

Regulatory framework for infrastructure projects

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Several reports, including the World Bank's *World Development Report on Investment Climate*, indicate that poor infrastructure is one of the main factors that discourages investment in a country and the development of its economy. Consistent with this view, the lack of infrastructure development in Vietnam, particularly in the electricity, roads, telecommunications, water supply and treatment and port sectors, is generally recognized to be a bottleneck to the development of the economy as a whole.

The main issue relating to the development of infrastructure in emerging markets is that infrastructure projects do not generally offer investors

a high enough rate of return. For example, the low road tariffs that local road users are willing or able to pay will often not support the costs of construction of an expressway project. This is further complicated by the fact that cost recovery occurs over a very long period of time before the project becomes profitable, requiring a long term commitment from the investor to the host country.

To date, most infrastructure projects in Vietnam have been implemented by state-owned enterprises and in reliance on official development assistance (ODA). However, in view of the extremely heavy demand for infrastructure in Vietnam, and the relatively limited amount of ODA (particularly non-

refundable ODA) that will be allotted to Vietnam over the coming years, it has been estimated that up to half of Vietnam's infrastructure requirements need to be financed by the private sector. Some of this financing will be provided by equity investors in individual projects, but a large portion of funds will also be provided by third party lenders with no equity stake in the project.

Against this background, state support of infrastructure projects and the minimization of the costs of project implementation, including a streamlined and transparent process for obtaining concession rights, are key. Investors and their lenders also require absolute certainty with respect to their inalienable rights in respect of



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the project. The existence of a clear and reliable legal framework supporting these aims is a prerequisite for attracting private investment, in particular offshore investment, to the infrastructure sector in Vietnam.

Legal landscape prior to 2007

The participation of the private sector, including foreign investors, in the Vietnamese infrastructure sector in the form of Build-Operate-Transfer (BOT), Build-Transfer-Operate (BTO) and Build-Transfer (BT) projects was recognised under the basic framework established in Decree 77-CP of June 18, 1997 (which developed investment in the form of BOT for domestic investors), Decree 62/1998/ND-CP (Decree 62) of August 15, 1998, and Decree 02/1999/ND-CP of August 15, 1999 (which amended Decree 62 and provided guidance on direct investment in the form of BOT, BTO and BT for foreign investors). Among other things, this legislation provided attractive tax incentives for entities implementing infrastructure projects and a framework for tendering projects requiring private investment.

Prior to 2007, notwithstanding the existence of these provisions, project contracts were typically negotiated bilaterally between the project's investors and the relevant state authority, without a competitive bidding process. This was a time consuming and ultimately a very costly process for investors. It also resulted in the contents of project contracts varying substantially from project to project and a very inefficient and unpredictable environment which was not conducive to private investment.

In addition, the complexity and opacity of the administrative procedures required to be undertaken in respect of any project at a number

of levels, including various ministries and People's Committees concerned, and ranging from the local Departments of Planning and Investment to the Prime Minister, discouraged private participation in the infrastructure sector.

The separate regulations applicable to foreign-invested project enterprises (as opposed to purely domestic enterprises) in relation to their incorporation or establishment, available forms of investment and taxation prior to 2006 provided further discouragement to potential foreign investors in the sector.

As a result, prior to 2007, only two foreign-invested infrastructure projects were successfully completed: the Phu My 2 power project in 2005 and the Phu My 3 power project in 2004.

New legislation

In recognition of the shortcomings of the previous legal framework, Decree 78/2007/ND-CP on BOT, BTO and BT contracts (Decree 78) of May 11, 2007, was implemented with the aim of providing a uniform framework applicable to both Vietnamese and foreign investors in BOT, BTO and BT projects. It represented a

significant development in terms of clarifying the procedures for selecting investors and obtaining investment licences for infrastructure projects, specifying sources of capital to be invested in projects and setting out certain rights of investors and obligations of the State, including specifically envisaging the possibility of government guarantees.

Two and a half years later, it was acknowledged, after consultation with investors and professionals in the market, that the experience of investors relating to the practical implementation of Decree 78, together with recent changes in certain laws relating to tax matters, tendering and construction, necessitated revisions to Decree 78.

On November 27, 2009, Decree 108/2009/ND-CP (Decree 108) was issued, superseding Decree 78 and taking effect on January 15, 2010, with respect to the implementation of BOT, BTO and BT projects.

Changes under Decree 108

Capital resources

The debt: Equity ratio requirements set out in Decree 78 and Decree 108 are compared below:

Decree 78		Decree 108	
Investment capital (VND billion)	Equity	Investment capital (VND billion)	Equity
< 75	30%		
75 - < 1,500	20%	≤ 1,500 ²	15%
≥ 1,500	10%	> 1,500	10% for amounts above VND 1,500 billion; 15% for the portion under VND 1,500 billion

² Approximately USD 82 million

The changes provide investors in smaller yet potentially significant projects (with a value no more than VND 1.5 trillion) with more flexibility in the application of their equity capital. However, the overall equity requirement for large-scale projects (with a value less than VND 1.5 trillion) is higher under Decree 108.

In addition, Decree 108 specifies that the state capital used to carry out a project must not exceed 49% of the “total investment capital” (comprising debt plus equity), of such project, whereas Decree 78 specified a limit of 49% or less the “required equity” of the investor. This allows the State’s greater participation in a project, providing more flexibility in the structuring of sources of capital to implement a project.

Calls for investment

With a view to streamlining the project tendering and award process, Decree 108 clearly stipulates that ministries and local People’s Committees must make an annual announcement, on January 1 each year, of the list of potential projects which require investment. This announcement must appear in three consecutive issues of the bidding press.

The details of the authorities in charge of each project must be disclosed to enable investors to make contact. Furthermore, unlike Decree 78, Decree 108 sets a time limit of 30 days from the last issued announcement published for investors to register for certain projects. If only one prospective investor tenders a bid in this period, the relevant authority may appoint a project investor (without any requirement for a competitive tendering process).

Feasibility reports

Decree 78 provided a general provision that “competent authorities” have the right to make proposals on any project and prepare the tender invitation

documents. The procedures in Decree 78 required a selected investor to prepare and formulate an “investment proposal” in accordance with the laws on construction, at their own cost, to be used as the basis for the negotiation. This step is not required by Decree 108.

Decree 108 specifically states that the relevant authorized state body has, depending on the nature and scale of the project, the authority to formulate the project proposal or feasibility report. In addition:

- 1 The Prime Minister is responsible for approving the project proposal and the feasibility report for certain projects of national importance, projects utilizing an area of land of 200 hectares or more, projects which require a government guarantee and certain projects with total invested capital of VND 1.5 trillion or more; and,

- 1 The minister and chairperson of the local People’s Committee must approve the feasibility report and project proposal for all other projects.

In a departure from Decree 78, Decree 108 specifically requires the investors in a project to reimburse the cost of preparing:

- 1 the evaluation of the feasibility study report; and,

- 1 proposals for projects, including the costs which were relevant to the preparation of the “other projects” (in the case of a BT project).

Procedures for selecting an investor

Both Decree 78 and Decree 108 provide for compulsory bidding for projects which are registered for implementation by two or more investors. However, both decrees also contain exceptions to this rule, where an investor may be appointed by the relevant authority without a competitive bid.

Most significantly, under Decree 108, any project proposed by an investor must in general be publicly tendered out,

whereas under Decree 78 a project could be negotiated exclusively and bilaterally with the proposing investor.

Under Decree 78, the exceptions to competitive tendering included circumstances in which a project was required to be implemented to satisfy an urgent need to use infrastructure facilities or ensure continuity in a way that would not allow a bidding process and “other cases decided by the Prime Minister.” The Prime Minister’s discretion is more limited in Decree 108, which provides that an exception will exist only where a project is required to be implemented in order to satisfy an urgent need to use infrastructure facilities as decided by the Prime Minister, following the recommendation of a ministry, branch or People’s Committee and an evaluation report from the Ministry of Planning and Investment (MPI).

Execution of project contracts

The procedure relating to the execution of the project contract differ in the two decrees. Decree 108 clearly states that the official project contracts between the competent state authorities and investors will only be signed after the issuance of the investment certificate for the project. Decree 108, however, provides that the form of the agreement may be agreed in advance and must be presented to the investment certificate-issuing body as part of the investment certificate application file. Although there was no clear stipulation relating to the timing for signing a project contract under Decree 78, the requirement in that Decree for the investment certificate application file to contain the executed project contract meant that the project contract must be signed before the investment certificate was officially granted by the MPI.

Under Decree 108, the MPI is clearly authorized to issue investment certificates for the following projects only:

- ┆ Projects of national importance;
- ┆ Projects for which a ministry or branch or a body delegated with authority by such ministry or branch is authorized to enter into the project contract; and,
- ┆ Projects which are to be implemented on an area covering a number of provinces or centrally run cities.

All other projects must be licensed by the local People's Committees. This is generally viewed as more appropriate to the reality of implementing smaller projects, which, under Decree 78 required an investment certificate issued by the MPI.

The timeline for obtaining an investment certificate is much clearer in Decree 108 than it was in Decree 78. In any event, in practice, the issuance of an investment certificate for implementing an infrastructure project will almost certainly take more time than the period stipulated by the law.

Security for performance

Under both decrees, investors are required to post a guarantee or security in respect of project performance. The amount of the security depends on the total invested capital of the relevant project and differs in the two decrees, as set out below:

Decree 78		Decree 108	
Investment capital (VND billion)	Deposit/guarantee amount (minimum)	Investment capital (VND billion)	Deposit/guarantee amount (minimum)
< 75	3%		
75 - < 1,500	2%	≤ 1,500	2%
≥ 1,500	1%	> 1,500	1% for an amount above VND 1,500 billion; 2% for the portion under VND 1,500 billion

Tax incentives

Corporate income tax (CIT) incentives for investors in BOT, BTO and BT projects under Decree 78 and Decree 108 may be compared as follows:

Decree 78		Decree 108
Preferential rate	10% for the whole life of the project	Does not contain specific CIT guidelines for projects but provides generally that CIT incentives are in accordance with the "applicable CIT regulations". This provides, for most infrastructure projects, that the 10% preferential rate is available for only 15 years of operation. In addition, the CIT regulations state that the tax exemption and reductions will be applied from the fourth year of operation regardless of the project's profitability at that time.
Tax exemption	four years from the profitable year	
50% reduction on CIT	nine years	

The changes to the tax regime applicable to BOT, BTO and BT projects are not viewed as appropriate by some investors, particularly as such projects envisage cost recovery and eventual profitability over long periods of time.

Looking ahead

The BOT regulations are a work in progress that are evolving in a way that generally provide more investor certainty with respect to developing an infrastructure project on a BOT, BTO or BT basis in Vietnam.

Key investor incentives for implementing projects (such as tax exemptions and reductions and exemption from land use levy and rent) are set out in the legislation. Furthermore, certain provisions of the regulations are clearly directed at providing comfort to third party lenders to the project (as opposed to the equity investors). By way of example, Decree 108 provides that land-use rights and fixed project assets may be mortgaged in favour of project lenders (with government consent), envisages that the government may provide guarantees in certain cases for project loans and enshrines the principle of "step-in rights" subject to state approval on a case-by-case basis that permit lenders to take control of a project on default under the finance documents.

Nonetheless, there is clearly room for further improvement of the drafting of the regulations and also, most importantly, of their practical implementation by the relevant state and municipal authorities.

Recent changes to the BOT regulations have largely been limited to administrative and procedural matters, and these will be elaborated further in a circular which currently exists in draft form.

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repaid many times by the vast increase in the legal security and user-friendliness of the legal system for all stakeholders.

The legal document jungle needs to be cleared up and transformed not just by codification but also by other efforts and techniques. Implementation of Project 30 on simplification of administrative procedures is expected to cut a number of bad trees in the jungle. The e-registry of procedures and their LNDs resulting from Project 30 may be a useful tool for codification. Once codified, it is a lot easier to identify and cut bad trees in the garden.

The regulatory impact assessment, if implemented successfully, should make sure that new regulations make sense. Probably the analogy is that RIA will help Vietnam plant good trees. Good trees will do their best in a sunny, well watered, well-organized garden rather than being overshadowed by big bad trees in the jungle.

Final words

It took Vietnam 17 years to move from a per capita GDP of USD 100 (1991) to USD 1,000 (2008). The next jump from USD 1,000 to USD 10,000 will require a much stronger engine of growth. Korea did it in 23 years (1977-2000). The current slowdown in growth and competitiveness indicates that the Vietnam needs a new wave of reforms to energize stronger development and productivity.

Experiences around the world have repeatedly shown that the quality of the regulatory and legal environment is probably the most important element for development. Efforts to improve the system the last five years have actually made the jungle more difficult to navigate, despite many good trees having been planted. It is

now high time to take a new look at the system and ponder a new approach to transform the jungle into a nice garden.

It is our hope that the visionary leadership of Vietnam, who planted the seed of codification in the Law on Laws, will do its best to realize their idea to its fullest in order to bestow on later generations of Vietnamese a

nice garden of legal documents rather than a jungle. President Roosevelt and his team did it for the Americans with the CFR. The system he created has been an important part of the engine of growth for the U.S. We hope that Vietnam will be able to benefit from strong growth as a result of a successful codification program in a near future.q

Regulatory framework...

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This reflects the current focus on attracting investment in the infrastructure sector by promoting efficiency and transparency in the tender and project award process. The Nghi Son 2 power project, the most recent case involving international bidders, has shown this to be long and arduous. The project documents for this project, upon which the bidders must submit their bids on the same contractual basis, are still under negotiation and continue to be revised by the State authorities with a view to making them satisfactory to prospective investors and their lenders.

The hope is that the finalized Nghi Son 2 documents could serve as a precedent for future tenders in the power sector, which should facilitate the process and make private investment in the Vietnamese power sector a more attractive prospect in the international arena. As the state authorities' experience in this area grows, this should further help the process become more efficient.

The Government is also cooperating with the World Bank to develop "pilot projects" in the expressway and water supply sectors in compliance with Decree 108. The

World Bank's role includes assisting the Government on the preparation of the feasibility studies and legal documents for competitive bidding, which are intended to serve as models for future projects in those sectors.

In the longer term, the overhaul of the legislation governing public-private partnerships (PPPs) is envisaged, which will focus on the separate sectors of infrastructure. There appears to be much confusion in the market about the meaning of "PPP", which is a broad term encompassing any form of partnership between the public authorities and private sector for the construction and management of infrastructure. Although BOT, BTO and BT projects are all forms of PPP, other forms of private participation in infrastructure, such, for example, a build-own-operate (BOO) and shorter term operation and management agreements for existing infrastructure would also be covered. Regulation relating to these types of contracts is necessary, not only as a way of mobilizing funds, but also as a way of ensuring the sharing of private sector international standard expertise and technology. Nonetheless, the priority at this stage seems to work towards developing models to facilitate the initiation of key infrastructure projects.q