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VIETNAM INTERNATIONAL LAW FIRM

**ADB SE Asia Energy Sector Development,
Investment Planning and Capacity Building
Facility**

Development of ESCOs in Viet Nam

Legal and regulatory technical assistance

VEPG Technical Working Group 4

13 June 2024



Introduction

ADB

ADB has committed USD 16.5 billion to Viet Nam under a programme of loans, grants and technical assistance focused on transitioning to a green economy, promoting the private sector and social justice.

Since 2023 ADB has implemented technical assistance to develop and scale up energy service companies (ESCOs) in Viet Nam in cooperation with the Department of Energy Efficiency and Sustainable Development (DEESD), Ministry of Industry and Trade (MOIT).

The technical assistance includes a research programme with the purpose of providing recommendations for legislative reform to support ESCOs under the Law on Efficient and Economical Use of Energy (EE Law) and related legislation.

Project Team

The Project Team is comprised of a consortium of Pioneer International Consulting (PIC), VILAF and VICI Law.

PIC is a Singapore-based strategic advisory firm with a Hanoi office, focused on energy policy and clean energy project development in Viet Nam.

VILAF and VICI Law are leading law firms in Viet Nam, working with investors and developers, delivering advice to both governmental and non-governmental agencies.

Development and Scaling-Up Energy Service Companies (ESCOs) in Vietnam

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Agenda

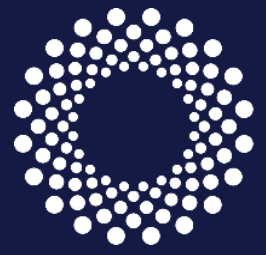
1. **Definitions of ESCO models in Viet Nam.**
2. **Regional review of ESCO markets and super ESCOs.**
3. **Legal and regulatory framework for ESCOs in Viet Nam.**
 - Review of existing legislation and regulations.
 - Challenges.
 - Recommendations.
4. **Viet Nam super ESCO and EE fund**
 - Proposed super ESCO model and EE fund for Viet Nam.
 - Challenges.
 - Key legal and regulatory reform required.

1. Energy Service Companies (ESCOs)

- An ESCO is an energy service company, which specialises in providing comprehensive energy solutions.
- An ESCO can be a privately owned or state owned company. Public non-business agencies and clients who self-invest in EE measures may also act as ESCOs.
- Three basic ESCO models: shared savings model (ESCO funds EE assets), guaranteed savings model (client funds EE assets), energy supply contracting (ESC) (common in the rooftop solar sector).

2. Super ESCO

- A super ESCO is an entity established by public and/or private investors which provides comprehensive energy performance contracting (EPC) services, including adapted financing on a large scale.
- A super ESCO is commonly a state utility overseeing projects in the public sector.
- The super ESCO in Viet Nam is expected to be a public power utility.



Regional review of ESCO markets and super ESCOs

Regional review of ESCO markets and super ESCOs

A comparative analysis has been made with China, India, Thailand, the US and Korea.

- 1. ESCO models:** Alongside the three basic and most popular EPC models, regional markets have seen the development of new models including the deemed savings model in India (i.e. the energy savings amount is calculated and agreed on a theoretical basis) and the hybrid model in Korea (i.e. ESCO guarantees energy savings periodically and shares saved costs and expenses which are realised with the client) .
- 2. Super ESCO:**
 - Development of a super ESCO is subject to the context of a specific country's power market, policy and strategy. During the formation of the ESCO market, a super ESCO is recommended.
 - The super ESCO is commonly a state-owned power utility applying the on-bill financing (OBF) approach.
 - Energy Efficiency Services Limited (EESL) in India is assessed as the most successful super ESCO to date.
- 3. Standard system:** A comprehensive standard system with uniform principles, methods and measurement for EE activities in general and specific benchmarks for each sector and industry is crucial for the development of an ESCO market.

Regional review of ESCO markets and super ESCOs

4. Promotional mechanisms:

- Internationally ESCOs receive various forms of support, both financial and non-financial.
- An EE fund is a common initiative for encouraging EE activities and fostering the early-stage development of the ESCO market.
- Mechanisms for fighting against tax avoidance need to be developed alongside tax incentives.

5. Dispute resolution agencies:

- Courts and arbitration are common channels for dispute settlement.
- A relevant state agency could be appointed to handle disputes between ESCOs and clients.
- Selecting entities with sufficient technical capability is advisable, whether for prevention or resolution of disputes.

6. Data collection and professional certification:

- Implementation of a system of national and local energy targets, statistics and data management contribute to a country's management of EE and support the development of the ESCO market.
- ESCO associations have been shown to be an effective means to coordinate policy and market activity.
- Adoption of relevant certification programmes and training courses helps build capacity.

Legal and regulatory framework for ESCOs in Viet Nam

Review of existing legislation and regulations

1. Stakeholders

- Key stakeholders: Prime Minister and Ministry of Industry and Trade (MOIT);
- Primary stakeholders: Ministry of Finance (MOF), Ministry of Science and Technology (MOST), Commission for the Management of State Capital at Enterprises ((CMSC), Ministry of Planning and Investment (MPI), and, EVN;
- Secondary stakeholders: Provincial people's committees (PPCs), Viet Nam Energy Conservation and Energy Efficiency Association (VECEA), financial institutions, and ESCO developers (private sector).

2. Current legal framework

The Project Team has reviewed:

- VCP policies;
- Legislation on EE, investment, bidding, finance;
- Government policies on EE, environmental protection, GHG mitigation and adaption to climate change;
- Technical standards;
- Intergovernmental communication on EE and EPC (MOIT and MOF);
- Relevant Viet Nam's international commitments;
- Legal regulations applying to EVN (the proposed super ESCO);
- Comments from relevant stakeholders.

Challenges

- **Funding and financing**
- **Classification and tax treatment of expenses**
- **Asset transfer**
- **Protective measures and dispute resolution**
- **On bill financing**
- **State incentives and support mechanisms**
- **Standard EE measurement**
- **ESCO associations**
- **Energy supply contracting**

Challenges

1. Funding and financing

- High upfront costs under the shared savings model and ESC (i.e. equipment invested by ESCOs).
- Limited access to financing and no financial support or incentives for ESCOs.

2. Regulatory and policy framework

2.1 Business and tax treatment of ESCO expenses

- EE project costs and expenses are not classified as deductible expenses causing issues for providers and clients.
- EE activities of ESCOs are currently not defined in Viet Nam's system of economic sectors.

2.2 Asset transfer

- Public entities are restricted from transferring/receiving assets to/from private entities on the conclusion of shared savings EPCs (auction requirements).

Challenges

2. Regulatory and policy framework (cont'd)

2.3 Protective measures for ESCOs under EPCs and dispute resolution

- ESCOs are exposed to finance and recovery risk for assets developed/financed by ESCOs but located on the premises of clients.
- No protective mechanism for ESCOs under EPCs and no specialised agency to resolve disputes arising from the ESCO model.

2.4 OBF mechanism

- Power utilities are currently not permitted to receive payments from EE projects via electricity bills.
- Payment of electricity bills is required to be compliant with regulatory electricity tariffs.

2.5 State incentives and support mechanisms

- Limited financial support to DR programmes under Circular 23/2017/TT-BCT.
- No legal framework for State incentives and support mechanisms for ESCOs and EE activities.
- Public agencies may face budget cuts when costs are reduced as a consequence of energy savings.

Challenges

2. Regulatory and policy framework (cont'd)

2.6. No standard EE measurement system

- No standard EE measurement system.

2.7 Association/community to promote the ESCO market:

- No separate association for ESCOs.

2.8 Stimulating demand for ESCO services

- The use of ESCO services is not a suggested EE solution for mandated energy users under the EE Law or its guiding document.

2.9 Energy supply contracting (ESC)

- ESC is not recognised as an EPC in the EE context, and is classified as electricity generation under the laws on electricity.
- The obstacles of ESC being a form of EPC are (i) duplication between EE Law and Electricity Law, (ii) difficulties in the State's management.

Recommendations

- **ESCO business and tax treatment of ESCO expenses**
- **Asset transfer mechanism**
- **Addressing dispute risk**
- **OBF mechanism**
- **State incentives and support, stimulating demand**
- **EE measurement, certification and template EPCs**
- **ESCO association**
- **EVN as a Super ESCO**
- **Establish an EE fund**

Recommendations

1. ESCO business and tax treatment of ESCO expenses

- Amend the EE Law to define (i) ESCO business activities and to classify costs and expenses related to those activities as Deductibles, and (ii) asset transfer by public entities and other SOEs while acting as an ESCO/a super ESCO
- Develop a mechanism to avoid businesses illegally benefiting from ESCO deductible expenses.
- Supplement Decision 27/2018/QD-TTg with a general definition of EE activities of ESCOs.
- Issue guidance on the CIT Law and Decree 31/2021/ND-CP to classify costs and expenses related to EE activities and ESCO services use as Deductibles.

2. Asset transfer mechanism

- For SOEs that seek to act as an ESCO supplement Decrees regulating the financial management of those SOEs.
- Amend Decree 151/2017 to create favourable conditions for public ESCOs to transfer EE assets to clients.

Recommendations

3. Address dispute risk

- Develop a protective mechanism for ESCOs.
- Issue a template EPC including a dispute settlement method as a reference point for market participants.
- Enable the MOIT or an agency under the MOIT to act a dispute resolution agency or set up a non-state dispute resolution agency.

4. OBF mechanism

- Revise the Electricity Law and Decree 137/2013/ND-CP to cover revenue streams arising from EE projects in electricity bills. Sửa đổi Luật Điện lực và Nghị định 137/2013/NĐ-CP nhằm quy định các dòng doanh thu phát sinh từ các dự án TKNL trong hóa đơn tiền điện.
- Trong trường hợp không áp dụng OBF, EVN sẽ nhận được khoản thanh toán từ khách hàng dựa trên thỏa thuận trong EPC.

5. State incentives and support

- Establish an EE Fund to provide financial support to ESCOs.
- Provide incentives including tax and fee preference and exemption.

Recommendations

6. EE measurement system and template EE contracts

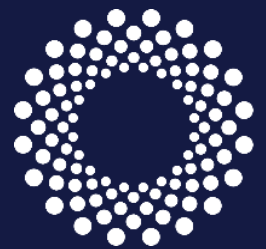
- Develop a standard system to measure and verify the EE value with various options for different situations.
- Publication of a template EPC contract as a reference point for market participants.
- Import Certified Measurement & Verification Professional (CMVP) and Certified Energy Manager (CEM) certification.

7. Association/community to promote the ESCO market

- Establish an ESCO association which is separate from and independent of the VECEA. The Vietnam Energy Association (VEA) may perform this function.

8. Stimulating demand for ESCO services

- Public entities should be relieved of the pressure of budget cuts due to energy cost savings.
- The EE Law should include ESCO services as a supported EE solution for energy users.



Viet Nam Super ESCO EE Fund

1. Proposed super ESCO model for Viet Nam

- The EESL in India is assessed as a relevant example for the purpose of establishing a super ESCO in Viet Nam.
- Article 64.2 of the latest draft of the Electricity Law requires power utilities to study electricity demand and implement DSM programmes. If approved, this would be an important legal basis for the super ESCO to proceed with making investment in DSM programmes, subject to relevant guidance.
- EVN is currently best placed to act as the super ESCO.
- It is recommended that EVN establishes a new subsidiary to act as the super ESCO under a 5-year pilot project approved under a Government's Decree.
- An alternative public or private entity super ESCO will be considered after the pilot project period.
- The required amount of initial funding for the Viet Nam super ESCO is proposed to range from USD 79.42 million to USD 140.79 million.
- ADB has a willingness to support the Government and the MOIT in developing the super ESCO through various channels such as technical assistance, concessional loans and grants.

2. Challenges

- EE business activities are not EVN's core business. The current scope of EVN's business lines or that of any other SOE do not cover the responsibilities required for a super ESCO
- EVN is not able to compete with other ESCOs at a competitive price due to strict regulations on the financial management of SOEs.
- EVN is not permitted to transfer the EE assets directly to the client at the end of term (as agreed) because of the required auction process.
- Performing the function of a super ESCO is not currently a government mandate for EVN and it is subject to EVN's assessment of the economic and strategic benefits.

3. Key legal and regulatory reform required

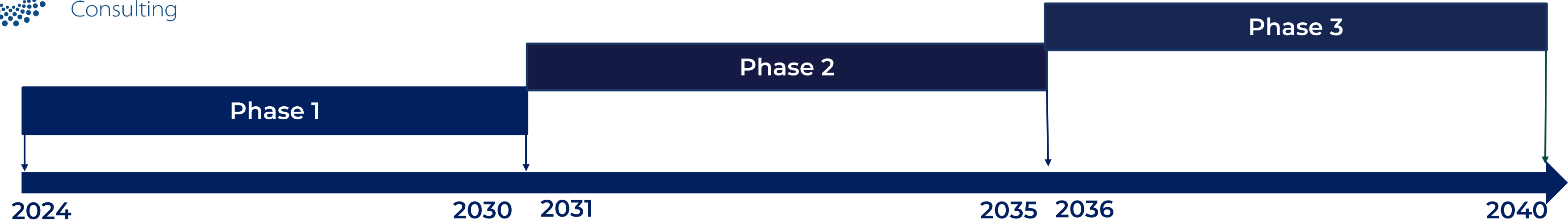
- Legal and regulatory reform required for the whole ESCO market (slides 15 through to 18).
- Supplement Decree 26/2018 on EVN's charter to reflect the ESCO business lines and the role of super ESCO.
- Issue a Decree under which EVN is mandated to perform its responsibilities of a super ESCO with (i) a specific scope of EE activities, (ii) roadmap to implement, and (iii) specific support and incentives.

Viet Nam EE Fund

- EE Fund is an initiative mandated under Decision 280/QD-TTg on VNEEP3.
- The Viet Nam Environmental Protection Fund (VEPF) is assessed as a relevant example for the purpose of establishing an EE Fund.
- The proposed EE Fund will be funded by both the state budget and legitimate external funding, such as ADB's funding.
- The EE Fund's support is available for both super and non-super ESCOs, public and private ESCOs in the form of loans with favourable interest rates and guarantees (with charges). In the future, other forms can be considered.
- Management regime: similar to that of the VEPF. The MOIT would be the key authority in charge, other relevant ministries include MOF, SBV, MPI and MONRE. Management board members should work on a permanent basis.
- Successful EE funds in the regions: India (Partial Risk Guarantee Fund for Energy Efficiency (PRGFEE), Venture Capital Fund for Energy Efficiency (VCFEE)), Thailand (Energy Efficiency Revolving Fund (EERF), Energy Service Company Revolving Fund (ESCO Fund)).
- The proposed charter capital of the EE Fund ranges from USD 55.594m to USD 112.632m.
- ADB has a willingness to support the Government and the MOIT in developing the EE Fund through various channels such as technical assistance, concessional loans and grants.



Legal reform roadmap



- Mandatory reforms:**
- Amendment to EE Law;
 - Amendment to Decision 27/2018
 - Amendment to Decree 26/2018 ;
 - Amendment to Decree 10/2017;
 - Development and issuance of guidance documents regarding the implementation of Super ESCOs.

- Amendment to Decree 218/2013;
- Issuance of Government guidance on CIT Law; and
- Amendment to Decree 137/2013.

- Issuance of a Decree regulating the functions, tasks, powers and organisational structure of MOIT (in case MOIT decides to be the dispute resolution agency);
- Development and issuance of protective mechanisms for ESCOs; and
- Other mechanisms to promote the ESCO market.

- Essential reforms:**
- Amendment to Electricity Law;
 - Amendment to CIT Law;
 - Amendment to VAT Law;
 - Amendment to Decree 31/2021;
 - Amendment to Decree 151/2017.
 - Development and issuance of an EPC template under a new circular;
 - Issuance of national standards on EE value – M&V

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Thank you for your attention.