreign countries who are foreigners not residing in Vietnam or overseas Vietnamese citizens residing outside Vietnam when certain services are provided.

### **VAT deduction**

The previous three-month time limit introduced in the old VAT regime has been removed. Errors in input VAT deductions can now be amended within six months from the date of discovery of the error.

One of the new conditions for claiming input VAT is that the payment of VND 20 million or more must be made through the banking system. Failure to comply with this requirement will invalidate any claims for input VAT deductions. If separate purchases of goods and services are made in a same day from a same supplier and amount to an aggregate value of more than VND 20 million, the deduction will only be applied to the amounts supported by a voucher for payment via a bank.

Under the new law, the following are fully deductible:

- input VAT for goods and services used for manufacture and business for valued added taxable goods and services;
- input VAT for fixed assets used for both taxable supplies and non-taxable supplies, except for credit institutions, reinsurance companies, life insurance companies, securities companies, hospitals, schools (in these cases it is accounted as the value of fixed assets);
- input VAT for goods and services supplied to foreign organizations or individuals using humanitarian or non refundable aid funds; and
- input VAT for prospection, exploration and development of the oil and gas industry.

In the case of input VAT for goods and services used for business and manufacture of both taxable and non taxable goods and services, only the amount of input VAT for the value added taxable goods and services shall be credited. Businesses shall hold separate accounts for creditable and non-creditable input VAT. If they fail to do so, creditable input VAT will be calculated at a ratio of the VAT on taxable turnover over the total turnover from goods and services sold.

Input VAT on passenger vehicles with nine or fewer seats (excluding vehicles used for the business purpose of transportation of passengers and cargo, or for business in the tourism and hotel sector) corresponding to the value of the vehicle in excess of VND 1.6 billion cannot be reclaimed.

### **Temporary VAT reduction**

In order to support businesses in the economic downturn, the Prime Minister issued Decision No 16/2009/QĐ-TTg on 21 January 2009 and Circular 91/2009/TT-BTC on 12 May 2009 to reduce the VAT rate by 50%. This applies to certain goods and products such as coal, chemicals, industrial concrete products, machines, automobiles and automobile components, transportation (except for international transportation), computers, tourism and hotels, etc.

In order to benefit from the temporary VAT reduction, taxpayers shall follow the following invoicing requirement: VAT rate: 10% x 50%

This VAT reduction shall apply from 1 February 2009 to 31 December 2009.



## VAT refund

As from 1 January 2009, export enterprises are entitled to a temporary refund of 90% of the input VAT. A refund can be requested even if the enterprises do not have the supporting documents showing that the payments were made via banks. The 10% remaining balance shall be refunded when additional documents are submitted to the local tax authorities.

Non-export enterprises may also claim a VAT refund according to the percentage of completion of the review by the local tax authorities. Thus non-export companies can collect the refund by installments without having to await the final decision on the total refundable amount.

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## PUBLIC-PRIVATE PARTNERSHIP: CURRENT GOVERNING LEGAL FRAMEWORK AND NEW DRAFT DECREE

The idea behind every public-private partnership (“PPP”) investment is to mobilize private finance and benefit from the operating efficiency of the private sector to build infrastructure projects of public interest. This form of investment is used worldwide, and specifically in developing nations as a means to securing financing for national development while lessening the burden of infrastructure investment on the state and promoting activity and creating investment.

However, looking at PPP infrastructure projects in Vietnam today, it appears that private finance mobilization is highly uncertain. Indeed, most of the State’s partners in PPP projects are State-owned enterprises. For instance, the USD 80 million Rach Mieu Bridge PPP Project was financed to the tune of 58% by the State Budget and the remaining 42% was invested by the Ministry of Communication and Transport’s Civil Construction Engineering Corporation (Cienco) No.1, Cienco No. 5 and Cienco No. 6.

In fact, many obstacles still stand in the way of investors in general and foreign investors in particular: site clearance and construction-related administrative procedures being the main issues. Moreover, time-consuming tendering procedures for selecting contractors have also discouraged foreign investors. And, very often, foreign investors have to deal with difficult negotiations with multiple authority departments and slow administrative formalities.

## Legal and contractual framework

The Law on Investment of 2005 has confirmed investors’ rights to carry out investment projects under PPPs, as forms of direct investment. The legal regime of PPP is set up by Decree 78/2007/ND-CP issued on May 11, 2007 (“Decree 78”).

Three types of contract are proposed to encourage partnerships between private investors and the State, in the performance of infrastructure projects (the “Project(s)”):

- (i) Build-operate-transfer (“BOT”) contracts between a Qualified Public Body and an investor. The purpose of such contracts is the construction and commercial operation of infrastructure for a defined term, at the end of which the investor is required to transfer the infrastructure to the Vietnamese State without compensation;
- (ii) Build-transfer-operate (“BTO”) contracts, between a Qualified Public Body and an investor. The purpose of such contracts is the construction of infrastructure that will be transferred to the Vietnamese State on the completion of construction. The Vietnamese government will then grant the investor the right to operate the infrastructure commercially to make the venture worthwhile to the investor financially and allow it to make a profit;
- (iii) Build-transfer (“BT”) contracts, between a Qualified Public Body and an investor. The purpose of such contracts is the construction of infrastructure which will be transferred to the Vietnamese State on the completion of construction. The government will then engage the investor for other infrastructure projects to make the venture worthwhile to the investor financially and allow it to make a profit, or will pay the investor according to the terms of the BT Contract.

## Financial requirements

Investors are responsible for arranging financing for the performance of Projects in accordance with the schedule agreed in the contract. Thus, the equity contributed by the investors must reach the following minimum ratios:

- at least 30% of the total investment capital for projects of below VND 75 billion (approximately USD 4.4 million);
- at least 20% of the total investment capital for projects of between VND 75 billion and VND 1,500 billion (approximately USD 4.4 million to USD 88.5 million);
- at least 10% of the total investment capital for projects of over VND 1,500 billion (approximately USD 88.5 million).



In addition, Decree 78 stresses the requirement for the investors to obtain performance bonds (such as bank guarantee or other security interests) of at least 3%, 2%, or 1% of the total investment respectively for the three levels of investment.

In practice, such financial requirements create difficulties and substantially limit the number of investors participating in the construction of public facilities under the form of PPPs.

### Licensing procedures

Another issue arising from the current legal framework is the evaluation and the issuance of investment certificates for PPP Projects. Indeed, while the licensing powers, for most other forms of investment, are allocated to provincial people's committees or an industrial zone's board of management, Projects carried out under PPP contracts must be solely evaluated and licensed by the Ministry of Planning and Investment (the "MPI"). This centralization of licensing power causes further unnecessary delays since, in all cases, the MPI will need to conduct the appraisals with the relevant provincial people's committees before issuing the investment certificate to the project.

### Selection processes

#### *Projects approval*

For national projects calling for PPP investment, Decree 78 requires the relevant ministries and provincial people's committees to publish once a year a list of projects calling for PPP investment. This list is posted on the web sites of the relevant ministries and provincial people's committees and appears in central and local daily newspapers for three consecutive issues.

Investors may propose a Project that is not included in the published list, as stipulated above. In this case, the investor should prepare a proposal to be submitted to the relevant State body, which will consult the government bodies concerned and then approve or reject the Project within 45 working days.

#### *Selection of the investor*

Before awarding PPP Projects, competitive tendering procedures must be held to select the investor, with the exception of the following cases when:

- only one investor satisfies the requirements of the pre-qualification;
- the project must be implemented in order to satisfy an urgent requirement for use of infrastructure facilities or to ensure a continuous requirement for the use of

products or services, but it is unable to carry out the tender for selection of the investor; and

- other cases as decided by the Prime Minister.

### Transfer of the infrastructure

Under the PPP mode, ownership of the facility reverts to the State after a certain period of time. Thus, for BOT Projects, the transfer of project facilities and documents relating to the exploitation or operation of the facility to the State, shall occur without compensation upon the expiry of the commercial operation of a project facility as stipulated in the contract. The property to be transferred shall not include any debts incurred by the project enterprise. All the financial obligations of the investor and the project enterprise to the State relating to the project must be fulfilled before the transfer.

For BTO and BT projects, the investor transfers the facility to the State upon completion of construction, in accordance with the conditions stipulated in the contract.

### Tax incentives

Under current applicable regulations, BOT and BTO projects enjoy preferential rates of corporate income tax, as prescribed for projects included in the list of sectors entitled to special investment incentives for the whole project life. The project contractor and subcontractors are exempt from import taxes throughout the implementation of the project. Similarly, industrial property, technical know-how, technological process, and technical services for the project are also exempt from taxes relating to technology transfer and royalty income.

The same tax incentives are also applied to other projects being carried out by the investor to recover capital invested in a BT Project, taking into account the time for recovery of capital invested in BT project facilities and profitability from the other project.

### New Draft Decree on PPP

The Ministry of Planning and Investment has recently submitted to the Government a draft decree revising Decree 78 ("**Draft Decree**").

Inheriting the progressive outlook of Decree 78, the new Draft Decree firstly reconfirms government policy encouraging the execution of PPP contracts for infrastructure projects.

The Draft Decree also reconfirms the investment incentives for PPP projects provided in Decree 78. Similarly to the current regulations under Decree 78, BOT and BTO enterprises would be entitled to corporate income tax



incentives applicable to projects included in the list of domains eligible for special investment incentives. However, incentives relating to corporate income tax rates would be no longer applicable for the whole duration of the project.

BOT and BTO enterprises would still be exempt from import duties and land-use levies and rents on areas allocated by the State throughout the duration of the project. BT enterprises would still be exempt from paying import duties on equipment and materials imported for the project.

One positive change is that the Draft Decree relaxes some financial requirements on investors. With regards to Projects of below VND 1,500 billion (approximately USD 88.5 million), the required rate of investors' equity capital would be lowered from 20% and 30% as currently provided in Decree 78 to 15%, while the guarantee for performance of a project contract would be fixed at 2% of total investment capital in every case.

Furthermore, the Draft Decree proposes to delegate licensing powers to local authorities, instead of being concentrated at the MPI. The latter will only issue investment certificates for Projects directly involving ministries, or bodies authorized by the ministries, as a contractual party; and for Projects which are implemented within an area of more than one city or within a province under central authority. All other Projects, and those conducted by investors in order to recover capital invested in BT Projects, will be subject to the licensing power of provincial people's committees.

Under the Draft Decree, Projects are now defined by competent State authorities before the selection of the investor (to the contrary of what is provided for in Decree 78), and such Projects as defined by State authorities would be used as the grounds for drafting tender documents and negotiating the project contract.

The Draft Decree also provides for more specific regulations on the rights of the investor to assign part or whole of its rights and obligations under the project contract (upon approval by competent State agencies). Besides, the Draft Decree also introduces a separate chapter making detailed provisions on the State administration of Projects under the form of BOT contracts.

However, the Draft Decree introduces stricter provisions as well, stating that the total capital owned by one or more State-owned enterprises participating in the implementation of one Project shall not exceed 49% of the equity of the project enterprise. It also requires the investor to prepare documents for finalizing the value of investment capital for the construction of the facility before or right after the completion of the PPP facility. The value of investment

capital for the construction of the facility will be audited by an independent auditing organization.

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## **CLEAN DEVELOPMENT MECHANISM IN VIETNAM**

Vietnam is one of the 183 countries to have ratified and adopted the Kyoto Protocol to the United Nations Framework Convention on Climate Change ("UNFCCC"), which entered into force on 16 February 2005 and intends to achieve "stabilization of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous anthropogenic interference with the climate system".

The Kyoto Protocol defines "flexible mechanisms" such as Emissions Trading, the Clean Development Mechanism and Joint Implementation to allow developed countries in the European Union, United States, Japan, etc. ("Annex I countries") to meet their greenhouse gas emission targets by purchasing greenhouse gas emission reductions credits from elsewhere, through financial exchanges, projects that reduce emissions, particularly in non Annex I countries including Vietnam.

Vietnam has assigned various State agencies to manage the implementation of the Kyoto Protocol, and put into place a legal framework to facilitate the implementation of the Clean Development Mechanism ("CDM") in the country.

Vietnam currently hosts two large projects which have been through the whole CDM projects cycle and are registered at the United Nations ("UN"): the Rang Dong Oil Field Associated Gas Project in the province of Vun Tau (gas recovery), and the Wind Power Plant n°1 in the province of Binh Thuan, which will become the first wind turbine plant in South-East Asia.

At the same time, a certain number of small-scale projects are being implemented. These are mainly hydro-power schemes so far, such as the Song Muc Small Hydro Power Station Project in Thanh Hoa province (the project is jointly implemented by Japanese company Tohoku Electric power and Vietnam's Agrimeco). Seventy-eight other CDM projects, already approved domestically, are undergoing registration at the UN.

Thus, Vietnam offers today clear and growing investment opportunities in CDM. Below we introduce the main institutional actors and regulatory bodies concerned with the CDM in Vietnam.



## Vietnam institutional structure

### Department of Meteorology, Hydrology and Climate Change

The UNFCCC provides that each party shall designate at least one “national authority” to act on its behalf in the performance of the administrative functions required by the convention. Accordingly, Vietnam has designated the *Department of Meteorology, Hydrology and Climate Change* of the Ministry of Natural Resources and Environment (“MoNRE”) as the Vietnamese Designated National Authority (“DNA”) by Decision No. 997/QD-BTNMT dated 12 May 2008.

### National Steering Committee for the UNFCCC and Kyoto Protocol

The National Steering Committee for the UNFCCC and Kyoto Protocol (“NSC”) and its Standing Bureau have been established by two decisions of the MoNRE (respectively Decision No. 1016/QD-BTNMT dated 14 July 2007. and Decision No. 1133/QD-BTNMT of 30 July 2007).

The Standing Bureau is responsible for assisting the NSC in drafting and creating documents, policies, measures in relation with reaction plans and programs on climate changes for purposes of implementing the UNFCCC and the Kyoto Protocol.

### Vietnam Environmental Protection Fund

The Vietnam Environmental Protection Fund is in charge of monitoring and managing Certificate of Emission Reductions (“CERs”) granted by the CDM Executive Board<sup>4</sup> for CDM projects implemented in Vietnam.

## Vietnamese legal provisions on CDM projects

### General Criteria of CDM projects:

A CDM project is defined as “an investment and production project under which new, advanced and environmentally friendly technologies are applied, and for which greenhouse gas emissions reductions are approved or registered and are certified by the CDM Executive Board”<sup>5</sup>.

A CDM project must satisfy the following conditions:<sup>6</sup>

- it is formulated in accordance with the current investment law, ministries’, branches’ or localities’ development strategies or plans, and contributes to Vietnam’s sustainable development;
- it is formulated and performed voluntarily by the investor and observes Vietnamese laws and treaties to which Vietnam is a contracting party;
- it is feasible with advanced technologies and suitable financial sources; it does not use official development assistance (ODA) or state budget investment capital to obtain CERs for transfer to overseas CDM project investors;
- it brings about real and additional reductions in greenhouse gas emissions which are measured, inspected and supervised according to specific plans;
- it has an environmental impact assessment report;
- it has been registered with and approved by the CDM Executive Board;
- the process of project execution does not give rise to new responsibility on the part of the Vietnamese government, compared with the responsibilities defined in the Kyoto Protocol;
- it is formulated in a proper order and according to procedures prescribed for a CDM project, for which it is granted a letter of certification or a letter of approval by MoNRE.

In practice, the most likely sectors for CDM projects in Vietnam, with promising investment prospects, are renewable energy (hydropower and wind), biomass and biogas (residues from sugar, rice, wood production, agriculture), waste and waste water treatment (landfills, animal farms, tapioca starch), fossil fuel switch (food, beverage, iron, steel, pulp, paper, rubber, wood), and energy efficiency (in both industry and buildings).<sup>7</sup>

Given Vietnam’s critical need for waste treatment solutions and new sources of energy, the favorable conditions for hydro-based power make the country a highly attractive destination for CDM projects.

### Implementation procedures for CDM projects

The procedures for implementing a CDM project are generally divided into the following phases (Project Cycle):

- preparation of Project Idea Note (“PIN”). The PIN is a primary document prepared and submitted for the purposes of confirmation of the planned CDM project to the DNA and serves as (1) a mechanism of introduction of the project to the relevant environmental authorities on both a local and a central level and also as (2) an approval in principle for the project.

<sup>4</sup> The CDM Executive Board is responsible for supervising the CDM, under the authority and guidance of the Conference of the Parties to the UNFCCC. It is responsible for deciding upon the registration of CDM projects. It is the executive body of the UNFCCC.

<sup>5</sup> Article 2.1 of Decision No. 130/2007/QD-TTg dated August 2, 2007 of the Prime Minister on a number of financial mechanisms and policies applicable to investment projects under the Clean Development Mechanism (“Decision No. 130”)

<sup>6</sup> Article 5.1 of Decision 130

<sup>7</sup> Report of 2009 of the Embassy of Denmark in Hanoi.



- preparation of project design document (“PDD”). The PDD is the main technical document prepared and submitted for the assessment of a potential CDM project.
- domestic approval. This approval process on the PDD takes 55 days. If the PPD is accepted by the NSC, the DNA will issue the letter of approval on the project which will lead to registration of the project at the UN.
- validation and registration. After domestic approval, the owner of the proposed CDM Project should contract with a Designated Operational Entity (the “DOE”) for independent evaluation and validation of its project activities. If the DOE determines that the proposed project activity is valid, it should request the CDM Executive Board to register the project as a CDM project.
- three DOEs operate in Vietnam and provide such evaluation services: Det Norske Veritas Certification AS; TUV SUD Industrie Service GmbH; and TUV NORD CERT GmbH.
- monitoring, verification and certification. Implementation of the monitoring plan as proposed in the PPD is a condition for the subsequent verification and certification of the monitored reductions in anthropogenic emissions by sources of greenhouse gas which have occurred as a result of the activity of the registered CDM project during the verification period by a DOE for purposes of issuing CERs to the project owner.
- Issuance of CERs. Upon instruction by the Executive Board to issue CERs for a registered CDM Project, the administrator of the CDM Register will issue the specified quantity of CERs equal to the verified amount of reductions of anthropogenic emissions by sources of greenhouse gas. After receipt of the administrative expenses of the CDM Executive Board, the CDM Registry will forward:
  - the quantity of CERs corresponding to 2% of the issued CERs for assisting developing countries that are particularly vulnerable to the adverse effects of climate change (the “Share of Proceeds for Adaptation”) to the relevant account for holding and transferring the Share of Proceeds for Adaptation; and
  - the remaining CERs to the accounts of the relevant parties and project participants in accordance with their request.

### Sales of CERs<sup>8</sup>

Once granted CERs, a company may sell them offshore based on the following procedure.

### Registration

The company must report the quantity of CERs to the MoNRE within 15 days from the date of their granting, receipt or distribution. In the event of a change in reported CERs, the project owner must re-register the changes within 10 days after the change<sup>9</sup>.

### Fee on sales of CERs:

A fee must be paid to the MoNRE and is determined as follows:

*Fee = the Fee Rate (%) x Quantity of CERs sold or transferred offshore x CERs unit price (Vietnamese Dong)*

The Fee Rate is between 1.2% and 2% of the total selling price of CERs, depending on the domains the project falls under.

The CERs selling unit price is based on an established agreement with regards to CER sales, or on the prevailing market price.

### Incentives for CDM project owners:

A CDM project owner may be entitled to:

- exemption from or reduction on land use fee or land rental;
- exemption from import duty levied on equipment for fixed assets purposes;
- exemption from export duty levied on CDM output products;
- favorable terms for subsidies and loans from certain designated State sources; and
- subsidies to CDM output product price; and to a preferential rate of Corporate Income Tax.

As the regulations mentioned above have been introduced quite recently, it is as yet unclear what incentives potential CDM investors may enjoy since there are outstanding discrepancies between CDM regulations and other laws. These will be analyzed case by case for each project.

<sup>8</sup> Chapter II of Joint Circular No. 58/2008/TTLT-BTC-BTNMT dated July 4, 2008 on guiding the implementation of a number of articles of the Prime Minister’s Decision No. 130/2007/QĐ-TTg dated August 2, 2007 of the Prime Minister on a number of financial mechanisms and policies applicable to investment projects under the Clean Development Mechanism

<sup>9</sup> Chapter II of Joint Circular No. 58/2008/TTLT-BTC-BTNMT dated July 4, 2008 on guiding the implementation of a number of articles of the Prime Minister’s Decision No. 130/2007/QĐ-TTg dated August 2, 2007 of the Prime Minister on a number of financial mechanisms and policies applicable to investment projects under the Clean Development Mechanism

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