



## **EQUITISATION OF STATE OWNED ENTERPRISES IN VIETNAM CHANGES IN THE REGULATORY FRAMEWORK**

### **Introduction**

The Vietnamese Government has recently confirmed its intention to restart the equitisation (or privatisation) of state owned enterprises (**SOEs**). According to the Ministry of Finance, 4,000 SOEs have been equitised to date with a further 10,000 enterprises earmarked for equitisation during the period from 2011 to 2015. Indeed, there appears to be a renewed sense of commitment by the Vietnamese Government to this process with the equitisation of state-owned enterprises, such as Vietnam Steel Corporation, Vietnam Mobile Telecom Service (Mobifone) and Vietnam Airlines Company Limited, either proceeding or being proposed for the coming year. Please refer to Schedule 1 for a more detailed list of the key SOEs that are proposed to be equitised.

On 18 July 2011, the Government promulgated Decree 59/2011/ND-CP (**Decree 59**) replacing Decree 109/2007/ND-CP dated 26 June 2007 on the conversion of SOEs into joint stock companies (**Decree 109**). Decree 59, which came into force on 5 September 2011, seeks to eliminate many of the legal obstacles formerly associated with the equitisation process in Vietnam. Previously, the Prime Minister of Vietnam has also issued decisions that take into account the new policies reflected in Decree 59.

Given recent announcements and media interest in the equitisation process, this Legal Update endeavours to provide a timely overview of the regulatory framework for the equitisation process, including some of the key changes made by Decree 59, and identify some practical legal issues that have arisen in recent equitisations.

### **Eligibility to equitise**

Pursuant to Decree 59, and unchanged from Decree 109, a SOE is eligible to be equitised if it satisfies both of the following conditions:

- (1) it is not in the list of the enterprises in which the State must hold 100% of the charter capital (**the 100% State Owned Enterprise List**), as listed in the Schedule to this Legal Update; the 100% State Owned Enterprise List has been expanded under Decree 59 to include SOEs with

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<sup>1</sup> Equitisation report issued by the Ministry of Finance on 15 December 2010.

<sup>2</sup> Details taken from a report by Mr. Cao Viet Sinh, Vice Minister of MPI at the 2011 Mid Term Consultative Group Meeting in Ha Tinh on 8-9 June 2011.

<sup>3</sup> Decision 14/2011/QĐ-TTg dated 4 March 2011 – the list of industries and sectors where the State must hold 100% of the charter capital is contained in Schedule 2 of this Legal Update.

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a key role in production and business developmental strategies and/or which hold business secrets or technology. and

- (2) it shall retain State capital after the re-valuation of its assets and the auditing of its financial statements in preparation for the proposed equitisation. Decree 59 removes the provisions of Decree 109 which provided that enterprises whose debts exceed equity following revaluation of the company pursuant to the provisions of Decree 109 would be sold, dissolved or made bankrupt. This is replaced, under to Decree 59, with a direction that the body responsible for the equitisation will formulate a plan to restructure the enterprise via the Debt and Asset Trading Corporation, a state owned corporation run by the Ministry of Finance. Only where this is not possible or effective will the enterprise be dissolved or otherwise dealt with.

Under the legislation there are three forms of equitisation, as follows:

- (1) maintaining existing State capital;
- (2) selling part of the existing State capital; and
- (3) selling all of the existing State capital,

each of which may be combined with the issuance of new capital.

### Eligibility to purchase shares

Both Decree 109 and Decree 59 provide that a strategic investor eligible to purchase shares in the SOE may be either a domestic investor or a foreign investor. A domestic investor (being an individual, economic institution or social organisation) can purchase an unlimited number of shares on offer to the public.

In contrast, a foreign investor (being a foreign organisation, foreign individual or foreign invested enterprise in Vietnam in which the foreign investor(s) own more than 49% of the charter capital) may only purchase a limited number of shares in accordance with the approved equitisation plan and the provisions of relevant industry specific laws in Vietnam. By way of illustration, foreign investors may own no more than 49% of the charter capital of a publicly listed company and, with respect to the banking sector, no more than 30% (in aggregate) of the charter capital of a commercial joint stock bank. However, foreign investors are not permitted to participate in the IPOs of SOEs which are involved in the businesses sectors which are restricted to foreign investment under Vietnam's WTO commitments and other relevant regulations (e.g. pharmaceutical products, petrol distribution, security services, etc).

A foreign investor seeking to purchase (and ultimately sell) shares in an enterprise to be equitised (and receive dividends) must open a capital transaction account with an organisation licensed in Vietnam to provide capital transaction services.

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Decree 59 enhances slightly the definition of a 'strategic investor' by encompassing domestic or foreign investors with sufficient financial capability and a long term interest in supporting the applicable SOE via:

- (1) the transfer of new technology;
- (2) the training and development of human resources;
- (3) the improvement of financial and management capabilities; and/or
- (4) where applicable, the supply of raw materials and/or the development of product consumption markets.

Under Decree 109 there had been no explicit requirement for the strategic investor to support the equitised entity through the training of human resources and/or the improvement of financial and management capabilities.

Decree 59 (as was the case with Decree 109) provides that an Equitisation Steering Committee (**ESC**) is required to be formed, with its primary obligations being to set criteria for the selection of the strategic investor(s) and the preparation of an equitisation plan with respect to the proposed sale and/or issuance of shares.

Under Decree 109 an ESC was required to report its equitisation plan to the Prime Minister of Vietnam, with the consequent delays attendant on this process. However, in an attempt to streamline the process, under Decree 59 only SOEs with State capital exceeding VND 500 billion (currently, approximately US\$25 million) and conducting business in specialised sectors (such as insurance, banking, communications, aviation and rare mineral exploitation) and who seek to select a strategic investor *in advance* of an initial public offer (**IPO**), are required to report to the Prime Minister to determine the criteria for the selection of strategic investors, the method of sale and the number of shares to be offered for sale. In other cases, the ESC reports to the relevant authorities at ministerial level for approval of the equitisation plan.

### Timing of Selection of Strategic Investors

Importantly, whilst Decree 109 did not permit the sale of shares to a strategic investor until *after* an IPO has taken place, Decree 59 provides a platform with which to select a strategic investor *before* or *after* an IPO.

With respect to the price of any shares transferred to or subscribed by a strategic investor prior to an IPO in order to ensure an appropriate level of investment, Decree 59 specifically provides that:

- (1) in the case of direct negotiation between the ESC and the preferred strategic investor before an IPO, the selling price shall be not lower than the tender floor price determined by the ESC in accordance with the approved equitisation plan;

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- (2) in the case of direct negotiation between the ESC and the preferred strategic investor after an IPO, the selling price shall be not lower than the lowest price of any shares issued in connection with the IPO; and
- (3) in the case of a closed tender among potential strategic investors, the price shall be the price quoted by the winning tenderer but shall be not lower than the proposed floor price determined by the ESC in accordance with the approved equitisation plan.

Strategic investors are also locked in for longer under the new legislation. While Decree 109 required that shares be held by each strategic investor for a minimum lock-up period of three years from the date of issuance of the Enterprise Registration Certificate to the equitised enterprise reflecting the interest held by the strategic investor, Decree 59 extends this period to five years. During such period, the strategic investor may, however, transfer shares in certain circumstances, subject to receipt of approval from the general meeting of shareholders. Furthermore, whilst there was no limitation to the number of strategic investors under Decree 109, Decree 59 provides that only a maximum of three strategic investors shall be permitted to purchase shares in each equitised enterprise.

In addition, a strategic investor must pay a non-refundable deposit of 10% of the shares to be acquired or subscribed at such value determined by the ESC. In the event that the strategic investor relinquishes its right to acquire or subscribe for shares in the SOE, the strategic investor is typically not entitled to receive a refund of the deposit. Decree 59 does not provide for the manner of the deposit. In practice, investors should seek to put in place a share subscription agreement which sets out the completion conditions for the payments with a proviso that the deposit will be refunded to the investor if one of the completion conditions is not satisfied. The deposit would usually be structured in the form of a bank guarantee, escrow account, or cash deposit subject to negotiation between the ESC and the strategic investor.

### Equitisation process

Pursuant to Decree 59, the equitisation process encompasses the following steps:

- Step 1 The issuance of a decision by the SOE concerning its proposed equitisation and the establishment of an ESC.
- Step 2 The preparation and dissemination of an equitisation plan.
- Step 3 The preparation of an application dossier, the selection of consultants and auditors and the completion of all financial obligations of the enterprise and an auditing report in connection with the equitisation process.
- Step 4 The restructuring of the SOE to facilitate the equitisation, such as transferring or selling any bad debts and/or transferring non-core businesses or assets to a third party, subject to receipt of approval from the Ministry of Finance.

Step 5 Determining the enterprise value of the SOE and preparing an evaluation report for approval by the Prime Minister of Vietnam, applicable Ministries, applicable provincial People's Committees and/or the Board of Management of the SOE.

Step 6 The preparation of any applicable employee share plan.

Step 7 The preparation of a business plan and a draft Charter.

Step 8 Verification and approval of the equitisation plan by the Prime Minister of Vietnam, applicable Ministries, applicable provincial People's Committees and/or the Board of Management of the SOE.

Step 9 Execution of the equitisation plan via:

- (1) an IPO through a public auction, underwritten share offer or direct negotiation;
- (2) the sale of shares to employees; and/or
- (3) the sale of shares to a strategic investor by closed tender or direct negotiation.

Step 10 Conducting the first general meeting of shareholders.

Step 11 Obtaining an Enterprise Registration Certificate for the new enterprise.

### **Proceeds from the equitisation**

Under Decree 59 the proceeds from the sale of a portion of State capital in the equitised enterprise will be used to:

- (1) pay for the expenses associated with the equitisation process and any benefits payable to employees who shall become redundant as a result of the equitisation; and
- (2) with respect to the balance (including any difference between the selling price of the shares), contribute to the Assistance Fund for Restructuring Enterprises applicable to the parent company of the equitised SOE.

Similarly, with respect to the proceeds from the issue of any additional shares issued by the equitised enterprise:

- (1) the enterprise shall be entitled to retain proceeds from the equitisation equal to the par value of the number of additional shares issued; and
- (2) any surplus (being the difference between the proceeds from the equitisation and the total par value of the additional shares issued) shall be:
  - (a) used to pay for the expenses associated with the equitisation process and any benefits payable to employees who shall become redundant as a result of the equitisation; and

- (b) with respect to the balance:
  - (i) retained by the enterprise in accordance with the ratio of additionally issued shares in the structure of charter capital; and
  - (ii) paid to the Assistance Fund for Restructuring Enterprises applicable to the parent company of the equitised enterprise on the basis set out in the equitisation plan.

### Practical issues

While Decree 59 should certainly assist in reducing certain legal obstacles associated with past equitisations, challenges will still remain, inter alia, in:

- (1) assessing the value of the assets to be retained by the equitised entity and determining the extent to which any particular assets shall be excluded;
- (2) assessing the value of State capital following completion of the equitisation;
- (3) determining the extent to which the equitisation proceeds shall be retained by the equitised entity or diverted to the applicable Assistance Fund;
- (4) negotiating the fees payable for:
  - (a) the future use of licensed State assets;
  - (b) shared, back office and/or administrative services provided, prior to the entity being equitised on a concessional basis;
- (5) negotiating the extent to which the strategic investor shall provide long term support and assistance to the equitised entity and any applicable pricing mechanism and/or secondment arrangements;
- (6) determining the basis upon on which the equitised entity shall be managed and operated following the equitisation and the representation rights of the investor on the Board of Management and executive management team;
- (7) negotiating the extent of any supra-majority rights sought by the strategic investor; and
- (8) negotiating the manner in which State capital may be divested in the future in light of foreign ownership restrictions.

## SCHEDULE 1

### List of key SOEs to be equitised

- (1) Vietnam Steel Corporation; (completed)
- (2) Vietnam Mobile Telecom Service;
- (3) Vietnam Airlines Company Limited;
- (4) Vietnam Textile and Garment Group (Vinatex);
- (5) Vietnam National Petroleum Corporation (Petrolimex); (completed)
- (6) EVN Telecom (EVNT);
- (7) Bank for Investment and Development of Vietnam (BIDV);
- (8) Vietnam Bank for Agriculture and Rural Development (Agribank);
- (9) Vietnam Paper Corporation;
- (10) Northern Food Corporation;
- (11) Vietnam National Chemical Corporation;
- (12) Vietnam Cement Corporation;
- (13) Vietnam Machinery Installation Corporation (LILAMA Corporation);
- (14) Urban and Industrial Zones Development Investment Corporation (IDICO);
- (15) Vietnam Construction Investment Corporation for Water Supply and Drainage and Environment;
- (16) Hanoi Construction Corporation;
- (17) Bach Dang Construction Corporation;
- (18) Northern Power Corporation;
- (19) Southern Power Corporation; and
- (20) Central Power Corporation.

## SCHEDULE 2

### List of industries and sectors where the State must hold 100% of the charter capital

Decision 14/2011/QĐ-TTg dated 4 March 2011 provides that the State shall hold 100% of the charter capital of enterprises operating in the following industries and sectors:

- (a) the manufacture and supply of explosives, toxic chemicals and radioactive materials;
- (b) the manufacture and repair of weapons, ammunition and specialised equipment used for national defence and security;
- (c) servicing national defence and security, including entities established in important strategic localities and remote areas;
- (d) load transmission on the national grid and large scale multi-objective electricity production and distribution with special socio-economic importance associated with national defence and security;
- (e) the management and operation of infrastructure systems of national and urban railways, airports and Level I seaports (especially important seaports on a large scale) and servicing the socio-economic development of the country or allied areas;
- (f) the operation of flights, national and urban rail transportation and maritime safety services;
- (g) public benefit posts;
- (h) radio and television;
- (i) lotteries;
- (j) publishing and press agencies;
- (k) the printing of money and the casting of coins;
- (l) the manufacture of cigarettes;
- (m) the management and operation of irrigation systems, inter-provincial and inter-district rural irrigation and sea walls;
- (n) the management and maintenance of dyke embankments and anti-flood and disaster prevention measures;
- (o) the planting and protection of catchment area forests, protective forest land and specialised use forests; and
- (q) policy credit, servicing socio-economic development,

as well as entities holding business secrets and/or technology in which it is necessary for the State to hold 100% of the charter capital.