As M&As rise, legal issues pose challenge

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Photo: Le Toan

Japan's Mizuho ASEAN Investment recently spent $9.3 million buying into Pham Nguyen Confectionery Company

As reported by the Institute of Mergers, Acquisitions, and Alliances (IMAA), the year 2015 has seen a surge of up to 40 per cent in M&A transactions involving Vietnam's enterprises, with a total value of circa $4.3 billion, surpassing the record pace of $4.2 billion in 2012. This figure is forecast by Bloomberg to rise further in 2016, driven by the enactment of the new laws on investment and enterprises and foreign investor interest in the fast-growing domestic consumer sector.

Although growing, Vietnam's M&A regulatory regime is still at the dawn of its development and requires further systematic reform to reach consistency in interpretation and implementation.

Unfavourable conditions for foreign investors

Under the Commitments of Vietnam to the WTO and other bilateral treaties, Vietnam undertakes to apply full "national treatment" principles for foreign investors to operate in certain service sectors. The Law on Promulgation of Legislative Documents 2015 also allows for the prevailing application of an international agreement, to which Vietnam is a member in case of different regulations on the same issue.

However, some of Vietnam's legal requirements are inconsistent with this principle and still applicable in practice. Article 23.1 of Investment Law 2014 provides that foreign-controlled enterprises must, regardless of which business sectors they operate in, follow the investment procedures applicable to foreign investors when (i) setting up a new enterprise; (ii) acquiring shares in existing private enterprises; and (iii) entering into a Business Operation Contract. Conditions for certain specific sectors also place extra burden and restriction on foreign investors. For example, the Insurance Law 2000 (Article 105) only allows foreign investors to set up foreign invested enterprises (FIEs) in insurance sector in the form of (i) a limited liability company; and (ii) a branch of a foreign non-life insurer.

Inconsistent provisions between international agreements and domestic laws on market access to certain services also constitute a barrier for foreign investment. For example, Vietnam does not commit to an open market for multimodal transportation business in the WTO Commitments; however Decree 87/2009ND-CP on international multimodal transportation seems to not limit the foreign ownership to that business. The Ministry of Planning and Investment, under its Correspondences in 2015, takes the view that opinions from relevant ministries for service sectors not included in WTO Commitments must be obtained before the investment certificate is issued. As such, the accessibility of a foreign investor to multimodal transportation services still depends on consultation between competent authorities on a case-by-case basis. .

Lengthy and complicated licensing procedures

The government's efforts to streamline licensing procedures under the new Investment Law 2014 and new Enterprise Law 2014 have not yielded the positive results that had been hoped for, and even had the opposite effect in some situations. For instance, certain information previously specified in the Business Registration Certificate (BRC) – such as shareholders, their shareholding ratio, and business lines of the target company – has been removed from the prescribed contents of the Enterprise Registration Certificate (ERC).

This change, on the face of it, aims at simplifying the procedures for enterprise registration. However, since an ERC no longer covers all the necessary information required to recognise the buyer as the new owner of the target company, the latter now must seek another government authorisation called "certification on changes in enterprise registration contents" to record information absent from the ERC, such as shareholders' names and their shareholding ratio. This change hence actually leads to extra licensing steps and creates more conditions for the transactions.

Another example, a foreign investor who intends to acquire equity in local companies needs to obtain pre-approval from DPIs. In practice, this approval process may be subject to enquiry and scrutiny from the local DPI, especially in cases of a large-scale investment project located in various cities and provinces, thus causing delays in M&A transactions.

Lack of synchronisation between new laws and corresponding updates to relevant decrees, circulars, and guidance also poses challenges for M&A deals. For example, trading businesses of FIEs are still regulated by Decree 23/2007 of the government, dated February 12, 2007, which is outdated. Under Decree 23/2007 (Articles 5.1 and 5.2), an FIE must obtain a Trading License in parallel with the application for, or an amendment to an Investment Certificate. This implies that only enterprises having Investment Certificates must apply for the Trading License. After the effectiveness of the Investment Law 2014, the Ministry of Industry and Trade (MoIT), in its correspondence of December 2015, opined that any Vietnamese company having foreign ownership which registers for import and distribution must obtain a Trading License under Decree 23/2007, even if such a company does not have an Investment Certificate. This guidance would complicate an acquisition process and is unreasonably impractical for listed companies whose numbers of foreign shareholders may constantly vary from time to time.

Vietnamese authorities and officials often have broad discretion in interpreting or applying a provision of the law. For example, although the Investment Law 2014 explicitly abolishes certain licensing procedures for foreign investors, such requirement remains applicable as a matter of licensing practice. In particular, an Investment Registration Certificate (IRC) is not required under Article 46.2 of Decree 118/2015 when a foreign investor acquires less than 49 per cent interest in a local company not operating in conditional business sectors. However, certain provincial licensing authorities still take the old approach to require issuance of an IRC for the above case.

Risky payment mechanism

Denomination is an issue in M&A activities in Vietnam, as payment and repatriation of foreign currency is subject to strict foreign exchange control by the State Bank of Vietnam (SBV). In particular, acquiring shares in listed companies in the securities market would be subject to foreign exchange risk since it must be effected in Vietnam dong (VND) via an indirect capital contribution account (ICCA) in the name of the buyer's name, pursuant to Article 4 of Circular 05/2014 of the SBV, dated March 12, 2014. In the case of failure to close the deal, the investor may further be exposed to the risk of convertibility in the market from VND into foreign currency.

The foreign currency regime is ambiguous and there is no uniform guidance on the same issue. In an official meeting with banks dated June 5, 2015, the SBV opined that payment from a foreign transferee to a foreign transferor must be in VND. Furthermore, the foreign exchange regulations require that any payment from the transferee to the transferor for shares or equity capital in non-listed FIEs must go through the direct investment capital account (DICA). This raises concerns for the transferee when he has to convert his purchase price into VND and put it in the account of another entity (i.e. DICA). In particular cases where the payment is made from an offshore transferor to another offshore transferee for transfer of equity in an FIE, SBV takes different view in a correspondence to a bank that the purchase price may be denominated in foreign currency and needs not go through the DICA. Parties to M&A deals, therefore, must obtain SBV's ruling specifically for each transaction.

Conflicting regulatory regime for unlisted public companies

It is still unclear whether an acquisition of shares in a public company is subject to licensing requirements under the Investment Law 2014 and Enterprise Law 2014. It may be argued that acquisition of shares in a public company should not follow procedures under the Investment Law 2014 and Enterprise Law 2014 since the Investment Law 2014 provides that in case of any difference between the Investment Law 2014 and Securities Law 2006 regarding "steps and procedures for investment", the provisions of Securities Law 2006 apply. Enterprise Law 2014 (Article 3) also allows for prevailing application of specialised law (i.e., the Securities Law 2006). This interpretation is reasonable since information on shareholders of a public company has already been managed by the Vietnam Securities Depository (VSD) system and going through lengthy procedures under the Investment Law 2014 and Enterprise Law 2014 will not ensure the liquidity of shares in a public company. By contrast, Article 52.1 of Decree 78/2015 explicitly requires that a public unlisted company must notify the changes in its foreign shareholder(s) and (ii) submit DPI pre-approval for acquisition to the relevant Business Registration Authority. This indicates that an acquisition of shares in a public company should comply with licensing requirements under the Investment Law and Enterprise Law 2014.

Issues on state-owned enterprise (SOE) deals

Investors wishing to acquire shares of an SOE during equitisation may encounter certain limitations. First, the value of the state's capital may be modified during the equitisation process, which will heavily affect the buyer's pre-money valuation. In some circumstances, the state may use the increased amount from revaluation to increase its capital in the company, which may lead to dilution of the buyer's shareholding ratio. Second, acquisition of existing state capital in SOEs is subject to price control mechanism (i.e., public auction requirement) in order to avoid "losses" of state assets. Last but not least, the buyer may only enjoy very limited flexibility in negotiating with the state.

Regulatory compliance is in many cases ignored by SOEs. For example, many equitised SOEs did not register for trading of shares on UPCoM, nor conduct share transactions via VSD, as required by Articles 14.1(a) and 14.2 of Decision 51 of the prime minister dated September 15, 2014, which can make investors reluctant to move ahead with deal-making.■