



# New regulations on foreign investment in existing Vietnamese enterprises

This briefing outlines the new regulations on foreign investment in existing Vietnamese enterprises effective from 15 August 2009.

Vietnamese law on the acquisition of interests in Vietnamese companies has engendered much puzzlement among practitioners since the new Investment Law was passed in 2005. The new Decision 88 of the Prime Minister dated 18 June 2009 on foreign investors' contribution of capital and purchase of shares in Vietnamese enterprises (*Decision 88*), which applies to primary and secondary investment by foreign investors in shares of existing Vietnamese enterprises, raises numerous issues. But finally foreign businesses and their lawyers have a framework to use in beginning to fill in the puzzle:

- Regulated Sector: foreign investment in regulated sectors (such as the financial sector) will be governed by the laws applicable to such sectors;
- Public Company Sector: foreign investment in public companies will be governed by the Securities Law, Decision 121 on activities of foreign investors in Vietnam's securities markets (see our briefing of January 2009), and Decision 55 on foreign ownership limitations in Vietnam's securities markets (see our briefing of April 2009);
- Foreign Direct Investment Sector: foreign investment involving the establishment of new enterprises with or without local investors, and foreign investment in the form of contracts (ie business co-operation contracts (BCCs), Build-Operate-Transfer contracts (BOT), Build-Transfer-Operate contracts (BTO) and Build Transfer contracts (BT)) will be governed by the Investment Law and its implementing regulations;
- M&A Sector: foreign investment by way of mergers and acquisitions will be governed by regulations not

yet in existence (and there remains doubt about what will fall within the concept of an 'acquisition'); and

- Residual Sector: foreign investment in Vietnamese companies outside of the above will fall within this Decision 88.

Of course, the framework will be subject to stress under various scenarios or structures, and the potential for numerous difficulties exists when there are overlaps between one part of the framework and another.

## Foreign ownership limitations

Apart from the filling in of the puzzle, the one significant development that can be drawn from Decision 88 is that it is now clearly possible to acquire more than 30 per cent of a Vietnamese company. The previous regulations on foreign investment in Vietnamese companies, Decision 36 of the Prime Minister dated 11 March 2003 (*Decision 36*), only allowed foreign investors to own up to an aggregate of 30 per cent of the capital of a Vietnamese company operating in a limited number of business sectors. Although this Decision had theoretically been overruled by the Investment Law of 2005, in the absence of implementing regulations, many local authorities continued to apply it in practice after 2005.

Decision 88 makes it clear that foreign investors can own in aggregate up to 100 per cent of the capital of a local company in the Residual Sector. But if that company also operates in another sector, the applicable foreign ownership limitation is the one applicable to the business

sector with the lowest foreign ownership limitation:

- for local companies doing business in the services business sectors, the foreign ownership limitations are those provided in international treaties to which Vietnam is a party including the Vietnam WTO Commitments;
- for companies operating in regulated sectors, the foreign ownership limitations are those set out in the relevant specialised laws applicable to such sectors;
- for public companies, the foreign ownership limitation is 49 per cent; and
- for 100 per cent State-owned enterprises undergoing equitisation, the relevant limitations above apply unless a more restrictive one is imposed by the equitisation plan approved by the relevant authority (which in practice is highly likely).

## Foreign investors

Under Decision 88 the term ‘foreign investors’ covers:

- entities established under foreign laws and their branches in Vietnam;
- foreign individuals who do not have Vietnamese nationality; and
- local entities whose foreign investors hold together more than 49 per cent of its capital.

This complicates the law because a foreign investor is now defined three different ways in three different contexts:

- a foreign investor investing under the Investment Law appears to be one that is established outside Vietnam;
- a foreign investor buying an interest in a Vietnamese company under this Decision includes local entities with more than 49 per cent of foreign capital; and
- a foreign investor investing in the securities market under Decision 121 includes local entities with foreign capital only if foreign investors own 100 per cent of the capital.

## Vietnamese enterprises

Decision 88 applies to investment in ‘Vietnamese enterprises’, a term that covers joint stock companies, limited liability companies and partnerships, and 100 per cent State-owned enterprises undergoing equitization (privatisation).

Decision 88 therefore seems to apply even to enterprises that have been established with foreign capital. However some provisions of the Investment Law and its related regulations would suggest that a foreign investment in an existing foreign-invested company should follow the rules and procedures of the Investment Law.

## Investment procedures

The new decision does not elucidate the regulatory procedures applicable to a foreign investment in a Vietnamese company. It simply lists the corporate procedures that must be followed. This may mean that the only regulatory steps to be undertaken in respect of foreign investment governed by Decision 88 are those provided in the Enterprise Law (obligations to update the business registration certificate of the company in some cases), as opposed to the cumbersome procedures applicable to foreign investors under the Investment Law. Or it may mean that the Investment Law procedures apply as well. Only time will tell, but a sporting man would give decent odds on the latter.

## Exception for ‘acquisitions’

As mentioned above, investment involving an ‘acquisition’ (*mua lại* in Vietnamese) is excluded from the scope of Decision 88. However Decision 88 fails to define the term ‘acquisition’. The definition will be important if the regulations issued in respect of mergers and acquisitions are more cumbersome than Decision 88.

## Contribution of capital

Decision 88 clarifies the concept of ‘contribution of capital’ to limited liability companies, which had led to uncertainties in the past. Specifically the new decision suggests that a ‘contribution of capital’ includes the acquisition of an existing capital contribution interest from an existing member of a limited liability company, and not only the contribution of capital to the company itself. If this clarification of ‘contribution of capital’ in Decision 88 can be used in other regulations on foreign investment issued by the Prime Minister, then this indirectly clarifies that foreign securities businesses can acquire capital contribution interests from existing members of securities companies or fund management

companies operating in the form of a limited liability company (see our briefing of April 2009 in respect of Decision 55 on foreign investors' participation in Vietnam's securities markets).

## Acquisition of initially issued shares

As mentioned above, foreign direct investment involving the establishment of new enterprises is excluded from the scope of Decision 88. One could have drawn the conclusion that foreigners can only acquire shares issued upon the establishment of a joint stock company in accordance with and subject to the conditions and procedures set out in the Investment Law. However Article 4.2 of Decision 88, which lists the types of foreign investment subject to the Decision, suggests a different interpretation, unfortunately without providing full certainty as to the right position: *'foreign investors shall [be entitled to] purchase initially issued shares from joint stock companies in accordance with the provisions of the Law on Enterprises'*.

Article 4.2 could mean, in connection with the establishment of a joint stock company, one of two things:

- that the obligation to follow the rules and procedures under the Investment Law only lies with founding shareholders (the shareholders who sign the initial charter of the company – under the Enterprise Law founding shareholders must buy at least 20 per cent of the initially issued shares), while the other initial investors in the company (who are not founding shareholders but buy initially issued shares) are not required to follow such rules and procedures. If this is true, then it means that one or more foreign investors can buy 80 per cent of the initially issued shares of a joint stock company operating in unrestricted sectors, without following the rules and procedures under the Investment Law. This would also arguably mean that such foreign investors could immediately thereafter acquire the remaining 20 per cent of the shares from the founding shareholders, only subject to the approval of the general shareholders meeting to allow the transfer of shares of founding shareholders to non-founding shareholders (such approval being required under the Enterprise Law); or
- that the foreign investor also has to comply with the procedures set out in the Investment Law.

## Foreign exchange

Decision 88 seems to authorise indirect foreign investment in 'Vietnamese Dong, freely convertible foreign currencies [or] other legal assets'.

Foreign currency has to be converted into Vietnamese Dong at the buying exchange rate quoted by authorised commercial banks, subject to 'the consent of the enterprises' authorised representative'. The approval of the authorised representative seems only relevant in the context of primary investment as opposed to secondary transactions. Therefore it is unclear whether the draftsman intended to allow transactions in foreign currencies between investors in respect of secondary equity interests in existing companies. In addition the wording of the new Decision is unclear and could be interpreted in a way that the foreign currency must first be converted into Vietnamese Dong by the foreign investor (before being paid).

This will have to be clarified in the implementing regulations from the State Bank of Vietnam that will be needed to implement the above principles. If payment in foreign currency is permitted, this may solve some issues faced by foreign investors in funding their investments in local enterprises when Vietnamese Dong is not available in the banking system due to foreign exchange pressures.

Decision 88 imposes valuation requirements in case of investment by a foreign investor made in assets other than Vietnamese Dong or freely convertible currencies. Unfortunately the rules may conflict with the rules set out in the Enterprise Law. In addition it is not clear whether the rules set out in Decision 88 are intended to apply to both primary investment and secondary investment, or only to the former.

## Right of foreign investors to pledge shares

Decision 88 provides that foreign investors are entitled to pledge their shares in local companies to secure their obligations. Under general principles a foreign investor should also be allowed to pledge its equity interest in a limited liability company. However the new Decision is silent as to whether a foreign investor may or may not do so, thereby creating an uncertainty as to whether it is possible.

## Effective date

Decision 88 will become effective on 15 August 2009.

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