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Should Foreign Firms Re-Register Under New Law?

The uniform Enterprise Law and common Investment Law take effect on July 1 and will significantly change the business environment in Vietnam. They replace the Law on Foreign Investment (LFI) which currently regulates the licensing and operation of foreign investment with a unified scheme that treats foreign and domestic enterprises more equally.

There is much interest amongst the approximately 6,000 foreign-invested enterprises already operating in Vietnam as to the advantages and drawbacks of re-registrating their enterprises under the new, unified scheme.

A draft decree currently being circulated for comment is intended to guide these enterprises on the procedures for re-registration and to specify how enterprises that elect not to re-register will be treated after July 1.

The unified Enterprise Law (UEL) provides that foreign-invested enterprises established before July 1 must elect whether to re-register under the UEL by July 1, 2008. Enterprises that re-register must re-organise their management and operations pursuant to the business forms set forth in the UEL.

Enterprises that choose not re-register may continue to operate as before but "shall only be allowed to conduct business activities in the industries and sectors and in the period stipulated in the investment licence." Accordingly, under the draft decree, non-re-registering enterprises would be prohibited from amending their investment licences to change business sectors, term of operations or investment incentives or to divide, consolidate or merge the enterprise.

The quorum rules under the UEL tend to be more management-friendly than those in the LFI, reducing, for instance, the ability of a minority party to deadlock a joint venture by failing to attend board meetings.

Voting rules under the UEL require a majority of 65 per cent to pass ordinary resolutions, and 75 per cent for special resolutions such as amendment of the charter. These provisions favour majority investors with a stake of over 75 per cent. Such an investor would have power to pass all resolutions, including amendment of the company's charter.

The present LFI, however, requires an amendment of the charter to receive unanimous consent of board members. On the other hand, investors with a stake of less than 65 per cent would lose their ability to ensure passage of ordinary resolutions which they currently enjoy under the LFI.

The UEL allows re-registered enterprises to increase and reduce their charter capital, although this is still subject to approval of amendment of the investment certificate under the common Investment Law. The LFI does not permit reduction of charter capital under any circumstances.

Transfer of capital between parties within a limited liability company (LLC) may be easier for re-registered companies, as the UEL and CIL only require 'registration' of the transfer with the authorities rather than 'evaluation' as required under the LFI.

Overall, re-registration would reduce confusion, allowing the enterprise to be governed by current law rather than operate by reference grandfathered provisions of the otherwise-defunct LFI. Dealings with authorities would likely be simpler for re-registered enterprises. In cases of disputes between joint venture parties, arbitrators are likely to refer to business practices as reflected in current law. Re-registered enterprises would already be operating in line with such practices.

Perhaps most importantly, re-registration would give the foreign-invested enterprise the flexibility to amend its investment license.

The only real disadvantage in re-registration would be cost. Apart from the cost of preparing the application, some time may have to be spent negotiating with minority parties who will want to protect their rights. In particular, if the majority party holds more than 75 per cent of capital then the other parties may want to negotiate a higher voting requirement for special resolutions to ensure that they retain some voice in management of the enterprise.

Enterprises with comprehensive and carefully drafted charters might also hesitate to re-register. Article 15.1. (a) of the draft decree would permit such enterprises to continue the organisational structure established under their charter. The charter and joint venture contract would continue in effect.

Some enterprises, however, may have charters silent on certain corporate governance matters. For example, if the company's charter does not deal with quorum issues, then will quorum requirements from the LFI continue to apply, or will the UEL provisions take effect? The common Investment Law expressly repeals the LFI as of July 1, so it becomes legally problematic to continue to apply its quorum rules after that date. However, one cannot use the UEL's quorum provisions because they refer to the "Members' Council", the new management body under the UEL, rather than the "Board of Management" of existing enterprises established under the LFI.

Quorum rules differ significantly between the LFI and UEL, so the resolution of this issue is crucial for investors, especially with the new legal regime coming into force in only a few weeks. Certainly, it would be easiest for some investors to continue to be governed by existing LFI rules, to minimise disruption. But there must be a lawful basis for applying such rules. ■