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Legal Update

Contemporary Issues in Construction Contracts: Common Sources of Disputes

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"Vietnam's construction industry has been one of the best performing in the region. It continues to be one of the largest employers in Vietnam, employing approximately 4.4 million workers and accounting for a GDP value of VND506 trillion equivalent to 6% of the country's total GDP. The construction industry continues to attract foreign direct investment from Vietnam's major trading partners with approximately 162 trillion Vietnamese dong worth of investments in the construction sector.

Despite the staggering numbers, Vietnam is no exception to the various disputes and issues that plague construction projects. This update discusses the contemporary issues in a construction contract that are commonly the source of disputes arising from a construction project, from a Vietnam perspective."

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I. Arbitration as a mode of dispute resolution in construction disputes

Vietnam's construction industry is billeted as among the best performing in the Asia-Pacific region, with growth expected to continue throughout the decade. With this industry growth, there is likewise an increased demand for efficient and effective dispute resolution mechanisms. In 2021, construction was among the top three sectors with the biggest number of cases submitted to the Vietnam International Arbitration Centre, accounting for about 20%.

However, there continue to be various pitfalls in resolving disputes by arbitration arising from construction projects with a Vietnam component. These are pitfalls that make arbitration difficult to navigate, but definitely, not impossible. It would be useful for any contracting party to be aware of these common pitfalls including but not limited to:

- Lack of familiarity with the arbitration procedure. This is especially so amongst Vietnamese contracting parties who are engaged in business only in Vietnam notably sub-contractors and suppliers with presence only in Vietnam.
- Limited pool of arbitrators. While it is possible to appoint arbitrators from overseas, the lack of regulation as to immunity from suit for both foreign and local arbitrators seems to be a common basis for non-acceptance of appointment or the basis of the more worrying trend of withdrawing or resigning from their arbitrator appointments in the middle of the arbitral procedure, especially when the imminent threat of civil or criminal action is being dangled against the arbitrators.
- Lack of predictability. Vietnam, being a civil law jurisdiction, has no published body of case authorities or precedents that could guide arbitrands in the process of the arbitration or guide arbitrators, and eventually first-instance courts on questions of law at the enforcement stage.

There is a robust body of legal and regulatory frameworks for construction projects in Vietnam. Construction contracts in Vietnam are governed by the Construction Law,[1] and the Civil Code 2015[2] (construction contracts are "*civil contracts established in writing*"). These laws are further implemented and clarified by Decrees and Circulars, which include Decree No. 37/2015/ND-CP amended and supplemented by Decree No. 50/2021/ND-CP, integrated by

[1] Integrated document No. 02/VBHN-VPQH dated 15 July 2020.
[2] Law No. 91/2015/QH13 dated 24 November 2015.

Integrated document No. 02/VBHN-BXD (***Integrated Decree No. 37***),[3] Circular No. 30/2016/TT-BXD,[4] and Circular No. 09/2016/TT-BXD.[5] Other decrees and circulars, while not specifically referring to construction contracts, may likewise be applicable.

Article 683.4. of the Civil Code on contracts having foreign elements provides that if the object of a contract is an immovable property, the law applicable for the transfer of that property's ownership rights and/or other property-related rights, lease of immovable property or using the immovable property as guarantee for the performance of obligations shall be the law of the country where the immovable property is located.

Article 11 of Decree No. 37/2015 provides that construction contracts falling within the scope of such Decree *"must apply the legal system of the Socialist Republic of Vietnam and comply with the regulations laid down in this Decree.*", i.e. for construction contracts in the private sector having foreign elements but which do not fall within the scope of Integrated Decree No. 37 and Article 683.4 of the Civil Code, the parties are able to choose the governing law of such contracts. Article 3 of Integrated Decree No. 37 provides that projects funded by official development assistance shall be regulated by the applicable international treaty.

Mediation, arbitration, and court litigation are expressly recognised as the modes of dispute resolution under Article 146.8.b of the Construction Law. Contracting parties must first negotiate for the resolution of their disputes. When negotiation is unsuccessful, they may proceed to commence further legal action. Arbitration may be commenced only if there is a valid and existing arbitration agreement in the construction contract. In theory, parties could enter into an arbitration agreement after a dispute arises, but such practice is uncommon in Vietnam.

As Vietnam law requires negotiation before arbitration, it is helpful if the dispute resolution clause provides a specific process and timeline for the negotiation process. Leaving the negotiation period open-ended may put into issue the commencement of arbitration as being premature.

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[3] Dated 17 May 2021. This Decree applies to construction contracts funded by public investment capital, state capital (other than state investment capital, and PPP projects.

[4] Dated 30 December 2016 on guidelines for EPC contracts.

[5] This Circular expressly applies construction projects by (i) regulatory agencies, socio/political/occupational organizations, units of people's armed forces, and public service providers; (ii) state-owned enterprises; and (iii) those at least 30%, or less than 30%, but over VND 500 billion, of whose investment capital is state capital / state-owned capital.

II. Salient points of Vietnam law in construction contracts

1. Determination of contract value and payment structure

Article 140.2 of the Construction Law and Article 15 of Integrated document No. 02/VBHN-BXD recognize six pricing structures in construction contracts:

- lump sum
- fixed unit price
- adjustable unit price
- time-based contract price
- cost-plus fee contract
- combined price

Payment in foreign currencies is allowed, provided that laws on foreign exchange such as the Ordinance on Foreign Exchange Control 2005 shall prevail.

Article 147 of the Construction Law requires that a construction contract be settled and liquidated in accordance with the provisions of the contract itself, following the required documents and procedure. Settlement is the process where the parties determine the total value of the payment due from the employer by the contractor submitting the required documents under the contract to prove the scope of work or milestones completed. Liquidation occurs when the parties have either fulfilled their obligations (including full payment by the employer) or when the contract is lawfully terminated or cancelled.[6]

The Construction Law and decrees impose additional restrictions and limitations when the construction projects involve funding from the State.

For example, Article 134.4 of the Construction Law provides that "*for projects using public investment funds and non-public investment state funds, the approved total construction investment amount is the maximum level which project owners may use to implement the projects.*" Another is Article 147 of the same law, which provides that *the limit for liquidation of state-funded contracts is 45 days. These limitations must be kept in mind when concluding state-funded projects.*

[6] Article 147, Construction Law; Articles 22 and 23, Integrated Decree No. 37.

2. Adjustments to construction contracts

A construction contract may be adjusted or amended as to "*volume, schedule, contract unit prices and other contents agreed upon in the contract*."[7] Article 143 of the Construction Law recognises limited grounds for adjusting a construction contract as follows:

- as agreed upon by the parties;
- when the State changes its policies;
- when the project is adjusted, affecting the contractual provisions; and
- *force majeure.*

Section 5 of Integrated Decree No. 37 provides additional guidelines on the adjustments available for the contracting parties.

Circular No. 07/2016/TT-BXD[8] has specific guidance on price adjustments. Article 3 of this Circular provides for two to four possible grounds for adjustment, depending on the pricing structure. Two grounds are given further clarity and definition: (i) "*reasonable additional ... or reduced work volumes*"; and (ii) *force majeure*. These two grounds are available in all five of the pricing structures mentioned above.

Also, Article 420 of the Civil Code provides that upon a "*basic change of circumstances*," a contract may be re-negotiated by the parties within "*a reasonable period of time*." A basic change of circumstances closely reflects the principle of *rebus sic stantibus.*

In case the parties are unable to renegotiate the change(s) of circumstance, they may request a court to either terminate the contract or "amend the contract to balance the lawful rights and interest of the parties." Notably, the primary remedy available from the courts is termination. Amendment by the courts is available only if "the termination of the contract would cause greater damage."

More often than not, these provisions are commonly used as legal basis in a number of claims arising from the unexpected circumstances surrounding the COVID-19 pandemic.

[7] Article 143.1, Construction Law.
[8] Guiding the adjustment of construction contract prices, 10 March 2016.

3. Warranties

Article 125 of the Construction Law and Article 8 of Circular No. 09/2016/TT-BXD allow the parties to agree as to warranties. Circular No. 09/2016/TT-BXD provides for the minimum periods of warranty of 24 months for Class 1 or Special Class work items, 12 months for other construction works, and 5 years for housing projects. The warranty period is calculated from the date of acceptance. The contractor must comply with the warranty within 21 days from receipt of notice to repair, otherwise, the principal may contract the repairs to another.[9] The contractor may refuse to uphold the warranty if the defects are due to the principal's fault or arising from *force majeure*.

4. Model construction contracts

If the parties consider it appropriate for their project, model template contracts are provided in Circular No. 30/2016/TT-BXD for EPC contracts, and Circular No. 09/2016/TT-BXD for "work construction contracts."[10] These model templates are provided as guidance with no obligation for any party to adopt the terms verbatim. Parties are enjoined to amend and adapt these model contracts to their specific contractual relationships. FIDIC model contracts may also be used and amended where necessary. In relation to dispute resolution, the FIDIC 2017 sets out a three-tiered system of determination of claims as follows: determination by a Dispute Avoidance/Adjudication Board (***DAAB***), amicable settlement, and arbitration. The DAAB can be constituted with one or three members, and if the DAAB is constituted, it is mandatory to obtain first the DAAB's decision before resorting to arbitration.

5. Statute of limitations

The statute of limitations is a matter of substance (as opposed to procedure) under Vietnamese law. Therefore, the time-bar set out in Vietnamese laws only applies when Vietnamese law is the governing law of the contract. Article 429 of Civil Code 2015 provides that the statute of limitations for initiating actions relating to a contract is 3 years. In contrast, Article 33 of the Law on Commercial Arbitration provides that the statute of limitations for commencing arbitration is 2 years, "*unless otherwise provided by discrete laws.*" As construction contracts are civil contracts, it is arguable that the Civil Code 2015 is that "discrete law" applicable to construction contracts. Therefore, the longer 3-year period could

[9] Article 46.2. of Integrated Decree No. 37.

[10] "Work construction contracts" are defined as "a type of contract for the performance of construction of the works, work items or part of construction work by design" under Decree No. No. 37/2015/ND-CP.

be the applicable period. As a matter of extra caution, it is advised to take a conservative approach when navigating these tricky areas of law.

III. Common sources of disputes

1. Ambiguous or unclear contract drafting

A common source of dispute in the implementation of construction contracts is the parties' conflicting interpretations of the terms of the contract, brought about by unclear drafting. Ambiguous or doubtful terms may lead to disputes involving the priority of contract documents and overlap among several provisions.

It is suggested that for each construction project, the relevant contracts must specify, to the level of certainty as much as possible, matters such as:

- the division of responsibilities between the investor, the supervisor, the employer, the contractor and sub-contractor(s), and
- the documents required to evidence proof of accomplishment of work and the corresponding payment.

Disputes commonly arise from the unclear division of responsibilities and allocation of risks between the investor and supervisor over the work of the contractors, for example, or which party should be liable for the false or fraudulent volume of materials delivered to the construction site, or the poor quality of the construction work. Without a clear division of responsibilities under a construction contract, and without good coordination between the primary construction contract other related contracts including design contract, supervision contract, etc., disputes may easily arise in the course of the construction project. In addition, from our experience, disputes often arise as regards non-submission or incomplete documents for the request of payment, particularly in cases where adjustments are requested, or where construction work is required to be stopped. Eliminating ambiguities, to the most practicable extent possible, would help minimize these sources of dispute.

2. Termination of contracts

Article 145 of the Construction Law, in relation to Article 41 of Integrated Decree No. 37, regulates the termination of construction contracts. The principal has the right to terminate when:

- the contractor falls bankrupt, is dissolved, or "transfers" the work to other contractors without approval of the principal; and

- the contractor refuses or continually fails to perform work for 56 straight days, resulting in violation of the agreed performance schedule.

The contractor has the right to terminate when:

- the principal becomes bankrupt or is dissolved, or contracts the work to another entity, without the contractor's approval.
- due to the principal's fault, the work is suspended for a period of 56 straight days.
- the principal fails to make payment within 56 days after the principal receives valid payment dossiers. The parties may extend the periods for termination by agreement.

A party terminating the contract must send written notice to the other with the reason for termination, otherwise, such terminating party may be liable for damages. Article 41 of Integrated Decree No. 37 provides that a party unilaterally terminating a contract without cause shall be liable for damages.

If the contractor does not fulfil its obligations, the principal may replace the contractor. However, such a change in contractor may be viewed as a termination of the prior construction contract, and the execution of a new one. Article 41 of Integrated Decree No. 37 provides that the employer may be liable for damages if it contracts the work to another contractor, without approval of the previous contractor. Further, the model contract in Circular 09/2016/TT-BXD provides that "*the principal may hire another contractor to complete the construction*" in the context of the termination clause.

3. Delays

Article 146 of the Construction Law specifically provides that the contractor or principal who causes delay shall be liable for damages. Article 51 of Integrated Decree No. 37 provides that "*parties must define responsibilities of each party of any damages caused by … delay.*" The same article provides for grounds in which the contract implementation (i.e. project schedule), is considered adjusted, which, includes *force majeure*, changes requested by the principal, suspension due to employer's fault, and "*other procedures caused by neither party.*"

4. Penalties, fines, and liquidated damages

The concept of liquidated damages under Vietnamese law has long been the subject of rigorous debate. As liquidated damages are not expressly recognized, two concepts have been

applied by analogy: (i) compensatory damages, and (ii) penalties/fines for breach of contract. These two are discussed below in the context of construction contracts.

On compensatory damages, the Civil Code 2015 provides that the breaching party must compensate the plaintiff for the "*whole damage*", including physical and spiritual damage, and "*supposed benefits that will be enjoyed by the contract offer*." The relevant provisions are interpreted as obligating the plaintiff to properly quantify the damages, with the debtor only being liable for what can be proven as actual loss (and nothing more).[11] However, these articles are qualified by the proviso "*unless otherwise agreed [by the parties]*", at Articles 13 and 360. This proviso is commonly and widely interpreted to support the principle of liquidated damages.

On the other hand, fines are defined in Article 418 of the Civil Code 2015 as "*the amount of money agreed by the parties to a contract that the default party will pay in case of breach of contract*. The fine "*shall be agreed by the parties, unless otherwise prescribed by relevant laws*." In relation to the proviso on "*relevant laws*," Construction Law provides, "*[r]ewards or fines for construction contracts shall be agreed upon by the parties and stated in the contracts.*" There is a limitation of 12% of the value of the violated contract "*[f]or works using public investment funds, non-public investment state funds*", which the breaching party must pay <u>in addition to</u> compensation for damages. There appears to be no similar limitation on works <u>not</u> involving public or state funds. Notably, the model contract in Circular No. 09/2016/TT-BXD does not provide such a limitation as well, leaving the amount for "*% of the contract value*" blank. However, Article 22.2 of the model EPC contract in Circular No. 30/2016/TT-BXD provides a 12% limitation, like the Construction Law. Therefore, these provisions appear to further complicate the debate on the validity of liquidated damages under Vietnamese law, particularly within the context of construction contracts.

[11] Specifically with respect to actual loss, another possible angle for dispute may arise from Article 419.2 of the Civil Code 2015. Under this provision, "*an obligee may demand compensation for loss and damage in respect of benefits from the contract which the obligee would have enjoyed*" and "*the obligee may <u>also</u> request the obligor to pay any fee arising from failure to fulfil contractual obligations without overlapping with the amount of compensation for loss and damage in respect of the benefits from the contract*".

5. Force majeure

The Civil Code 2015 defines force majeure as "*an event which occurs in an objective manner which is not able to be foreseen and which is not able to be remedied by all possible necessary and admissible measures being taken*." Force majeure in construction contracts is a "*risky event that takes place objectively, unforeseeably and cannot be controlled even though all necessary measures and are taken and capabilities are employed such as natural disaster, environmental problem, enemy-inflicted disaster, conflagration and other irresistible factors*."[12]

Force majeure is different from "risks", which are "possible negative effects on the implementation of construction contract in the future."[13] Parties are liable for damages according to risks allocated to them in the contract (and, generally when they are at fault). Contrasted, force majeure relieves the impacted party from liability for delay.

However, payment obligations for the work which has been completed are not affected by force majeure.[14]

In force majeure cases, either party must send a notice to the other, specifying the cause of force majeure and the impact on the project. The contract may be terminated "*[i]f the period of delay due to force majeure is longer than that in the notice*." [15]

Within the context of the COVID-19 pandemic, it appears that there is much debate as to whether the disruptions caused by COVID-19 are considered force majeure. Considering the implications of Vietnamese law on the matter, a party claiming that works have been affected by force majeure must ensure compliance with the notification requirement, as well as sufficiently plead and prove that the risks were unforeseeable and unavoidable.

Please contact us if you have any questions relating to this update at legalenquiries@frasersvn.com.

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[12] Article 51.2., Integrated Decree No. 37.
[13] Article 51, Integrated Decree No. 37.
[14] Article 10, Circular No. 09/2016/TT-BXD.
[15] Article 10, Circular No. 09/2016/TT-BXD.

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