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### **COMMERCIAL RESERVATIONS**

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An appeals court ruling may have a negative impact on Vietnam's legal environment by reintroducing uncertainty into commercial transactions

#### **Introduction**

The Convention on the Recognition and Enforcement of Foreign Arbitral Awards signed in New York on June 10, 1958 is of great practical importance for the legal effectiveness of international arbitration. The Convention is adhered to by more than 100 States and continues to attract new signatories. Vietnam is a member of the Convention and has implemented it through its own Ordinance on the Recognition and Enforcement of Foreign Arbitral Awards passed by the Standing Committee of the National Assembly in 1995.

The Convention expressly provides in Article I(3) two possible reservations, a 'reciprocity' reservation and a 'commercial' reservation:

"When signing, ratifying or acceding to this Convention, or notifying extension under article X hereof, any State may on the basis of reciprocity declare that it will apply the Convention to the recognition and enforcement of awards made only in the territory of another Contracting State. It may also declare that it will apply the Convention only to differences arising out of legal relationships, whether contractual or not, which are considered as commercial under the national law of the State making such declaration."

This first reservation has been adopted by approximately two-third of the States party to the Convention. The 'reciprocity' reservation may preclude application of the Convention to the recognition and enforcement of arbitral awards made in non-party countries since courts in States making such reservation may refuse to recognise or enforce an arbitral award made in a non-party State. As more States become party to the Convention it will move closer to universal applicability and the impact of the reciprocity reservation becomes less significant.

The second reservation, the 'commercial' reservation, has been adopted by approximately the remaining one-third of States, including Vietnam, and is potentially problematic. It depends on how legal relations are characterised under the national law of the State which has made such reservation. If the legal relations are not considered commercial in nature, the arbitral awards could run the risk of being denied recognition and enforcement. Recent rulings made by the courts in HCMC in relation to a contractual dispute between two foreign construction companies have shed some light on how the commercial reservation is applied under Vietnamese law.

#### **Recent Rulings – Court of First Instance**

The case in point relates to a contractual dispute between two construction companies, Tyco Services Singapore Pte. Ltd and Leighton Contractor (VN) Ltd with respect to a contract signed in 1995 concerning the development of a beach resort in the central part of Vietnam. The dispute was referred to arbitration in Queensland, Australia, and two arbitral awards were made by the Queensland arbitrators in favour of Tyco which then sought recognition and enforcement of the

awards in Vietnam. On May 23, 2002, the Economic Court of HCMC recognised the arbitral awards. This is probably the first time a court in HCMC has recognised a foreign arbitral award for enforcement in Vietnam.

One of the key arguments made by Leighton for not recognising and enforcing the awards was that the contractual relations underlying the dispute were construction relations and not commercial ones in light of the provisions of the Commercial Law adopted by the National Assembly on March 23, 1997. Article 45 of the 1997 Commercial Law provides for an exhaustive list of 14 'commercial acts' which include the sale and purchase of goods, agency arrangement for purchase or sale of goods, and representation of business persons. Basically, most acts revolve around sale or purchase of goods, and construction does not constitute a commercial act.

The HCMC Court rejected Leighton's argument and explained that the Contract was signed prior to the enactment of the 1997 Commercial Law, and hence it was impossible to conclude that the transactions contemplated in the Contract were not commercial in nature at the time the Contract was made. Two things can be noted. First, the ruling presupposed that there did not exist any law regulating commercial transactions before the 1997 Commercial Law. Second, the ruling may be inferred to mean that for transactions entered into after the enactment of the 1997 Commercial Law, that Law may be used as the basis to determine whether such transactions are commercial in nature or not.

#### **Ministry of Justice's Opinion and Court of Appeal**

Leighton made a request for appeal and the Court of Appeal of the Supreme Court in Ho Chi Minh City assumed jurisdiction. In relation to the appeal proceedings, on August 22, 2002, Tyco sent a request to the Department of International Law and International Cooperation of the Ministry of Justice for explanation of the applicability of the 1997 Commercial Law. In its response dated August 29, 2002, the Ministry of Justice echoed the theme of the court of first instance decision. It noted that the 1995 Ordinance and the 1995 Contract were issued and signed respectively prior to the enactment of the 1997 Commercial Law. It then held that prior to the enactment of the 1997 Commercial Law, there existed no distinction in the legal theory between commercial acts and non-commercial acts, and hence it was impossible to establish that the transactions contemplated by the 1995 Contract were not commercial in nature. In the Ministry of Justice's view, the awards were qualified for recognition and enforcement in Vietnam.

On January 21, 2003, the Court of Appeal of the Supreme Court in Ho Chi Minh re-heard the case and overturned the decision rendered by the court of first instance. The Court of Appeal ruled in the hearing that the transactions contemplated in the 1995 Contract related to construction matters and were not commercial in nature under *both* Vietnamese law then in effect and the 1997 Commercial Law, and hence the award was not eligible for recognition and enforcement in Vietnam.

Contrary to the Ministry of Justice's explanation, the Court of Appeal held that there existed rules governing commercial acts prior to the issuance of the 1997 Commercial Law. Specifically, reference was made to Decree No. 02/CP of the Government dated January 1, 1995, regulating goods and services that are prohibited or the trade of which is subject to conditions, and Decree No. 01/CP of the Government dated January 3, 1996, on resolution of administrative violations in the trade area. According to the Court of Appeal, these decrees had references to commercial acts and purported to govern commercial acts. Like the 1997 Commercial Law, the commercial acts referred to in these Government decrees were limited in number and mainly related to trade

in goods. Again, construction was not included. On that basis, the Court of Appeal found no legal basis for recognition.

In short, the decision by a HCMC court for the first time to recognise a foreign arbitral award in Vietnam has been overturned on appeal. While the Ministry of Justice and the HCMC Court seemingly believed there was a legal vacuum prior to the enactment of the 1997 Commercial Law, the Court of Appeal took the opposite view. However they all appeared to agree that the 1997 Commercial Law would be used as the basis to determine the commercial nature of transactions entered into after its enactment.

### **Conclusions**

Overall, the bad news is that Vietnam cannot claim that it has recognised and enforced a foreign arbitral award in HCMC since the issuance of the 1995 Ordinance. The rulings may also dispel some firmly rooted notions that Vietnamese courts will not look carefully at the commercial reservation to deny recognition and enforcement because 'commercial' is a broad concept. The opposite is true.

The most critical precedent of the case is that Vietnamese courts will likely use the 1997 Commercial Law to determine the commercial nature of the underlying transactions if such transactions were entered into after the enactment of the 1997 Commercial Law. As such, the commercial reservation becomes a powerful weapon for the losing parties. The applicability of the Government decrees cited by the Court of Appeal with respect to transactions entered into before the enactment of the 1997 Commercial Law is a little less clear since the HCMC Court, the Ministry of Justice and the Supreme Court do not have a consensus view on this issue.

As noted above, the list of 14 commercial acts in the 1997 Commercial Law is narrow and mainly revolves around trade in goods. Many important transactions are left out. Lending, security, construction (including EPC arrangements), for example, and most types of services are not included in the list and hence are not qualified for enforcement under the 1995 Ordinance.

Since disputes arising out of most transaction documents of large infrastructure and other projects in Vietnam are normally submitted to foreign arbitration, the rulings create significant risks for foreign lenders and EPC contractors. They could find an arbitral award in their favour rendered by ICC or UNCITRAL arbitration in a neutral country like Singapore not eligible for recognition and enforcement in Vietnam because of the narrow interpretation of the commercial reservation. At the end of the day, these parties would have to reconsider how this risk could be addressed, mitigated or compensated. Project costs will likely be increased.

Until resolution of disputes by Vietnamese courts or Vietnamese arbitration bodies becomes a viable option, there does not seem to exist an effective mechanism for dispute resolution since judgements rendered by foreign courts are generally not enforceable in Vietnam. Two solutions are available although probably impractical in the immediate future. Either the commercial reservation will be dropped or the definition of commercial acts in domestic law, including the 1997 Commercial Law, will be expanded to the effect that it will also cover all business transactions. In the second scenario, the commercial reservation will be *de facto* of little importance.

The recent Vietnam-US Bilateral Trade Agreement (BTA) makes the second solution a more viable one. It requires Vietnam to amend its domestic law to be consistent with its commitments in the BTA which covers both 'trade in goods' and 'trade in services', with goods and services being broadly defined to include virtually all business activities. The new Ordinance on Commercial Arbitration issued by the Standing Committee of the National Assembly on February 25, 2003

started to go along these lines. It governs arbitration proceedings for disputes arising from 'commercial activities', which as defined in the new Ordinance include almost everything from sale or purchase of goods to provision of services, and make specific mention of construction, investment, finance, banking, insurance and 'other commercial activities as provided by law.'

It is likely that similar concepts will have to be built into the 1997 Commercial Law and a narrow definition of commercial acts will no longer be appropriate. The question is when these amendments will be made. Unfortunately, it is not expected to happen soon, probably not before 2005. Until then, the risk still exists.

In conclusion, the precedent created by the rulings has a negative impact on Vietnam's legal environment. A narrow interpretation of the commercial reservation is likely to increase the legal risks (and consequently the costs) associated with doing business in Vietnam, and undermine the only viable dispute resolution forum currently available for large and complex projects in Vietnam. Notwithstanding any legal argument to the contrary, a policy judgement should probably be made to resolve these issues as soon as practically possible. To this end, the Ministry of Justice and the Supreme Court may provide an immediate solution by applying the definition of 'commercial activities' in the new Ordinance on Commercial Arbitration pending future amendments to the 1997 Commercial Law.