Issues to Consider When Embarking on M&A Transactions in Vietnam

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I. Introduction

According to the Institute of Mergers, Acquisitions and Alliances ("**IMAA**"), there were 413 M&A transactions in Vietnam in 2011, valued at approximately US$4.7 billion. These figures represent a 7% increase in the number of transactions from 2010, but more impressively, the value of these deals *more than doubled* (+103%), and is the highest value of M&A transactions ever in Vietnam.

These figures take on even more significance when compared to the recent trend in the entire Asia-Pacific region. According to the IMAA, the Asia-Pacific region experienced a 9% decrease in the number of total transactions, and a 24% decrease in the overall value of such transactions from 2010 – possibly evidencing perceived value in Vietnam vis-à-vis the Asia-Pacific region amongst investors.

Most of the M&A transactions in Vietnam (77%) comprised wholly domestic transactions, which did not involve any foreign element or investors. However, 66% of the aggregate value of all of the M&A transactions in Vietnam came from inbound (i.e. foreign) investment, with Japanese investors leading the way both in terms of the total number and the aggregate value of such transactions.

In light of the economic and market trends above, many believe that the number and value of M&A transactions in Vietnam could increase even more in the coming years. What is more, these figures are rising despite an M&A regulatory regime that, while evolving, is still very much in its infancy and requires immediate and sweeping reforms in order to fully maximize the market's potential.

In this article, I address several legal, procedural and practical issues which, based on my experience assisting foreign investors with M&A transactions in Vietnam over the last eight years, can often delay, hold up or even sink a deal unless addressed by the parties in an even and mutually understanding manner. Of course, there may be other issues that arise – for example tax, financial, valuation and accounting issues – but the issues I address herein deal with the process leading towards completion and post-completion legal concerns, and how delays may be caused. Furthermore, this article addresses only private M&A transactions in Vietnam. While there have been some acquisitions of public companies in Vietnam, the vast majority of M&A transactions only involve private companies; moreover, I do not address any issues pertaining to the equitization (i.e. privatization) of State-owned enterprises in this article, as this particular topic is complex and complicated enough to deserve separate attention.

II. Capital Account

Timing is an important issue when conducting M&A transactions in any jurisdiction, as all parties generally desire to expedite a transaction as quickly as possible – the vendors want their consideration in as short as time as possible, while the purchaser will normally want to close a transaction quickly so that they can recoup their investment and grow their business.

In this regard, when a foreign investor is seeking to acquire shares or an interest in an existing Vietnamese company, one of the first things it should do is to open up a "capital account" with a duly licensed bank in Vietnam. Any sale and purchase of shares, capital contribution or transfer, receipt and remittance of distributed dividends and profits, remittance of other monies abroad and other activities relevant to investment in Vietnamese enterprises must be conducted through such an account. Typically, opening up such an account is not complicated, but depending on the bank selected by the investor, may require certain "know your client" procedures and information that may add to the time required to open up such an account. Hence, every investor should address this requirement as soon as possible within the M&A transaction process, so it does not experience any unnecessary delays.

III. Due Diligence

The difficulties associated with the due diligence process in Vietnam stem from a variety of factors -- the first being that there are no reliable public search systems or databases in Vietnam. The laws pertaining to investment and enterprises contain language and provisions about a "national business registration database", but apart from a few references to it in some legislation, little progress has been made in setting it up. Hence, the purchasers must rely heavily on the vendors to provide the necessary documents and fully disclose the legal, tax, financial and operational information sought to conduct a proper due diligence exercise.

Which leads to the second significant difficulty often associated with due diligence exercises in Vietnam – the inexperience of many Vietnamese vendors vis-à-vis international and cross-border M&A transactions, and their general reluctance to divulge or disclose too much information about their target companies. This leads to difficult and drawn-out due diligence exercises, as much time is incurred by the foreign purchasers explaining what documents and information they require and why. Indeed, this often may lead to a certain amount of tension between the parties, particularly when it comes to negotiating and deliberating over the representations and warranties in the relevant agreement. Often the vendors will not fully appreciate the need for the purchaser to conduct both a due diligence exercise and require the representations and warranties. Purchasers will of course derive a great deal more comfort with the representations and warranties, particularly in light of their need to fully rely on the vendors for the full and accurate disclosure of information and because of the inherent lack of clarity in many Vietnamese regulations.

IV. Competition Law

The next three issues addressed all deal with the procedures required for an M&A transaction to reach completion. The first one I will address is the Law on Competition, which prohibits any "economic concentration" which results in the companies involved in such transaction having a "market share" of more than 50% in the "relevant market". (The term "economic concentration" includes all M&A transactions in Vietnam.)

Any "economic concentration" which results in a combined "market share" of between 30% and 50% of the "relevant market" must be notified to the Vietnam Competition Administration Department ("**VCAD**"), at least 30 days before the proposed "economic concentration". The VCAD must confirm in writing that the proposed "economic concentration" is permitted before

it can proceed. Any proposed "economic concentration" resulting in a combined "market share" below 30% does not need to be notified to VCAD.

The major issue that arises with these requirements under the Competition Law is that, while defined in the law, the terms "relevant market" and "market share" have not been sufficiently explained and expanded upon to allow the relevant parties to determine and calculate their respective parameters and values. Hence, more clarity and guidance is still required by either further legislation or direction directly from the VCAD to address this issue.

V. Licensing Issues

The licensing process for foreign invested enterprises in Vietnam is often cumbersome, lengthy and subject to many different and inconsistent interpretations, depending on the location of the target company and the relevant licensing authorities. As an example, the current laws pertaining to investment and enterprises in Vietnam were effected in 2006 with the intent of unifying the investment procedures to be applicable uniformly to foreign and domestic investors alike. However, in practice, separate licensing procedures for foreign investors and domestic investors were enacted. Foreign investors, when directly investing in Vietnam for the first time must obtain an "investment certificate", which can be a long, arduous evaluation process requiring approvals or opinions from many levels of government and officials.

It was not entirely clear if foreign investors that entered into Vietnam by way of an M&A transaction would have to embark on the same investment certificate evaluation process, or if they could avail themselves of the more straightforward and easy "registration" process utilized by local domestic investors for a "business registration certificate". To address this, a rule was enacted in Decree No. 102/2010/ND/CP dated 1 October 2012 of the Government, which stated that if foreign investment exceeded 49% of the total equity in the company, an "investment certificate" was required, and if the level of foreign investment was equivalent to or less than 49% of the total equity, only a simple amendment to the "business registration certificate" was necessary.

However, unfortunately this basic "49% Rule" was not consistently interpreted and enforced, and has not settled this issue entirely. It appears that an investment certificate will be required regardless of the level of foreign investment (i.e. possibly as little as 1%) for certain industries considered to be "conditional" under the Law on Investment or which is subject to Vietnam's commitments to the WTO. In particular, foreign investors seeking to acquire stakes in Vietnamese import, trading and distribution companies often must go through the long and arduous "evaluation" procedure to obtain an "investment certificate" (including obtaining the approval from the Ministry of Industry and Trade), even where they are acquiring significantly less than 49% of the total shares or capital in the target. If an evaluation process is required for an investment certificate, the time required can be from four to six to 12 months or even beyond. Also it is important to note that, in practice, obtaining an "investment certificate" is not guaranteed, even if Vietnam has committed to the WTO to open up a particular industry or service sector.

VI. Processing Payment

The final issue I address pertaining to how to properly structure the completion of the transaction is the payment procedure. For any assignment of shares in a joint stock company (i.e. a shareholding company) involving "founding shareholders" within their initial three year lock-in period, or for any change of members in a limited liability company with two or more members, Decree No. 43/2010/NP/CD dated 15 April 2010 of the Government, requires that some sort of documentary "evidence of completion" be provided to the relevant licensing authority to register the assignment and amend either the "investment certificate" or the "business registration certificate", as the case may be.

This is problematic because the phrase "evidence of completion" has not been defined or explained adequately, which has resulted in many different interpretations and practices. In some instances, the relevant authorities will require that evidence be produced that the consideration has been paid *in full* to the assignor. Obviously this is a risk that a foreign purchaser would not want to face since it would have paid for the shares or interest in full, but still has not yet received the necessary approvals for the transfer of such shares or interest.

Often, to address this requirement, parties have elected to use escrow accounts and some authorities have accepted remittance into such an account as "evidence of completion". But setting up and using an escrow account is not always straightforward and adds costs and time to the process. Moreover, if an acquisition is being debt-financed, using an escrow account may be problematic if the loan agreement requires that draw-down may only occur once various conditions have been met, including the relevant authority approval or issuance of the relevant amended license.

VII. Enforcement of Typical M&A Contractual Provisions

The final issue I will discuss pertains more towards post-completion rights and obligations commonly utilized in M&A transactions, namely put and call options and non-competition provisions. The Civil Code of Vietnam generally allows parties to contract and agree on terms which are not contrary to the laws of Vietnam. However, in practice, often officials and courts in Vietnam may take the position that if the laws of Vietnam do not explicitly grant a right, the parties may not agree to any such contractual rights. This inconsistent approach is amplified by the fact that Vietnam, as a civil law country, does not adhere to the use of binding precedence – in other words, every contract will be interpreted and enforced on a case-by-case basis, so it is difficult to prognosticate how a court or official may interpret and enforce its terms.

This is especially problematic when it comes to certain types of exit strategies – such as put and call options – that a foreign investor may require to alleviate some its concerns when acquiring a company in Vietnam, since the laws of Vietnam do not explicitly mention such options. Moreover, because of the various licensing and payment issues explained above, often any transaction involving a foreign investor will require some level of authority consent, meaning that any such put or call option will also ultimately be subject to approval.

Furthermore, when it comes to non-competition clauses, unlike in common law and other civil law jurisdictions, there is no regulation that is directly on-point, nor is there any relevant established case law or jurisprudence. In other words, it is difficult to prognosticate whether

any such clauses will ultimately be enforceable, regardless of the geographic or time limitations agreed upon in such clauses.