



June 2004

Indochina notes

Legal updates on investment, infrastructure and finance

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Overseas Vietnamese

Vietnam constantly reiterates its support of overseas Vietnamese investors. Most recently, Resolution 36 of the Politburo passed on 26 March 2004 promised new legislation to encourage overseas Vietnamese to engage in small and medium sized projects, the liberalisation of foreign exchange regulations and certain other platitudes.

Vietnam has yet to follow China's lead in providing an environment in which its overseas residents are truly encouraged to return to do business. It is hoped that Resolution 36 presages real policy changes that will encourage overseas Vietnamese to take a greater part in Vietnam's renovation.

Domestic companies

The government issued Decree 125 on 19 May 2004 as further implementation of the Enterprise Law. The most welcome reform in Decree 125 is the confirmation that foreign organisations and non-resident individuals purchasing shares in a domestic company have the right to nominate a person (not restricted to Vietnamese citizens) to the board of management in accordance with the company's charter. Although Decree 125 clarifies the right, it perpetuates the restriction on who may be the nominee of a non-resident or corporate foreign shareholders. Currently, under the Law on Enterprises and Decision 36, the only foreigners who may participate personally in management are resident foreign individuals and overseas Vietnamese.

Decree 125 also stipulates that the founder and legal representative of a company are responsible for

implementing all legal and regulatory conditions to the company conducting business and that board members will be jointly liable for any business operations carried on without having satisfied all conditions.

Purchasing shares in Vietnamese enterprises

More and more businesses are buying interests in unlisted Vietnamese companies. The three issues that often bedevil such transactions are how to structure effective control, foreign exchange, and tax. Circular 3 of the State Bank of Vietnam (SBV) dated 25 May 2004 has shed light on the foreign exchange area, but in the process it has encumbered all transactions with a fine layer of bureaucracy.

- Foreign investors are obliged to open a Vietnam dong gateway account, called a 'Vietnam dong capital contribution and share purchase account'. All transactions in relation to the investment in the local company, including capital contribution, receipt of profits and dividends, and purchase of foreign currency for remittance overseas, must be made through this account.
- Foreign investors are obliged to register the capital contribution with the SBV within two business days after opening the account. Any change in the name, address or legal status of the foreign investor must be registered with the SBV.
- Banks are responsible for checking the documents when effecting transactions through the account.
- Reports on the foreign investor's capital contributions and share purchases must be submitted annually and quarterly to the SBV.

Equitisation

Some optimists see an impending boom in equitisations. There is even talk of the equitisation of the country's most reputable state-owned bank, Vietcombank. Decision 84 of the Prime Minister dated 13 May 2004 fuelled the speculation by approving the equitisation of three substantial national corporations: Electronics and Informatics Corporation (under the Ministry of Industry), Vietnam Construction and Import-Export Corporation – Vinaconex (under the Ministry of Construction), and Trade and Construction Corporation (under the Ministry of Transportation and Communications). Meanwhile, the pace of actual equitisations in 2004 is running even slower than last year's lacklustre pace.

Residential housing

Residential housing in Vietnam is poor. The Prime Minister in Decision 76 of 6 May 2004 has approved a 'plan' to make it better by 2020. The target by the year 2020 is for city dwellers to have approximately 20 sq m of space each instead of the current paltry 4 sq m or so. The plan consists of plenty of exhortations and schemes.

Foreign direct investment in the construction of residential housing is stated to be encouraged. However, foreign direct investment in the residential property sector is unlikely to increase significantly until there is some liberalisation of the regulations governing the ability of a developer to sell units in its development.

Residential housing in Hanoi

Curiously and confusingly, a Decision 76 of the Hanoi People's Committee was passed about the same time as the Prime Minister's Decision 76. This seems destined to make residential housing in Hanoi poorer and shows up in stark terms some of the difficulties with the Prime Minister's plan.

The Decision covers a broad range of issues associated with property development, including investment procedures, speed of implementation, planning approvals, construction quality, occupational safety and environmental issues.

The Hanoi Decision 76 has a quasi-expropriatory effect as follows.

- Investors are obliged to hand over 20 per cent of their site with full technical infrastructure free of charge to the city for construction of apartment buildings for the city's Housing Fund.
- Investors are obliged to hand over 25 per cent of the accommodation area of villas they have built and 50 per cent of the area of the apartment buildings they have built to the city at construction cost (to be determined by the city's Price Determination Committee).
- Investors are obliged to permit the city to use the first floor of each apartment building without rent.

Management of foreign contractors

Decision 87 of the Government dated 19 May 2004 streamlines the procedure for issuing permits to foreign contractors.

Auditing

Independent auditors celebrated 10 years of existence in Vietnam with a new decree, Decree 105 dated 30 March 2004.

Vietnam clearly does not want an Enron. Under Decree 105 auditing companies are not permitted to provide auditing services to a client if the auditing company is providing, or has provided in the previous year, any book keeping, internal auditing, property evaluation, or financial or management consulting services.

Foreign auditing organisations with no branch in Vietnam may provide auditing services in Vietnam by admitting a Vietnam-based auditing company as a member or by co-operating with a Vietnam-based auditing company in each audit project.

Vietnam-South Korea

Decision 68 of the Prime Minister dated 27 April 2004 approved the Agreement on Investment Promotion and Protection between Vietnam and the Government of the Republic of Korea. The Agreement is not as far reaching as many of the investment treaties with other countries, but may result in more foreign direct investment from South Korea.

Reinvestment of profits

As of 1 January 2004, foreign investors reinvesting profits derived from investments in Vietnam are not entitled to a refund of corporate income tax. However, investors whose reinvestments were licensed prior to 1 January 2004 and that use profits earned up to 1 January 2004 may still obtain a refund of corporate income tax. Circular 26 of the Ministry of Finance dated 31 March 2004.

Automobile industry

The auto industry has been in the doldrums as a result of various tax hikes. Now comes early warning of domestic competition. Notice 63 of the Deputy Prime Minister dated 2 April 2004 provides a plan for the development of the auto industry to the year 2010, and an outline view of its development up to the year 2020.

As in other industrial sectors, Notice 63 envisages a rationalisation through the creation of a small number of dominant domestic companies. According to Notice 63, the Ministry of Industry will develop three large domestic corporations:

- the Vietnam Auto Industry Corporation will focus on the manufacture and assembly of cars, buses and trucks, and the manufacture of engines and gearboxes;
- the Agricultural Machine and Engine Corporation will assemble buses, and small and medium sized trucks for agricultural purposes;
- and the Viet Nam Coal Corporation will produce heavy-duty and special use trucks.

Joint ventures are encouraged to co-operate with local companies to manufacture spare parts and develop other supporting industries.

Insurance – administrative sanctions

The insurance industry in Vietnam has grown quickly during the last decade. Yet along with growth come problems. Circular 31 of the Ministry of Finance dated 12 April 2004 provides further details on the administrative sanctions applicable to breaches of the insurance laws.

- ‘Unlawful acts of promotion,’ for which fines of up to 20m dong may be imposed, are defined as acts that are prohibited in the Commercial Law and other

regulations, including: (i) the promotion of insurance products that have not been registered or approved; (ii) promotions that are untruthful or misleading and intended to deceive the public; (iii) promotions that adversely affect the natural environment and landscape; and (iv) failing to comply with the terms of a promotion.

- ‘Illegally compelling others to sign an insurance policy,’ for which a fine of up to 5m dong may be imposed, is defined as using influence, administrative measures or other pressure to force an individual to enter into an insurance contract, or to force an insurer to accept insurance or re-insurance against his will.

Infrastructure

Power project feasibility studies

One of the problems for foreign power developers in Vietnam is that discussions about the power sales price have occurred in the darkest penumbra of an opaque regulatory regime. There was basically only one rule: the developer negotiated against itself until it walked away. Now, if developers can wade through Decision 709 dated 13 April 2004 of the Ministry of Industry, they have the option of walking away immediately.

Decision 709 contains the guidelines for preparing an economic and financial analysis of a power project. Under it, the economic efficiency of a power project is determined through certain financial calculations, including the estimated cost/benefit ratio, the economic internal rate of recovery (IRR), the net present value, and the breakeven point. In calculating these values, the project costs will include the invested capital and implementation costs (such as fuel costs and operation and maintenance costs).

Project benefits include revenues from the sale of power and related products (eg coal ash) and other benefits to the national economy (eg reduction of power outages that damage the economy). To calculate the cost and benefit parameters, the revenues and expenses of each year in a project's life are discounted at a rate of 10 per cent to the first year in which the investment is made. If the results of the economic efficiency analysis show that the net present value is less than 0 and the economic IRR

is less than 10 per cent, the Ministry of Industry (MOI) in principle should not approve the project. If the net present value is greater than 0 and economic IRR is greater than 10 a financial efficiency analysis will be required.

Financial analysis results have to be illustrated in three statements to be prepared in accordance with the MOI's model forms, namely: (i) a statement of evaluation of financial efficiency, which covers the cost/benefit ratio, the financial IRR, the net present value and the breakeven point; (ii) a statement of revenues, which demonstrates the revenue, expenditure and net income of the project; and (iii) a statement specifying the use of capital and the loan repayment schedule for each year during the project's life.

In performing the financial and economic efficiency calculations, the IRR in respect of equity capital is capped at 14 per cent and the IRR in respect of loan capital will be equivalent to the long-term loan interest rate in the domestic inter-bank market applicable at the time of project preparation. Other input assumptions for the financial and economic analysis are provided in schedule 1 of Decision 709 such as operating and maintenance costs, frequency of outages and restoration period, value of 1kWh outage damage, recommended power selling prices, taxes and currency of calculation. In particular, the recommended 'switch bar' selling price for a coal-fired power plant varies from 3.5-4.5 US cents/kWh during the dry season and 3.5-4.0 US cents/kWh during the wet season.

An investor may be permitted to use calculations and input statistics that are different from those prescribed in Decision 709 if it can provide a satisfactory explanation for such differences in the process of project evaluation and approval and negotiation of the power purchase agreement.

VNPT

A recent corruption investigation into VNPT executives has highlighted one of the reasons foreign businesses find it hard to negotiate acceptable agreements in Vietnam. State prosecutors have accused four senior VNPT executives of making irresponsible contract concessions to Comvik, a licensed mobile network operator. The media has reported that in 1995 VNPT signed a 10-year

deal with Comvik. The profit from the deal was to be split equally between the two companies for the first five years. In the second five year period, VNPT would enjoy 60 percent of the profit and Comvik 40 percent. In 2000, however, VNPT asked the MPI to maintain the profit sharing ratio of 50-50 throughout the duration of the agreement. Although this must have had some valid justification to be approved by the MPI, it has led to the current corruption allegations. Such allegations can surface any time a deal benefiting a foreigner is viewed as 'too good' for the foreigner. This makes it difficult for Vietnamese state sector officials ever to agree anything without passing it ever higher up the chain of command.

Ports

The Prime Minister issued Decision 695 on 24 June 2004 approving the Cai Mep-Thi Vai international deep-water port investment. Cai Mep-Thi Vai international port will be located in Ba Ria-Vung Tau province and will comprise the Thi Vai general port and the Cai Mep international container port, with a total area of 27 hectares. The project's total investment capital is expected to be more than 4,731bn dong, of which 85 per cent is to come from the Japan Bank for International Co-operation and 15 per cent from the Vietnamese state budget. The construction is scheduled to commence in 2006 and to be complete by 2009 or 2010.

Onshore gas transportation pipeline system safety

Decision 46 of the Prime Minister dated 26 March 2004 deals with the safety of onshore gas pipelines. It stipulates how a safety corridor will be set up and maintained along a pipeline system, depending on whether the system runs through a residential area or an industrial area, alongside a road or otherwise. A number of activities are prohibited within safety corridors. Decision 46 also defines the so-called affected area that extends for 200m from the centre to both sides of the pipeline.

Radio frequency regulations

Decree 24 of the Government dated 14 January 2004 provides regulations governing radio frequencies, including: (i) the national radio frequency spectrum (to be approved by the Prime Minister); (ii) radio bands (to be issued by the Ministry of Post and Telematics (MPT)); (iii) radio channels (to be issued by the MPT); and (iv) regional radio frequencies (to be issued by the MPT).

Banking and finance

Amendment to the Law on Credit Institutions

The National Assembly has just amended the 1997 Law on Credit Institutions. The changes are not enormous. For the first time, foreign credit institutions are permitted to open subsidiaries and to contribute capital to and buy shares of credit institutions operating in Vietnam (though this right will not be operative until the government has issued regulations).

Credit institutions have finally been given official autonomy on whether to lend with or without security. Under the 1997 Law, credit institutions were only permitted to make secured loans, though regulations in the intervening years had eased the position substantially.

Foreign exchange products

Foreign exchange floors in Vietnam are not the free-wheeling dealers of Wall Street. But the handcuffs have been eased a notch under Decision 648 of the SBV dated 28 May 2004. This allows credit institutions to engage in forward and swap transactions with a term of between 3 and 365 days. Previously, under Decision 679, the term of such transactions was limited to between 7 and 180 days.

A further relaxation has occurred in relation to the interest rates applicable to spot transactions. Under Decision 679, the rate for spot transactions was capped at the average interbank rate of +0.25 per cent, plus a permitted margin. Under Decision 648, the parties are permitted to agree the exchange rate for forward and swap transactions between dong and US dollars subject to not exceeding a rate determined on the basis of: (i) the spot foreign exchange rate on the contract date; (ii) the difference between the annual base dong interest rate announced by the SBV and the US dollar federal funds target rate; and (iii) the term of the contract.

Money brokerage

Money brokers in Vietnam are everywhere. They will now have to be licensed under Decision 351 of the SBV dated 7 April 2004.

Broking fees cannot exceed 0.02 per cent of the value of the transaction. Brokers are obliged to provide monthly reports to the SBV in accordance with the model form attached to the Decision.

Joint stock commercial banks – stock exchange listing

The Vietnamese stock market will receive a substantial boost if one or more of the country's joint stock banks (JSBs) lists. This has now become possible, as the SBV has issued regulations governing such listings. Under Decision 787 dated 24 June 2004:

- JSBs can submit a listing application to the State Securities Commission (SSC) only after receiving the written approval of the SBV;
- to list, JSBs would have to: (i) have been profitable for the prior two consecutive years; (ii) have had bad debts of under 3 per cent for the prior two years; (iii) have been in compliance with banking regulations and 'other stipulations,' and not have received a fine of over 1m dong during the year before the application; (iv) have complied with the SBV's regulations on share ownership; and (v) have received an A grade from the SBV for the prior two years;
- the SBV needs to approve the increase in a JSB's capital; and
- the SBV will retain jurisdiction over the ownership and operations of a JSB even after it has listed on the stock exchange.

Joint stock commercial banks – share purchases

According to Official Correspondence 151 of the SBV dated 11 March 2004, overseas Vietnamese are regarded as foreign investors when purchasing shares in JSBs, and so can only buy shares with the approval of the SBV and up to a maximum of 10 per cent. Since they are regarded as foreign investors, their holding will count towards the 30 per cent maximum that foreign investors as a group are permitted to hold.

Interestingly, a wholly foreign-owned company established under the Foreign Investment Law will be treated as a Vietnamese legal entity when purchasing shares in JSBs. We wonder how far this principle actually goes, given that most foreign-owned companies have to act within the terms of their investment licences, most of which do not permit the ownership of subsidiary businesses.

JSBs have complained that the SBV's position on overseas Vietnamese is not consistent with the policy of encouraging investment from overseas Vietnamese. The rhetoric of the first note in this issue of the *Indochina Notes* is thus unmasked by the reality revealed by this last note.

The information and opinions contained in this bulletin are not intended to be a comprehensive study, nor to provide legal advice, and should not be relied on or treated as a substitute for specific advice concerning individual situations.

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