

**V I L A F****VIETNAM INTERNATIONAL LAW FIRM**

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Nominee arrangements under the new law of investment

Vietnam is currently one of the most attractive places in the world for foreign investment.¹ With an investment-focused political climate, Vietnam is currently drawing entrepreneurs and large, established companies alike. One controversial method that investors employ to enter Vietnam is investment through a local nominee.

In its simplest form, a common nominee structure consists of a foreign investor providing funds to a local nominee. The funded amount is then used by the local nominee to invest in a target local company whose business lines may be subject to foreign ownership limits

under Vietnam's laws and WTO commitments, or where the foreign investor might otherwise face roadblocks. The nominee then contractually acts on behalf and at the direction of the foreign investor in matters relating to the investment and operation of the local company.

These agreements range in complexity from the simple, straight-line example set out above, to complex agreements that are carried out in many different stages, utilizing numerous different investment vehicles. The use of local nominees is not uncommon and some agencies specialize in providing nominee services.

¹ U.S. New & World Report, Best Countries to Invest In, 2020

Current Legal Framework

Unlike several other countries, Vietnam does not have legal guidance specifically addressing whether foreign investors can invest through local nominees. Instead, the use of nominees is governed by an ambiguous provision of the Vietnamese Civil Code that can be used to invalidate civil transactions entered into “for the purpose of concealing another transaction.”¹ Foreign investors’ use of nominees is also subject to the oversight of the State Bank of Vietnam. Loans made by offshore lenders are subject to loan registration in certain circumstances and the foreign investor must state the purpose for the loans when doing so.

Under this legal framework, foreign investors face risks that the nominee agreement could be invalidated by a court if a dispute with their nominee arose, or that Vietnamese banks might refuse to remit funds from their investment if the bank determined that the purpose for the underlying transaction was invalid.

Additional guidance in the New Law on Investment

Recently, the National Assembly of Vietnam promulgated a new Law on Investment which will go into effect on January 1st, 2021 (the “New LOI”). In the New LOI, there is a provision that requires the agency administering the investment to terminate an investment project that is based on an “artificial civil transaction in accordance with the civil regulations.”²

Moreover, a draft decree guiding the New LOI³ provides that, when the competent authorities decide to terminate the operation of the investment project, they must also withdraw the investment registration certificate (“IRC”) at the same time if an IRC was issued for the investment project. This process is similar to the previous procedure regarding investment project termination. However, it is now specifically applied to instances where the project is terminated as a result of an artificial civil transaction.

Unfortunately, the New LOI does not provide any guidance as to what constitutes an “artificial civil transaction.” Additionally, as with the previous legal framework, there is no specific

application to the use of a nominee arrangement. The two main changes that can be drawn from the New LOI are:

- that the provision of the Civil Code related to invalidating transactions is now explicitly linked with investment-related transactions; and
- the competent authorities that are administering the investment now have the authority to directly and unilaterally terminate an investment project that is the subject of a nominee arrangement under the Civil Code if it is deemed to be artificial.

As applied to nominee arrangements, a cautious reading would interpret these changes as a direct attempt to limit the use of nominee arrangements for foreign investment.

Challenges under the new LOI

As noted above, significant issues remain related to clarity.

Definition of an “artificial civil transaction”

Based on the New LOI, as noted above, the very definition of what constitutes an artificial civil transaction in this context remains unclear. No metrics or factors have been provided in the New LOI and no additional guidance has been forthcoming. Moreover, while most disputes over the validity of transactions relate to civil, commercial, and labor sectors of law, there have not been any published decisions related to the validity of artificial civil transactions in the investment sector. Thus, how the competent authorities will determine that a nominee arrangement is an artificial civil transaction remains a mystery. This mystery can lead to arbitrary decisions of the competent authorities affecting healthy business relationship between foreign investors and local partners.

Scope

The exact scope of application to nominee arrangements remains unclear. While inferences can be drawn, the provision does not directly refer to nominee arrangements. However, a report covering an older draft of the New LOI sent by the Government to National Assembly submitted last October stated that the rationale

1 Article 124 of the Civil Code 2015

2 Article 48.2(e) of the New LOI

3 Draft Decree replacing the Decree 118/2015/ND-CP

for the additional provision was to create legal grounds for competent authorities to handle cases of underground and hidden investment. This suggests that the provision was created with nominee arrangements in mind. Nevertheless, especially considering that there are legitimate reasons for utilizing a nominee arrangement, such as simplicity or concerns related to investor privacy, reading the New LOI as a complete prohibition on nominee arrangements would seemingly go too far.

Procedure

Finally, the procedural aspects of how the competent authorities will terminate an investment activity on the basis of an artificial civil transaction are similarly unclear. Under the old legal framework, the risk that a nominee arrangement would be invalidated primarily arose in the context of a dispute between the foreign investor and the nominee. Practically, this would have occurred under the procedural rules provided in the Civil Code. These rules provided safeguards for foreign investors, such as a two-year time-limit to request that a court declare the transaction invalid. However, this regulation is not applied to artificial civil transactions.¹ Under the New LOI, there are no procedural steps provided. Accordingly, it appears that at any time, the competent authorities can unilaterally declare that an investment is an artificial civil transaction, regardless of whether there was a good relationship between the nominee and the foreign investor. Whether that decision can be appealed is currently unknown, as is the process for doing so. When considered alongside the questions of scope noted above, this risk is similarly present in all transactions between foreign lenders and local borrowers.

1 Article 132 of the Civil Code 2015

Looking forward

To mitigate the risk that the transaction between the foreign investor and the nominee will be declared invalid, foreign investors should be cautious when engaging in nominee arrangements. This is especially true where the target entity's registered business lines are not open for foreign investors or create a limit on foreign ownership percentage. Investors already engaged in nominee arrangements should closely monitor developments under the New LOI.

Under the old legal framework, when a transaction was declared invalid, the nominee was responsible for returning the funded amount to the foreign investor.² However, if such amount was fully contributed to the target company and the investment project is terminated, the foreign investor was unlikely to recover the entire funded amount from the nominee without a well-drafted agreement that provided adequate safeguards. This is especially pertinent now, and any foreign investor contemplating a nominee arrangement would be wise to seek experienced legal counsel.

Before the New LOI takes effect, the relevant authorities will hopefully provide more detailed guidance on how this provision will be interpreted, implemented, and enforced. Such guidance is necessary to promote investor confidence and the added clarity would be a step forward in developing Vietnam's investor-focused regulatory framework.

2 Article 131.2 of the Civil Code 2015

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