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# Import & Distribution Update

August 2005

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*This Update tracks Vietnam's progress towards opening its import & distribution sector to foreign investment.*

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## Introduction

The potential of Vietnam's consumer market is huge. But, for many years, foreign investors have been locked out, unless they invested in manufacturing their products in-country. Vietnam's import and distribution sector was initially the province of State owned import enterprises only. Then private Vietnamese enterprises were allowed in. Then Vietnam opened a crack in the door for very limited foreign investment in its import and distribution sector. To date, licensing has remained on a purely discretionary case-by-case basis. The US-Vietnam Bilateral Trade Agreement (**BTA**) gives some hope. But real law reform has lagged sorely behind foreign expectation. Meanwhile, foreign investors have continued to find other ways to get their products into the Vietnamese market and control how and where they are marketed. Now, Vietnam is widening the crack in its doors to allow broader foreign investment in its import and distribution sector. And it's giving frontrunning to US companies.

## Current black letter law

Under the Law on Foreign Investment in Vietnam dated 12 November 1996 (as amended 9 June 2000) (**LFI**) and Decree 24-2000-ND-CP of the Government dated 31 July 2000 (as amended 19 March 2003) Providing Detailed Regulations on Implementation of the LFI (**Decree 24**), licensing of foreign investment in a number of sectors is subject to conditions. "Investment projects in import services and domestic distribution services" are subject to the condition that they must be implemented in accordance with separate provisions of the Prime Minister.<sup>1</sup> No such separate provisions have ever been issued. So, at present, foreign direct investment in the import and distribution sector in Vietnam faces a legal vacuum. It is not prohibited but there is no enabling legislation.<sup>2</sup>

Outside the foreign direct investment regime, foreign trading branch offices may be established and operate under Decree 45-2000-ND-CP of the Government dated 6 September 2000 on Representative Offices and Branches of Foreign Business Entities and Foreign Tourism Enterprises in Vietnam (**Decree 45**). However, such branch offices are only permitted to conduct trading in a very limited range of goods and services. Only 5 categories of goods (handicrafts; processed agricultural products and agricultural products other than rice and coffee; fresh and processed fruit and vegetables; industrial consumer goods; meat of livestock and poultry and processed foodstuffs) may be exported. Only 3 categories of goods (machinery and equipment for mining or processing of agricultural and aquatic products; raw materials for production of human medicines or veterinary medicines; raw materials for production of fertilizer and insecticide) may be imported for sale in the Vietnamese market. An import permit is required to be obtained from the Ministry of Trade. Further, foreign trading branch offices are subject to the restriction that turnover from import may not exceed turnover from export. They are not permitted to purchase goods in Vietnam for resale in Vietnam. At the time of issuance of Decree 45, our informal discussions with one of the draftspersons revealed that the Government was aware of the impracticalities and unattractiveness of the limitations on Decree 45 branch offices but was attempting to open (albeit ineffectively) a small segment of the trading sector to foreign participation, which at that time was seen as in need of foreign assistance with respect to import and export markets.

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1 Appendix I.IV of Decree 24.

2 This was confirmed by the Ministry of Trade in its Official Letter 3067-TM-DT dated 7 August 2002 to the Office of Government.

### Practice to date

In the absence of enabling regulations under the foreign investment regime, licensing of foreign investment projects in the import and distribution sector has been approved by the Prime Minister on a limited, discretionary case-by-case basis only. Licensed projects include:

- > A foreign invested enterprise ("FIE") in the agricultural chemicals sector is licensed to import its products in bulk and package them for sale in Vietnam (without any manufacturing obligation).
- > FIEs "Big C" and Metro Cash and Carry are expressly licensed to invest (on a large scale) in distribution only (ie without any, or only very little, value adding processing or packaging).
- > Several FIEs (in this case, only 100% foreign owned enterprises (**100%FOEs**)) are licensed to provide various services related to import and distribution of products of their foreign parent. Most of these are in the industrial sector, where they are licensed to install, commission, maintain, repair and stock spare parts. In this way, the FIEs can also manage the supply of equipment, lifts, airconditioners, etc to customers in Vietnam. In the consumer products sector, at least one 100%FOE has been licensed to provide "ancillary" activities of storage, packaging, labelling, warehousing, delivery and record-keeping services. In this case, the import and distribution of the products of the foreign parent is conducted by a Vietnamese company "controlled" by the FIE.

Based on the above and similar "exceptional" cases, licensing of import and distribution activities depends on a range of factors, including size of investment; extent to which proposed activities include processing packaging or other value-adding, and substitution of finished-product imports where products cannot be manufactured locally; and "sweeteners" offered, such as undertaking to invest in improvement of supply chains for Vietnamese agricultural producers.

Outside the foreign investment regime, many foreign companies utilize "other means" of getting their products to market in Vietnam:

- > *Local importer/distributor.* Under this option, the foreign company appoints a local Vietnamese company as its importer and distributor. The foreign company may establish a representative office in order to "manage" the import and distribution process. This arrangement is very common. Some foreign companies have acquired an interest in their local distributor/partner (up to 30%) in order to exercise some control over such entity. Alternatively, if the foreign company has invested in a manufacturing FIE in Vietnam, then the FIE may be able to manage the import and distribution process (depending on the FIE's investment license).
- > *Manufacturer/distributor.* Some manufacturing FIEs argue that the wording of their "authorized scope of activities" in their investment licenses allows them to distribute imported products that they have not manufactured. In such cases, it may be possible for the FIE's foreign parent company to appoint a local Vietnamese company as its import agent and then supply the finished products to the FIE in Vietnam, for sale to distributors and customers in Vietnam. In one case, a FIE was apparently even permitted to import the finished products (pharmaceuticals) itself, and so could avoid the need for a local import agent. Whether such activities are possible depends on the wording of the investment license. Foreign investors should be aware that the Ministry of Planning and Investment has challenged a number of investment licenses issued by provincial/city people's committees and industrial zone authorities as "not being in accordance with the law".
- > *Import permit.* FIEs may apply to the Ministry of Trade for a permit to import finished products for "market seeding purposes". The volume that may be imported under such a permit may not exceed 0.5% of the designed capacity of the factory, or USD500,000 in value. Several FIEs have also succeeded in obtaining import permits from the Ministry of Trade to import and distribute "complementary" products (subject to quota limits and annual review) to the products that they manufacture, or where there has been some disruption to manufacture in Vietnam. In all cases, such import permits have been subject to both volume and time restrictions.

### What hope does the BTA give?

Under the BTA, Vietnam has committed to opening the import and distribution sector to US participation in stages. Generally, the BTA has been viewed as representing the roadmap for liberalization of the Vietnamese market for *all* foreign investors (not just US investors). On that basis, foreign participation in the import and distribution sector is expected to develop as follows:

Stage	Trading <sup>3</sup>	Distribution <sup>4</sup>
From December 2004	FIEs engaging in "substantial" production and manufacturing will be permitted to conduct trading activities <sup>5</sup> , subject to the restrictions <sup>6</sup> listed in Annexes B, C and D of the BTA <sup>7</sup>  Joint venture enterprises ( <b>JVEs</b> ) (51% Vietnamese/49% foreign legal capital) will be permitted to be licensed to conduct trading activities in all products, subject to the restrictions listed in Annexes B, C and D of the BTA	JVEs (51% Vietnamese/49% foreign legal capital) will be permitted to be licensed to provide distribution services, subject to the restrictions listed in Annex D of the BTA
From December 2007	JVEs (49% Vietnamese/51% foreign legal capital) will be permitted to be licensed to conduct trading activities, subject to above restrictions	JVEs (no limitation on % foreign legal capital) will be permitted to be licensed to provide distribution services, subject to above restrictions
From December 2008	100%FOEs will be permitted to be licensed to conduct trading activities, subject to above restrictions	100%FOEs will be permitted to be licensed to provide distribution services, subject to above restrictions
From December 2011	Most restrictions applicable to specific products will have been phased out	Most restrictions applicable to specific products will have been phased out

3 BTA, Chapter I - Trade in Goods, article 2.7. The BTA defines "trading rights" as "the right to engage in import and export activities". "Trading activities" should be interpreted in light of this definition.

4 BTA, Chapter III - Trade in Services, article 7.1. Under Annex G.IV of the BTA, "distribution services" includes wholesale and retail sales services, agent services (excluding agent services for foreign legal persons), franchising services, but excludes oil and oil derivatives, gas, fertilizer, pesticides and insecticides, alcohol, cigarettes and cigars, medicines, precious metals and stones, explosives, rice and wheat flour.

5 Presumably, existing FIEs engaged in "substantial manufacturing" will be permitted to distribute the products that they import, but strangely, this is not stated in the BTA.

6 Again strangely, the BTA does not restrict existing FIEs engaged in "substantial manufacturing" to importing products related to those that they manufacture in Vietnam. The only restrictions appear to be those listed in Annexes B, C and D.

7 Annex B comprises: Import Quantitative Restrictions for Agricultural Products; Import Quantitative Restrictions for Industrial Products; Export Quantitative Restrictions; Prohibited Import and Exports.

Annex C comprises: Imports Subject to State Trading and Phase-out Schedule; Exports Subject to State Trading and Phase-out Schedule.

Annex D comprises: Phase-out Periods for Restrictions on Import Trading Rights and Distribution Rights for Agricultural Products; Phase-out Periods for Restrictions on Import Trading Rights and Distribution Rights for Industrial Products; Phase-out Periods for Restrictions on Export Trading Rights.

Examples of the above restrictions: quantitative restrictions apply to the importation of products such as bicycles and frozen orange juice until 10 December 2006; rice, television and radio parts may not be imported and distributed at all.

Unfortunately, it is not certain that all foreign investors will enjoy the above reforms at the same time as their US counterparts. Vietnam's track record in implementing its BTA commitments is inconsistent. Some BTA reforms, such as establishment of 100% foreign owned credit institutions, have been enjoyed by all foreign investors. Others, such as relaxation of caps on VND deposits at foreign bank branches<sup>8</sup>, have been enjoyed only by US investors (and belatedly, after bargaining, by EU investors). Also, it now appears that, as one of the terms of Vietnam's accession to the WTO, a delay may be imposed on investors from countries with which Vietnam does not have an agreement with respect to trading in goods and services (ie non-US and non-Japanese, query non-EU) can enjoy the import and distribution reforms under the BTA (see below).

### What has happened post-BTA?

Since June 2002, Vietnam has been pursuing (very slowly) the following law reform process:<sup>9</sup>

- > *Expansion of the scope of applicability of Vietnam's Commercial Law to provide for import and distribution activities by foreign branch offices and FIEs in Vietnam:*

On 14 June 2005, a new Commercial Law was passed by Vietnam's National Assembly (**2005 Commercial Law**). In a very brief section entitled "Foreign Business Entities Conducting Commercial Activities in Vietnam", the 2005 Commercial Law enables foreign branch offices to engage in commercial activities, enables FIEs to be licensed to engage solely in commercial activities without any investment in manufacturing ("commercial FIEs" - a completely new class of FIE) and enables existing FIEs in the manufacturing sector to engage in commercial activities.

Regrettably, there is no specific reference to "import-export" or "distribution" in the 2005 Commercial Law's definition of "commercial activities". However, the Ministry of Trade has informally advised that the general catch-all "other activities for profit making purposes" in the 2005 Commercial Law's definition of "commercial activities" is expected to be interpreted to encompass import-export and distribution activities.

Of interest, the 2005 Commercial Law provides for a separate regulatory framework for commercial FIEs. They will be under the control of the Ministry of Trade. (This is similar to foreign credit institutions in Vietnam which are governed by a separate regulatory framework from the LFI and under the control of the State Bank of Vietnam.) FIEs undertaking commercial activities in addition to manufacturing will remain under the control of the Ministry of Planning and Investment.

The 2005 Commercial Law will come into force as of 1 January 2006.

- > *Promulgation of detailed guidelines for implementation of the Commercial Law with respect to import and distribution activities of foreign branch offices and FIEs:*

Before August 2005, the Ministry of Trade had proposed a single decree to provide detailed guidelines for implementation of the Commercial Law with respect to foreign branch offices *and* FIEs. Now, the Ministry of Trade has split the proposed guidelines into two separate decrees:

- a draft decree providing detailed guidelines for implementation of the Commercial Law with respect to representative offices and branch offices of foreign business entities in Vietnam (**decree on branch offices**);
- a draft decree providing detailed guidelines for implementation of the Commercial Law with respect to commercial activities of FIEs in Vietnam (**decree on commercial activities of FIEs**)

8 See March 2005 Issue of Vietnam Legal Update for our latest discussion of this subject.

9 Official Letter 2177-TM-DT of the Ministry of Trade dated 5 June 2002

Decree on branch offices: This will replace Decree 45. It allows foreign business entities to establish branch offices in order to conduct commercial activities, being import-export and "supporting" activities. What qualifies as "supporting" activities is not clear. Of note, the earlier single draft decree of the Ministry of Trade had "encouraged" foreign business entities to establish commercial FIEs in order to conduct commercial activities on a permanent basis in Vietnam, in preference to branch offices. This provision has not survived in either of the August 2005 draft decrees, but it may remain policy - and it may be that the scope of commercial activities of branch offices will remain limited to import-export and exclude distribution.

Branches will be permitted to export all types of goods, except petroleum, petroleum products, gas, fertilizer, insecticide, beer and spirits, cigarettes, medicine, precious metals and stones, explosives, rice, wheat flour, and other goods the export of which is prohibited. But the goods that may be imported by branch offices will remain restricted (albeit less restricted than under Decree 45). Permitted imports are confined to machinery and equipment, and raw materials and supplies used for production and construction. The licensed duration of a branch office is limited to 5 years (extendable)<sup>10</sup>.

The Prime Minister will decide on the continuation of existing, licensed branch offices which engage in commercial activities beyond the above limited range of goods (we are not aware of the existence of any such branch offices). New branch offices will be licensed by the Ministry of Trade.

Decree on commercial activities of FIEs: Under this Decree, commercial FIEs may be established in the forms of JVE or 100% FOE. They may conduct the following activities: (i) wholesale of goods; (ii) retail of goods; (iii) agency for buying and selling goods and/or services; (iv) commercial franchising; and (v) import and export of goods.<sup>11</sup> The range of goods in which commercial FIEs may conduct activities appears to be restricted. In addition to restrictions on goods under international treaties (discussed below), the following goods are excluded: petroleum, petroleum products, gas, fertilizer, insecticide, beer and spirits, cigarettes, medicine, precious metals and stones, explosives, rice and wheat flour, and other goods the export of which is prohibited.

The most significant limitation on the establishment of commercial FIEs is that they will be licensed only in accordance with the terms of and timetable for Vietnam's commitments under international treaties. For US investors, this means in accordance with Vietnam's BTA commitments (or its WTO commitments, whichever are more favourable). So, for US investors, *at worst*, they will be limited by the BTA timetable and the restrictions in Annexes B, C and D of the BTA (see above). For investors from other countries with which Vietnam has an agreement with respect to trading in goods and services, this means in accordance with the commitments in such agreement (or Vietnam's WTO commitments, whichever are more favourable). For other investors, it means *at best* Vietnam's WTO commitments.

The decree on commercial activities of FIEs also provides for existing, licensed FIEs to engage in distribution of goods subject to amendment of their investment license. There is no mention of import-export.<sup>12</sup> It is expected (but not stated) that the amendment of their investment licenses will be restricted by the corresponding terms and timetable for introduction of new commercial FIEs.

10 Currently, Decree 45 allows unlimited duration for branches.

11 This is a significant improvement on the Ministry of Trade's single draft decree which only permitted commercial FIEs to engage in sale and purchase of goods, with no express reference to the activities of wholesale and retail of goods or import and export of goods.

12 The Ministry of Trade's single draft decree had provided for import rights for existing manufacturing FIEs, even though the extent of such rights (who could import and what they could import) was not settled. Informal discussions with the Ministry of Trade in early June 2005 suggested that only existing FIEs with investors from countries with which Vietnam has reciprocal MFN status would be permitted to import products for sale in the Vietnamese market. Other proposed conditions for existing FIEs to import products included: completion of capital construction and commencement of production or manufacturing; total invested capital of USD40 million or more; completion of legal capital contribution; commencement of income generation. What goods could be imported ranged from all goods subject to the restrictions set out in Annexes A, B and D of the BTA or (as suggested in informal discussions

Under the decree on commercial FIEs, Prime Ministerial approval will be required for the licensing of commercial FIEs where the foreign business entity is incorporated in a country with which Vietnam has not made a relevant treaty commitment. The establishment of commercial FIEs by any foreign business entity incorporated in a country with which Vietnam *does* have a relevant treaty commitment, eg US, will be licensed by the Ministry of Trade. The draft decree is not clear but it is anticipated that the amendment of investment licenses of existing FIEs so that they may conduct distribution (as well as their licensed activities) will be performed by a foreign investment licensing body.<sup>13</sup> It is also unclear whether approval from the Ministry of Trade is required before the amendment of investment licenses.

The above decrees are expected to be promulgated soon and to come into force on the same date as the 2005 Commercial Law. (However, we note that this was also the expectation with the Government decrees to implement the 2004 Competition Law but, to date, only one has been issued and it's now 2 months since that Law came into force.)

### So, what of the now overdue obligations under the BTA?

The 2005 Commercial Law won't come into force until 1 January 2006. By then, the first stage of Vietnam's import and distribution sector reforms (scheduled to be introduced by 10 December 2004) will be overdue by more than a year.

What stopgap measures would be taken by Vietnam to give effect to its BTA commitments pending the 2005 Commercial Law coming into force has been the subject of much debate - and delay - by Vietnamese authorities. It is understood that this highly sensitive subject has been an important bargaining chip in Vietnam's negotiations to join the WTO by the end of 2005.

Arguably, there is no need to introduce enabling legislation in order to give effect to Vietnam's commitments under the BTA. Vietnamese laws often contain a provision that the terms of treaties to which Vietnam has acceded will override any contrary provisions in such laws. So, based on just such a provision in Decree 24<sup>14</sup>, Vietnamese authorities could simply start to issue licenses (or license amendments) in order to allow US investors to import and distribute goods in Vietnam as permitted under the BTA. However, enabling legislation would still be required in order to give body to the skeleton commitments under the BTA.

Now, finally, Vietnam has played its hand. It appears that Vietnam will indeed commence licensing in advance of enabling legislation. On 28 July 2005, the Ministry of Trade issued a Diplomatic Note to the US Embassy in Hanoi advising that Vietnam is now ready to issue licenses to US investors interested in import and distribution rights in conformity with the provisions of the BTA. According to the Diplomatic Note, this was agreed during the BTA Joint Committee Session on 17 June 2005 in Washington DC. The Diplomatic Note provides the following point of contact for interested US investors: Ms. Hoang Tuyet Hoa, Department for Investment and Planning, Ministry of Trade, 31 Trang Tien Street, Hanoi, Vietnam, Tel: 84-4-826 5826, Fax: 84-4-826 4696.

### Where to from here?

The Diplomatic Note is considered to be a stopgap measure only. When the 2005 Commercial Law and (presumably) the implementing decrees come into force on 1 January 2006, US investors will have a clear basis for exercise of their import and distribution rights.

At that same time, other investors from countries with which Vietnam does not have an agreement with respect to trading in goods and services will also *in principle* be entitled to participate in the import and distribution sector pursuant to the 2005 Commercial Law. But, based on the limitations enshrined in the

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with the Ministry of Trade in late June 2005) to only those goods stipulated in the investment license of the existing FIE. Now it appears the issue is to be ignored completely.

13 It is not clear whether only the Ministry of Planning and Investment may approve such amendment or whether lower-level investment licensing bodies may do so also.

14 Article 120.1 of Decree 24

August 2005 draft of the implementing decrees, such investors may be locked out *in practice* from Vietnam's import and distribution sector until the terms of Vietnam's WTO accession allow them in. This may be some time after 1 January 2006. At the May 2005 Geneva meeting of its WTO working party, Vietnam is understood to have agreed to extend trading rights to investors from all WTO member countries (with similar restrictions as in Annexes B, C and D to the BTA) but to have requested a one year transition period for implementation. If these terms of WTO accession are accepted, and assuming Vietnam's accession is approved at the WTO Ministerial Meeting in December 2005, investors from countries with which Vietnam does not have an agreement with respect to trading in goods and services may remain locked out *in practice* from Vietnam's import and distribution sector until 2007 at the earliest.

One thing is certain, the Diplomatic Note gives US investors an invaluable headstart in establishing their brands in the Vietnamese market, ahead of all other non-manufacturing investors. How much of a headstart remains to be seen - at a minimum, US investors have a 5 month advantage, but this may stretch to 17 months or more.