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**DECREE LAYS DOWN PATH FOR BOT RESTRUCTURING**

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Build-Operate-Transfer (BOT) projects in Vietnam can be counted on two hands and all of them are currently behind schedule. The delays are primarily attributable to the regional financial crisis that has made financing infrastructure projects in Asian countries, including Vietnam, extremely difficult. In addition, the legal framework governing BOT projects - Government Decree 62 dated August 15, 1998 - does not provide sufficient assurances for project sponsors and lenders and it is therefore very difficult to structure a bankable BOT project in Vietnam.

Government Decree 02 issued recently amends Decree 62 and provides for significant changes in regulations relating to BOT projects by addressing issues that are critical to the successful financing of such a project. These issues include novation of the rights and obligations of project sponsors to the BOT company, step-in right of lenders, governing law and dispute resolution. Although the amendments do not remove all obstacles currently being faced by project sponsors and lenders, they touch upon some of the fundamental issues and provide an avenue for structuring BOT projects so as to be more bankable. We discuss here the highlights of Decree 02 and, where appropriate, compare with the relevant provisions of Decree 62.

### **Novation**

Decree 62 provides that a BOT contract is entered into by project sponsors and an authorised state body (ASB), usually a ministry or a people's committee designated by the prime minister. A BOT contract sets forth the rights and obligations of the ASB and project sponsors in connection with the implementation of a BOT project. Upon issuance of an investment licence by the Ministry of Planning and Investment (MPI), a BOT company is formed to implement the project. The question often raised is how the rights and obligations of project sponsors become rights and obligations of the BOT company. Such a transfer is called a novation because it amounts to remaking or "novating" the BOT contract to include the BOT company as a party. Decree 62 is unfortunately silent on this issue.

In practice prior to Decree 02, project sponsors could enter an agreement with the BOT company and the ASB pursuant to which the ASB essentially agreed that all rights and obligations of the project sponsors 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 restated the rights and obligations of the BOT company in the implementation of the project. Since Decree 62 specifically provides that a BOT contract must be between an ASB and project sponsors, it created uncertainty as to the legal basis for a novation agreement and the authorisation for the execution of a restated BOT contract.

Article 1 of Decree 02 for the first time addresses the relationship between project sponsors 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 project sponsors, as forming part of the foreign side to the BOT contract; (ii) the BOT company can take over the rights and obligations of project sponsors by a written agreement between the BOT company, the project sponsors and the ASB and, following 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 MPI.

### Step-in Right of Lenders

Decree 02 also for the first time refers to the right of lenders to "take over the project" upon default under the BOT contract or the loan agreement. Article 2 of 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 project sponsors fail to perform under the BOT contract or loan agreement. Decree 02 requires that such rights be specifically provided for in the loan agreement and be subject to approval of the ASB. The right to take over a BOT project (usually known as the step-in right) by lenders upon occurrence of default is customary in project financing arrangements around the world.

Project financing is usually made on a limited recourse basis; that is, lenders must rely on the anticipated cashflow of the BOT project rather than the assets of the project sponsors. 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 more important because the taking of project assets as collateral is of limited use. An effective mechanism for the perfection and enforcement of collateral is not available in Vietnam and therefore it is not certain that lenders can have a first perfected security interest enforceable in Vietnam. In addition, it is also not clear whether lenders can take all project assets as collateral since foreign lenders cannot have a security interest in land use rights of the BOT company. The purpose of the security arrangements therefore, in most cases (except for pledge of revenue streams and insurance proceeds), may be confined to preventing the BOT company from transferring or disposing of the secured assets to third parties. In order for lenders to take over the project and replace the initial BOT company by a new one, an assignment of the BOT company's equity to lenders conditional upon the occurrence of an event of default is required. If all project sponsors are foreign entities, a pledge of the BOT company's equity to lenders under foreign law is possible. Obviously, prior approval of the pledge by the MPI and the ASB will be needed and further guidelines of the government need to be issued.

### Governing Law

Decree 62 provides that Vietnamese law must apply to the project documents, including the Build Operate Transfer (BOT) contract and an off-take agreement. Where Vietnamese law is silent, foreign law can be applied provided it is not contrary to Vietnamese law.

This combination presents significant issues. First, it is generally believed that the applicability of Vietnamese law to a complex infrastructure project often worth hundred millions of dollars is somehow inappropriate because Vietnamese law does not provide enough protection for project sponsors and lenders. Second, determination of how Vietnamese law governs a specific issue sometimes proves difficult. For example, lawyers are puzzled on how an off-take agreement is characterised under Vietnamese contract law since three bodies of contract law - the Ordinance on Economic Contracts, the Law on Commerce and the Civil Code - may in theory all apply. Finally, any attempt to marry Vietnamese law with a foreign law is unpredictable.

Decree 02 clears these hindrances by providing in Article 3 that a BOT contract or an ancillary contract (such as an off-take agreement) under which the obligations of a Vietnamese entity are guaranteed by an authorised state body (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). As such, the BOT contract and especially the off-take agreement may be governed by a foreign law. As a practical matter, MoJ approval should include an opinion that the choice of foreign law does not contravene any Vietnamese law.

**Dispute Resolution**

Decree 62 dictates that a dispute between a BOT company and a Vietnamese off-taker be referred to a Vietnamese court or a Vietnamese arbitration body. The off-take agreement determines inter alia the output price and revenue streams of the project. Since financing is usually based on the project's revenue streams, lenders are often uncomfortable about bringing a dispute relating to such contract to a Vietnamese forum that has yet been tested.

Article 4 of Decree 02 provides that disputes between the BOT firm 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. Therefore, a dispute between the BOT company and a Vietnamese off-taker may now be referred to foreign arbitration. The advantage of this is that a foreign arbitral award is more reliable and can be enforced in Vietnam and elsewhere under the New York Convention. But the enforcement by Vietnamese courts of a foreign arbitral award against the ASB or the Vietnam Government is uncertain. Further assurances regarding the enforcement of a foreign arbitral award in these particular circumstances are still needed.

**Conclusions**

Decree 02 enhances the legal framework governing BOT projects in Vietnam. It lays out resolutions for some of the fundamental issues hampering BOT projects and provides a way to structure BOT projects to make them more bankable. But other issues considered by sponsors and lenders as difficulties for financing a BOT project are not addressed by Decree 02. It is vital such issues as a guarantee for convertibility and availability of foreign currency, guarantee for payment obligations under the BOT contract and the off-take agreement, the taking of land use rights as security and perfection and enforcement of such a security interest, be resolved. Hopefully implementing regulations for Decree 62 and Decree 02 will further enhance the legal framework governing BOT projects in Vietnam.