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Ten key M&A legal issues for foreign investors in Vietnam

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In recent years, there's been a sharp increase in cross-border M&A activity in Vietnam, both in the number and the value of transactions. While many investments in Vietnam continue to be strategic, with the investor aiming for long-term growth in the target, international private equity investors have also started to become regular participants in the market. Our Vietnam team reports on the legal issues holding back the growth of the M&A market, and the way forward.

Background

Vietnam is considered an important investment destination by many investors due to the strong annual growth seen in the economy, currently around 6-7 per cent, and the underlying factors that contribute to that growth, such as a stable political system, a young and dynamic workforce, low wage economy, growing middle class, etc.

Despite these positive developments, M&A transactions in Vietnam are still relatively small compared with those in other countries in the region, although they can often be more complex and time-consuming than materially larger transactions undertaken in other countries. In addition to the usual commercial issues that may arise, Vietnam's legal framework has been one of the main brakes holding back the growth of M&A activity. In this article, we discuss 10 of the key legal issues that foreign investors should consider when looking at M&A transactions in Vietnam to ensure their investments run as smoothly as possible.

1 > Lack of clear legal recognition, and track record of enforcement, of international M&A concepts creates uncertainties for foreign investors

As the participation of more sophisticated players in the Vietnamese market has increased in recent years, in particular international private equity investors, this has resulted in an increased demand for more complex deal structures to reflect the parties' commercial agreement. Common features of transactions now include put and call options, drag-along and tag-along rights, various classes of preference shares, corporate reorganisations to create holding company/subsidiary group structures and convertible instruments (both bonds and loans).

However, the developing legal framework for M&A transactions in Vietnam has not fully kept pace with the growing use of these more advanced structures and concepts. This leads to uncertainties for investors.

While the view is taken that these types of arrangements should be permitted under the general principle of 'freedom of contract' that is enshrined in the Civil Code, the absence of express legal recognition of many of these structures and concepts and the lack of an established track record of enforcement creates further uncertainties as to whether and how such structures and concepts would be enforced, even though they are commonly used in other jurisdictions.

2 > Absence of detailed guidelines for public company M&A continues to limit opportunities for foreign investors

Public companies (which includes all listed companies) were previously subject to a maximum blanket foreign ownership cap of 49 per cent. In 2015, this cap was removed and public companies operating in non-conditional business sectors can now increase their foreign ownership limit to 100 per cent.

However, despite initial enthusiasm, there has been no immediate M&A boom involving public companies following this change in the regulations. This appears to be mainly due to the absence of detailed guidelines on the implementation of this general regulation.

For example, to date, the list of conditional sectors for foreign investment (ie those restricted for foreign investors) has not been issued. Further, there has been no clarification on the legal status of a public company after its 49 per cent foreign ownership limit has been lifted and the company can no longer control its foreign ownership ratio, which could change every day depending on the trading of the company's shares by foreign investors on the stock exchange. For example, companies operating in certain sectors are subject to ownership restrictions by 'foreign investors' and a situation could arise where one day a public company has 49 per cent foreign ownership and is considered a 'domestic investor' under the Law on Investment, and then the next day, it has 51 per cent foreign ownership and would be considered a 'foreign investor'. Unfortunately, there is currently no guidance as to how this will impact on the public company's investments.

These issues have resulted in listed companies being hesitant to proceed with lifting their 49 per cent foreign ownership cap. This continues to limit the opportunities for foreign investment in public companies in Vietnam.

3 > Equity investments face VND currency exposure

As part of the Government's efforts to de-dollarise the Vietnamese economy, the use of foreign currency in Vietnam is tightly regulated and the use of foreign currency in sale and purchase transactions in Vietnam (including by way of equity investment), or even the practice of referencing prices to the value of a foreign currency, are strictly prohibited (except in very limited circumstances).

Therefore, as investments in Vietnamese companies' shares must be denominated in Vietnamese Dong, foreign investors will be exposed to exchange rate risk with respect to the returns from their equity investments in Vietnam. Although there are options for hedging against this exchange rate risk to varying degrees, no option has been proven to be both cost-effective and practicable.

One option to avoid the above FX risk is to structure investments as a convertible loan or bond, which can be denominated in foreign currency. However, these options present their own set of issues and may not be available and/or suitable in all cases.

4 > Anti-trust issues can be a deal-breaker

M&A transactions, particularly those that are high-profile, are becoming increasingly scrutinised for compliance with Vietnam's Law on Competition. Under this law, transactions resulting in a combined share in Vietnam for the parties of between 30 per cent to 50 per cent in a 'relevant market' must be notified to the Vietnam Competition Authority (***VCA***), and transactions resulting in a combined market share of over 50 per cent are prohibited (unless special exemptions apply).

In practice, the enforcement of these rules has been challenging for both enterprises and the authorities. For example, it is unclear whether the law applies to transactions involving investment by an offshore party, where the new investor has no prior commercial presence in Vietnam. In addition, it is particularly difficult for parties to determine what constitutes a 'relevant market' under the law and to thereafter generate data analysis on their respective market shares. Guidance can be obtained from approaches taken in other jurisdictions, but there is still a wide range of differences in opinion on the correct delineation of many markets, both in terms of the product/services and the geographies that make up the 'relevant market'.

Due to the above ambiguities, investors have to make their own judgment and determine whether or not they must go through the merger control process before proceeding with the transaction. This is a difficult judgment to make given the potentially large fines that the VCA can impose for breaches of the law and the cost and reputational damage that may be incurred in proceeding with, and then having to unwind, a transaction. Therefore, it has become another factor causing investors to pause when considering an investment in Vietnam.

5 > Managing the different expectations of foreign and Vietnamese parties

In M&A transactions between foreign and Vietnamese parties, there may, at times, be a large gap in the parties' expectations regarding the commercial terms and, in particular, the content of the transaction documents. Therefore, both parties may need to rein back their expectations in order to come to a common agreement. For example, the use of lengthy and complex international transaction documents and advanced M&A concepts may not be familiar to the Vietnam counterparties, resulting in extensive negotiation and potential deadlock. The parties may also have different negotiation styles. Negotiation with the State or State-owned enterprises can be more difficult and time-consuming since it often involves a multi-level decision making process and political considerations.

In our experience, it is important for the Vietnamese party to seek experienced professional legal representation to assist them with the negotiation process.

6 > Lengthy regulatory approval processes

In addition to the potentially extensive negotiations with the Vietnamese counterparties, as discussed above, there is often a lengthy regulatory approval process involved in Vietnamese M&A transactions, which can result in an overall timetable that is considerably longer than in other jurisdictions.

Most M&A transactions in Vietnam require some sort of regulatory approval from the Vietnamese licensing authorities. Such approvals may take several months to obtain, which can cause the parties to experience a prolonged gap between signing and closing of a transaction. For example, an 'M&A approval' is required for foreign investors to acquire 51 per cent or more stake in a private Vietnamese company or any stake in a private company operating in conditional sectors for foreign investors. If the transaction involves a sensitive sector for foreign investment, the M&A approval process may require input from various central and local authorities, which may further prolong the closing process.

Compared to share acquisition transactions, the approval processes involved in asset sale transactions are likely to be even longer, as Vietnamese law does not contemplate the concept of a 'business transfer'. Therefore, asset sales usually involve applications for new operational licenses as they often cannot be transferred across (as well as separate transfers of assets, contracts, employees, etc.).

Generally Vietnamese investment law does not capture offshore changes of control. Therefore, usually no regulatory approval in Vietnam is required for an acquisition of an offshore holding company that holds shares in Vietnamese companies. However, following closing, if the new investor wants to change corporate features of the Vietnamese companies (eg change of name, change of management personnel or increase in equity capital), often an approval from Vietnamese authorities would be required. Of particular note in this regard is that, in the past couple of years, such approvals may be used as a leverage for the Vietnamese authorities to claim capital gains tax in respect of the offshore acquisition transaction (as contemplated in the law) and this is a topic on which specialist tax advice should be sought.

7 > Lack of reliable publicly available information on target companies

Currently, there is no reliable system in Vietnam for public searches of corporate information, litigation or bankruptcy. Therefore, when conducting due diligence on a company in Vietnam, foreign investors often have to heavily rely on the documents and information provided by the seller(s) and/or the target company. Consequently, extensive contractual protections are needed in relation to the quality and completeness of the disclosed due diligence data.

With respect to public and listed target companies, appropriate arrangements need to be put in place in respect of disclosure of 'insider information' to avoid insider trading risks.

8 > Choice of foreign governing law and dispute resolution permitted but restricted

Generally, parties to a cross-border M&A transaction may agree on a foreign governing law for the transaction documents and foreign arbitration for resolution of disputes under those documents.

However, the ability to choose foreign law and foreign arbitration has some conditionality attached, including that the result of the application of the foreign law or the enforcement of the foreign arbitration's award must not contradict the 'fundamental principles of Vietnamese law' – and this concept has no clearly defined parameters.

This means that a choice of foreign governing law, even where permitted in principle, may not ultimately result in the application of foreign law in the manner intended or anticipated by the foreign party, in particular where the matter ends up in a Vietnamese court.

Although Vietnam is a party to the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards, the limited experience of enforcement of foreign arbitral awards by Vietnamese courts to date suggests that such enforcement may be difficult and Vietnamese courts may refuse enforcement on technical grounds or for formalities not having been correctly followed.

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9 > Payment of consideration must be made via accounts in Vietnam

For foreign exchange and tax management purposes, Vietnamese law requires that the disbursement of foreign equity investment and the subsequent repatriation of profits and divestment proceeds to offshore must be made through a system of investment capital accounts in Vietnam. Unfortunately, there is an inconsistency in the current laws of Vietnam that has caused much confusion regarding the types of accounts to be opened and used for different investment purposes.

For this reason, in practice, the payment process for an M&A transaction needs to be considered on a case-by-case basis and confirmed with the relevant remitting bank. For example, proceeds from a sale of a stake in a Vietnamese company, even if conducted offshore between two foreign investors, are required to be transferred through the foreign investors' respective VND capital accounts opened in Vietnam. As another example, proceeds from a sale of a stake in a foreign invested company in Vietnam must be first transferred by the purchaser through the direct investment capital account of the target company in Vietnam before being remitted to the seller's account.

10 > Post-closing integration can be a challenge

In addition to other common integration issues, such as commercial or technical barriers, corporate governance is one of the key concerns in the integration process in Vietnam. Corporate governance practices in Vietnam, especially in family-run businesses, are often not in line with international standards. Accordingly, the integration process often involves the foreign investor(s) attempting to introduce international corporate governance rules and practices not familiar to the company and its employees.

While some target companies are open to adopting international practices, this can be difficult in many target companies, especially when the foreign investors have only acquired a minority stake in the company and consequently have limited decision-making power.

What's next?

Despite the above challenges, Vietnam remains an attractive destination for foreign investors in the region. In order to encourage more foreign investment, the Government is currently working to implement policies that address many of the legal issues considered in this article. We are optimistic that such matters will be sufficiently addressed in the near future, and, as a result, we expect to see continued growth in M&A transactions in the coming years.

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