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According to Vietnam International Arbitration Center annual reports, about 15% of its total disputes involve construction contracts,<sup>1</sup> among which, disputes in relation to penalties figure prominently; yet, the limit that applies to private-sector construction contract penalty rates remains controversial in Vietnam.<sup>2</sup>

## 1. Governing laws

It is of paramount importance to confirm the laws that govern a construction contract in Vietnam.

Generally, the Law on Construction (the “**LOC**”) and relevant guiding legal documents of the LOC,<sup>3</sup> as the specialized law that is intended to govern construction activities in Vietnam, applies first.

A problem arises, however, where the LOC is silent on, or fails to elaborate, any matter. In principle, what law applies to such matter depends on the sector to which such matter relates and the relevant specialized laws available to such particular sector. (To avoid doubt, such prevalence principle is repeated in various specialized laws.)

Under the LOC, construction contracts are defined as civil contracts, which should be governed by the Civil Code where the LOC is silent. At the same time, it is generally accepted that construction activities are commercial activities and thus fall under the governing scope of the Law on Commerce.<sup>4</sup>

Therefore, there remains a question as to what body of law prevails in case of a conflict between the Law on Commerce and the Civil Code with respect to any matter.

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<sup>1</sup> <https://www.viac.vn/en/statistics>

<sup>2</sup> It is only because penalty regulations are expressly set forth for public-sector contracts that this article discusses the latter.

<sup>3</sup> For simplicity's sake, please assume that when a reference is made to a specific law in this article, such reference also includes the reference to the relevant guiding legal documents of such law.

<sup>4</sup> Characteristically, construction contracts are considered “commercial” when satisfying certain subject and purpose conditions (i.e. at least one party is a business entity and the intent is profit-making).

## 2. Conflicts on penalties

A common but not trivial conflict exists between construction contract penalty regulations under the LOC and Law on Commerce and general penalty regulations on contracts under the Civil Code. Other than the 12% cap on penalties applicable to public-sector construction contracts, the LOC simply provides that the penalty should be agreed by the parties and specified in the contract. The Civil Code allows the parties to a contract to (freely) agree on the penalty for contractual violation, *unless otherwise set out by the relevant law*. On the other hand, the Law on Commerce sets forth that contractual penalty amounts must not exceed eight percent of the breached contractual obligation value; hence, the penalty is restricted by both the eight percent limitation and by the value of the breached portion of the contract.<sup>5</sup>

The simplest approach to analysis is that the Law on Commerce is the relevant specialized law upon the grounds that (i) the construction activity should be classified as a commercial activity that must comply with the Law on Commerce, (ii) the Civil Code itself states that only matters not governed by the provisions of specialized laws will be governed by the Civil Code, and (iii) the literal text of the penalty provision of the Civil Code carves out an exception for other laws. If this approach is taken, the Law on Commerce should apply first for construction contract penalties.

On the other hand, as noted in the previous section, it is not entirely clear whether a matter under the LOC should fall back on the Law on Commerce or the Civil Code. The Law on Commerce itself sets out the rule that a commercial activity in a specific industry is governed by the law applicable to that specific industry; but if a commercial activity is governed by neither the specific law nor the Law on Commerce, then the Civil Code applies. Contrastingly, the Civil Code provides that, among other things, (i) the Civil Code is the general law to govern all civil relations, and (ii) matters not governed by the provisions of specialized laws will be governed by the Civil Code. Thus, there is merit in the argument that once the LOC fails to elaborate a matter, it should fall back on the Civil Code, rather than the Law on Commerce itself, which is intended to govern non-specific-industry commercial activity only.

Additionally, though the LOC is silent on the penalty applicable to *private-sector* contracts, it provides that the penalty should be agreed by the parties and specified in the contract. Moreover, it stipulates that the penalty applicable to *public-sector* construction contracts may be up to 12% of the contractual obligation's value. The Civil Code states that (i) no other related laws on civil relations may be contrary to the fundamental principles of the Civil Code, and (ii) a fundamental principle of the Civil Code is the freedom of contract so that all commitments and agreements that do not contravene any prohibition by law or social ethics are valid among the relevant parties and must be honored by all other (third party) subjects. It is, therefore, possible to make a case for the non-application of the eight percent cap on penalties provided by the Law on Commerce for the reason that it is inconsistent with the specific nature of the transactions governed by the LOC and the LOC does not restrict the penalty applicable to private-sector contracts, unlike that of the public-sector contracts.

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<sup>5</sup> For a side note, the penalty rate is based on the breached contractual obligation portion instead of total value contract, which is the popular basis of liquidated damages clauses. This point may be considered as significant and notable matters in commercial contracts governed by Vietnamese law, in comparison with other jurisdictions.

### 3. Certain precedents and practice

Certain judges and officials of the Ministry of Construction (“**MOC**”) have taken the view that for any regulations not elaborated under the LOC, the Civil Code should apply.

In one instance, to answer a question on a penalty matter in 2019, the MOC opined that the parties should be entitled to freely agree on the penalty if such construction contract is in the private sector. As such, though it remains unclear whether they relied upon the Civil Code or their own interpretation of the LOC in the answer, the MOC took the view that the maximum amount of penalty under the Law on Commerce was not applicable and the parties were free to agree on the penalty.

In another instance in 2019, the Supreme People’s Court concluded that construction laws must apply to disputes related to the construction sector, and in absence of relevant guidance under the construction laws, the Civil Code should apply. It is notable that this conclusion was only a general guidance for the application of law and might not apply to the penalty question, which is quite specific. Indeed, this cassation decision has not been picked up by the Supreme People’s Court as a formal precedent case, which would mandate all the courts to comply with it in like circumstances.

Certain lower level courts, prior to the issuance date of the judgment above, held the same view as the Supreme People’s Court in several publicized judgments.<sup>6</sup>

Nevertheless, in contrast to the above view taken by the MOC and the Supreme People’s Court, many courts’ common practice is prioritization of the Law on Commerce in construction disputes. For instance, the People’s Court of Hanoi City, in a 2020 judgment, referred to the Law on Commerce in its decision that the penalty rate agreed in the construction contract, which was ten percent of the breached portion’s value, was higher than eight percent cap provided under Article 301 of the Law on Commerce and therefore the parties could only enforce a penalty of eight percent of the total delayed value of the construction contract.

### 4. Conclusion

In absence of formal guidance or a conclusion from the competent authority, it can only be said at the time of writing that this matter is unclear. One may apply the eight percent penalty to construction contracts for the simple reason that, at the very least, such rate cannot be subject to any claim of violation of the limitation under the Law on Commerce. On the other hand, a higher penalty rate may allow more room for argument in a dispute, bearing in mind the risk that the adjudicatory authority might adopt its own view and grant a different penalty.

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<sup>6</sup> In a case, the court reasoned that (i) since the legal relationship in this dispute was in relation to construction contract and (ii) the construction contract was signed on 1 April 2011, the interest calculation should comply with the provisions of the Civil Code 2005. In another case, the court quoted Article 418.1 of the Civil Code on penalty to argue that the voluntary agreement of the parties on the penalty amount in the construction contract should be accepted.

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