

## CORPORATE GOVERNANCE OF RELATED-PARTY TRANSACTIONS: VIETNAMESE LAWS IN BRIEF

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### Introduction

The corporate governance of related-party transactions (the “**RPT(s)**”) stems from the recognition that persons in whom the directorial, managerial or influential power over a company is vested can compromise (or be enticed to compromise) their fiduciary duties<sup>1</sup> towards such company to maximise their personal interests. In layman’s terms, an entry into a RPT may not genuinely represent the interests of the company but may be, more or less, affected or motivated by personal gains. Absence of rules on controlling RPTs will allow certain stakeholders opportunism to ripe pecuniary private benefits at the expense of the company. For instance, uncontrolled RPTs may cause property damage or even affect the financial position and debt solvency of the enterprise. The lack of transparency in RPTs also significantly degrades the reputation of the enterprise, thus adversely affecting any investment decision of the investors<sup>2</sup>.

From an international perspective, the basic rules for controlling transactions between the company and its related persons are commonly established in the corporate laws and securities regulations<sup>3</sup> and this also applies to Vietnam. The general concept of RPTs were originally introduced in Law on Enterprise 1999 and now sits in the Law on Enterprise 2020.

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<sup>1</sup> Fiduciary duties of directors or controlling shareholders towards the company is a common concept under the common law but it remains largely doubtful under the laws of Vietnam.

<sup>2</sup> This problem is even more prevalent in the context of publicly listed company as transparency in operation and management creates trust for investors.

<sup>3</sup> Laura Luputi, “Reporting related party transactions and Conflict of interests” (2004) OECD, 7.

In light of the laws of Vietnam, this article seeks to address the following questions<sup>4</sup>:

1. What are the transactions that fall within the boundaries of RPTs?
2. What are the statutory requirements applicable to the RPTs?
3. What are the legal consequences for the non-compliance with the statutory requirements applicable to the RPTs?

For the sake of description and analysis to be made hereunder, this article will not touch upon the RPTs regime under the securities laws.

## What are the transactions that fall within the boundaries of RPTs?

The laws provide only the definition for “related persons” but the RPTs. Common understanding views that RPTs are essentially those transactions to which the related person is a party<sup>5</sup>. Under the 2020 Enterprise Law, anyone of the below groups will be considered as *related persons*<sup>6</sup>:

Group Category	Related Persons
Group 1 – Selected shareholders and related persons	(a) Parental companies <sup>7</sup> ;

<sup>4</sup> RPTs are placed under governance by the regulations of laws in different field including enterprise, bankruptcy, securities, credit institutions, auditing. This article will focus on the RPTs of non-state owned company under the laws on enterprise.

<sup>5</sup> Nguyen Thi Van Anh, *Perfecting laws on controlling transactions between companies and related persons* (in Vietnamese: *Hoàn thiện pháp luật về kiểm soát giao dịch giữa công ty với người có liên quan*), doctoral thesis (2015), 43.

<sup>6</sup> 2020 Enterprise Law, Art. 4.23.

<sup>7</sup> In accordance with Art. 195.1(a) of the 2020 Enterprise Law, a company is deemed a parental company if it, among other cases, holds more than 50% of the charter capital or ordinary shares.

	<p>(b) <a href="#">Shareholder / Group of shareholders having the ability to control operation of the Company (via ownership structure or otherwise);</a></p> <p>(c) In relation to such parental companies in item (a), (i) its executives, legal representative; (ii) persons with the authority to appoint those specified in item (i) and (iii) authorised persons of such shareholder and (ii);</p> <p>(d) In relation such shareholder (if such shareholder is an individual), the close relatives<sup>8</sup> of such individual.</p>
<b>Group 2</b> – Subsidiary of the Company and related persons	<p>(a) Subsidiary;</p> <p>(b) Executives and legal representative of such subsidiary;</p> <p>(c) Authorised persons of such subsidiary.</p>
<b>Group 3</b> – Executives of the Company and related persons	<p>(a) Executives, legal representative or supervisory member of the Company;</p> <p>(b) Close relatives of those specified in item (a);</p>
<b>Group 4</b> – Miscellaneous	<p>(a) Enterprises in which the person or institution as specified in any Group 1 to 3 has the ownership to the extent that it be able to control the decision-making capacity of such enterprise;</p> <p>(b) <a href="#">Person or organizations or group of persons or organizations having the ability to control the operation of the Company (via ownership or otherwise);</a></p> <p>(c) The authorised persons of such organizations in item (b).</p>

Most of those being classified as related persons are quite clear except for (i) those having *controlling ability* in the Company and (ii) those acting as group ([blue texts above](#)).

## How the test on *controlling ability* should be examined?

<sup>8</sup> Close relatives include, among other, parents, spouse, child, parents-in-law, siblings, etc.

Considering a shareholder, albeit having only minority shares, has a veto right over material decision of the Company in accordance with an effective shareholders' agreement, would their ability to set aside those decisions fall under the ambit of *controlling ability*? One may argue that the entitlement to *veto* an operation decision would be an aspect of the controlling ability, making any of those with *veto right* a related person to the Company. Nonetheless, we argue that such presumption would be too broad and more importantly, it does not in any manner serve the underlying purpose of controlling RPTs, which is to protect the interest of minority shareholders. Given such, it would be reasonable and logical to assume that *controlling ability* should be restricted to the ability of one or ones (acting as a group) can arbitrarily pass (rather than disapprove) a decision without requiring the favorable votes from the others.

Furthermore, as can be seen in the above table, we broke down Art. 4.23(c) into two main parts, with the first one related to direct shareholders of the company as specified in item (b) of Group 1 and the second one related to "other persons/organizations" as specified in item (b) of Group 4. The latter includes the majority shareholders or group of them sitting at the level of the ultimate holding company as they have indirect control over the concerned company via the operation of their voting rights at the holding company or other persons with the sufficient managerial capacity but is somehow not defined as executives of the company under the 2020 Enterprise Law.

## **Group amounting to related persons – How to understand it?**

Article 4.23(c) of the 2020 Enterprise Law reads that a group of individuals or organizations will be considered as related persons if they have the ability to control the operation of the enterprise, either by way of voting shares or decision-making capabilities. As far as we concern, if a group of individuals or organizations acting as a whole can substantially influence the operation of the Company, transactions with such group would essentially become RPTs. However, the laws seem to be unclear about a scenario whereby a group of individuals or organizations can control the Company but only one of them enters into transaction with the Company. Such scenario is demonstrated as below.

*X JSC has 4 shareholders, including A (9%), B (30%), C (35%) and D (26%) in which B and C are A's close relatives. X JSC intends to enter into a transaction with Y which is a wholly-owned company of A. Would that transaction be considered a RPT?*

Since A neither holds dominating shares nor at least 10% of ordinary shares to be treated or subject to the requirement on RPTs<sup>9</sup>. The transaction between Y and X JSC will not be amount to a RPT. However, there is a practical ground to believe that when the matter of contract execution with Y is raised at a board meeting, B and C are no longer objective in their votes. Hence, B and C should be treated as a group with A in dealing with the transaction between Y and X JSC. However, since the outreach of RPTs does not clearly provide for such outreach, the potential link between Y, B and C falls outside the control of the rules on RPTs.

## What are the statutory requirements in relation to LLC and JSC applicable to RPTs?

The purpose of governing RPTs is to screen out the fair and value-creating RPTs apart from the harmful and private interest-led ones<sup>10</sup>. The RPTs controlling regime in Vietnam focuses on the following measures<sup>11</sup>, briefed out as below:

Measures	JSC (joint-stock company)	MLLC (multi-member limited liability companies)	SLLC (sole-member limited liability companies) <sup>12</sup>
<b>Publicity &amp; Record</b>	The legal representative to notify the company of the enterprises in which he / she or his / her related persons own shares or capital contribution (irrespective of the ownership ratio) <sup>13</sup>		

<sup>9</sup> See also the answer to the next question "What are the statutory requirements in relation to LLC and JSC applicable RPTs?"

<sup>10</sup> Luca Enriques and Tobias Troger, "The Law and (Some) Finance of Related Party Transactions: An Introduction" (2018) ECGI Law Working Paper No. 411/2018, 9.

<sup>11</sup> The below table excludes those specifically designed for State-owned Enterprises (SOEs).

<sup>12</sup> RPTs controlling regime for SLLC is only applicable to those being owned by institutional owner (2020 Enterprise Law, Art. 86.1).

<sup>13</sup> 2020 Enterprise Law, Art. 13.1(c).

	<ul style="list-style-type: none"> <li>▪ The executives are required to disclose those enterprises in which<sup>14</sup> <ul style="list-style-type: none"> <li>✓ they own shares / capital contributions (irrespective of the ownership ratio); and</li> <li>✓ their related persons holding more than 10% of the charter capital.</li> </ul> </li> <li>▪ The company is required to<sup>15</sup> <ul style="list-style-type: none"> <li>✓ maintain, update record of related persons of the company and their transaction with the company</li> <li>✓ notify list of related persons and related interest in annual GMS.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ The executives of a MLLC have the similar disclosure obligations as those of a JSC, except that the executives are only obliged to notify of the enterprises related to their related persons if such related persons are dominating members/shareholders<sup>16</sup>.</li> <li>▪ The company shall maintain, update a list of the enterprises notified by the executives and their transactions with the company<sup>17</sup>.</li> </ul>	<ul style="list-style-type: none"> <li>▪ The executives have similar disclosure obligations as those of the JSC, except that these are only applicable if the executives or their related persons are dominating members/shareholders of the relevant enterprises<sup>18</sup>.</li> <li>▪ No specific clause requires the company to maintain and update records.</li> </ul>
<b>Obtaining approval by</b>	Subject to the value of the relevant transactions, a prior approval from BOM or GMS will be required for the	Members of the Members' Council (the " <b>MC</b> ") to vote to approve the RPTs <sup>20</sup> .	Prior approval from each the MC / Chairman <u>and</u> Director / General

<sup>14</sup> 2020 Enterprise Law, Article 164.2.  
<sup>15</sup> 2020 Enterprise Law, Article 164.1 & Art. 164. 4  
<sup>16</sup> 2020 Enterprise Law, Article 71.1(c).  
<sup>17</sup> 2020 Enterprise Law, Article 71.4.  
<sup>18</sup> 2020 Enterprise Law, Article 83.4.  
<sup>20</sup> 2020 Enterprise Law, Article 67.1.

<p><b>corporate bodies</b></p>	<p>following cases (“<b>Related Transactions Required Approval</b>”)<sup>19</sup>:</p> <ul style="list-style-type: none"> <li>▪ Transactions executed with shareholder or its representative (if such shareholder is an organization) and their related</li> </ul>		<p>Director <u>and</u> Inspector will be required for the following cases:<sup>21</sup></p> <ul style="list-style-type: none"> <li>▪ Owner of the company and its related persons;</li> <li>▪ Members of the MC, Chairman of the company, Director / General</li> </ul>
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Not all subject mentioned in Article 67 are related persons in accordance with Article 4.23 (for instance minority members or authorized persons of minority members). However, it seems that the language of Article 67 determines that the listed subjects are related persons. Thereby, the transactions between the Company and those subject shall governed by the the rules of RPTs (to be approved by the MC before its execution).

<sup>19</sup> Article 167 of the 2020 Enterprise Law lists out specifically RPTs (in a JSC) which shall be approved by the BOM or GMS (as the case may be). This Article 167 stipulates in detail the related persons (and RPTs to be controlled) instead of generally using the term defined in Article 4.23. There is an inconsistency in regard to determination of related persons and RPTs in the 2020 Enterprise Law. The scope of Article 167 is broader than that of Article 4.23 taking into account the following cases:

Case 1: X JSC (all outstanding shares are ordinary shares) has 3 shareholders: Shareholder A (holding 60% of shares), B (holding 29% of shares) and Shareholder C (holding 11% of shares). X JSC intends to execute a transaction with Shareholder C.

Case 2: A is a board member of X JSC. X JSC is considering a transaction with one of the below companies:

- Y LLC (with 2 members), in which A owns 10% of the charter capital;
- Z LLC (with 2 members), in which A’s spouse owns 15% of the charter capital.

According to Article 167, Shareholder C, Y LLC, and Z LLC are deemed related persons, and accordingly, all contemplated transactions with such subjects are RPTs. However, it can be seen from the transactions in both cases that while considering the ownership structure, either Shareholder C, A or A’s spouse may not have the controlling ability over the company operation. Thus, Shareholder C, Y LLC, and Z LLC may not be the related persons in accordance with Article 4.23 (since they do not fall under any group of related persons as stipulated under Article 4.23).

<sup>21</sup> 2020 Enterprise Law, Article 86.3.

	<p>persons, if such shareholder holds more than 10% of the total ordinary shares of the company; and</p> <ul style="list-style-type: none"> <li>▪ Transactions executed with the executives or their related persons;</li> <li>▪ Transactions executed with those being disclosed as specified in “Publicity &amp; Record” measures.</li> </ul> <p>Accordingly, the authority of the BOD falls in the Related Transactions Required Approval of which the value is less than 35% of the total value of the company assets recorded in the latest financial statements. Any other transactions not falling under the authority of BOD will be subject to the approval of GMS, plus the borrowing, lending and assets selling contracts with a value of more than 10% of the total value of the company’s assets recorded in the latest financial statement between the company and a shareholder</p>		<p>Director or Inspector of the company and their related persons;</p> <ul style="list-style-type: none"> <li>▪ The executives of the owner and their related persons; and</li> <li>▪ Persons with the authority to appoint the executives of the owner and their related persons.</li> </ul>
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	owning from 51% of the voting shares or its related persons		
<b>Mode of approval</b>			
	<ul style="list-style-type: none"> <li>▪ BOM approval<sup>22</sup>:               <ul style="list-style-type: none"> <li>✓ Person requesting approval: person acting on behalf of the Company to execute the RPTs</li> <li>✓ Voting threshold: RPTs to be approved by the majority of BOM members. Votes of BOM members with related interest will not be counted.</li> </ul> </li> <li>▪ GMS approval<sup>23</sup>:               <ul style="list-style-type: none"> <li>✓ Person requesting approval: person acting on behalf of the Company to execute the RPTs</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>✓ The MC approval prior to execution of RPTs<sup>24</sup>;</li> <li>✓ Person requesting approval: person acting on behalf of the Company to execute the RPTs;</li> <li>✓ Voting threshold: 65% or 75% (as the case may be) affirmative votes will be required at the MC's meeting (votes of members related to such RPTs will not be counted)<sup>25</sup>.</li> </ul>	<ul style="list-style-type: none"> <li>✓ The MC or chairman approval and director approval and inspector approval prior to the execution of the RPTs;</li> <li>✓ Person requesting approval: person acting on behalf of the Company to execute the RPTs;</li> <li>✓ Voting threshold: RPTs to be approved by the majority of voters. Votes of voters being related persons will not be counted<sup>26</sup>.</li> </ul>

<sup>22</sup> 2020 Enterprise Law, Article 167.2

<sup>23</sup> Enterprise Law 2020, Article 167.4.

<sup>24</sup> If the MLLC has inspector/supervisory member (*Kiểm soát viên* in Vietnamese), such inspector/supervisory member must also be notified of the RPTs.

<sup>25</sup> Enterprise Law 2020, Article 59.3.

<sup>26</sup> Under Art. 86.3 of the 2020 Enterprise Law, each member of the MC, Director / General Director, Inspector, each has one vote.

	<p>✓ Voting threshold: at least 65% of the total vote of attendees. Votes of shareholder with related interest will not be counted.</p>		
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## Consequences of violations of regulations on controlling transactions with related persons

### *Violation of disclosure measures by the executives and the legal representative*

As mentioned above, the executives and legal representative are liable for disclosing some of their related persons and related interest to the company. However, in respect of the violation of disclosures measures, the 2020 Enterprise Law does not set out the legal liabilities for the company's executives, legal representative being in breach of their disclosure. This may be reasonably explained by the fact that the breach of the publicity obligation itself could not directly result in an unfavorable legal consequence. Thereby, to prescribe specific legal liabilities applicable to the executives and legal representative in this case would not make sense. In addition, by nature, the ultimate purpose of the disclosure / publicity obligations is to determine the RPTs which need to be controlled. Regarding transactions are RPTs which fails to comply with the requirements for obtainment of approvals from corporate bodies of the company to be executed, the 2020 Enterprise Law has stipulated the mechanism for resolving the validity and the consequences of such violating transactions.

### *Violation of measure of obtainment of corporate bodies approval*

RPTs not complying with the requirements for obtainment of corporate bodies approval may face the following legal consequences:

1. *RPTs may be invalid.* Since the 2020 Enterprise Law does not stipulate the procedures for declaration of invalid RPTs, the relevant regulations of the Civil Code are applicable in this case. The case where RPTs fail to comply with the requirements for obtainment of

corporate bodies approval may be deemed similar with the case where transaction entered into and performed by unauthorized persons as stipulated under Article 142 of the Civil Code<sup>27</sup>. Unlike the provisions of the 2014 Enterprise Law, RPTs being in breach of the measure of obtainment of corporate bodies approval shall not automatically be deemed invalid unless it is decided by the Court. It seems that this change of the enterprise laws is favourable due to the fact that the ultimate purposes of the measure is to prevent the RPTs carrying the potential risks of affecting the Company's interest. This new provision may ensure that the RPTs without risks for the Company's interest will not be revoked only due to the violation of the requirements for obtainment of corporate bodies approval. In addition, causing damage is no longer a mandatory element to determine an invalid RPT. Thus, a RPT showing a sign of risk of violation may be determined to be void<sup>28</sup>.

2. *The Company's executives, legal representative and the related persons shall be legally liable for the consequence of invalid RPTs. In particular, the following persons shall compensate for any loss incurred by the Company and return any profit gained from the invalid RPTs<sup>29</sup>.*

JSC	MLLC	SLLC
<ul style="list-style-type: none"> <li>▪ the person signing the contract;</li> <li>▪ relevant shareholders;</li> <li>▪ relevant board members;</li> <li>▪ the relevant director / general director</li> </ul>	<ul style="list-style-type: none"> <li>▪ the person signing the contract;</li> <li>▪ members related to the transaction;</li> <li>▪ the related person participating in the transaction</li> </ul>	<ul style="list-style-type: none"> <li>▪ the person signing the contract;</li> <li>▪ the related person being a party to the transaction</li> </ul>

<sup>27</sup> Pham Hoai Huan, Law on Enterprise in practice: Transactions with related parties (In Vietnamese: *Luật Doanh nghiệp thực chiến: Giao dịch với người có liên quan*) (2021), <<https://www.phamhoaihuan.com/2021/08/luat-doanh-nghiep-thuc-chien-giao-dich.html>>.

<sup>28</sup> Do Minh Tuan, Duty of loyalty of a joint stock company's manager (In Vietnamese: *Nghĩa vụ trung thành của người quản lý công ty cổ phần*) (2016), Research and Legislation (In Vietnamese: *Nghiên cứu và Lập pháp*), <<http://www.lapphap.vn/Pages/tintuc/tinchitiet.aspx?tintucid=208548>>.

<sup>29</sup> 2020 Enterprise Law, Article 67.3, Article 86.5, Article 167.5.

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