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Bankruptcy Proceedings in Vietnam – Chances and Perils

Introduction. After its introduction in 1993, the possibility of filing for bankruptcy was modified and strengthened in the Vietnamese legal system by Law No. 21/2004/QH1 in June 2004 ("Bankruptcy Law 2004"). As from 1 January 2015, Law No. 51/2014/QH13 ("Bankruptcy Law 2014") replaced this regulation and has since been in force with few alterations. Since its introduction, there have been many issues with the Bankruptcy Law 2014, with applicators bemoaning the inefficiency of the procedure and the lack of professionalism when dealing with the chronological steps of this lengthy and complicated procedure. The nature of bankruptcy lawsuits comprises a plethora of protagonists, as well as several layers of oftentimes conflicting interests. Due to the confusion often allocated to this kind of proceedings they are often attributed to be disadvantageous for creditors and the affected business alike. Hence, not many bankruptcy procedures have been carried out in Vietnam to date.

Legal basis and procedure. The legal basis for any bankruptcy proceedings in Vietnam today is still the Bankruptcy Law of 2014. Bankruptcy Law 2014 contains a definition of "bankruptcy" and "insolvency" which seems to establish a very low threshold for bankruptcy proceedings. Accordingly, an enterprise is deemed insolvent when it fails to meet its financial obligations and pay its debts within three months after such debts become due. In such case, and after a bankruptcy procedure has been carried out successfully, an enterprise is bankrupt when it is declared so by the competent People's Court.

The rationale of bankruptcy law is to enable creditors in danger of losing their rightful claims against a defaulting party to enforce those claims, alongside other creditors, who also have a vested interest in the restructuring or liquidation of a company in order to collect debts. From the nature of this protective purpose arises the condition that the claims against the target company must be unsecured. In case the claims of a creditor are secured by collateral, the value of which suffices to cover the debt, this creditor does not have the right to petition for bankruptcy of its debtor, but must enforce its securities in order to enforce its claims.

Under Bankruptcy Law 2014, bankruptcy proceedings will be carried out by one Judge or a team of three Judges as assigned by a Chief Justice of the People's Court. The procedure is commenced by filing a petition to commence bankruptcy proceedings. The responsible panel of judges will then consider the petition and issue its acceptance or rejection. If the Court accepts the bankruptcy petition, it will have 30 days to decide whether to commence further bankruptcy proceedings. Should the Court decide to commence the bankruptcy proceedings, it will have three working days to appoint the asset management officer or the asset management enterprise in charge of carrying out the evaluation of left assets in the target company. Next, all (unsecured!) creditors of the company are sought out and contacted (if possible) and then invited to a "creditors' meeting". The creditors' meeting will decide on the course of action and the destiny of the insolvent company from there onwards, discuss and agree any proposed restructuring plans for the target company and steer the commencement of recovery procedures for business operations. In case the company cannot be restructured, or such agreement cannot be reached amongst the creditors, the company will be declared bankrupt and its assets will be liquidated and distributed amongst the creditors according to certain quotas, after first covering the expenses for the bankruptcy proceedings, payments to employees (if any), debts that have been made for the purpose of restructuring and debts towards the state. Insolvency and bankruptcy proceedings

can, however, only be brought against enterprises and cooperatives or cooperative unions. The Bankruptcy Law 2014 does not apply to natural persons.

Asset protection. It is important to note that, as in most other bankruptcy regulations globally, there are certain measures to safeguard the interests of (unsecured) creditors in the orbit of a company's insolvency. With the intention of preserving assets, the Bankruptcy Law 2014 provides for some effective mechanisms to prevent the target company from diluting or disposing of its assets. Thus, the following transactions of insolvent enterprises will be deemed invalid, if they were conducted within six months before the People's Court issues the Commencement Decision for the bankruptcy proceedings:

(i) transactions related to the assignment of assets not at market price;
(ii) conversions of unsecured debt(s) into debt(s) secured or partly secured by the assets of the enterprise;
(iii) payments or setoffs which benefit a creditor in respect of a debt that has not yet become due or with a sum that is larger than a debt which has become due;
(iv) donations of assets;
(v) transactions outside the purpose of business operations of the enterprise; and
(vi) other transactions that dispose of the assets of the enterprise.

In addition to these measures, transactions of insolvent enterprises which are conducted with an array of relevant entities/persons listed in Art. 59 para. 3 of the Bankruptcy Law 2014 (i.e. parent company, subsidiaries, relatives of shareholders, etc.) within 18 months before the People's Court issues the Commencement Decision will also be deemed invalid. The civil judgment enforcement agency is responsible for enforcing the decisions declaring the civil transactions invalid in accordance with the law on civil judgment enforcement.

Right and reasons to file for bankruptcy. The Bankruptcy Law 2014 names a number of possible applicants for a bankruptcy petition. But before merely enumerating who is entitled to instigate such proceedings against a company, it also makes sense to consider under what circumstances such a step can bring a decisive advantage on either side of the trench.

Generally speaking, every creditor in pursuit of his claim against a debtor (enterprise), will eventually consider to take legal action against his defaulting debtor. A creditor will, however, usually be more inclined to file a "normal" lawsuit (aimed at obtaining an enforceable verdict for payment of the owed amount) against the counterparty, in which he hopes to recover the outstanding amount without involving any third parties with adversary interests in the case. In fact, there will oftentimes be a high degree of reluctance on the creditor's side to instigate bankruptcy proceedings against a counterparty, particularly with regard to the fear of having to share any remaining asset in the insolvent company with other creditors limited by a certain quota.

a) Creditors.

The most prominent group of potential applicants still are the insolvent company's (unsecured) creditors. Despite the fact that a creditor might limit itself to a certain quota of the remaining assets in the company if filing for bankruptcy, there remain certain situations and constellations, in which filing for a debtor's bankruptcy is the most promising way to make any recovery from a defaulting debtor at all:

Such situation include, for example, if the respective creditor is comparatively "late" in considering enforcement measures against the debtor and other creditors have already taken prior legal action.

There thus might be a multitude of similar "conventional" lawsuits, which have already been filed at an earlier date and will therefore come to sooner conclusions with enforceable verdicts against the common debtor, which can potentially weaken the position of the single creditor. This "race of the creditors" comes to a sudden halt in case a bankruptcy lawsuit is proclaimed.

In such situations it can be commendable to file for bankruptcy, simply to stall the other cases and to have them dropped in favour of the new, combined bankruptcy lawsuit, which will unite the (unsecured) creditors in the above-mentioned creditors' meeting. The same is true for situations, in which a debtor has been hiding its assets or is transferring them to other entities or individuals in an attempt to dispossess itself of any remaining values in the company. In such cases the responsible asset manager will be able to rescind and revoke any transactions made for that purpose, thereby securing the creditors' combined interests in preserving values inside the defaulting company.

Additionally, the mere threat of petitioning for bankruptcy might incentivise a defaulter to reconsider his position and make speedy payment, when faced with the potential consequences of a bankruptcy lawsuit, which will severely disrupt the operation and potentially result in a complete suspension of his business.

b) Debtors.

Of course, the debtor itself also has the right to file for its own bankruptcy through its representatives and other administrative organs.

It does seem, however, illogical that a debtor might want to bring this action against itself. Such a step might, after all, result in the demise of the company and also yield further consequences, such as e.g. a 3-year ban from starting another business or holding managerial positions in other companies. (Art. 130 para. 3: "[...] *the Judge shall consider and give a Decision on the prohibition of the establishment of the enterprise or cooperative and working as manager of any enterprise or cooperative within 3 years from the day on which People's Court issues the Decision on declaration of bankruptcy.*")

It can, however, be a smart strategical move in order to clear old debts and (re)start a success story after restructuring the company, as it will consolidate all pending litigation against a debtor into one bankruptcy case, which will make the situation more transparent and save time and money by streamlining the procedure and assigning clear roles and tasks to all involved parties.

Furthermore, the legal representative of each enterprise or cooperative is obliged and therefore liable to send a written request for initiation of bankruptcy process when his entity is insolvent. Otherwise he risks facing pecuniary consequences of the bankruptcy, as *"compensation shall be paid if there is any damage caused by the failure to request initiation of bankruptcy process after the insolvency of the enterprise or the cooperative"* (Art. 28 para. 5 Bankruptcy Law). The same duty also applies to the owner of any private enterprise, the President of the Board of Directors of any joint-stock company, President of the Member assembly of any multi-member limited liability company, the owner of any single limited liability company or any general partner of any partnership.

There is, however, no criminal liability to be expected from not filing for bankruptcy in the case of insolvency contrary to duty. Different than many other countries Vietnam does not criminalise the delayed filing of insolvency.

c) Others.

Other entities and individuals also have the right to petition for bankruptcy of a company under certain circumstances. This includes: employees and trade unions, shareholders of a joint stock company holding 20 % ordinary shares for six consecutive months or more.

Recent developments and outlook. Despite the Vietnamese legislator's intention and efforts to strengthen its legal framework to allow the efficient and effective execution of the bankruptcy regulations since 2014, progress is still encumbered by the lack of practical experience on all sides of the spectrum. Legal professionals with noteworthy experience in this kind of highly complex procedure lack the numbers to provide reliable precedent. On the other side, the authorities and decision makers responsible for carrying out the bankruptcy procedure do not possess the routine and guidance to handle these cases appropriately and in an expedited fashion. As a consequence of this deficit, the Supreme People's Court of Vietnam in a joint effort with the Ministry of Justice and the Supreme People's Procuracy, last year released the Joint Circular No. 07/2018/TTLT-BTP-VKSNDTC-TANDTC ("Circular No. 7") on June 12, 2018, to ensure coordination in the enforcement of bankruptcy decisions by the court. It includes guidelines on issues related to enforcement procedures for court decisions on bankruptcy cases. Circular No. 7 came into effect on August 1, 2018 and was designed to lead to better coordination between the enforcement agencies and courts to further strengthen the bankruptcy and insolvency framework issued in 2014. One year from its entering into force, we can see some positive effects of the new guidelines. Given the trajectory of these developments, we expect to see some additional regulatory guidance being added to the mix in the near future, which will further clarify and streamline the procedure.

Conclusion. Although bankruptcy lawsuits still form a major exception in the landscape of Vietnamese legal practice, the sword given to creditors by filing for bankruptcy against a counterparty has been significantly sharpened in recent years. As legal professionals with many years of experience in the Vietnamese market, we expect this measure to become more and more attractive for foreign creditors, who oftentimes struggle with the poor payment behaviour of Vietnamese counterparties or business partners. Especially where debtors owe money as their principle obligation, considering (the threat of) a bankruptcy lawsuit against the counterparty might significantly increase its management's motivation to settle open invoices and live up to other contractual obligations. With the potential threat of a long-lasting procedure, which can freeze assets, suspend operations, rescind transactions and close down entire businesses, therein lies a high risk potential for local companies. Executives of Vietnamese companies might thus want to consider these possibilities, before risking the name and the assets of their company and themselves in a bankruptcy case, which will potentially bring down their entire business over an unsettled invoice.

If you require any additional information or would like to discuss your case with one of our experienced lawyers, please reach out to snb.vietnam@snblaw.com.