



PENALTY AND LATE PAYMENT INTEREST ON OVERDUE PAYMENT

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The below Legal Summary prepared by BLG contains a brief discussion with tailored practical information for investment and business activities in Vietnam.

The article concentrates on the application of penalty and late interest on overdue payment under applicable laws.

Payment is a common contractual obligation, and disputes are often around monetary matters. Thus, it is critical to protecting one's business interests by minimizing the late payment. Under applicable laws of Vietnam, there are two frequently used measures to secure the duly performance of payment obligation named penalties and late payment interest. This article will highlight some worthy notes to ensure those remedies are enforceable.

1. Penalty

1.1 Definition

Generally, as defined in current laws of Vietnam, penalty is an agreement under which the breaching party has to pay the non-breaching one an amount as agreed unless otherwise prescribed by relevant laws^[1]. It is deterrent to encourage the duly contractual obligation performance to avoid paying a large amount of money.

1.2 Enforceability

The precedent condition to claim a penalty against late payment is that there must be a penalty agreement, which may be a part of the contract or an independent agreement.

To be enforceable, the penalty clause also needs to follow the regulations on the maximum level applicable to each kind of contract. Currently, we are aware that the penalty level against late payment as follows:

- Up to 08% of the overdue amount arising from commercial contracts^[2].
- Up to 12% of the overdue amount arising from the state-funded construction contract^[3].
- No limit and as agreed by the parties of other contracts.

1.3 Notes

^[1] Clause 1 of Article 428 of Civil Code 2015 and Article 300 of Commercial Law 2005.

^[2] Article 301 of Commercial Law 2005.

^[3] Clause 2 of Article 146 of Construction Law 2014 amended by Law No. 62/2020/QH14 dated 17 June 2020.

In practice, when there is a limit for penalty under relevant laws governing the disputed contract, the court shall not accept the claim exceeding that threshold^[4].

Thus, it is important to determine the type of contract and the applicable laws so that the contractual parties are able to optimize the penalty clause to ensure their legitimate rights and interests.

2. Late Payment Interest

2.1 Definition

Different from penalty, late payment interest is “statutory measure” which can be applied without contractual agreement. It serves as compensation for the loss of use of the money.

2.2 Enforceability

As a rule of thumb, according to Articles 357 and 468 of Civil Code 2015, an obligor failing to make timely payment is subject to paying late payment interest as agreed between the contractual parties; unless otherwise stipulated by other relevant laws, this rate is capped at 20% per annum.

In loan contract with credit institutions, as per Clause 4 of Article 13 of Circular 39/2016/TT-NHNN, where the borrower fails to make payments for the loan principle, they shall be subject to late payment interest as agreed but not exceed 150% of the interest on the loan principle. While the failure to make payments for the loan interest shall give rise to a late payment interest up to 10% per annum.

In commercial contract, according to Article 306 of Commercial Law 2005, where a party delays payment for goods or services and other reasonable fees, the aggrieved party may claim an interest on such delayed payment at the average interest rate applicable to overdue debts in the market at the time of payment for the delayed period, unless otherwise agreed or provided for by law.

In construction contract financed with public investment, State capital other than State investment capital and public-private partnership (PPP) projects, according to Article 43 of Decree 37/2015/ND-CP amended by Decree 50/2021/ND-CP, in case the employer (client) fails to make payment timely and adequately, they have to pay late payment interest at the rate of the commercial bank where the contractor opens its payment accounts.

^[4] Magazine of People’s Court (*Tạp chí Tòa án nhân dân*), Penalty in commercial activities some inadequacies and solutions, <https://tapchitoaan.vn/phat-vi-pham-trong-hoat-dong-thuong-mai-mot-so-bat-cap-va-giai-phap-hoan-thien-phap-luat5881.html>.

2.3 Notes

It might be seen that the more specific the late payment interest rate, the easier its application becomes.

In regard to commercial contracts governed by Article 306 of Commercial Law 2005, up to now, Precedent No.09/2016/AL and Article 11 of Resolution No.01/2019/NQ-HDTP provide clear guidance on calculating the average interest rate applicable to overdue debts in the market. Accordingly, to determine the late payment interest rate, the Court will collect the average interest rates applicable to overdue debts in the market announced at the time of payment (i.e. during the first-instance hearing) by at least 03 commercial banks (such as Vietcombank, VietinBank, Agribank, etc.) that have their head offices, branches or transaction offices located in the province or central-level city where the Court resolving the lawsuit is located.

In fact, other than the Court, it is very difficult to get official information from bank about the rates on overdue debt. Thus, instead of using the wordings above, it is recommended that contractual parties stipulate the specific late payment interest for quick and smooth application.

Similar to penalty, in practice, the Court shall not accept the late payment interest rate higher than the maximum prescribed by laws but apply the statutory cap instead, which should be noted when making the late payment interest clause^[5].

3. Simultaneous Application of Penalty and Late Payment Interest

In case where a payment obligation is breached, parties often agree that a penalty shall be calculated at a fixed rate (%) of the overdue amount for each day of delay and also a penalty cap (if any). Such penalty clause seems like a late payment interest one.

The question arises whether the non-breaching party may simultaneously apply both penalty and late payment interest against overdue payment.

It is not controversial when the contract explicitly states both above penalty and late interest payment clauses. Current regulations do not prohibit or limit the simultaneous application,^[6] and one fundamental principle of laws of Vietnam is to

^[5] Civil Law Department, Department of Civil - Economic Law, Ministry of Justice, https://htpldn.moj.gov.vn/SMPT_Publishing_UC/TinTuc/PrintTL.aspx?idb=2&ItemID=1835&I=noidung/tintuc/Lists/NghiencuuTraodoi

^[6] In civil transactions, according to Article 418 of Civil Code 2015, in case the parties have a penalty agreement against violation but do not specify that the violating party has to pay both a penalty and a compensation for damage, then the violating party has to pay only the penalty for violations.

respect the lawful agreements of relevant parties. The court will accept the claim of both penalty and late payment interest if there is an agreement stating that.

However, ambiguity may arise when the contract does not clearly express as discussed above^[7]. Thus, the contracting parties should specify which measures can be applied against overdue payment and details on how to apply those.

The application of penalty and late payment interest, which means that a breach of payment obligation has occurred, is a scenario neither party desires. Therefore, it is highly recommended to prevent the breach from occurring in the first place. Any contract should always include a payment clause which explain in detail how payments are to be made, whenever possible, list dates, requirements and methods of payment. Besides, penalty and late payment interest clauses should be properly structured and crafted to manage the risks and to mitigate the damage to the aggrieved party.

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^[7] Opinions of Mr. Do Van Dai, Mr. Truong Thanh Duc, Mr, Truong Nhat Quang (Arbitrators at Vietnam International Arbitration Center) at webinar named Interest rate in dispute at arbitration on 01 July 2021, http://viart.org.vn/images/RESOURCES/Research-Material/210701_VAS-2021-CD05/2021VAS_Tai-lieu-webinar-05.pdf.




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