

VIETNAM: New regulations on SOEs

In 2013 Decree 71 (“Decree 71”) issued by the Vietnamese Government took effect which set out requirements for the direct investment of state capital by the state budget and state concentrated funds in enterprises and certain requirements for the financial management of state-owned enterprises (“SOEs”) wholly owned by the Government (“100% SOEs”). This Decree has significant implications for SOEs and investors.

Implications of Decree 71

As a result of Decree 71 imposing strict regulations on 100% SOEs investing in non-core businesses, a number of investments held by 100% SOEs in Limited Sectors (as explained below) will be up for sale. This may present opportunities for both Vietnamese and foreign investors. It is likely that companies in Limited Sectors, having a 100% SOE as a shareholder, can expect to go through a sale process as the 100% SOEs exit from these sectors. The Prime Minister may, however, make an exception and permit such 100% SOEs to continue to maintain their outward investments in the companies in those Limited Sectors.

Provisions of Decree 71

Outward investment by 100% SOE's – Limited Sectors

Decree 71 imposes strict regulations on 100% SOEs investing in non-core businesses. Decree 71 stipulates that a 100% SOE is not permitted to invest in real estate (to the extent real estate is not its core business), banking, insurance, securities, venture capital funds or investment funds (“Limited Sectors”) except as permitted by the

Prime Minister. This requirement is more stringent than the previous Decree 09/2009 which permitted an SOE to invest up to 30% of its capital in Limited Sectors. A 100% SOE which has invested in a Limited Sector must restructure and divest any capital held in a Limited Sector company. Decree 09/2009 provided all SOEs with two years to divest any holding in Limited Sectors. However, under Decree 71 this duration will be specified in each specific approved sale plan.

Sale of state capital invested in SOEs

Corporate power/ approval process

- Decree 71 provides clear authority for the sale of state capital by relevant Governmental authorities. Authority for the sale of interests in enterprises established by the Prime Minister, either in the form of equitisation, selling enterprises, or conversion into multi-member limited liability companies, must be obtained from the Prime Minister.
- Authority for the sale of interests in enterprises established by the Ministries or People's Committees either in the form of equitisation, selling enterprises, or conversion into multi-member

limited liability companies, must be obtained from the respective Minister or Chairman, subject to the restructuring plan being pre-approved by the Prime Minister or prior consultations with the Ministry of Finance and the Ministry of Planning and Investment.

Key issues

- Restrictions on 100% SOEs investing in non-core businesses presents opportunities for investors
- SOE's may sell outward investments at the market price, possibly at a loss
- Restrictions on investment with related parties and within the same group may require 100% SOEs to restructure
- The aim of Decree 71 is to prevent heavily-indebted SOE's from investing in non-core businesses
- Decree 71 may have a side effect in increasing the number of new SOEs

Sale price

Divestment of a holding in a limited liability company

- Divestment of a holding in a limited liability company engaging in Limited Sectors by a 100% SOE must be conducted in accordance with the Law on Enterprises. This implies that a 100% SOE might freely transfer its capital contributed in other limited liability companies engaging in Limited Sectors to third party investors at their own discretion. This is subject to only the approval by other capital contributing members in such limited liability company in the case of a multi-member limited liability company. This is because Article 44.2 of the Law on Enterprise allows a capital contributing member of a limited liability company to transfer its contributed capital to a non-member where the other members of the company do not purchase, or do not purchase in full, within 30 days from the date of offer. If the limited liability company is a one-member limited liability company, then it is likely that a 100% SOE is also allowed to freely transfer part of its contributed capital to other investors to convert such one-member limited liability company to a multi-member limited liability company.

The sale of an investment in a joint stock company listed on a stock exchange or on the “UPCOM” market

- The sale of an investment in a joint stock company listed on a stock exchange or on the “UPCOM” market must be made through auction sale, negotiated sale or matching order. While the

transfer of an investment in a listed joint stock company by way of auction sale will be made via auction agent, under the matched order method, a seller or a buyer places an open order to sell or to buy shares at a certain price and the trading system of the stock exchange will automatically match the sell order with the buyer order.

- Under the negotiated sale method, the trading members will agree on the terms of the transaction and the transaction details will be entered into the trading system by the relevant brokerage.

The sale of an investment in an unlisted joint stock company

- The sale of an investment in an unlisted joint stock company, regardless of whether or not it is a public company, must be completed by way of public auction or direct negotiation (where only one buyer is identified). If transferring an investment with a total par value of VND 10 billion or more, the transfer must be made via an auction at a Stock Exchange. If the transfer value is less than VND 10 billion, a 100% SOE might decide either to transfer via an auction held by an intermediate financial institution (securities company), to organize the auction itself, or to transfer via an auction at a Stock Exchange at its own discretion.

Sale at a loss may be possible

- Decree 71 provides the Members Council or Chairman of a 100% SOE with the authority to make a decision on the sale of outward investments within their competence, provided that the sale achieved is at the market

price (including land use right value) and not below book value. A sale below book value requires the approval of its owner, the relevant Government authority.

- This implies that Decree 71 allows 100% SOEs to sell their outward investment at a loss. This is an important development as previously Decree 09/2009 required an SOE to “preserve” State capital when divesting investments in Limited Sectors. Decree 71 requires the sale price to be in accordance with the market price but not lower than the book value of the capital. If the sale price is lower than the book value, the SOE must report to the State owner representative for consideration and approval.

Approval process for the sale of an investment by an 100% SOE in other enterprises

Although Decree 71 provides a 100% SOE with the authority to sell their outward investment the likelihood of this occurring without higher approval from the relevant Government authority is unlikely. The Members Council of 100% SOEs consists of Government authority representatives who are required to obtain prior written approval from their Government authority before casting their votes at a Members Council meeting. Likewise, it is likely that the Chairman of a 100% SOE will be a representative of a Government authority and must obtain prior approval from their Government authority before making any material decision.

Additional regulations

Debt equity ratio

If the debt equity ratio of a 100% SOE is equal to or less than 3:1 a 100% SOE is permitted to borrow money for

the operation of its business at its own discretion. When a 100% SOE's debt equity ratio is more than 3:1, approval from its owner, being the relevant Governmental authority is required prior to further borrowing.

Related businesses and persons

Decree 71 also provides that:

- A 100% SOE must not contribute capital or buy shares from other enterprises of which the managers or key owners are spouses, parents, children or siblings by blood of the Chairman and members of the Member Council, the controller, the General Director (Deputy General Director), the Director (Deputy Director) and the chief accountant of such 100% SOE;
- A 100% SOE must not receive capital contributions from its subsidiary companies ("100% SOE Subsidiary"); and
- A 100% SOE Subsidiary must not:
 - co-invest with its parent 100% SOE to establish new enterprises; or
 - buy shares in other 100% SOE Subsidiaries in the same group of companies or in the same system when such other 100% SOE Subsidiaries are equitized.

As a result, a 100% SOE and its 100% Subsidiaries will have to restructure its investment mechanism to comply with the above new regulations. This also means that more divestments from 100% SOEs and their 100% Subsidiaries are expected. If a 100% SOE makes improper outward investments without restructuring the investment mechanism, then the Member Council or the Chairman of that 100% SOE will have to answer to the Prime

Minister, based on a request by the Managing Ministries/provincial People's Committees and Ministry of Finance.

Applicability of Decree 71

SOEs were previously governed by the Law on State Owned Enterprises dated 26 November 2003 ("Law on SOEs"). From 1 July 2006, when the Law on Enterprises came into effect, the Law on SOEs was repealed as a result of the Government's intention to convert all SOEs into limited liability companies and joint stock companies in accordance with the Law on Enterprises, which mainly regulate corporate forms of private business. The economic uncertainty which followed the repeal of the Law on SOEs forced the Government to implement various regulations to govern SOEs activities. Decree 71 is a further addition to these regulations. Although it is not clear, it seems that Decree 71 will partially replace the previous Decree 09/2009 on financial management of SOEs and management of state capital invested in other enterprises ("Decree 09") from 1 September 2013. This is because these 2 regulations, issued by the same authority, are seen to govern the same matter, therefore the regulation that was issued later shall be applied in accordance with the rule provided in the Law on Promulgation of Legal Documents of the National Assembly dated 3 June 2008.

Aims of Decree 71

Investment in non-core businesses by SOEs is considered one of the main reasons for the current economic slump in Vietnam. The issuance of Decree 71 is evidence of the

Government's intention to exercise tighter control over the use of the State budget by the relevant government authorities and 100% SOEs to ensure heavily-indebted SOEs do not continue to invest in non-core businesses. In addition, Decree 71 aims to fill the gap left by the repealed Law on SOEs to regulate the operations of SOEs since as a result of the abolition of Law on SOEs, SOEs were insufficiently covered by the Law on Enterprise dated 29 November 2005 ("Law on Enterprises"). However, apart from such tighter control, Decree 71 may have a side effect in increasing the number of new SOEs (which is not the agenda of the Government) at the expense of the equitisation and divestment of SOEs.

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