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Amended investment and enterprise laws: Pros and cons for foreign investors

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On 17 June 2020 the National Assembly of Vietnam adopted Law no. 61/2020/QH14 on investment (amended LOI) and Law no. 59/2020/QH14 on enterprises (amended LOE), which will take effect from 1 January 2021 and replace the current versions of these laws. Though largely a continuation of existing law, there are nonetheless several changes that could impact foreign investors in relation to their Vietnamese investments.

Foreign investor threshold lowered to 50 percent

Under current law, enterprises incorporated in Vietnam with 51 percent or more foreign-owned capital are treated as "foreign investors" for purposes of licensing and investment activities, which can give rise to more burdensome conditions and procedures when establishing subsidiaries or subscribing for or acquiring shares or other equity interests. The 51 percent threshold (as opposed to a seemingly more intuitive 50 percent) has always been a bit of a curiosity, but one benefit, whether intended or not, has been the ability of a foreign investor to hold a majority equity stake in a company while preserving the company's treatment as a "domestic investor" for licensing and investment purposes.

This will no longer be possible under the amended LOI, however, as the new law lowers the "foreign investor" threshold from 51 percent to 50 percent. Going forward, foreign investors will therefore need to decide between, on the one hand, holding more than 50 percent of the equity and accepting "foreign investor" treatment for the subsidiary company or, on the other hand, preserving the subsidiary's domestic investor treatment at the expense of foregoing majority ownership. Other means of control are of course still available (e.g., through voting preference shares or contractual "reserved matters" provisions set out in a shareholders' agreement or charter), but may not address other reasons for wanting to hold a majority equity position, such as the ability to consolidate results for financial reporting purposes.

Threat to nominee arrangements

Foreign investors sometimes use nominee arrangements as a means of circumventing conditions or restrictions on foreign ownership in "conditional" business sectors such as retail and education. The amended LOI may signal an intention to crack down on such arrangements, as it makes investing through a sham transaction a basis for terminating an investment project.

Under Vietnam's Civil Code, a sham transaction is a (legitimate) transaction undertaken in order to conceal another (illegitimate) transaction, which would include using a local nominee to mask the underlying foreign ownership of a company. The amended LOI potentially puts such arrangements at risk by providing a basis for terminating the investment project if the underlying arrangement is discovered.

Simplified licensing procedure for acquisitions that do not increase foreign ownership

Currently, foreign investors who subscribe for or acquire 51 percent or more of the shares or equity in a company, or any amount of shares or equity in a company that operates within a conditional business sector, must carry out a registration procedure with the local Department of Planning and Investment before completing the transaction (this procedure is colloquially known as a "mergers and acquisitions (M&A) approval"). The M&A approval can be a significant gating item in the pre-completion timeline, and requires a number of documents to be notarized and legalized by consular authorities in the foreign investor's home jurisdiction.

Broadly speaking, the amended LOI removes the M&A approval requirement so long as the overall foreign ownership of the target company is not increasing and the target company does not hold land use rights in certain strategically important areas. The pre-completion licensing and approval process will therefore be both shorter and simpler in cases where there is no increase in the overall foreign ownership of the target company, such as a secondary sale between two foreign investors (so long as there is no accompanying primary share subscription) or a pro rata rights issue to existing shareholders, or where the foreign ownership remains below 50 percent and the target company is not engaged in business lines that are conditional to foreign investment.

Waiting period to nominate director candidates eliminated

Under current law, a shareholder or group of shareholders holding at least 10 percent of the voting shares of a company are expressly entitled to nominate candidates to the company's board of directors only after holding the shares for a period of at least six months. As is often the case in Vietnam, what was undoubtedly codified as an affirmative right (i.e., an express nomination right after six months) has in some cases been turned on its head and misconstrued as a negative proscription (i.e., a prohibition on nominating directors in the first six months after investment) in order to deny an incoming investor the right to nominate director candidates at the time of investment completion. Any ambiguity has now been removed as the amended LOE expressly provides for a director nomination right for 10 percent shareholders (or groups of shareholders) regardless of how long they have held their shares.

Supermajority class vote required to amend terms of preference shares

Under Vietnamese law preference shares are non-voting and holders of such shares therefore lack a voice at the general meeting of shareholders. The specific rights attaching to a class of preference shares, which are typically heavily negotiated, are often protected through contractual veto or consent rights enshrined in a shareholders' agreement or company charter, which prevent the terms of such shares from being amended without the consent of the holders thereof. Under current law, however, it is technically possible for ordinary shareholders to amend the terms of a class of preference shares by way of general shareholders resolution in which the preference shareholders would have no say. Although such amendment could trigger a breach of contract claim if done in contravention of contractually agreed veto rights, the change may nonetheless still be effective as a matter of law.

The amended LOE partially addresses this issue by requiring that any adverse change to the rights of a class of preference shares be approved by the holders of at least 75 percent of the outstanding shares of the affected class. While helpful, smaller holders (i.e., of less than 25 percent) of a class of preference shares would still be subject to the whims of the other class holders whose circumstances and objectives may diverge from their own, so even under the amended LOE such smaller preference shareholders will need to rely on contractual protections of their agreed rights and preferences. In many cases it may be preferable for such preference shareholders to insist on receiving their own class of preference shares so as to skirt the issue entirely.

Conclusion

All investors will no doubt welcome the clarification (by way of elimination) of the six-month holding period prior to nominating director candidates and the class voting requirement for changes to the rights of preferred shareholders, while foreign investors also stand to benefit from the removal of the M&A approval requirement in certain instances. There will be less rejoicing over the lowered threshold to be considered a "foreign investor" and a potentially more stringent approach toward nominee arrangements, though these at least signal an intention to view and treat shareholding structures according to their "true" nature.

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