Is Vietnam going in blind in its solar venture?

Vietnam goes gung-ho on solar development

Small Vietnam just went big on improving its policies on solar projects, but analysts are skeptical if the regulatory changes are bringing more harm than good into the country's solar industry.

When Vietnam released Circular 16 in September, it outlined the official template for the power purchase agreements (PPA) on solar projects effective until mid-2019, but alongside praise that the PPA will finally put an investment structure in the high-potential solar sector are criticisms that the risk burden has been tipped too much to the side of investors. The perceived inadequacies of the PPA template - that it has no take-or pay obligation is one of several grievous shortcomings cited by analysts - come not from a lack of advice. The Vietnamese government has been bombarded by suggestions on how to improve the PPA rules since April when a draft version was released, but officials were unwilling to yield ground. This raises questions on how the current PPA provisions viewed as deterrent to investment will test the patience of interested sponsors and hinder long-term solar development.

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"Having largely ignored recommendations provided, the final text does little to inspire confidence," said **Giles T. Cooper,** partner at Duane Morris Vietnam, LLC. "The final PPA does not improve upon the main critical issues highlighted in April. Issues include a lack of measures to compensate producers for interruption in the ability to receive power, force majeure conditions, contract suspension, and settlement of disputes."

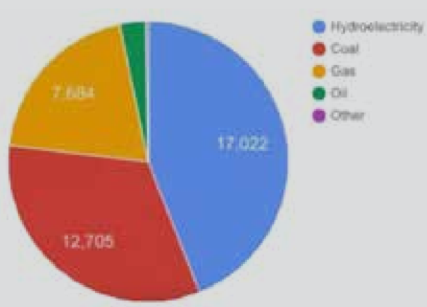
In recent months, Cooper was one of many experts that warned the Vietnamese government that its draft PPA, if not revised, would be considered unbankable by investors, many of whom are otherwise keen to start financing solar projects in the fast-growing, power-hungry nation. Vietnam is targeting to raise its share of renewable energy to around 10% of total energy production - and a third of that share from solar energy alone - but the resistance to PPA revisions sends mixed signals to investors that the country that needs their funding will be playing hard ball. "The PPA can be considered an attempt to test the waters – asking how much risk investors are willing to bear in return for a piece of the action," said Cooper.

Significant investor risk

As it stands, the investor risk remains significant. The PPA presents major concerns that investors will find hard to swallow: It has no take-or-pay obligation, no offshore arbitration, no sovereign guarantee or coverage of credit risk, and no provision addressing the risks of changes in applicable laws, said **Rik Teeuwen,** project manager of Solarplaza, a Netherlands-based firm that organises exploratory trade missions in Vietnam and other emerging markets.

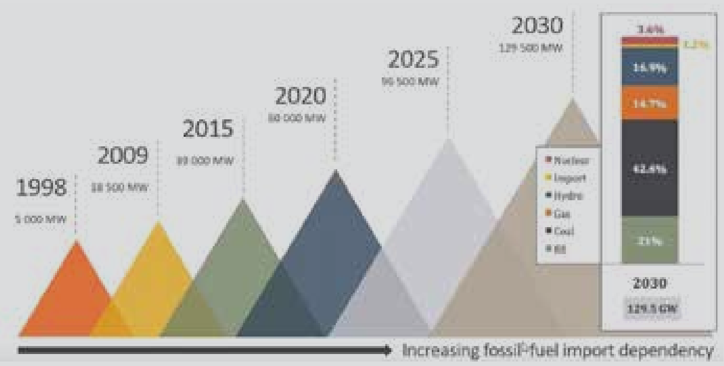
Of these concerns, the lack of take-or-pay obligation is considered one of the most worrisome for investors. The PPA relieves Electricity of Vietnam Group (EVN), named as the sole purchaser of energy generated from solar power projects, from payment obligations even where it is unable to take power due to a breakdown of the transmission or distribution grid.

Vietnam's total intalled capacity by source (in MW)



Source: Solarplaza webinar

Installed power capacity - current and projected



Source: GIZ Energy Support Programme VN, PDP VII revised, March 2016

"Particularly problematic is the fact that the purchaser has the right to stop purchasing electricity in circumstances that are outside of the control of the seller, and without having to provide any compensation," said Cooper.

"This lack of payment protection in instances of force majeure shifts a large portion of risk onto investors. In general, and as per comparable agreements worldwide, the power producer is rarely required to take on such risks," he warned. "Too much risk, and producers will look elsewhere."

A fair rate?

David Harrison, partner at Mayer Brown JSM, reckoned that in an ideal PPA scenario for investors, if the purchaser cannot take power due to a breakdown of the transmission or distribution grid, minimum take-or-pay obligations should remain in place as long as the plant exists. For Harrison, the draft PPA template - which was unaltered to a great extent when the Vietnamese government released the final PPA template - resembles that of Vietnamese independent power producer wind power projects, as opposed to the more international standard, seller-friendly PPAs that are generally used on larger build-operate-transfer projects.

"Whilst local onshore banks may be comfortable with this form of PPA, it will likely raise significant concerns on bankability with offshore financiers as well as international sponsors," he said.

Analysts were also disappointed that the final PPA kept the approved Feed-in-Tariff (FiT) rate of VND2,086 per kWh (US$0.0935 per kWh) for grid-connected projects, based on the VND/USD exchange rate.

"Although this is a reasonable rate for the region, the proposal means that significant risk is shouldered by investors," said Cooper. "Lacking an escalation clause, the PPA proposes no indexation of the rate according to Consumer Price Index or inflation."The omission of a security clause for potential cost increases will lower the confidence of investors to secure profits over the course of the solar projects.

There was market expectation that the revisions to the draft solar PPA would address key concerns, but **Fred Burke**, partner at Baker & McKenzie (Vietnam) Ltd., said that in light of only "minor" improvements to the draft as well as the removal of specific provisions on lender's step-in rights, investors might worry about the bankability of Vietnam solar projects.

"Compared to the previous draft of this solar PPA, released in April 2017, Circular 16 removes specific provisions on lenders' step-in-rights. In addition, most of the Ministry of Industry and Trade (MOIT) improvements to the previous draft are minor, leaving certain major issues unresolved, which may have an impact on the bankability of large utility-scale solar power plants on a 'project finance' basis."

He highlighted that the current version of model PPA does not specifically provide for offshore arbitration, which can further discourage international investors to enter Vietnam's solar power sector.

PPA workarounds

Another red flag to bankability in the model PPA is its silence on lenders' step-in-rights, specifically in relation to receiving notice of any default and additional period in which to cure such default by the seller in case of the seller's failure to comply with the terms of the PPA or the financing arrangements. Burke said that the model PPA removes some of the basic provisions in relation to the these rights of lenders which were previously included in the draft PPA. In addition, the model PPA fails to include any provision on separate PPA direct agreements between EVN,

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Rainer Brohm

Rik Teeuwen

or the government, and the lenders. For investors that find the Vietnamese solar market irresistible, there are workarounds to the PPA, but these will entail a lot of effort and coordination. "Ultimately, although the PPA is 'final' on paper, the real trick is for investors to work hard and smart to agree adjustments on a project-to-project basis that re-align specific risks in acceptable ways," said Cooper.

Investors that can find a way forward despite the risk-heavy environment will find a country that is brimming with large development potential driven by a large demand for power, abundant solar resources and a predisposition to pursue solar power plants.

Power development plan

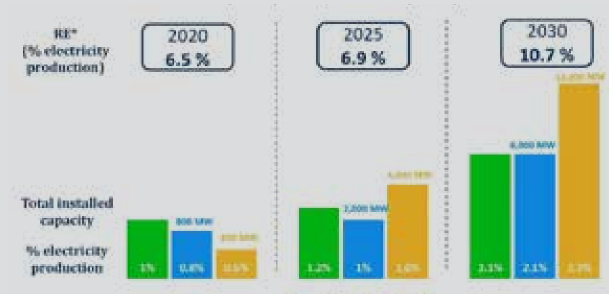
Rainer Brohm, an independent consultant on renewable energy in Vietnam, said electricity demand in the country increases annually by 10-11% and persistent droughts in certain times of the year have made it hard for coal power plants to sate the growing power demand.

The government, in response, has put forward a power development plan that will quickly expand solar and other renewables in the coming decades. The plan targets the growth of renewable energy to 6.5% of total electricity production by 2020 (0.5% of which will be solar), to 6.9% by 2025 (1.6% solar), and to 10.7% by 2030 (3.3% solar).

"To maintain its high rate of growth Vietnam will be looking for huge investment over the coming years. In order to do this, and keep to its international greenhouse gas commitments, the government has set its sights on some ambitious targets for solar power generation," said Cooper.

"Vietnam appears to be betting on gung ho enthusiasm to kick start solar power development rather than taking bold steps to deliver a stable backbone to the industry," said Cooper. "It's a gamble that may pay off in the short term but might also saddle the country with poorly-conceived and under-performing projects in the long term.

Solar PV: from <10MW (2015) to 12,000MW (2030)



Source: GIZ Energy Support Programme VN, Power Development PLan VII (March 2016)