

Newsletter:

Business Cooperation Agreement: Legal Risks You Should Know



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In Brief

Business collaborations often stem from preexisting relationships built on familiarity and trust. As a result, these partnerships are initially characterized by strong, amicable relations, with minimal conflicts arising since the tasks outlined in the cooperation agreement have yet to be executed. However, once the implementation phase begins, various challenges may emerge that hinder consensus. Such difficulties typically occur when one party fails to honor its commitments, particularly in the absence of enforceable mechanisms or binding contractual terms. These circumstances frequently lead to the deterioration of the once-solid cooperative relationship. In this context, several common factors can be identified as contributing causes.

Key Takeaways

1. The objectives of the business cooperation are not clearly defined.

In some agreements, these objectives are recorded in vague or incomplete terms, failing to capture the full expectations and goals of each party. Consequently, when conflicts arise, the parties often refer back to their original intentions to reach a mutual understanding. This process encourages goodwill and facilitates the resolution of any disagreements.

2. The contributions of each party are not clearly defined

In business cooperation agreements, the failure to clearly define each party's contributions—whether in the form of assets, capital, effort, technology, or other resources—is a primary cause of disputes and operational disruptions. When a contract does not explicitly outline these obligations, misunderstandings regarding responsibilities can occur, making it challenging to resolve conflicts and undermining the feasibility of the planned activities.

Moreover, neglecting to establish a timeline for contributions is critical. Without clearly defined deadlines and progress milestones, delays by one party can directly hinder the progress of the joint project, potentially resulting in financial losses or other disruptions for the other parties.

Additionally, a lack of stipulated penalties for non-compliance further weakens the contract. Without enforcement mechanisms to address delays or failures in fulfilling contribution obligations, the rights of the other parties remain unprotected, creating an imbalance in the cooperative relationship.

To mitigate these risks, the contract should explicitly detail each party's contributions, specifying the form (e.g., cash, assets, technology, human resources) and measurable values. It should also set forth clear deadlines and milestones to ensure timely contributions. Furthermore, the contract must include robust penalty provisions—such as financial penalties, adjustments to profit shares or benefits, or even the right to unilaterally terminate the agreement—to enforce compliance and protect all parties involved.



- **Fixed Assets:** Fixed assets are pivotal in reflecting an enterprise's value and potential. Buyers must conduct a thorough evaluation of the assets listed in the financial statements—such as machinery, equipment, real estate, and transportation vehicles—to verify both completeness and accuracy. Additionally, it is crucial to confirm the legal ownership of these assets to rule out any disputes or encumbrances, such as mortgages. Finally, assessing the physical condition and depreciation levels ensures that recorded data aligns with the actual state of the assets, further reinforcing transparency and reliability.
- **Cross-Checking Liabilities:** A thorough review of liabilities is critical to ensure that no financial obligations are overlooked. Begin by verifying receivables and payables with partners, suppliers, and customers to obtain an accurate picture of the company's financial standing. It is also essential to scrutinize the payment terms for outstanding debts—both overdue and current—to identify any potential cash flow risks. Moreover, special attention should be given to potential liabilities, which are obligations not yet formally recorded but that could arise in the future. These steps collectively promote transparency and help mitigate financial risks during the evaluation of the target company.
- **Reviewing Accounting Items:** Ensuring transparency and regulatory compliance in financial transactions requires a detailed examination of accounting records. First, verify revenue by cross-referencing the recorded data with business contracts and sales invoices to ensure adherence to accounting standards. Next, carefully review expense records to confirm the validity of reported amounts and to eliminate errors or fraud. Additionally, assess adjustment entries and account transfers to ensure they are conducted transparently and accurately. Ultimately, full compliance with current legal regulations and accounting standards is essential to maintain the integrity and reliability of the financial statements.

Tax Compliance and State Budget Contributions:

During financial due diligence in an M&A transaction, buyers must rigorously assess the target company's adherence to tax regulations. This evaluation should include a thorough review of corporate income tax and value-added tax (VAT) filings to confirm that all taxes have been accurately declared and paid on time. Additionally, it is essential to scrutinize obligations related to land and property taxes, with particular attention to any unpaid liabilities or financial commitments owed to government authorities. The company's history of tax penalties also serves as a critical indicator of potential regulatory breaches that could impact its reputation and financial stability.

Other Financial Obligations – Loans, Third Parties, and Employee Commitments:

In addition to tax matters, buyers should comprehensively evaluate the target company's broader financial obligations. For bank loans or borrowings from credit institutions, it is vital to review the loan documentation in detail, including the loan amount, interest rate, term, and repayment status. Identifying any assets or rights pledged as collateral, as well as obligations arising from credit agreements or business partnerships, is equally important. Furthermore, a careful examination of any outstanding payments to suppliers, investors, or third parties is necessary to uncover hidden financial risks. Finally, employee-related obligations—such as wages, social insurance contributions, and potential labor disputes—must be thoroughly reviewed to ensure that the company is fully compliant with its responsibilities toward its workforce.

3. Consequences of Inadequate Appraisal for the Buyer

- **Financial Implications:** Insufficient due diligence may expose the buyer to hidden financial obligations that the target company failed to disclose. For instance, undisclosed bank loans, overdue supplier debts, or liabilities not recorded in the financial statements could transfer to the buyer upon closing the deal. Additionally, unstable cash flows caused by uncollectible receivables or substantial overdue debts can diminish the company's operational capacity, leading to significant financial losses.
- **Legal Risks:** A cursory review of the target company's legal standing can result in serious violations. Issues such as non-compliance with tax obligations—like untimely payments or incomplete declarations—land ownership disputes, or labor infractions (e.g., failure to pay social insurance) can incur heavy fines and trigger complex lawsuits. These legal challenges not only entail substantial costs but may also damage the buyer's reputation.
- **Operational Challenges:** Errors in valuing the target company often stem from overlooking mortgaged assets, existing disputes, or inaccurately assessing the condition of fixed assets. Consequently, the buyer may end up overpaying and incur additional costs to remedy these issues. Furthermore, unclear financial commitments—such as convoluted credit agreements or hidden operational expenses—can disrupt business operations and impede the buyer's post-M&A development objectives.

Conclusion

Financial due diligence is a cornerstone of any successful M&A transaction, offering all parties a comprehensive view of the target company's financial health. This rigorous process enables buyers to accurately assess the intrinsic value of the business while uncovering potential risks—such as undisclosed liabilities, hidden financial commitments, and challenges related to cash flow and capital efficiency.

By undertaking thorough and systematic financial due diligence, buyers can negotiate more effectively, safeguard their interests, and make informed strategic investment decisions. In a dynamic market like Vietnam, partnering with professional appraisal firms for meticulous preparation is essential for mitigating risks, achieving success, and maximizing value in every M&A transaction.

This article provides general information for reference. If you wish to receive legal advice regarding any issues you are facing, please contact our Lawyers at info@cdlaf.vn.