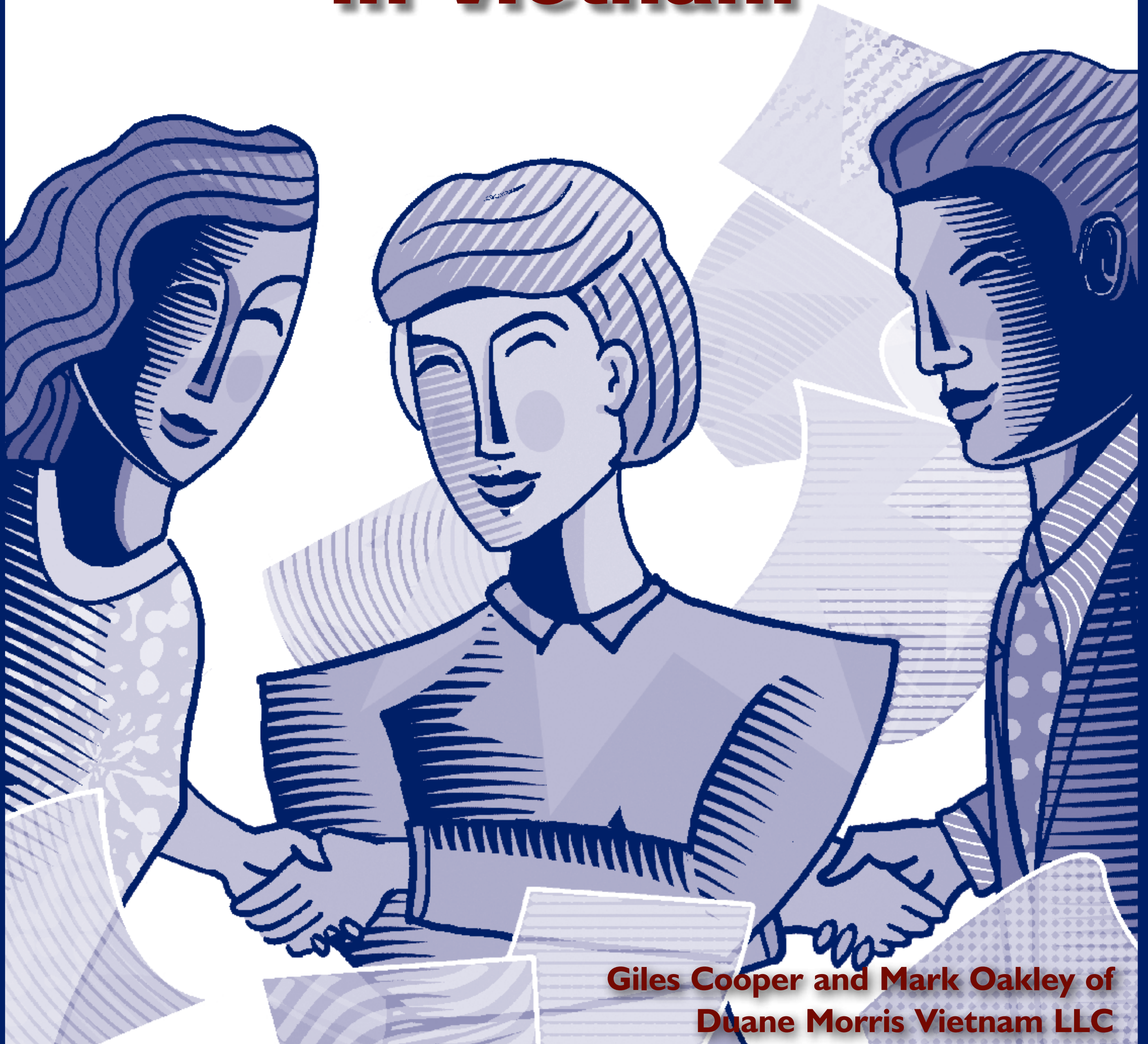
OPENING
the doors to investment in Vietnam



Giles Cooper and Mark Oakley of
Duane Morris Vietnam LLC

Vietnam has made considerable progress in recent years to make the country a more attractive investment destination, confirm partner *Giles Cooper* and special counsel Mark Oakley of *Duane Morris Vietnam LLC*, yet there is still work to be done.

During the past five years, Vietnam's government has undertaken a host of positive legislative measures to improve the country's mergers and acquisitions (M&A) and private equity environment – and pave the way for increased foreign direct investment in the country. These legislative changes, combined with Vietnam's accession to the WTO in January 2007, have significantly enhanced Vietnam's attractiveness as an investment destination and have brought its laws closer to international standards.

Until these changes, M&A activity in Vietnam was severely hampered by unclear regulation and a generally accepted maximum 30 percent cap on foreign stakes in private companies. This resulted in the creative use of alternative funding structures and local "straw man" investors – practices which were at best unlikely to be enforceable, and which were at worst illegal.

The principal current legislation supporting M&A activity in Vietnam – which took effect in 2006 and was prompted by the goal of WTO accession – includes, inter alia, the *Investment Law,* the *Enterprise Law* and the *Securities Law*. In addition, Government Decree No. 139, which became effective on 1 January 2008, removed (subject to certain important limitations) in-principle restrictions on foreign ownership of Vietnamese private companies.

Although these new laws have helped to introduce legal certainty and regulatory transparency to the investment framework, and although restrictions on levels of foreign ownership in domestic private companies have largely been removed, a number of legislative and bureaucratic obstacles still impede the successful conclusion of many M&A deals and private equity investments in Vietnam. Currently, would-be investors targeting stakes in local entities face inconsistent application of regulations and a legal and policy environment prone to rapid change. Nevertheless, rewards are there for those who persevere as Vietnam's continuing economic growth, political stability and legislative and regulatory reform offer attractive long-term rewards for patient investors.

The government is keenly aware of the need to simplify procedural conditions for doing business in Vietnam (as can be seen by the Prime Minister-led Administrative Procedure Special Task Force – known as Project 30 – which is developing clear proposals to simplify or eliminate unnecessary and unreasonable administrative procedures that impact the business community), but much remains to be done.

The recent financial crisis has provided additional impetus for reform by bringing pressure on the regulators to simplify investment procedures. The sharp decrease in available capital for dealmakers also forced local authorities to adjust their mindset in the face of decreasing interest from investors. In addition to this, the crisis arguably led to declining valuation expectations, and a shift in negotiation strength in favor of foreign buyers as alternative sources of capital dried up. These factors might explain why the overall deal value in Vietnam between 2007 and 2009 dropped by approximately one-third, while the number of deals almost tripled in the same period.[1]

Opening the doors to investment in Vietnam

By Giles Cooper and Mark Oakley, ***Duane Morris Vietnam LLC***

The purpose of this article is to identify some of the key issues facing dealmakers pursuing M&A transactions and private equity investments in Vietnam. The article will discuss the possibility of, and issues concerning, 100 percent equity acquisitions of private companies in Vietnam, and some practical measures that can be taken to avoid major legislative and bureaucratic pitfalls.

Vietnamese law provides that foreign investors may invest in the country in accordance with the *Investment Law*. The *Investment Law* distinguishes between two categories of investments: "direct investment" and "indirect investment". Broadly speaking, M&A and private equity investments are categorised as direct investments, as they usually involve a capital contribution and some form of participation in the management of the investment activity. However, in fact, the meaning of the term M&A is open to debate in Vietnam. Some contend that, according to the letter of the law, the "acquisitions" part of M&A refers only to 100 percent acquisitions that, historically, were not legally or practically possible for foreign investors eyeing domestic company targets. This is one critical point causing confusion and inconsistent application of rules by local authorities around the country. It is hoped that the long-awaited issuance of a so-called "M&A decree" by the government will address this clearly. For the purposes of this article, M&A is used in the general sense of acquiring an equity stake in an existing enterprise. (Please note that whilst mergers are possible in Vietnam and there a number of examples, these are of less interest to foreign investors at present than acquisitions.)

Similarly, this article focuses on acquisitions of stakes in domestically owned targets as traditionally, acquisitions of foreign-invested companies have been conducted outside Vietnam at investor level in order to avoid regulatory procedures within Vietnam.

The legal structure of a direct investment acquisition will depend on whether the transaction is structured as an asset or share deal. Asset deals usually involve the establishment of a wholly foreign or domestically owned entity (usually a Joint Stock Company (JSC) or Limited Liability Company (LLC)) to acquire the business and undertaking of the seller, whereas share deals are usually structured as joint venture companies between foreign and domestic investors. As with most jurisdictions, the buyer may either purchase equity (in the form of shares where the target is a JSC, or capital contribution where the target is an LLC) from an existing investor(s) or purchase newly issued shares (for JSCs), or contribute or inject fresh capital (for LLCs).

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Given the regulators' different levels of capacity around the country and the still-basic regulatory framework, many investors prefer to keep things as simple as possible and choose to acquire assets (as opposed to equity). Investors do this by acquiring the target business via a wholly owned entity, usually incorporated in Vietnam specifically for the purpose of the acquisition. Business deals are often favored by investors in Vietnam, as with other emerging markets, for two main reasons. Firstly, legal, financial and tax due diligence are often limited and unreliable, and even sophisticated investors become unstuck on the realisation that basic M&A practice or standard deal protocol – such as due diligence, disclosure and acquisition finance – are unfamiliar concepts to most local sellers. To this end, cherry-picking allows investors to avoid the hidden liabilities of acquiring equity, which is often very important considering the practical difficulties associated with enforcing contractual reps and warranties inherent in any developing jurisdiction. In any case, investors may fare well by insisting on a clear and detailed term sheet allowing them to identify deal breakers quickly and exit the deal before incurring significant time and financial costs. Secondly, investors are often keen to acquire 100 percent of a target business to avoid the pitfalls of corporate joint ventures with unknown local partners and related difficulties of enforcing corporate agreements against joint venture partners due to protracted and complicated court processes.

Until recently, buying assets has been the only viable structure for foreigners wishing to acquire 100 percent of domestically owned businesses, as Vietnamese law does not yet provide clear procedures for foreign investors wishing to acquire 100 percent of the equity of private companies. The Ministry of Planning and Investment is currently researching M&A guidelines, due to be issued this year, which will hopefully shed light on M&A procedures in Vietnam.

In spite of the lack of detailed regulations, Vietnamese licensing authorities have arguably adopted a proactive approach to facilitating 100 percent share acquisitions of private equities, and these types of transactions are definitely possible for motivated buyers. Procedurally, the acquisition is relatively straightforward, and not dissimilar to a foreign investor establishing a 100 percent foreign-owned enterprise through the establishment of an investment project in Vietnam.

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The licensing procedure for a 100 percent equity acquisition remains subject to one of two procedures: "investment registration" or "investment evaluation". The investment registration procedure is far simpler than the investment evaluation procedure, as it applies to investment projects whose investment capital is less than VND300 billion (approximately US$16 million), and which do not fall within "conditional" investment sectors. For projects with a capital investment of VND300 billion or more, or projects in a conditional sector, the investors are required to undergo investment evaluation before being issued an investment certificate. In practice, determining whether a proposed investment falls within a "conditional" sector can be problematic and ultimately, investors can expect the authorities to take a conservative view.

Unlike licensing procedures for establishing a new wholly owned subsidiary, it is not only the investor per se that submits the investment certificate application, but the target company itself. This means that the buyer and seller must work jointly to submit the investment certificate application to the licensing authorities. The acquisition will generally be completed when the relevant licensing authority issues an investment certificate in the name of the buyer (and/or an amended Business Registration Certificate for the target company) and when the target's share registry is updated with the name(s) of the buyer (in the case of JSC targets). Although this procedure appears straightforward, we now highlight a few of the major issues faced by foreign investors pursuing 100 percent acquisitions.

Business scope

Although the government has ostensibly relaxed its approach to licensing foreign investment projects since Vietnam's accession to the WTO, it remains essential for those pursuing M&A deals or private equity investments in Vietnam to examine closely the scope of business activities of the target. Vietnamese law still provides for prohibitions and restrictions on foreigners operating in certain business sectors and also provides for caps on maximum foreign participation for shareholdings (e.g., foreign investors are restricted from owning more than 49 percent of shares in listed or public companies except for the banking sector, where the foreign ownership limit is capped at 30 percent).

Settlement steps

One major issue surrounding this process involves completion and payment mechanics. Obviously, the foreign investor will not be prepared to pay the purchase price to the seller until the investment certificate has been issued. At the same time, the seller will not be comfortable submitting the investment certificate application dossier to the licensing authorities until security of payment has been settled. In practice, a number of ways exist to address these issues and

settlement steps, such as escrow arrangements or the buyer granting security over the equity in the target company to the seller from the date of the issuance of the investment certificate, to be released on the payment of the purchase price. Settlement steps become further complicated where acquisitions are debt financed, as loan agreements usually provide that draw-down may only occur once various conditions precedent have been satisfied including, inter alia, the issuance of the investment certificate. This situation represents a major payment security issue for the seller, as it means that the seller cannot be certain that the buyer is able to complete the acquisition until after the investment certificate is issued.

Other settlement issues can arise in relation to Article 33 of Decree 88, which applies to the procedure to change the members of a LLC having two or more members and provides that the investment certificate application must include a share-purchase agreement accompanied by evidence of the completion of the transfer of the capital contribution. As the evidence of completion necessarily requires evidence of payment, this represents a significant challenge if the target is an LLC.

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Conversion of land status

In addition to sale and funding issues, other regulatory issues often arise in relation to land, such as the foreign investor's potential liability to pay land rental fees on the conversion of allotted land (i.e., land allotted to a domestically owned company) that needs to be converted to lease-

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hold status (wholly foreign-owned enterprises are limited to leasehold land-use rights under current law). The law itself, notably Decree 84, is silent on land-use fees / rental payments in cases of share sale and purchase, creating a "new" wholly foreign-owned enterprise – an anomaly highlighting the fact that such 100 percent acquisitions were not contemplated as possible until recently. The foreign investor must either seek to understand the basis for calculating land rental payments and price in respect of their potential liability, or seek indemnification from the sellers. Timing of land conversion and related title documents (the "red book" or Land Use Rights Certificate) often become an issue when agreeing on settlement steps. The land-lease agreement and title documents may be handled by different bodies, and title documents in particular often take some time to be issued by the competent authorities.

Capital accounts

Crucially, foreign investors acquiring 100 percent of the equity in private companies must also observe Vietnam's foreign exchange control laws in order to ensure the successful repatriation of dividends and funds on any future sale of the target company. Vietnamese law (Decree 160) provides for two types of capital accounts for capital transactions: (i) direct investment-capital foreign currency accounts; and (ii) indirect investment-capital Vietnamese dong accounts. The direct-investment capital foreign currency accounts are used for the transfer of capital to invest directly into Vietnam, i.e., these accounts are opened in the name of the newly established company into which the foreign investor pays in the charter capital. Indirect investment-capital Vietnamese dong accounts are used for the activity of investing indirectly into Vietnam by foreign investors wishing to invest in listed or unlisted securities.

Although the acquisition of 100 percent in shares of a Vietnamese private company is a direct investment, as the investor is involved in the management of investment activities, Vietnamese law provides that the acquirer must open an indirect investment-capital Vietnamese dong account. This anomaly arises because Vietnamese law anticipates that all direct investments will be used to capitalise newly incorporated Vietnamese companies, and not to fund acquisitions as consideration paid directly to the seller of a company. Again, this is a case of the law simply not foreseeing 100 percent acquisitions of local companies by foreign investors. Given the status quo, the only viable solution may be for the prospective purchaser to open an indirect investment-capital Vietnamese dong account, which is a relatively straightforward process. That said, the buyer should be aware that this type of account must be registered with the State Bank of Vietnam within two working days after operating at a commercial bank in Vietnam.

A proactive approach

As Vietnam's legislative framework continues to evolve and transaction procedures and practices are simplified, it is becoming a far-more attractive investment destination from a regulatory perspective. The sharp surge in the number of deals since 2007 suggests a liberalisation of licensing policy, which is expected to improve further as comfort levels with 100 percent acquisitions improve and the specific M&A regulations are issued.

Regulatory reform, combined with economic growth and political stability, underpins Vietnam's development potential. Despite these growth factors, Vietnam will need to continue its efforts to tackle a number of key issues to ensure its competitiveness as an investment destination in Southeast Asia. These issues include poor infrastructure, corruption, unrealistic pricing expectations, currency instability, a highly regulated labor market, high taxation and conservative home-ownership laws.

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ENDNOTES

1 PricewaterhouseCoopers Vietnam M&A Activity Review – 2009.