
BOT PROJECT FINANCING IN VIETNAM
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Overview

In recent years, build-operate-transfer (BOT) project finance has become one of the main methods for foreign investor infrastructure investment in certain industries such as power production, treated water production and toll roads in Vietnam. Vietnam first enacted regulations for BOT projects in 1994 within the framework of the Foreign Investment Law (FIL). These initial regulations left many questions unanswered, especially in the area of financing. In August 1998, the Government of Vietnam issued Decree 62 (Decree 62) to regulate the implementation and financing of BOT projects. Partly in response to concerns raised by foreign investors and lenders after the Asian financial crisis, the Government of Vietnam further liberalized the BOT regime by issuing Decree 02 (Decree 02) in January 1999 amending Decree 62. The FIL, Decree 62 and Decree 02 are the key components of Vietnam BOT law.

Under the BOT law, a BOT project essentially is a partnership between the Government and a foreign investor to implement an infrastructure project that would normally be carried out by a public utility. In order to encourage a foreign investor to undertake development of a BOT project and provide financing for it, the Government agrees in a BOT contract to allow the investor to operate the project and earn a profit from the cashflow it generates over a specified period of time. At the end of this time period, the investor must hand over the project in operating condition to the Government. This structure has been developed to allow the Government to rely on the expertise of foreign investors to build and operate a particular project with an agreement to transfer the facility at some point back to the Government.

An "authorized state body" (ASB) is one of the key concepts introduced in the BOT law. In order to implement a BOT project, an ASB, usually being a ministry or a local people's committee, is designated by the Prime Minister to represent the Government to sign the BOT contract (*i.e.*, the concession agreement) and act as a focal point to coordinate the activities of Vietnamese project counterparties in relation to the negotiation of project documents with foreign investors and lenders and the implementation of the project in general.

Given the high political risks involved in projects located in Vietnam and the low creditworthiness of the Vietnamese project counterparties, it is not unusual that political risk insurance provided by foreign export credit agencies to cover both political and commercial risks is sought. Foreign lenders in most (if not all) cases include one or more multilateral or bilateral agencies such as the World Bank, the International Finance Corporation, the Asian Development Bank and the Japan Bank for International Cooperation. These agencies who are also the main aid agencies for Vietnam provide direct loans, direct guarantees and, no less importantly, indirect political risk insurance by their presence in the transactions. Such a presence gives significant additional comfort to international commercial banks (who provide the balance of the funds required for the financing).

The next sections of this paper provide an overview of fundamental Vietnamese law issues in relation to a BOT international limited recourse project financing in Vietnam.

Transfer of Obligations from Investors to Project Company

Under the BOT law, a BOT contract is generally understood as a concession agreement entered into by an ASB (representing the Government) and foreign investors. A BOT contract sets forth the rights and obligations of the ASB and foreign investors in connection with the implementation

of the BOT project. Upon issuance of an investment license by the Ministry of Planning and Investment (MPI), a BOT company (*i.e.*, the project company) is formed to implement the project. A question often raised is how the rights and obligations of foreign investors become rights and obligations of the BOT company so that the ASB has no recourse or limited recourse to the foreign investors in case the project fails.

Decree 02 addresses the relationship between foreign investors and a BOT company. The parties are free to structure such a relationship as they see fit as long as it is validated in one of three ways:

- (i) the BOT company can ratify the BOT contract by becoming a party to the contract and will be considered, together with the foreign investors, as forming part of the foreign side to the BOT contract;
- (ii) the BOT company can take over the rights and obligations of foreign investors by a written agreement between the BOT company, the foreign investors and the ASB and, following the MPI approval, such written agreement will form an integral part of the BOT contract; or
- (iii) the relationship can be validated in any other way approved by the MPI.

In the first way, the newly formed BOT company basically signs and becomes party to the BOT contract already signed by the ASB and foreign investors. In this case, the BOT contract should include mechanism to transfer the rights and obligations of the foreign investors to the BOT company upon signature by the latter. In the second way, foreign investors could enter an agreement with the BOT company and the ASB pursuant to which the ASB essentially agrees that all rights and obligations of the foreign investors are novated to the BOT company. On the basis of such a novation agreement, the BOT company and the ASB sign a new BOT contract, which restates the rights and obligations of the BOT company in the implementation of the project.

Step-in Right of Lenders

The step-in right of lenders is a newly recognized concept under the BOT law. Decree 02 refers to the right of lenders to "take over the project" upon default under the BOT contract or the loan agreement. Decree 02 gives lenders the right to take over in whole or in part the rights and obligations of the BOT company in the implementation of the project should the BOT company or foreign investors fail to perform under the BOT contract or loan agreement. It requires that such rights be specifically provided for in the loan agreement and be subject to approval of the ASB.

The step-in right is very important to lenders. In a limited recourse project finance, lenders rely on the anticipated cashflows of the BOT project and not on the assets of the foreign investors. It is therefore in the interest of lenders to have the project continue to operate to generate revenues even if default occurs. Lenders may prefer not to foreclose on the project assets and instead step in to replace the initial BOT company with a new one that is capable of operating the project. In Vietnam, the step-in right of lenders is even more important because the taking of project assets as collateral is of limited use and primarily for defensive purposes (*i.e.*, to strengthen the negative pledge covenant).

An effective mechanism for lenders to exercise their step-in right is a pledge by the foreign investors of their equity interests in the BOT company to the foreign lenders. Upon the occurrence of an event of default, the lenders will be entitled to take an assignment of the equity interests and become new investors of the BOT company. If all foreign investors are foreign entities, a pledge of the BOT company's equity to lenders under foreign law is also possible. Obviously, prior approval of the pledge by the ASB will be needed. The step in right of lenders could also be further elaborated in other transaction documents such as the loan agreement, the BOT contract and any direct agreement signed between the lenders and the ASB.

Security in Vietnam

The rights of foreign lenders taking security over movables, immovables and land use rights located in Vietnam continue to be of great importance to project lenders. Decree 62 permits a BOT Company subject to ASB approval to mortgage or pledge the following assets "in accordance with Vietnamese law":

- (i) value of the land use rights in accordance with the laws of Vietnam;
- (ii) equipment, plant, architectural works and immovables which have been purchased or constructed with the invested capital of a BOT company;
- (iii) other assets owned by a BOT company; and
- (iv) property rights of a BOT company.

In Vietnam, there is no private ownership of land. Land is owned by the people and administered exclusively by the State. Land use rights therefore represent the maximum ownership interest that an individual or legal person may have in land and such land use rights can be mortgaged. Decree 62 provides for a BOT company to mortgage land use rights "in accordance with Vietnamese law." The land law only permits a BOT company to mortgage land use rights to Vietnamese credit organizations, joint venture banks and foreign bank branches operating in Vietnam. Therefore, it implicitly prohibits the taking by foreign lenders who do not have branch presence in Vietnam of mortgages over land use rights unless special approval for such mortgages is obtained. Assets other than land use rights could be mortgaged or pledged to foreign lenders subject to the ASB approval.

Subsequent security regulations issued by the Government of Vietnam, including Decree 165 in November 1999, have clarified and broadened the types of collateral (except land use rights) that could be mortgaged or pledged to foreign lenders. Under Decree 165, a BOT Company can mortgage or pledge virtually all of its assets except land use rights. In particular, Decree 165 clarifies that a BOT Company is entitled to mortgage or pledge its "future assets" (or after-acquired assets) including, among others, assets financed by loan proceeds, new structures affixed to land, revenue streams under contracts (*e.g.*, payments under off-take agreements and other contractual property rights, and income and benefits derived from the collateral. Foreign lenders could also take a non-possessory pledge of "assets circulating in the business or production process" including "machinery, equipment, raw material, material, fuel, consumer products, other movable property or immovable property used to exchange or trade in the business or production process of the securing party."

Vietnam is in the process of setting up a national registration system for pledges of movables and contractual rights and a local registration system for mortgages of immovables and land use rights. The national registration system began functioning in the second half of 2002. The local registration system is expected to be fully operational soon after a recent regulation issued to provide detailed guidelines for the operations of such a system. Until then, mortgages of immovables cannot be perfected and the priority of lenders cannot be ascertained. Enforcement of foreign lender security interests have not been widely tested in Vietnam and it remains to be seen how these interests will be enforced in practice.

Given the land use rights exception, the lack of a registration system for immovables and an effective enforcement mechanism, project security in Vietnam is primarily negative and defensive and intended to prevent other creditors from obtaining adverse interests in the project assets and thereby limiting the rights of foreign lenders.

Foreign Exchange

Under Vietnamese law on foreign exchange control, foreign loans (with a term of more than 1 year) must be registered with and approved by the State Bank of Vietnam (SBV) prior to the first drawdown. A BOT company is permitted to make authorized transfers from Vietnam into an authorized offshore account of the borrower in respect of amounts payable on account of principal, debt service, fees and insurance premia subject to SBV approval of the foreign loans and appropriate documentary evidence. It is also entitled to convert its revenues in Vietnamese Dong to foreign currency at commercial banks without being required to obtain SBV approval. Hence, transferability and convertibility risks to a large extent are no longer an issue.

In case there is a foreign currency shortage in the commercial bank system, the law also provides for a three-tier assistance regime for foreign exchange availability, namely:

- (i) especially important projects;
- (ii) infrastructure projects and other important projects; and
- (iii) ordinary projects (other than the projects listed in (i) and (ii)).

Especially important projects are entitled to availability guarantees. At the second tier is “guaranteed assistance” in the balancing of foreign exchange in the event that commercial banks are unable to meet the required foreign currency needs of a project company. No assurance on availability is provided to ordinary projects. There is no clear definition of especially important projects in the BOT law. It seems that a project obtains the “especially important project” status on the basis of a resolution of either the National Assembly or the Government. A BOT project is likely to fall within the second tier unless it obtains the “especially important project” status.

Governing Law

Decree 02 makes a fundamental change in the BOT law with respect to the governing law of project contracts. A BOT contract or an ancillary project contract under which the obligations of a Vietnamese entity are guaranteed by the ASB may be governed by a foreign law provided that the choice of such foreign law (i) is not contrary to Vietnamese law and (ii) is approved by the Ministry of Justice (MOJ). Therefore, subject to MOJ approval, a BOT contract and ancillary agreements such as an off-take agreement and a feedstock supply agreement (to the extent that the obligations of the Vietnamese counterparties are guaranteed by the ASB) could be governed by foreign law.

Decree 02 permits the MOJ to determine whether there are choice of law rules contained in the BOT law and other laws that conflict with the choice of law rule stated in Decree 02. If no such rules exist, then the parties should be allowed to agree that foreign law would govern the interpretation of the BOT contracts and any related contract, the performance of which is guaranteed by relevant Vietnamese authorities. Since the BOT law and other laws do not appear to provide any choice of law rules for BOT projects conflicting with Decree 02, the parties to a BOT project should be free to choose a foreign law as long as they obtain the approval of the MOJ.

The choice of a foreign law to govern a BOT contract and ancillary contracts nevertheless does not mean that the BOT law no longer applies. The BOT law addresses numerous issues and procedures relating to the implementation of BOT projects, including the preparation of the pre-feasibility study, selection of foreign developers, preparation of the feasibility study, granting of land-use rights, bidding for selection of contractors, tax incentives, foreign exchange, taking of the BOT company's assets as security, choice of law and dispute resolution as noted elsewhere in this paper.

Dispute Resolution

The BOT law provides that disputes between the BOT company and Vietnamese entities whose obligations are guaranteed by the ASB may be referred to (i) a Vietnamese arbitration body, (ii) an

arbitration council established by the parties or (iii) foreign arbitration. Any other disputes may be referred to foreign arbitration or a foreign court.

Awards rendered by foreign arbitration theoretically are enforceable because Vietnam has acceded to the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards. Vietnam has implemented the New York Convention through its own Ordinance on Recognition and Enforcement of Foreign Arbitral Awards passed by the Standing Committee of the National Assembly in 1995. Under the Ordinance, foreign arbitral awards must be recognized and held enforceable by Vietnamese courts except where (i) the agreed-upon arbitration procedures were not complied with; (ii) the recognition of the foreign arbitral award for enforcement in Vietnam is contrary to the “basic principles of the laws of Vietnam” (*i.e.*, public policy); or (iii) the transaction in dispute was not commercial in nature.

The “commercial in nature” reservation is very problematic. To determine whether the transactions are commercial in nature, recent court precedents indicate that Vietnamese courts refer to the exhaustive list of 14 ‘commercial acts’ provided in the Commercial Law adopted by the National Assembly on March 23, 1997. The list of 14 commercial acts in the Commercial Law is narrow and mainly revolves around trade in goods. Many important transactions are left out. Among others, lending, security and construction (including EPC arrangements) are not included in the list and hence are not qualified for enforcement under the Ordinance. Therefore, foreign lenders face a significant risk that they cannot enforce foreign arbitral awards in their favor in Vietnam.

Judgements rendered by foreign courts are generally not enforceable in Vietnam unless the country where the court is located has a bilateral treaty on recognition and enforcement of court judgements with Vietnam. Only a small number of mostly-former Soviet bloc countries have such a treaty with Vietnam.

Conclusions

The legal framework governing BOT projects in Vietnam exists and all the basic elements are in place. There are tremendous opportunities in project finance for infrastructure projects in Vietnam as the country embarks on its “industrialization and modernization” program. Although the BOT law currently in effect cannot be said to be fully satisfactory to foreign investors and lenders, Vietnamese law has been gradually developing to meet the concerns of both project investors and lenders.