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Part 1 Selected New Legal Instruments

1.1 Land leasing

Decree 142-2005-ND-CP of the Government dated 14 November 2005 on Land Leasing and Collection of Land Rent

Generally, Decree 142 applies to all individuals and economic entities, including foreign invested enterprises, which directly lease land from the State. It does not apply to individuals or economic entities which are allocated land from the State or sublease or receive land assignment from others.

Main points of Decree 142 include:

> *Land rent*: Land rent = Land rent rate x Number of leasing years x Land area – Amount of reduction and land compensation already paid (if any)

> *Land rent rate*: Provincial and municipal people's committees are required to issue a list of land prices for their respective provinces and cities under central authority. Based on such list of land prices, they then issue another list of land rent rates, taking into account the type of land, location of land, etc. The land rent rate must be equal to 0.5% of the land price applicable to a specific type of land. However, the land rent rate can be increased up to 2% of the land price with respect to a piece of land which is located in a commercial centre, residential area, etc. The land rent rate can also be lowered to 0.25% of the land price with respect to a piece of land which is located in a remote region or encouraged to be invested.

> *Land rent rate for a specific foreign invested project*: The director of the department of finance of the relevant province or city under central authority is required to determine the specific land rent rate for a foreign invested project based on the list of land rent rates issued by the provincial or municipal people's committee.

> *Payment of land rent*: Land rent is calculated from the time when the lessee is issued with a decision to lease land by the relevant authority. Land rent can be paid annually or for the entire lease term in accordance with the land lease contract.

> *Adjustment of land rent rate*: The land rent rates can be adjusted every 5 years based on the list of land prices issued by the provincial or municipal people's committee.

> *Land rent rate applicable to current projects leasing land from the State*: Land rent rates calculated in accordance with Decree 142 will be effective as from 1 January 2006. Therefore, (i) if land rent for current projects is paid annually, then the land rent must be adjusted in accordance with Decree 142 commencing from 1 January 2006; (ii) if land rent has already been paid for a period which extends beyond 1 January 2006, the land rent must be adjusted upon expiry of such period; and (iii) if the land rent has been paid for the entire lease term, the land rent will not be adjusted.

With respect to foreign invested projects in which the Vietnamese party has been allowed to contribute the value of leased land use rights as capital (eg in joint ventures), the land rent under Decree 142 will not apply.

> *Land rent exemption or reduction*: Reduction of land rent will apply when a lessee's business activities are adversely affected by natural disasters, fires or other force majeure events.

Projects satisfying the 2 criteria of being engaged in especially encouraged investment sectors *and* being located in regions having especially difficult social and economic conditions will be exempt totally from land rent collection. Projects for building houses for workers in industrial zones will also be exempt totally from land rent collection.

Further, exemption from land rent also will apply in the following cases:

- 3 year exemption applies to projects either being engaged in encouraged investment sectors *or* being relocated to a new region because of the environment pollution;
- 7 year exemption applies to projects either being engaged in especially encouraged investment sectors *or* being implemented in regions having difficult social and economic conditions;
- 11 year exemption applies to projects satisfying the 2 criteria of being engaged in encouraged investment sectors *and* being implemented in regions having difficult social and economic conditions; and applies to projects being implemented in regions having especially difficult social and economic conditions;
- 15 year exemption applies to projects satisfying the 2 criteria of being engaged in encouraged investment sectors *and* being implemented in regions having especially difficult social and economic conditions.

Decree 142 became effective as of 26 November and will apply to the calculation of land rent rates as of 1 January 2006.

1.2 Foreign loans

Decree 134-2005-ND-CP of the Government dated 1 November 2005 issuing Regulations on Control of Foreign Loans and Loan Repayments

Decree 134 replaces the longstanding Decree 90-1998-ND-CP of the Government dated 7 November 1998 and its accompanying Regulations on Control of Foreign Loans and Loan Repayments ("Decree 90").

Like its predecessor, Decree 134 regulates the borrowing and repayment of foreign loans by the State of Vietnam, the Government and resident Vietnamese organizations. Resident Vietnamese organizations are now as defined in Vietnamese forex laws. So, at present, Decree 134 has the same impact as Decree 90 and applies to foreign invested enterprises ("FIEs") established in Vietnam (the difference is that Decree 90 applied expressly to FIEs). Decree 134 does not regulate the foreign loans of resident individuals.

Any loan borrowed by a resident from a non-resident (whether international financial institution, foreign Government, or other organization/individual) constitutes a foreign loan. Decree 134 expressly includes finance leases with offshore companies as foreign loans. Decree 134 also regulates the borrowing of foreign loan capital via issuance of international bonds.

Decree 134 now expressly distinguishes:

> "ODA loans" (official development aid loans) and "foreign commercial loans" (the latter being all foreign loans except ODA loans);

> "National foreign debt" and its sub-groups "public sector foreign debt" (comprising all foreign loans of the Government, all foreign loans of administrative authorities of provinces and cities under central authority, and all foreign loans of State owned enterprises, of State owned financial and credit institutions, and of State owned economic institutions, collectively referred to as SOEs) and "private sector foreign debt" (all foreign loans of enterprises and economic institutions belonging to the private sector).

The most significant reforms under Decree 134 relate to the management of the national foreign debt and, in particular, of the public sector foreign debt.

For management of the national foreign debt, Decree 134 introduces a number of new specific reporting tools: *long term national debt strategy on foreign loans* (in conformity with Vietnam's 5 and 10 year strategies for socio-economic development), *program on management of medium term loans* (the strategy on long term debt for periods of from 3 to 5 years, which is updated each year, in conformity with the framework on economic and financial policy, and the medium term and annual State Budget targets of the Government) and *annual master plan on foreign loans and loan repayment* (annual plan for drawdown and repayment of loans

by the public sector and overall quota on national foreign commercial loans). The basic contents of these reports are prescribed in Decree 134. They are formulated by the Ministry of Finance ("MoF"), in co-ordination with the Ministry of Planning and Investment and the State Bank of Vietnam ("SBV"), and approved by the Prime Minister.

With respect to public sector debt, the reforms are based on the policy that the borrowing of all foreign loans to be used in the public sector (excluding by SOEs) should be implemented by the method of loans being made to the Government and the Government then re-lending to the public sector. Decree 134 now requires all foreign loans of the Government to be obtained by the MoF and all public sector bodies seeking foreign loan capital for investment projects to enter into re-lending agreements with the MoF or other body or institution authorized by the MoF (such as the Fund for Development Aid, State owned commercial bank or social policy bank). Notably, the MoF is entitled to a re-lending fee.

Within the public sector provisions, Decree 134 deals separately with:

- Foreign loans of the Government, including ODA and foreign commercial loans (both foreign currency loans and foreign commodity loans), and re-lending thereof (conditions on currency, term, interest rates and fees, eligible sub-borrowers, security, are prescribed).
- Foreign loans of SOEs, which are permitted to borrow foreign loans directly subject to prescribed conditions and registration requirements and subject to the restrictions that all foreign commercial loans must be within the annual overall quota on national foreign commercial loans. The Government is not liable for foreign loan debts of SOEs, unless guaranteed by the Government.
- Government guarantees, which may now only be given by the Government via the MoF (previously, also by the SBV). The entities eligible for consideration for issuance of a Government guarantee now comprise domestic enterprises, economic institutions and credit institutions from all economic sectors (not just SOEs, unless in special cases, as under Decree 90) undertaking the following types of projects:

    - investment programs/projects of a high importance for which the National Assembly or the Prime Minister has approved the investment policy;
    - programs/projects importing high technology equipment or producing goods or providing services for export and programs or projects in sectors to which the State gives investment priority and which have the ability to repay;
    - programs/projects eligible for aid in the form of commercial loans or mixed ODA credit;
    - loan programs/projects of credit institutions which the SBV appraises and recommends the issuance of a Government guarantee (this last type is new under Decree 134).

    New conditions for Government guarantees under Decree 134 include:

    - The capital of the owner being the investor of the program/project must be no less than 20% of the total invested capital of such program/project;
    - Loans to be guaranteed must have a value of at least the equivalent of USD10 million (except for mixed ODA/commercial loans). (In contrast, Decree 90 capped the maximum amount that could be guaranteed by the Government.)

    The application file for a Government guarantee is prescribed in Decree 134. Of note, audited financial statements showing no losses in the most recent 3 consecutive years and no overdue domestic or foreign loans are required.

    Decree 134 requires the entire assets formed from foreign loan capital guaranteed by the Government to be used to provide a mortgage for the Government guarantee. Such assets may not be used to provide a mortgage in order to borrow other funds.

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New *Regulations on Issuance and Control of Government Guarantees for Foreign Loans* are expected soon to accommodate the reforms in Decree 134.

With respect to private sector foreign loans, Decree 134 includes more abbreviated principles for control than under Decree 90, but offers no real reforms. As previously, all private sector foreign loans are subject to supervision and monitoring by the Government via mandatory conditions which must be satisfied, registration with the SBV and regular reporting to the SBV. Private sector enterprises are fully liable for repayment of foreign loans in accordance with the undertakings in loan agreements, the laws of Vietnam and (now also expressly) international legal practice. Possibly some reforms may be introduced when the new detailed guidelines to implement Decree 134's regulation of private sector foreign loans are issued, eg a relaxation of the registration requirements for foreign loans. (For the most recent guidelines under Decree 90, see the January-February 2005 Issue of Vietnam Legal Update on www.vietnamlaws.com.)

Of note, where a private sector foreign loan is guaranteed by the Government or some other public sector institution authorized to issue guarantees (such as a State owned financial or credit institution), the control and supervision of the loan will be as applicable to foreign loans of SOEs. Interestingly, Decree 134 includes provisions on bank guarantees for foreign loans of SOEs only, not also for private sector foreign loans as previously under Decree 90.

Decree 134 became effective as of 22 November 2005.

>>> For English translations of Decree 134 as well as its predecessor Decree 90 and detailed guidelines on foreign loans, subscribe to Vietnam Laws Online Database on www.vietnamlaws.com.

1.3 Auditing

Decree 133-2005-ND-CP of the Government dated 31 October 2005 on Amendment of and Addition to a Number of Articles of Decree 105-2004-ND-CP of the Government dated 30 March 2004 on Independent Auditing

Decree 133 amends 2 articles of Decree 105 as follows:

> Article 20: Now, auditing enterprises may be established and operate in the form of a limited liability company as well as (as previously) the forms of partnership, private enterprise, or foreign invested enterprise. Also, now, an auditing enterprise must publicly announce its form during the process of its trading and operating.

Of note, an auditing enterprise may not (now or since Decree 105) be established in the form of a State owned enterprise or shareholding company. Any State owned auditing enterprise or shareholding auditing company which was established and operating prior to the date of effectiveness of Decree 105 (ie 21 April 2004) is required (under Decrees 105 and 133) to convert to one of the above forms of enterprise within three years after the date of effectiveness of Decree 105 (ie by 21 April 2007).

> Article 34: Now, the Ministry of Finance is responsible to provide specific guidelines on the criteria and conditions for establishment of a limited liability auditing company (now permissible under Decree 133) or an auditing partnership (permissible since Decree 105).

Decree 133 became effective as of 22 November 2005.

>>> For English translations of Decree 133, Decree 105 and other Vietnamese legislation on auditing and accounting, subscribe to Vietnam Laws Online Database on www.vietnamlaws.com.

Part 2 Features

2.1 Law on Investment update

The new Law on Investment has been vigorously debated both inside the halls of the National Assembly during the National Assembly's just concluded 8th Session and outside within the domestic and foreign investor communities. There was a hint of possible postponement of promulgation of the Law if the issues of debate could not be resolved. But, after eleventh-hour contributions from foreign business chambers Auscham, Eurocham and Amcham, from foreign lawyers, from domestic business associations and ultimately from the Prime Minister's Research Group, the new Law on Investment has been approved.

The new Law on Investment will come into effect on 1 July 2006. Between now and then, we will review various aspects of the new investment (and new enterprise) regime which will apply to domestic and foreign businesses. First, below we track how some of our main concerns in the earlier drafts (in particular, Draft 16 reviewed in the October 2005 Issue of Vietnam Legal Update) have fared in the final version (Draft 18) of the Law on Investment.

> New registration and licensing system

One of the main stated aims of the Law on Investment was to modernize and simplify establishment procedures for investment. As in earlier drafts, the multi-tier, multi-step system adopted in the new Law on Investment appears to be a backward step, rather than an improvement of the current dual investment/enterprise regime.

Small domestic investors are the main winners in the changes from Draft 16 to Draft 18. Domestic projects below VND15 billion (USD943,990) which are not in conditional sectors (see below) no longer require investment registration (Article 45.1). So long as they do not want their investment incentives recorded (see below), they are free to follow the simple business registration procedures originally introduced under the 1999 Law on Enterprises (and replicated in the new Law on Enterprises just passed by the National Assembly at its current Session).

Domestic projects from VND15-300 billion and foreign projects below VND300 billion (USD18,880,000) which are not in conditional sectors still require investment registration and issuance of an investment certificate (Articles 45.2 and 46.1). A new feature of Draft 18 is that the procedures for registration differ for domestic projects and for foreign projects (more documentation is required for the latter) (Articles 45.3 and 46.2). For domestic projects, it is expressly stated that an investor must carry out investment registration prior to implementation of its investment project (presumably this is applicable also for foreign projects, but curiously it's not expressly stated to be). For foreign projects, it is expressly stated that an investment certificate must be issued within 15 days of receipt of a valid file for investment registration (again, presumably a time-limit is applicable for domestic projects also, but curiously it's not expressly stated to be). Aside, the time-limit of 15 days is up from 7 days under Draft 16! (Articles 45.4 and 46.3) When foreign investors first invest in Vietnam, they must conduct investment registration procedures. Happily, as under current law, their investment certificate will also act as their business registration certificate. Thereafter, it is just their new investment projects (if any) that need to be registered, not a new enterprise (Articles 50.1 and 50.2). For domestic projects, it is presumed (but, unfortunately, not as clear as under earlier drafts) that investment registration procedures are conducted at the same time as business registration under the Law on Enterprises (Article 50.3). A '1-step' process is desirable. But the 2 parts (investment and business) to the 1 (registration) step is a backward move in that, under current law, domestic investors do not need to conduct any investment registration (only business registration) procedures (unless they want the benefit of domestic investment incentives). Of note, there is no bilateral or multilateral undertaking by Vietnam that required it to re-introduce State approval of domestic investment. But, at least, it is now clear that foreign investors do not need to conduct any separate business registration (only investment licensing) procedures.

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All projects in conditional sectors and projects of VND300 billion or more (whether domestic or foreign) still require investment evaluation. Somewhat confusingly, under Draft 18, different procedures apply for evaluation of (i) projects below VND300 billion which are in conditional sectors, (ii) projects over VND300 billion which are in conditional sectors, and (iii) projects over VND300 billion which are *not* in conditional sectors! The mandatory contents of evaluation application files have been expanded from earlier drafts. The time-limit for evaluation of 30 (45 on complex cases) days is retained. (Articles 47, 48 and 49) Again, although proposed as a '1-step' process (investment approval and business registration conducted at the same time), an additional burden is imposed on domestic investors (as noted above).

All in all, the new system (summarized below) is still likely to create confusion and may delay/deter new investment:

	Who is entitled?	**What investment process applies?**	**What investment document is issued?**
Business registration (only)	Domestic investment projects with invested capital below VND15 billion (USD943,990), excluding conditional projects	None, unless recording of investment incentives is desired	None, business registration certificate issued under the (new) Law on Enterprises
Investment registration/ certification	Domestic investment projects with invested capital from VND15-300 billion; Foreign invested projects with invested capital below VND300 billion (USD18,880,000); excluding conditional projects	Registration of investment on sample form at provincial State administrative body for investment, accompanied by prescribed documentation (more onerous for foreign projects) (Notably, Draft 18 no longer uses the language of "application" for registration, but it omits the assurance in Draft 16 that investors would not be required to supplement their registration file with any other documents!)	For foreign projects, investment certificate (which is also business registration certificate in the case of initial establishment of economic organization to undertake first investment project); For domestic projects, investment certificate and business registration certificate (a one-step but two-part process)
Investment evaluation/ certification	Conditional projects (see list below); Projects with invested capital of VND300 billion (USD18,880,000) or more	Different project file depending on sub-category of project: (i) projects below VND300 billion which are in conditional sectors, (ii) projects over VND300 billion which are in conditional sectors, and (iii) projects over VND300 billion which are *not* in conditional sectors	For foreign projects, investment certificate (which is also business registration certificate in the case of initial establishment of economic organization to undertake first investment project); For domestic projects, investment certificate and business registration certificate (a one-step but two-part process)

The simple 'enterprise registration' procedures that it was hoped Vietnam would adopt, whereby investors (whether domestic or foreign) only have to register the establishment of an enterprise and, once established, may be active in many sectors at once without the need to obtain a certificate for every project (unless of course, the project falls within a conditional or prohibited area of investment), will have to wait until the next major overhaul of Vietnamese investment law!

> Evaluation criteria

The criteria for evaluation are still only stated in general. Draft 18 still provides for the Government to stipulate *separately* from the Law on Investment the criteria for evaluation of investment projects. This lack of transparency is a backward step. Investors will have to wait for implementing regulations to know the true investment environment.

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> **List of conditional sectors**

The range of conditional sectors is still broad and vague (Article 29). The only improvement is that "sectors impacting on financial policy and the national currency" is now clarified as "banking and finance sector" (but it's still so broad). Other changes include: along with "sectors impacting on social order and safety", sectors impacting on "national security" are now conditional; it's now "development of education and training" (not just "education and training") that's conditional (query what the difference is!); and all aspects of natural resources investment projects (not just survey and mining, but also prospecting and exploration) are now conditional. As before, other conditional projects include: sectors impacting on public health; culture, information, the press and publishing; entertainment services; real estate business; ecological environment; (and the catch-all) "a number of other sectors in accordance with law".

For foreign investors, the range of conditional sectors remains wider still. Any foreign invested project in a sector which is subject to conditions on market access under an international treaty of which Vietnam is a "conditional project", and those conditions on market access (including the schedule for opening of the sector) will apply.

The list of conditional sectors will still be regulated by the Government "based on the requirements for socio-economic development in each period and consistent with the undertakings in international treaties of which Vietnam is a member". The Government will also stipulate separately the conditions applicable to the establishment of economic organizations, the forms of investment, and the opening of sectors to foreign investors.

For investor certainty, the onus is now on the Government to issue the necessary guidelines in advance of the Law's effective date of 1 July 2006.

> **Investment incentives**

Draft 18 clarifies that incentives will be available to new projects *and also* existing projects when they expand, etc. (Article 32).

With respect to the recording of incentives, of the two plans considered by the National Assembly, Plan 1 was adopted (Article 38). Incentives will be recorded in the certificates of (only) domestic projects subject to investment approval and in the certificates of (all) foreign projects. Domestic projects not subject to registration (ie most domestic projects) have the option to request the recording of incentives by the State administrative body for investment. If they exercise this option, they must conduct the procedures for investment registration. Plan 2 was for incentives to be recorded in certificates of all projects.

The adoption of Plan 1 should please both sides of the investment debate. The recording of incentives was not supported by some domestic business associations (eg Vietnam Association of Financial Investors), which were concerned that business registration offices were not sufficiently expert in tax law to discharge this important role. But the recording of incentives was argued for by foreign investors, especially those with experience in struggling with the tax office for the benefit of incentives to which they are entitled.

> **Government guarantees**

Draft 18 greatly improves the range of guarantees that can be given by the Government to support important investment projects, compared with Draft 16. Under Draft 16, the power of the Government to provide guarantees of obligations was limited to (only) guarantees for foreign loans. This was in stark contrast to the current Law on Foreign Investment which permits the Government to provide more general guarantees regarding investment. Now, under Draft 18, the scope of Government guarantees available has been widened to guarantees for loans, supply of raw materials, sale of products, payment and guarantee for performance of other contractual obligations to projects (Article 66).

> Dispute resolution

Draft 18 clarifies that investment disputes involving a foreign investor or foreign invested enterprise or between foreign investors may now be resolved by foreign/international/ad-hoc arbitration. Only investment disputes between domestic investors or between a domestic investor and a State body of Vietnam must be resolved at a Vietnamese arbitration body or court. This makes foreign invested projects much more 'bankable' - the process of obtaining finance from international lenders who require international arbitration clauses in project documents will be easier (and costs will be lower). (Articles 12.2 and 12.3)

Disputes between a foreign investor and State administrative body of Vietnam relating to investment activities in the territory of Vietnam may be resolved by Vietnamese arbitration or a Vietnamese court if so provided in an international treaty of which Vietnam is a member body (eg ICSID Convention) or (now also) if so provided 'in a contract signed between a representative of a competent State body of Vietnam with the foreign investor' (Article 12.4).

> Investment guarantees

In the event of adverse changes in law or policies, the Government will ensure the investor will enjoy incentives the same as in the investment license (as is current law and as re-inserted into Draft 18) *or* the Government may offer one or (now) a number of the following options for resolution:

(a) Continuation of enjoyment of rights and incentives for a specified period in accordance with regulations of the Government;

(b) … deduction of the loss from taxable income in accordance with the law on tax;

(c) ... change of the operational objective of the project;

(d) Consideration …[of]… paying compensation in necessary circumstances.

Option (d) is available under the current foreign investment law but was not in Draft 16. We are pleased to see it re-instated. Unfortunately, the above (b) is a dilution of two options under current law (which offer "tax reductions or exemptions in accordance with law" and "set off [of loss] against the taxable income of the enterprise"). The draftsmen's tinkering with these important guarantees has done little to instil confidence in the investment regime. (Article 11)

Of note, under Draft 16, it was the State that could offer the above options; now, it's the Government. And there is a new clause in Draft 18: "Based on the provisions of the laws and commitments in international treaties of which Vietnam is a member, the Government shall make specific provisions on guarantee for interests of investors in the case where a change in laws or policies affects adversely the interests of the investors."

> Duration

Duration of (now only) foreign projects is still limited to 50 years (or 70 years maximum). However, that duration is no longer linked to land tenure (as it has been misguidedly until now). As under current law, domestic projects may exist in perpetuity under the new regime. (Article 52)

> Mortgages

No change. Only onshore mortgages of land use rights are permitted. (Article 18)

> Direct and indirect investment

The distinction between direct and indirect investment in shares is still confusing. It appears to be based on whether or not the investor participates *directly* in the management of the investment activity. It's 'direct investment' if the investor does. It's 'indirect investment' if the investor doesn't. But there's no definition of 'participates directly'. Presumably it means eg the investor sits on the board of the company. But maybe it's wide enough to cover an investor who happens to be the general director. And what about the statutory rights of all shareholders to participate in the annual general meeting of shareholders - does that fall within "participates directly in management of the investment activity"? Further, there is no clarification of whether

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"intention" to participate directly in management when acquiring shares is a necessary element. (Articles 3.2 and 3.3, 21.5 and 26)

It appears that all securities investment (irrespective of whether 'direct' or 'indirect', ie whether or not there is direct participation in management) and (now also) all other indirect investment is not subject to the registration/evaluation requirements of the new Law on Investment, and is only regulated under the laws on securities and other relevant laws, although this remains to be confirmed (Article 26.2).

How the distinction between direct and indirect investment will play out in practice needs to be clarified.

> Governing law

Now, in foreign investment activities, foreign governing law (or international investment custom) may be agreed in contracts, subject to the following troublesome provisos (Article 5.4):

- where the law of Vietnam does not yet contain any provision (even we lawyers can't always be certain of this!);
- if application of such foreign law (or international investment custom) is not contrary to the fundamental principles of the law of Vietnam (how long is a piece of string?).

> Termination

There has been little improvement in the grounds for termination of investment projects (as distinct from investment vehicles), which are now as follows (Article 65):

1. Upon expiry of the duration of operation as stipulated in the investment certificate (this only applies to foreign projects, see comments on duration above).
2. In accordance with the conditions which will result in termination as stipulated in the contract, charter of the enterprise or agreement or undertakings of investors about the project implementation schedule.
3. Where the investor decides to terminate the operation of the project.
4. The operation is terminated pursuant to the decision of the State administrative body for investment or a judgement of the court or arbitration due to a breach of law.

Ground 3 is welcome in that it replaces the misconceived "upon declaration of bankruptcy" in Draft 17 - misconceived because investment vehicles become bankrupt, not projects.

Ground 4 is of the greatest concern. As under Draft 16, it allows termination where there is *any* breach of law, not just a *serious* breach of law or license as is the threshold under the current foreign investment law. Further, it allows termination at the order of a court or arbitration tribunal, which is not possible under current law. Only the State (through the responsible State administrative body) should have the power to terminate investment projects. These aspects of Ground 4 are serious defects and yet another backward step in Vietnam's investment regime.

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2.2 Factoring in Vietnam

Factoring is a business financing tool whereby the factor/discounter purchases trade debts (invoices raised not yet paid) from a business and, in exchange, pays cash (or prepays a certain percentage) against those debts. Factoring/discounting arrangements involve the assignment to the factor/discounter of debts owed by debtors to the client. This differs to an arrangement to provide a loan to fund debtors. Under a lending arrangement, the lender is usually granted security over the debtors of the business via a pledge over the business. The main benefit of factoring is that it brings forward the receipt of a large proportion of the funds which were expected from a debtor at a future date and therefore enhances the cash flow position of a business.

Factoring activities in Vietnam are relatively new. The relevant regulations were only issued in 2004 under Decision 1096-2004-QD-NHNN of the State Bank of Vietnam dated 6 September 2004. However, in recent months, the factoring trade in Vietnam has seen a flurry of activity - a growing number of banks are adding factoring to their services (including Citibank, Habubank and the Orient Commercial Joint Stock Bank in conjunction with the Far East National Bank) and there is a growing interest in factoring activities shown by local businesses.

Who may conduct factoring activities?

Only credit institutions may conduct debt factoring activities, and only with specific approval from the State Bank. The State Bank will only grant approval if the following criteria are satisfied:

- There is a requirement for the debt factoring activity;
- The ratio of overdue debts over total loan balance of the credit institution at the end of the preceding 3 months is less than 5%;
- The credit institution is not in breach of the regulations on prudential ratios in banking operations;
- The credit institution is not subject to consideration for imposition of an administrative penalty in the finance and banking sector. If an administrative offence has been penalized, then the credit institution must remedy the breach.

Types of debt factoring

Under Decision 1096, 2 types of factoring activities are contemplated:

- *Recourse factoring*: Under a recourse arrangement, funding is provided on the basis that the credit institution has recourse to the client if the debtor fails to pay. Recourse arrangements are the norm in countries such as Australia and New Zealand. In contrast, in the USA and Italy (which are the 2 biggest factoring economies in the world), factoring arrangements are usually non recourse.
- *Non recourse factoring*: Under a non recourse arrangement, the credit institution assumes the credit risk should the debtor be unable to pay. The factoring house does not assume all risks of the purchaser being unable to discharge the obligation to pay, but the factoring house will bear the risk of the debtor failing to pay due to the purchaser's financial inability to pay.

Items not subject to debt factoring

Curiously, the definition of "debt factoring" under article 2 of Decision 1096 only relates to the purchase and sale of goods. This severely limits the scope of Decision 1096 in comparison to the regime in many other countries. A significant part of the business of a factor in other countries comprises the purchase of debts arising from the provision of services.

Under article 19, particular accounts receivable are excluded from factoring activities, including long term debts (more than 180 days) and overdue debts.

Import-export debt factoring activities are permitted if the credit institution is permitted by the State Bank to conduct foreign exchange activities.

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Procedure

Decision 1096 contemplates the following steps:

1. *Request:* The seller of goods requests a factoring house to carry out factoring activities.
2. *Due diligence:* The factoring house analyzes the accounts receivable, operational status and financial capability of the seller and purchaser.
3. *Contract:* A factoring contract is signed.
4. *Notice:* The factoring house and the seller sign a notice disclosing the debt factoring contract to the purchaser and related parties.
5. *Response:* The purchaser must send a response to the factoring house acknowledging receipt of the notice and gives an undertaking to make payment to the factoring house.
6. *Delivery of documents:* The seller delivers to the factoring house the contract for purchase and sale of goods and other related documents.
7. *Advance payment:* The factoring house remits advance payment to the seller.
8. *Collection of debt:* The factoring house monitors and collects debts from the purchaser.
9. *Full payment:* The factoring house makes full payment to the seller.

Step 4 is very limiting. It does not seem to contemplate confidential (also called invoice) factoring. Step 5 is novel. We are not aware of any law in other countries which requires the purchaser to provide an acknowledgment of receipt of the notice. This is particularly tedious for an ongoing factoring arrangement. Usually, each invoice by the client would normally note the assignment details of the factoring arrangement by way of a specifically worded clause. However, under step 5, a special acknowledgment from the purchaser is required in Vietnam. It is not clear what the consequences are if the purchaser refuses to provide such a document. It is also not clear who the "other related parties" to the purchase and sale agreement may be.

Fees, interest and taxes

The factoring house and the seller of goods may reach their own agreement on interest and fees.

The tax position in relation to debt factoring activities was recently clarified under Official Letter 4080-TCT-DTNN of the Ministry of Finance (General Department of Taxation) dated 10 November 2005 to the Bank of Tokyo Mitsubishi Ltd - HCMC Branch. The following guidance has been provided:

> Debt factoring activities are not VAT taxable.

> A foreign credit institution which provides debt factoring services to Vietnamese client must pay corporate income tax at the rate of 10% on interest and fees.

> In relation to the tax payable on the debt itself (not the interest and fees collected by the factoring house), the Ministry of Finance declined from providing any guidelines, and instead requested more information from the Bank of Tokyo Mitsubishi Ltd.

>>> For more information on Vietnam's banking and finance sector, go to http://www.vietnamlaws.com/other_legal_updates.aspx

>>> For English translations of Vietnam's banking and finance laws, subscribe to Vietnam Laws Online Database on www.vietnamlaws.com

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Part 3 Did You Know?

3.1 National Assembly update

The 8th Session of Legislature XI of the National Assembly ("NA") concluded on 29 November with the approval of the following 14 Laws:

> Previously considered at the NA's May-June 2005 Session:

- Law on Tendering
- Law on Anti-Corruption
- Law on Negotiable Instruments
- Law on Intellectual Property
- Law on Protection of the Environment (Amended)
- Law on Electronic Transactions
- Law on Youth
- Law on Residential Housing
- Law on People's Police

> Considered for the first time at this NA Session:

- Law on Amendment of the Law on VAT and Law on SST (a single law to cover amendments to two existing laws - a first in Vietnam)
- Law on Amendment of the Law on Complaints and Denunciations
- Law on Practising Thrift to Reduce Expenditure
- Law on Enterprises
- Law on Investment (after much debate, discussed in Part 2.1 above)

>>> For English translations of Vietnam's new Law on Investment and (soon) all of the above new laws, subscribe to Vietnam Laws Online Database on www.vietnamlaws.com

3.2 Death of economic contracts

The 1989 Ordinance and 1990 Decree on Economic Contracts have been the bane of lawyers and investors alike for many years in Vietnam. Originally conceived to regulate contracts between State owned enterprises and fledgling private companies (what other kinds of business contracts could there possibly be?), these two legal instruments outlived their relevance some time ago. But despite new laws regulating "civil contracts" and "commercial contracts" issued in the '90s, the Ordinance and Decree on Economic Contracts have remained stubbornly in place. The result has been three overlapping and often conflicting bodies of contract law in Vietnam.

The Ordinance and Decree on Economic Contracts prescribe compulsory contents for "economic contracts" (including stipulation of each parties' bank account details). Their provisions on termination are unworkable (including requirement for termination decision of an arbitral body that no longer exists in the event that the parties cannot agree on termination of the contract) and the way they regulate damages for breach borders on the bizarre (including x% of contract value of one type of breach and y% of contract value for another type of breach). The limitation period for commencement of legal action in respect of disputes involving "economic contracts" is only 6 months from the date on which the dispute arose. And the most basic of issues, no-one (including authorities, court officials and Vietnamese lawyers) can clearly delineate "economic contracts" from "civil contracts" and "commercial contracts".

As from 1 January next year, we won't need to worry about identifying what is and what is not an "economic contract"; nor will we need to worry about the 6 month limitation period for commencement of actions and the other "special" rules that apply to "economic contracts". Under point 1 of Resolution 45 of the National Assembly adopting the new Civil Code dated 14 June 2005, the Ordinance and Decree on Economic Contracts will finally be abolished from 1 January 2006.

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3.3 Franchising update

The Ministry of Trade has now released its Draft 5 of the proposed Government decree on franchising. The decree provides more detailed regulations to implement the new Commercial Law 14 June 2005, which will 'take over' regulation of franchising as of 1 January 2006 (see the October 2005 Issue of Vietnam Legal Update on www.vietnamlaws.com). The proposed decree on franchising has been submitted to the Government and is expected to be issued in early December - possibly the first to be issued of the various implementing decrees required to give practical effect to the 2005 Commercial Law.

Under the 2005 Commercial Law, franchising is defined as a commercial activity whereby a franchisor authorizes and requires a franchisee to conduct on its own behalf the purchase and sale of goods or provision of services in accordance with the following conditions: (i) the purchase and sale of goods or provision of services must be conducted according to the method of business organization specified by the franchisor and be associated with the trademark, trade name, business know-how, business mission statements, business logo and advertising of the franchisor; (ii) the franchisor has the right to control and offer assistance to the franchisee in the conduct of the business.

The draft implementing decree regulates franchising activities involving Vietnamese business entities (in the capacity of franchisor or franchisee) and foreign business entities (apparently, in the capacity of franchisor only, but this is one of many aspects of the new regime yet to be confirmed). The range of the decree appears to encompass (although, unlike the earlier draft, Draft 5 no longer distinguishes expressly between):

- inbound franchising (from a foreign country into Vietnam);
- domestic franchising (within the territory of Vietnam); and
- outbound franchising (from Vietnam to foreign countries), but only with respect to the Vietnamese franchisor where the franchisee is a foreign business.

The recognized forms of franchising include primary and secondary franchising under a master franchise and franchising development (where the franchisor grants the franchisee the right to set up more than one establishment to conduct the franchise business within a specific geographical area).

Prescribed conditions for businesses to grant franchises include:

(i) The franchisor business must be a lawfully established/recognized enterprise (either in Vietnam or foreign country);

(ii) The franchised business system must have been in operation for at least one year (in the case of a foreign franchisor granting a primary franchise to a Vietnamese business entity, such Vietnamese business entity must operate the franchise business in Vietnam for at least 1 year before sub-franchising);

(iii) The franchising must be registered (see below); and

(iv) The goods and services which are the subject of the franchise contract are allowed to be franchised (ie they are not prohibited from circulation in Vietnam and, if circulation is restricted/conditional, the necessary conditions for circulation are satisfied, eg business license to deal in gold).

Condition (ii) replaces the earlier draft condition requiring the franchisor to have been in operation for 2 years. Both the earlier version and this revised version of condition (ii) are aimed at protecting potential franchisees against unscrupulous and unsound franchisors. But (although an improvement on its predecessor) the Draft 5 condition will still delay start-up companies from franchising innovative new business concepts immediately. The previous draft condition that the franchisor must be the legal owner of the relevant commercial rights subject to franchise is no longer expressly included.

Franchisees are subject to the following conditions: (a) must be a lawfully established enterprise in Vietnam (contrast (i) above); and (b) must have business registration appropriate for the franchise business.

All franchising must be implemented on the basis of a written contract or (now also) 'other legally equivalent form'. Where Vietnamese law is the governing law of a franchise (ie for inbound and domestic franchising), the contents of the contract must comply with the decree. In the case of outbound franchising, the parties have the option to apply a foreign governing law and the contents of the contract are not restricted by the decree (subject to the always troublesome proviso that the foreign governing law must "not be contrary to the provisions of Vietnamese law"!).

Draft 5 now requires franchising contracts to be in the Vietnamese language, except in the case of outbound franchising (where the parties have the option of a foreign language). Under the earlier draft, a foreign language could be adopted if a foreign business entity was participating, whether in inbound or outbound franchising. This step-backward in Draft 5 is unfortunate.

The term of a franchise contract will be open to negotiation by the parties, subject to a statutory *minimum* duration of 5 years. The circumstances for termination prior to expiry of the agreed term are prescribed in the decree, as follows:

- at the franchisee's request;
- at the franchisor's option if the franchisee loses its license (or equivalent legal requirement) to carry out the franchise business, becomes bankrupt or is dissolved in accordance with Vietnamese law, commits a serious breach of law which may significantly damage the reputation of the franchise system, or fails to remedy immaterial breaches of the franchising contract within a reasonable time despite written notice from the franchisor.

Under Draft 5, franchising *activities* must be registered in advance by the franchisor. This is a significant change in policy from earlier drafts, which required registration of each franchising contract. We understand this change to be aimed at avoiding the administrative load arising from a need to register every franchising contract of a successful franchisor. So now, before a business can franchise its business system in Vietnam, it must submit prescribed documents (not including specific contracts) to register itself as being qualified to act as a franchisor and that is enough. The relevant registration bodies are:

- the Ministry of Trade for inbound and outbound franchising; and
- the Department of Trade of the province or city under central authority in which the franchisee is located for domestic franchising.

Registration must be completed by registration bodies within 5 days. Applications must include a very detailed 'franchise description document' (with contents as prescribed in the appendix to Draft 5). Although Draft 5 (and the earlier draft) use the language of 'application' for registration, the registration bodies appear to (only) check the completeness and validity of the documents submitted and to not have any discretion with respect to registration. The licensing of any industrial property rights in a franchise contract must be registered (separately and additionally) in accordance with Vietnamese industrial property laws. Any material changes (to be defined by the Ministry of Trade in subsequent legislation) to the franchising arrangements must be notified by the franchisor to the relevant registration body within 30 days.

Happily, the draft decree does not cap franchising fees, but leaves them to negotiation between the franchisor and franchisee.

Of note, any current franchising activities will be required to be registered under the decree within three months of its effectiveness (which is expected to be 1 January 2006 so the deadline would be 1 April 2006).

3.4 Tax self-declaration

On 1 January 2004 (when the last round of substantial tax reforms became effective), pursuant to Decision 197-2003-QD-TTg of the Prime Minister dated 23 September 2003, a pilot test of reforms in self-declaration and payment of taxes commenced. In this first stage, the pilot focused on VAT and corporate income tax.

In mid-2005, pursuant to Decision 161-2005-QD-TTg of the Prime Minister dated 30 June 2005, the second stage of the pilot was introduced to allow self-declaration and payment of SST, royalty tax, housing and land tax, personal income tax and business registration tax. In September, the Ministry of Finance provided guidelines for self-declaration and payment of SST and royalty tax (see the October 2005 Issue of Vietnam Legal Update on **www.vietnamlaws.com**).

Originally, under Decision 197, only a limited number of production and trading establishments in HCMC and Quang Ninh province were selected by the Ministry of Finance (in consultation with relevant ministries and localities) to participate in the first stage of the pilot test (from amongst all production and trading establishments which declare and pay VAT by the tax credit method and which implement the regime on accounting, invoices and source documents in accordance with Vietnamese regulations). In Quang Ninh province, only 122 State owned enterprises were selected. In HCMC, 337 enterprises participated in the pilot test in 2004.

The first stage of the pilot has been extended in 2005 to allow all enterprises in Quang Ninh province and another 100 enterprises in HCMC (making 437 enterprises in HCMC) to participate. The first stage of the pilot has also been extended into other localities, including Hanoi, Ba Ria-Vung Tau and Dong Nai provinces. In 2005, 100 of 3000 enterprises in Dong Nai have been selected to participate in the first stage of the pilot (ie self-declaration and payment of VAT and corporate income tax).

At present, the second stage of the pilot under Decision 161 (ie self-declaration and payment of SST, royalty tax etc) is only open to those enterprises which have successfully participated in the first stage.

The Ministry of Finance believes the pilot test has been a great success - it has increased the awareness of enterprises of their tax obligations and reduced the burden of administrative procedures. The Ministry is considering an extension of the pilot test to all entities no matter where located.

3.5 Recent court case - invalidity of contract

In July 2005, for the first time ever, Vietnam published all judicial review decisions made by the Council of Judges of the Supreme People's Court in the years 2000-2004 in civil, commercial and labour cases (Volume 1) and criminal and administrative cases (Volume 2) - a total of 103 decisions. This is a significant step for Vietnam, not only in terms of transparency (a key WTO requirement), but also in terms of providing precedents to lower courts as well as investors and their lawyers looking for indications of how laws might be interpreted and applied (although how much certainty can be derived from these decisions is not yet tested). Below we look at another selected decision to see what general lessons we can learn.

Facts: In July 1995, Company D (a foreign invested joint venture company specializing in manufacture and sale of cars) and Company T (a Vietnamese limited liability company) entered into a contract for the purchase of 100 brand new cars with a deferred term of payment for use in Company T's business of passenger transportation services ("Contract"). To secure payment, Company T arranged for a guarantee from Bank V to be issued to Company D. In the process of implementation of the Contract, a dispute arose between the parties in respect of payment. Company D instituted court proceedings claiming for payment from Company T or payment of the guarantee from Bank V if Company T was unable to discharge payment.

Preliminary decision: According to the decision of the Ho Chi Minh City People's Court at first instance, the Contract was held to be valid and Company T was obliged to discharge payment for the delivered cars and, in the event of Company T's failure to pay, Bank V was required to implement the guarantee in favor of Company D.

On appeal: The Court of Appeal of the Supreme Court in Ho Chi Minh City held that the Contract between the parties was wholly invalid as (i) the representative of Company D did not possess the power to enter into the

Contract on behalf of Company D and (ii) at the time of its signing, Company T had not conducted business registration for passenger transportation services. As a consequence, the Court ordered Company T to return the 100 delivered cars, Company D to refund the paid amounts, and Bank V to cancel the Guarantee issued.

Decision of the Council of Judges of the Supreme Court: The Council of Judges of the Supreme People's Court cancelled the decision of the Court of Appeal and returned the case to the Court of Appeal of the Supreme Court in Ho Chi Minh City to be re-heard for the following reasons:

> In respect of the power of Company D's representative to enter into the Contract: The representative of Company D (Mr. K) had full power to enter into the Contract at the time of its signing as he was appointed to the post of General Director of Company D by a written resolution signed by all members of the Board of Management, which has the same effect as a resolution adopted in person at a Board meeting.

> In respect of Company T's scope of business: Before entering into the Contract, Company T was legally established under the laws. The purpose of the Contract was preparation for the passenger transportation services project of Company T. On the next day after signing the Contract, Company T applied to supplement the scope of its business registration by adding passenger transportation services. Further, the parties later entered into an appendix and amendment to the Contract and, at that time, Company T had already registered passenger transportation services as one of its line of business.

Based on the above, the Council of Judges of the Supreme Court held the Contract between Company D and Company T was valid in accordance with Vietnamese laws.

General lessons:

> Validity of a contract depends on, amongst others:

- Proper authority to enter into contracts (which, in turn, depends on proper appointment to the position with such authority, see below); and
- The registered scope of business of the parties. A contract will be considered invalid if the subject of such contract is outside of the registered scope of business of the parties. Of note, after entering into a contract, if one party supplements its scope of business with the appropriate business line in accordance with the concluded contract and the parties later sign an appendix and amendment to the contract, such contract will be valid and of full effect.

> Under current law (article 18 of the foreign investment regulations issued in 2000 and amended in 2003), resolutions of the board of management of a joint venture company can be passed by voting in person at a meeting or by obtaining written opinions/approval from the Board members. A resolution adopted by the latter method has the same effect as a resolution passed directly at a Board meeting.

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Part 4 What's New on Vietnam Laws Online Database?

Vietnam Laws Online Database on **www.vietnamlaws.com** is an online searchable database of English translations of close to 3,000 Vietnamese laws relating to foreign investment and far beyond - the most extensive online Vietnamese law library in the world. Various search options are available. Translations can be viewed online, printed and downloaded (subject to terms & conditions).

>>> NEW keyword search option >>>

In October, we launched our new keyword search option. This allows subscribers to search keywords in our descriptions of legislation. So, now, subscribers can search by subject category, date, issuing body, official number, legislation type, and keyword - or do an advanced search, combining two or more of these search options.

Feedback: We welcome feedback at any time. So we can continue to improve Vietnam Laws Online Database, we would appreciate if subscribers could spend a few minutes completing the feedback form available on the Vietnam Laws Online Database Welcome Page.

>>> What's new on Vietnam Laws Online Database?

On 1 December 2005, Vietnam Laws Online Database will be updated with translations of, amongst others:

> New Law on Investment 2005 (only just passed by the National Assembly!)

> Decree 134 on foreign loans

> Decree 133 on auditing

> Draft 5 of proposed franchising decree

> New Maritime Code 2005

In November 2005, Vietnam Laws Online Database was updated with translations of, amongst others:

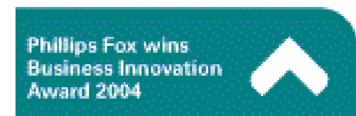
> New Civil Code 2005 (complete translation)

> Decree 131 on forex

> Decree 120 on competition offences

> Decree 105 on electricity

Above is just a snapshot of the wide range of legislation available.



Phillips Fox was proud to accept the **Business Innovation Award** at the Australian Business Awards in Vietnam 2004, in recognition of our innovative work in developing **www.vietnamlaws.com** and our **Vietnam Laws Online Database**.

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