



Project Finance and Guarantees

January 2003

Project Finance & Guarantees Department
Private Sector and Infrastructure Vice Presidency

IDA Guarantee supports first competitively-bid private power project in Vietnam

IDA provided its first Partial Risk Guarantee (PRG) for Vietnam in support of **the Phu My 2 Phase 2 Power Project**. This is the first private infrastructure BOT project launched under an internationally competitive bid in Vietnam, and it is expected to set the framework for future private sector infrastructure developments in the country.

The Phu My 2.2 is a 715-MW gas-fired power project to be built, owned and operated by Mekong Energy Company Ltd. (MECO), a project company established by the private sponsor consortium of EDF International (EDFI 56.25%), Sumitomo Corporation (28.125%) and Tokyo Electric Power Company (TEPCO) International (15.625%). With the total financing requirements of US\$480 million, it is the first project in Vietnam with a limited recourse financing package of such a significant size. The project achieved financial closure in December 2002 and is expected to start commercial operation by the end of 2004.

The Project

The project is located in the Phu My Power Generation Center in Ba Ria – Vung Tau (BR-VT) province, 70km southeast of Ho Chi Minh City. It will be implemented under a 20-year *BOT Contract*. The project will sell power exclusively to state-owned Electricity of Vietnam (EVN) under a 20-year *Power Purchase Agreement*; and will be fueled by domestic gas supplied by state-owned Vietnam Oil and Gas Corporation or Petro Vietnam (PV) under a 20-year *Agreement for the Sale of Natural Gas*. The gas will be sourced from the Nam Con Son Basin gas fields jointly owned by private developers and PV; and will be transported onshore by the new 400km gas pipeline under construction. Power generated by the project will be evacuated through the existing transmission system augmented by the new 500kV transmission line being constructed by EVN.

The project will deliver power to EVN at US cents 4.1/kWh (including fuel costs based on gas price agreed with PV) on a levelized basis over the life of the project.

Project Background

Under *the Power Development Project* (CR 2820-VN), IDA helped finance the 1st phase of the Phu My 2 power project as a public project; and financed technical assistance for the development of the 2nd phase as a BOT project. The government issued *the Request for Proposals* in late 1997, and offered an IDA PRG of up to US\$75 million in support of commercial debt financing as an option to the bidders. Five international bidders indicated their intention to use the IDA PRG option in their offers. The EDFI-led consortium was awarded the project in January 1999; key project documents including *the BOT Contract* were signed and *the Investment License* was issued in September 2001; and the financing documents were signed in October 2002. The closure of this deal highlights the interest of the government in promoting private projects in key infrastructure sectors such as power generation.

Vietnam Power Sector

Electricity demand in Vietnam has increased at about 14% per annum over the period of 1995-2000. In 2002 Vietnam had an installed capacity of 6195MW, half of which was from hydropower plants. It has a system reserve margin of about 8% in the dry season, leading to load shedding and brownouts. To sustain the projected economic growth of about 6-8% per annum over the medium term, the country needs to increase its electricity supplies at the rate of about 10-14% per annum. The government has decided to promote private sector participation as part of its strategy to address the need for increased power generation capacity required to sustain economic growth and reduce poverty.

*Asia Pacific Power Deal
of the Year 2002*

*"It is a significant deal in
a difficult market."*

**Project Finance
International**

*Best Project Finance Deal
of the Year 2002*

**Finance Asia
& Asiamoney**

Financing Plan
\$ million

Debt		
	IDA PRG Loan	75
	ADB GOR+Private PRI	25
	ADB Loan	50
	JBIC Loan	150
	Proparco Loan	40
	Total Debt	340
Equity		
	Equity	140
Total Sources		480

Retail electricity tariffs, currently uniform across Vietnam, are set by the government and have been raised periodically since 1992. Average retail tariffs were raised to US 5.6 cents/kWh in October 2002 and are expected to be gradually increased to achieve US 7.0 cents/kWh, close to long run marginal cost for the sector, by 2005.

Financing Structure

The total financing requirement for the project is estimated at US\$480 million, including stand-by financing of US\$80 million, which is financed with debt of US\$340 million (base debt of US\$300 million; stand-by debt of US\$40 million) and sponsor equity of US\$140 million (base equity of US\$100 million; stand-by equity of US\$40 million). The debt equity ratio would be 75:25 for the base project costs; and the contingent financing would be disbursed on the basis of a 50:50 ratio.

The debt facility consists of: two commercial bank tranches, the US\$75 million IDA guaranteed loan and the US\$25 million loan with ADB as the guarantor of record covered by private political risk insurance (PRI); US\$50 million ADB direct loan; US\$150 million JBIC loan; and US\$40 million Proparco loan. The commercial bank debt facilities including the IDA guaranteed loan were arranged by ANZ Investment Bank, Société Générale and Sumitomo Mitsui Banking Corporation. The IDA guaranteed loan has a 16-year maturity including a 2-year construction period.

Contractual Framework

Key project agreements with Vietnamese counter-parties are as follows:

- *Investment License (IL)* issued by the Ministry of Planning and Investment (MPI) sets out the terms of the license and provides for the establishment of MECO.
- *BOT Contract* between MECO and the Ministry of Industry (MOI) defines the rights and obligations of the parties. Under the contract, MOI grants MECO the exclusive right to construct, own and operate the power station on the site. MECO will transfer the ownership of the plant to MOI free of charge at the end of the term of 20 years from commercial operation of the project.
- *Power Purchase Agreement (PPA)* between MECO and EVN provides for the sale of

electricity by MECO to EVN for 20 years on the basis of a two-part tariff payable in Dong. The Capacity Charge consists of a Fixed Capacity Charge (FCC) and a Fixed O&M Charge; the Energy Charge covers a Fuel Charge (FC) payable to PV and a Variable O&M Charge. FCC, FC and portions of O&M Charges are indexed to the US dollar; and FC and O&M Charges are escalated to take account of inflation.

- *Agreement for the Sale of Natural Gas (GSA)* between MECO and PV provides for the supply by PV of all of the gas requirements for the project and MECO's obligations to purchase a minimum quantity of gas from PV for 20 years. The project is expected to consume about 0.85bcm of gas per year. Gas prices are paid in Dong but indexed to the US dollar and escalated at a fixed rate of 2% per annum.
- *Water Supply Agreement (WSA)* between MECO and BR-VT provincial Water Supply Company (WSC) defines the supply of potable and process mark-up water for the power station by the WSC.
- *Land Lease Agreement (LLA)* between MECO and the Urban Development Construction Company (UDEC) of BR-VT province sets out the land to be leased, rent free, and provides for the *Certificate of Right to Use Land* issued to MECO.
- *Government Guarantee* between MECO and MPI. MPI on behalf of the government guarantees the performance of responsibilities and obligations of each Vietnamese contractual party to MECO, including payment obligations, under the *BOT Contract, PPA, GSA, WSA and LLA*. It also guarantees the availability, convertibility and transferability of foreign exchange; permits off-shore accounts for project financing.
- Key contractual arrangements among private parties include the following:
 - *EPC Contract* between MECO and EDF-CNET, an engineering department of EDF. It provides for a fixed price, date certain turnkey completion for the entire power plant.
 - *Technical Services Agreement for Operations and Maintenance* between MECO and EDF and TEPCO, under which EDF and TEPCO will provide technical services to assist MECO in operations and maintenance.

- *Long Term Services Agreement* between MECO and GE International, the major equipment supplier. It provides for technical support until the first major overhaul in year six.

IDA Partial Risk Guarantee

The IDA PRG guarantees commercial lenders against default in scheduled debt service payments of principal and interest resulting from the government's failure to meet its payment obligations (both periodic payments and termination amounts) under *the BOT Contract or Government Guarantee*. The guarantee is non-accelerated: in the event the project is terminated as a result of a government default, IDA would be called on to make payments only according to the original debt service schedule. The IDA Guarantee excludes coverage of government obligations arising in connection with a MECO event of default.

The principal categories of risks covered under the IDA PRG are as follows:

- *Breach of Contract* by the government with respect to its payment obligations under *the BOT Contract and Government Guarantee* relating to the purchase of power by EVN, the supply of gas by PV, etc.
- *Currency convertibility and transferability* relating to the government's undertaking to make sufficient foreign exchange available for local currency conversion and repatriation of debt service payments.
- *Vietnam political force majeure events and change in law* negatively affecting the project; and expropriation.
- *Frustration of arbitration* relating to action by the government or third parties to frustrate the dispute resolution process.

The Guarantee Agreement with the lenders defines the scope of IDA's risk coverage and the trigger mechanics of the guarantee. IDA entered into *the Project Agreement* with MECO, under which the company covenants that it complies with World Bank environmental guidelines and other applicable requirements. IDA charges a guarantee fee of 75bp per annum on the outstanding principal amount of the guaranteed loan, payable by MECO. In parallel, IDA and Vietnam concluded *the Indemnity Agreement*, under which the state counter guarantees IDA for

any payments made under *the Guarantee Agreement*.

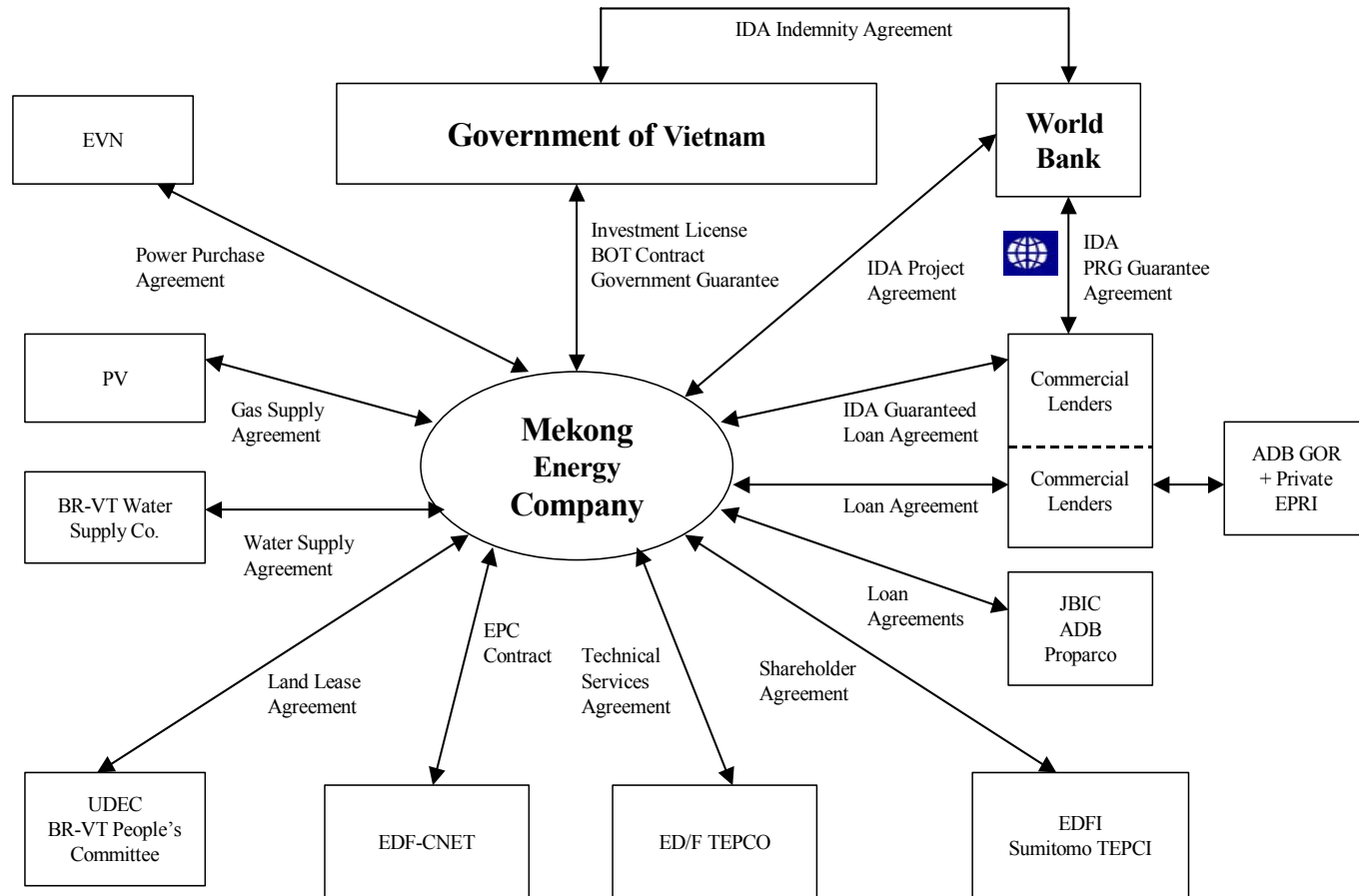
Benefits of the Guarantee

- The IDA guarantee helped Vietnam in mobilizing private financing for infrastructure development to supplement limited public resources. The successful financial closure of Phu My 2.2 through the deployment of the IDA PRG is an important milestone for attracting further private capital flows to the country.
- It helped mobilize long-term debt substantially beyond prevailing market terms for the country, contributing to the achievement of competitive generation tariffs.
- It catalyzed co-financing of over \$400 million. IDA support was only US\$75 million (15.6%) of total project financing.

For more information on the Phu My 2 Phase 2 Power Project IDA PRG, please contact:

*Suman Babbar, Senior Adviser, or
Tomoko Matsukawa, Senior Financial Officer,
Project Finance & Guarantees Department
Tel: (202) 473-2029 or 473-1225
Fax: (202) 522-0761
Sbabbar or Tmatsukawa@worldbank.org*

IDA Partial Risk Guarantee for Vietnam: Phu My 2 Phase 2 Power Project Contractual Structure



To obtain a copy of the brochure, The World Bank Guarantee: Catalyst for Private Capital Flows, please contact Andres Londono at (202) 473-2326, or by email at alondono1@worldbank.org