

UPDATE ON DEVELOPING LNG TO POWER PROJECTS IN VIETNAM

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In 2020 we produced a webinar and published an article on the potential for development of LNG to Power projects in Vietnam. We noted that Vietnam has a successful track record in developing coal-fired power plants sponsored by international investors who would have assumed that the risk allocation that has been developed could be used as a starting point for developing LNG to Power plants. However, we also noted that there were a lot of uncertainties on how the market would develop due to:

- a major change in Vietnamese law, including the PPP Law which took effect as of 1 January 2021;
- the lack of precedent LNG to Power projects in Vietnam; and
- the lack of any large conventional power projects, which were not developed under the PPP scheme, that have been successfully financed on a non-recourse basis.

The new laws ("New Laws") are now in force and WFW has been advising on the introductory stages of several LNG to Power projects in Vietnam. In this article, we discuss some of the developments under the New Laws, and our practical experience advising on LNG to Power projects in Vietnam.

THE NEW LAWS

The New Laws consist of:

- The Law on *Public – Private Partnership Investment No. 64/2020/QH14* ("PPP Law"), passed by the National Assembly on 18 June 2020 and taking effect on 1 January 2021, sets out the new legal regime for projects developed on a PPP basis.
- The Law on *Enterprises No. 59/2020/QH14* (the "Law on Enterprise"), passed by the National Assembly on 17 June 2020 and taking effect on 1 January 2021, sets out the regulations on incorporation and management of all types of enterprises.
- The Law on *Investment No. 61/2020/QH14* (the "Law on Investment"), passed by the National Assembly on 17 June 2020 and taking effect on 1 January 2021, sets out the regime for foreign direct investment in Vietnam.

In particular, we will look at:

- choosing between build-operate-transfer projects (“BOTs”) and independent power projects (“IPPs”);
- investment approvals and project awards;
- government guarantees (“GGUs”);
- power purchase agreements (“PPAs”);
- concession agreements and termination payments;
- issues relating to floating storage regasification units (“FSRUs”) and LNG terminals; and
- revenue sharing

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BOT OR IPP?

In our previous article, we highlighted that projects in Vietnam can be implemented as either (i) BOT projects under the PPP Law or (ii) IPP under the Investment Law. Different regimes apply to BOTs and IPPs. Traditionally, the BOT scheme offers greater protections than IPPs do and, prior to this year, were favoured by all internationally invested power projects in Vietnam. However, we have seen that the majority of currently proposed LNG to Power projects in Vietnam prefer the IPP structure for a number of reasons set out below and so far only two projects we are aware of will be developed on a BOT basis.

This change could be because the PPP Law has reduced the protections available to BOTs and, as a result, the differences between BOTs and IPPs are now less pronounced. More particularly, it is a legal requirement under the PPP Law that

investors in BOT projects must be selected through a bidding process under Vietnam’s Tender Law which can be very onerous (see section *Investment Approvals and Project Award* below). In addition, the well-known risk allocation structure and precedent contracts that have been developed for coal-fired BOT projects – which have been banked with international lenders – are subject to changes due to the new PPP Law. As a result, the already long negotiation process for BOTs threatens to be even more complex for LNG projects under the new PPP Law.

Throughout this article we will highlight the effects of the New Laws on BOTs and the differences between the BOT and IPP regimes.

INVESTMENT APPROVALS AND PROJECT AWARDS

The investment approvals required to develop an LNG to Power project in Vietnam are complex and will vary depending upon certain factors, including:

- the size of the project;
- the region it is located in;

- whether it will utilise an FSRU or a fixed terminal; and
- whether the FSRU/terminal will be developed as an aggregated project together with the power plant or as a separate project.

OVERVIEW OF INITIAL PROJECT APPROVAL PROCESS

At a high level, the key stages of investment approval for a foreign invested LNG to Power project are:

1. Approval of the Power Master Plan and the Gas Master Plan;
2. Approval of Investment Policy – a more detailed approval than a Master Plan and includes details such as the objectives, location, scale, schedule and duration/term of project implementation, as well as the identity of the investor how they were selected for the project;
3. Investor Selection – process that attaches the sponsor to the project;
4. Investment Registration Certificate – follows obtaining approval of the projects investment policy (not required for BOT projects); and
5. Enterprise Registration Certificate – formal approval allowing the project company to be incorporated in Vietnam.

The Investor Selection process has been heavily impacted by the New Laws and some confusion remains regarding the process. In general, it is the local People Provincial's Committee ("PPC") that is responsible for investor selection. Under the New Laws, the selection of the investor(s) for a project should follow one of the following processes:

1. auction of land use rights in accordance with the laws on land;
2. bidding process in accordance with the relevant laws on bidding; or
3. direct appointment.

The auction of land use rights only applies in certain limited cases and conditions, that are unlikely to be applicable to LNG to Power projects.

Bidding in accordance with the relevant laws on bidding is compulsory in certain cases, including for public-private partnership projects ("PPPs") (which includes BOT projects). In our view, the bidding process is not compulsory for IPPs. However, based on our experience, even if it is not compulsory, a PPC may require a bidding process for IPPs, though they would not be bound by the formal legal requirements and can use a fast track bidding procedure. If the PPC decides to appoint the investor for an IPP project by direct appointment and more than one sponsor submits an application to them, then they may also make the award decision based on a shortened bidding process.

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For BOTs, bidding is compulsorily and the law sets out the details of the process (see PPP Bidding Process). In practice, there is still a degree of uncertainty around the process for sponsor award and the criteria that will be applied. Our understanding is that the government's intention under the New Laws is for local authorities (i.e. PPCs) to become more heavily involved in the project award process. However, PPCs currently lack experience in international competitive bidding processes for complex projects like LNG to Power, adding further uncertainty.

PPP BIDDING PROCESS

In bidding for a PPP Project, the following process will apply¹:

- selecting an investor short list in cases of tendering with pre-qualifications where there are six or more potential investors;
- preparing for the investor selection process including the preparation, evaluation and approval of tender invitation documents;
- organising the selection of investors including inviting tenders, issuing, clarifying and amending tender invitation documents; extending the time limit for submitting tenders if required; preparing, submitting, receiving, managing, amending and withdrawing tenders;
- assessing all tenders, including opening and assessing technical, financial and commercial proposals;
- submitting, evaluating, approving and publicly announcing the results of the investor selection process; and
- negotiating, finalising and executing the PPP project contracts and disclosing the relevant information therein.

The only recent project successfully awarded in Vietnam on the basis of an international bidding process is the Nghi Son 2 coal-fired project ("NS2"). For that project, the project documents were substantially drafted in advance and the sponsors able to bid with a degree of certainty that there was a bankable project structure. Currently, it appears that Vietnam is not following NS2 approach and is awarding projects instead at early stages, when there are still many uncertainties as to how the project will progress which preclude a fully competitive bidding process. In addition, NS2 strictly followed the Vietnamese Bidding Law and the submission of the responses to the RFP were binding on EVN and the tariff, which would not be the case for these projects selected by local PPCs.

GOVERNMENT GUARANTEES

Prior to 1 January 2021, a BOT project had an automatic right to receive a GGU backing the obligations of Electricity Vietnam ("EVN") under the PPA and Ministry of Industry and Trade ("MOIT") under the concession agreement. The project could also include tariffs denominated in USD (but payable in VND) and the GGU contain a foreign currency regime guaranteeing a certain percentage of VND revenue to USD.

Guarantee

There is no legal basis for a GGU under the PPP Law for BOTs or under the Investment Law for IPPs. Therefore, it is not automatic that a project will receive a GGU.

However, Decree 31 on the implementation of the Investment Law² provides that the Prime Minister (“PM”) has the discretion to award forms of security to both PPPs and IPPs. The forms of security can include (i) foreign currency support and (ii) other forms of state security as decided by PM, which could include a GGU. As yet, there is no precedent or guidance on when the PM will exercise this discretion.

Our understanding is that most major international banks would be reluctant to bank a project without a GGU. We would however note that, to date, EVN has not defaulted on any payment obligations to internationally invested power projects and has the same credit rating as the Vietnamese state.

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Foreign Currency Risks

The foreign currency risks for projects are two-fold: (1) exchange rate risk; and (2) availability of USDs in Vietnam.

"Prior to the implementation of the New Laws, BOTs benefited from a specific exemption permitting payments to be denominated in USD and paid in VND. This meant that exchange rate risk was limited to the 30-day payment period."

Under Vietnamese law, absent of any specific exemption, any payments between two Vietnamese companies must be denominated and paid for in VND (including payments between EVN and a Vietnamese project company). Prior to the implementation of the New Laws, BOTs benefited from a specific exemption permitting payments to be denominated in USD and paid in VND. This meant that exchange rate risk was limited to the 30-day payment period. It is unclear whether this is permitted under the new PPP Law, therefore both BOTs and IPPs face additional exchange rate risk.

Under Circular 57 (see section *The PPA* below), a PPA can contain a mechanism to take into account foreign exchange rate differences and propose a payment plan that takes into account (i) the amount of foreign currency loans; (ii) the repayment plan for foreign currency loans; and (iii) the difference between the exchange rate agreed by the parties and the actual exchange rate in the immediately preceding year. This may offer some mitigation of exchange rate risk to sponsors, although it is still

unclear how such payment plans would work in practice. Sponsors should also be able to enter into foreign hedging agreements with Vietnamese banks for additional protection, though this adds an additional cost to the project.

Foreign sponsors have a right to convert VND to USD, however VND are not freely convertible and the ease of conversion depends upon the availability of USD in Vietnam. This risk can be mitigated if foreign currency protection is granted under the Investment Law (as set out above in relation to the Guarantee). For PPPs, the maximum foreign currency convertibility guarantee is 30% of the project's revenue in VND after deducting expenses in VND³. Prior to the New Laws, BOT coal-fired projects received a guarantee of 30% convertibility and an additional assistance obligation in respect of the remaining 70%.

THE PPA

EVN is currently the sole offtaker in Vietnam. IPPs are required to enter the standard form PPA with EVN in the form attached to Circular 57⁴ (the "Standard PPA"). The Standard PPA is a short form document that lacks many of the protections required by international lenders. Circular 57 permits EVN and project companies to negotiate and supplement the Standard PPA. This potentially allows a degree of flexibility but, to date, EVN has not agreed on any PPAs for LNG to Power projects and their negotiation will be a key issue for any project.

BOT projects are entitled to a full and comprehensive PPA and those for coal-fired power plants can be seen as a starting point. However, there will be a number of important points to negotiate:

- As a result of limitations in the PPP Law on payments that can be made by MOIT under the concession agreement (see *Concession Agreement* section below), payments during a government force majeure (which is not caused by EVN) which were traditionally contained in the BOT contract for coal-fired power plants, will need to be moved to the PPA and negotiated with EVN. In addition, the categories of termination payment MOIT can approve in the concession agreement are limited and do not include termination payments due to extended force majeure events;
- Amendments will need to be made to risk allocation to take into account specific issues relating to LNG, in particular the costs of the FSRU/terminal (see *FSRU or Terminal* section below); and
- EVN is a commercial organisation and can be expected to negotiate hard on all commercial points in the PPA, including key bankability points previously agreed for coal-fired power plants.

KEY BANKABILITY ISSUES IN THE PPA

Issue	IPP	BOT
Take or Pay	<p>There is no take or pay provision in the Standard PPA.</p> <p>EVN is not obliged to dispatch if there are any technical issues with the grid or transmission line, therefore the sponsor has responsibility for curtailment risks.</p> <p>Sponsors can expect heavy negotiations with EVN on this issue.</p>	<p>Take or pay is available, but there may be issues recovering capacity charge for FSRU/terminal costs.</p>

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Issue	IPP	BOT
Change in Law	There is no change in law in the Standard PPA, but Circular 57 allows the parties to re-negotiate the tariff if a change in law impacts their legitimate interests.	Change in law protection has historically been included in concession agreement. Change in law provisions are permitted under the new PPP Law, although forms of compensation will be more limited.
Termination Payment	The Standard PPA does not include a termination formula and damages would be limited to direct and actual damages determined in accordance with Vietnamese law. Sponsors can expect heavy negotiations with EVN on this issue.	Traditionally included in the concession agreement. Due to limits under the new PPP Law, termination payments for extended force majeure events cannot be included in the concession agreement.
Step-in Rights	Not included in the Standard PPA and would need to be negotiated with EVN.	The PPP Law provides that Vietnamese counterparties may enter into direct agreements with lenders.
Governing law	Vietnamese law. Concepts such as liquidated damages are not recognised under Vietnamese law and alternative mechanisms will need to be considered.	Vietnamese law. This is a major change under the new PPP Law.

CONCESSION AGREEMENT

BOT projects enter into a concession agreement (BOT Contract) with MOIT containing certain important protections. As a result of the PPP Law, there are a number of changes that will need to be included as against the bankable precedents agreed for coal-fired projects.

Termination Payments

Under the new PPP Law, MOIT will only make a termination payment in two cases:

1. due to national interest or to ensure requirements on national defence and security are complied with, and for protection of State secrets; or
2. MOIT event of default.

As a result, MOIT cannot make termination payments following an EVN event of default (unless the government approves a GGU for the project to guarantee EVN's obligation – see *Government Guarantees* above) or a termination for extended force majeure. There is no possibility for a termination payment in the event of an extended force majeure affecting the developer side. In case of an extended force majeure affecting EVN or EVN default, a developer may attempt to negotiate a termination payment with EVN in the PPA.

Capacity charge

In terms of ongoing capacity charge payments during force majeure, including a government force majeure, there is no legal basis for MOIT to pay any capacity charge payments if the project is not operating due to force majeure. In the limited case where a force majeure affecting EVN prevents commissioning, EVN may pay deemed commissioning payments. Otherwise, the available remedy would be to extend the term (during operation phase) or the required commercial operation date (during construction phase). As an alternative, the parties may be able to apply the new revenue sharing mechanism set out in the PPP Law (see below).

Governing law

A BOT contract must be governed by Vietnamese law. Previously, BOT contracts for coal projects were governed by English law. As noted above, concepts such as liquidated damages are not enforceable under Vietnamese law and will need to be revised.

Form

The PPP Law provides that PPP contracts must follow the template contract to be issued by the Government. Appendix 6 of Decree 35/2021/ND-CP has set out certain key contents for the PPP contract.

The content listed in Appendix 6 of Decree 35 includes project objectives and scale; location and demand for land; contract term and project implementation schedule; lease of land and water surface; technical requirements; total investment, capital structure, financial plan; revenue sharing; rights and obligations of parties during construction and operation phases and during transfer; performance guarantee and penalty; project company; early termination; governing law and dispute resolution.

FSRU/TERMINAL

The decision to operate with either an onshore terminal or an FSRU is crucial to any project. All technical considerations that are applicable to projects generally will also apply equally in Vietnam. The following Vietnam-specific points should also be noted:

- Where an onshore terminal is on the coast and requires use of the sea surface, Vietnamese law is silent on whether assets legally constructed at said the sea site can be mortgaged or otherwise subject to security. Thus, the authorities take the conservative view that it is not possible to grant security over assets constructed on the sea site;

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- Where an onshore terminal requires the use of inland waterways for access (such as in the Mekong Delta), dredging will be an important issue and negotiating a dredging schedule with the competent authorities will be challenging;
- There are still competing views between MOIT, the Ministry of Transport and the Maritime Administration on whether an FSRU should be categorised as a ship or a port under Vietnamese law. The outcome of this will determine the necessary licenses and approvals;
- To the extent that the costs for an FSRU or onshore terminal are passed through to the price under the PPA, the sponsors can expect heavy negotiations with EVN to justify said price; and
- An onshore terminal will have greater capacity to sell the re-gasified LNG to third parties (for more on this see the WFW webinar [here](#)). This is not prohibited under Vietnamese law (subject to licensing, see *Integrated or Segregated* section below), but at present there is no supply network for gas in Vietnam.

INTEGRATED OR SEGREGATED

The second key decision in relation to the FSRU/terminal question is whether to use an integrated model (with the power project and the terminal/FSRU owned by one project company) or a segregated model (with two project companies). We explored this issue in some depth in the **first of our series of LNG webinars**, our webinar on **LNG in Vietnam** and in the first article of the LNG to Power campaign, **The Anatomy of an LNG to Power Project**.

There are some specific practical issues in Vietnam we have noted when advising on the first stages of LNG to Power projects in Vietnam:

- Negotiating risk allocation is proving more complex for segregated projects. For BOTs, terminal/FSRU projects would not be entitled to the protections provided in the PPP Law when it is segregated from the power project. In addition, EVN is taking the initial view that in a segregated project, the FSRU/terminal project is a third-party contractor of the power plant project and therefore a power project risk. It is difficult to agree on risk allocation and pass-through of FSRU/terminal capacity charge to the capacity charge element of the tariff. Sponsors will need to negotiate hard with EVN to agree on pass-through to the tariff of a “take or pay” element under the tolling agreement to the tariff;
- In terms of approvals and permits, a segregated project will require more approvals and consents than an integrated project. Specifically, under the segregated model, master plan inclusion, investment consents, feasibility studies, environmental impact assessment reports, construction permits, and fire prevention appraisals will all be required for both separate projects;
- The segregated model should enable third parties to gain access to the LNG facilities, where re-gasified LNG may be provided to other third-party consumers rather than exclusively for the power plant; and
- An integrated project may also provide LNG to third party consumers if (i) it is approved in the investment consents, and (ii) the project company has fulfilled the business conditions for conducting business in gas (particularly Certificate of Eligibility for LNG importer/LNG sales/LNG processing/LNG filling station for vehicles as applicable). However, it may be more difficult to explain and obtain approval from competent authorities for an integrated project which also provides LNG to third party consumers because the traditional view is that in the integrated project the LNG terminal is an integral part of the power plant and as a result, LNG should be provided exclusively for the power plant.

REVENUE SHARING

The PPP Law introduces the new concept of revenue sharing for BOT:

- when the actual turnover of a project is more than 125% of the level of turnover set out in the concession agreement's financial plan, the investor and PPP enterprise shall share with the State 50% of the difference between the actual turnover and 125% of the level of turnover specified in the financial plan; and
- when the actual turnover is lower than 75% of the level of turnover set out in the financial plan in the PPP contract, the state will share with the investor and PPP enterprise 50% of the difference between 75% of the level of turnover set out in the financial plan and the actual turnover.

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The revenue sharing mechanism shall only apply if the agreed thresholds are reached after taking into account any increase/change in cost and term in the concession agreement.

Where the turnover is lower than the 75% threshold, there will be an additional condition that the lower turnover is attributable to change in law, policy or master plan.

A number of projects are exploring whether this sharing mechanism can be utilised to address risk allocation issues such as government force majeure or non-government force majeure and change in law.

CONCLUSION AND FINAL THOUGHTS

Despite the uncertainties, the case for LNG in Vietnam remains strong. The demand for power is projected to grow, large scale coal projects are no longer being backed and renewables alone cannot meet the future demand for power in Vietnam. The

latest draft of the Vietnamese government's Master Plan VIII is oriented to promote the development of power sources using LNG with the development of terminals, ports and infrastructure for LNG importation, given the increasingly difficulty in further developing coal power plants.

A number of major developers are looking at LNG to Power projects in Vietnam. Once the key uncertainties have been addressed – in particular agreeing a bankable PPA and risk allocation – and the first project reaches financial close, we anticipate that a number of projects will follow.

[1] Decree No. 35/2021/ND-CP guiding the implementation of the Law on PPP provides for the bidding process for PPP projects

[2] Article 3 of Decree 31/2021/ND-CP guiding the Investment Law

[3] Article 81 of PPP Law

[4] Circular 57 prescribes the methods of determining electricity tariff and PPA standard form for power projects with capacity of more than 30MW connecting to grid or power projects with capacity below 30MW voluntarily participating in the power market (excluding BOT and renewable power projects).

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