INDOCHINE COUNSEL

Bui Ngoc Hong,
Partner

VIETNAM: SPECIAL RULE AND RESPECTIVE APPLICATION CONDITIONS FOR VOTING IN A JOINT VENTURE COMPANY

By **Bui Ngoc Hong**, Partner (*hong.bui@indochinecounsel.com*)

Introduction of the two different voting rules
On 27 October 2006, the Report by the Working Party on Vietnam's Accession to the World Trade Organisation ("WTO") was finalized (the "Working Party Report"). Not too long before the finalization of the Working Party Report, on 1 July 2006 Vietnam's new Law on Enterprises (the "2005 Enterprise Law") took effect. While Report is one of Vietnam's international treaties; the 2005 Enterprise Law is the national law. With respect to voting ratios required for passing management decisions in a company, there is a huge difference between the 2005 Enterprise Law and the Working Party Report, in which provisions of the Working Party Report are much in favor of a simple majority shareholder (i.e. the one holding as much as only 51% equity in the company).

Of note, a simple majority shareholder cannot take it for granted that provisions of the Working Party Report are to apply in any foreign invested company. Rather, for a simple majority shareholder to be entitled to exercising their management control by the rule under the Working Party Report, quite a number of conditions must be met.

The WTO Commitments and simple majority shareholders' victory
In the 2005 Enterprise Law, via Articles 51, 52, 103 and 104, Vietnam provides that a shareholder needs to own at least 65% of the total votes at a meeting so as to on its own successfully pass a number of the company's decisions; and at least 75% of the total votes at a meeting so as to on its own successfully pass all of the company's decisions.

During the negotiations for Vietnam to access to the WTO, the then WTO's members noticed that in many service sectors Vietnam agreed to open to foreign investment, the maximum foreign ownership permitted to foreign investors is only 51% equity of a joint venture company ("JVC"). Accordingly, a shareholder possessing 51% equity in a JVC would not be able to on its own pass any decision in the JVC, and a shareholder of 49% could still block the passing of any decision in the JVC. With that insight, the then WTO's members had requested and Vietnam finally made concession to not apply the voting rule under the 2005 Enterprise Law. As part of Paragraph 502 of the Working Party Report, this concession reads,

> "Viet Nam would ensure that, notwithstanding the requirements in the 2005 Enterprise Law, investors establishing a commercial presence as a joint-venture under the commitments in Viet Nam's Schedule of Specific Commitments would have the right to establish, through the enterprise's Charter, all the types of decisions that had to be submitted to the Members' Council or Shareholders' Meeting for approval; the quorum rules, if any, that governed voting procedures; and the precise percentages of voting majorities necessary to make all decisions, including a simple majority of 51 per cent".

It looks like the then WTO's members could claim a perfect victory for enabling a (foreign) shareholder of 51% equity to pass any decisions in a foreign invested company. In reality, however, interpretation and implementation of the above cited part bring a very restrictive use of the rule.

The devils are always in the details
The above cited Paragraph 502 of the Working Party Report cannot apply to all sectors or industries invested by foreign investors; it cannot apply to all foreign invested companies; and it cannot apply without the minority party's agreement. Why?

A task force for implementation of the 2005 Enterprise Law, via its document No. 771/BKH-TCT dated 26 November 2007, provided a strict interpretation of Paragraph 502 of the Working Party Report. Accordingly, a shareholder of 51% equity may on its own pass all decisions in a company only when all the following conditions are in place:

1. The company is a JVC;
2. The company's scope of business is within the service sectors committed under Vietnam's commitments to the WTO, on market opening in services; and
3. The voting majority (e.g. of 51%) is established in the JVC's charter (i.e. articles of association).

With respect to the condition in Item 1 above, the company must be a JVC. This means a shareholder of 51% equity will not be entitled to use the rule in the Working Party Report if (i) it is a shareholder of a wholly foreign owned company (e.g. all the shareholdings belong to foreign investors only); or (ii) it invests by way of indirect investment, i.e. purchasing shares on the stock exchange.

With respect to the condition in Item 2 above, a shareholder of 51% equity will not be entitled to use the rule in the Working Party Report if the JVC engages (i)

IC Indochine Counsel
Business Law Practitioners

A: Unit 4A2, 4th Floor,
Han Nam Office Bldg.
65 Nguyen Du, District 1
Ho Chi Minh City, Vietnam
W: www.indochinecounsel.com

in non-service sectors, or (ii) in any one service sector not committed for market opening under Vietnam's commitments to the WTO. It is not easy for a foreign investor to get approval for investing in service sectors that Vietnam has not yet committed for market opening. However, it should be noted that JVCs in non-service sectors, e.g. JVCs in manufacturing or production industries, cannot be the place for exercising the voting rule in the Working Party Report.

But most interesting is the condition in Item 3 above, which requires that voting majority (e.g. of 51%) is established in the JVC's charter. This is because this condition can be a mother of many other conditions to be negotiated by the JVC's parties.

The voting rule in the Working Party Report cannot be "established", i.e. recorded in a JVC's charter, without the agreement of the shareholder(s) holding 49% equity. That is because, when not yet agreeing, such minority shareholder(s) will not sign into the Charter for submission.

By virtue of the condition in the above Item 3, the JVC's charter, not the joint venture agreement, becomes a document recording contractual arrangements between the JVC's parties. Following the voting rule under the 2005 Enterprise Law, a minority shareholder holding as much as 49% of the JVC's equity may still prevent the shareholder of 51% equity from passing decisions in the JVC. Following the voting rule under the Working Party Report, however, that minority shareholder of 49% equity can no longer exercise any vetoing power, but leaves the entire decision-making to the discretion of the 51% equity shareholder. There must be something for the minority shareholder to trade off for such a concession. Such "something", depending on the negotiation between the JVC parties, may be taken as consideration in return for waiver of the minority's negotiation conditions.

The way out when investment sectors and JVC form become obstacle

In many cases, the minority shareholder of 49% equity is willing to trade off to be bound by the voting rule under the Working Party Report. However, due to the JVC's operation sectors, it is not permitted to apply the voting rule under the Working Party Report. In some other cases, there are many shareholders, but these are all foreign – while forming a JVC requires at least one foreign shareholder and one domestic shareholder - the voting rule under the Working Party Report cannot apply. And in some JVCs, the minority shareholder possessing only less than 51% is the party desiring to take management control of the JVC.

In such cases, deploying non-voting preference shares is perhaps the most appropriate solution. Accordingly, non-voting preference shares (e.g. dividend preference share) are allocated to the party wishing to trade off their voting power for non-voting benefits. That way, the shareholder of the voting shares, even with a minority proportion of equity, may still take management control of the company. Of course, this structure is applicable only to a joint stock company, where equity are made in shares – comprising of voting shares and non-voting shares.

Notes for shareholders to take management control in Vietnam

Vietnam's concession on voting rule in a JVC is eventually a concession for...further negotiations (by minority shareholder of 49% equity). As a result of this concession, in order for a shareholder holding as little as 51% equity to take management control of a JVC, the most important condition is obtainment of agreement by the remaining shareholder(s), so that the JVC can apply the voting rule under the WTO Working Party. This is the most substantive condition. The others – investment sectors, JVC form – usually take little time to sort out.

And where it is impossible for a simple majority shareholder to meet all the conditions required for applying the voting rule under the Working Party Report, deploying a structure with non-voting preference shares should be the best solution for taking management control in a company in Vietnam.