

**LEGAL UPDATE**

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**REPRESENTATIONS AND WARRANTIES IN VIETNAMESE CONTRACT LAW****INTRODUCTION**

In reviewing a contract drafted by a common-law trained lawyer,<sup>1</sup> Vietnamese lawyers or law researchers often notice a significant difference: the existence of the representation and warranty clause. This clause is especially important and often takes the longest time for negotiation by the buyer and the seller in merger and share acquisition transactions (a.k.a. M&A transactions).

Contracts based on the civil law tradition normally only contain the rights and obligations of the parties. For example, in a sale transaction, the seller's obligation is to deliver the sold goods and the buyer's obligation is to pay for them. The doctrines of "representation" and "warranty" do not exist in the contract law of Vietnam (as well as other countries following the civil law tradition) and are not taught in law schools. For this reason, many Vietnamese lawyers and law researchers are fairly unfamiliar with the meaning of "representation" and "warranty" and the legal consequences of their breach under Vietnamese laws.

This article briefly introduces the history of the doctrines of "representation" and "warranty," their application in contracts, especially share sale contracts, and the consequences of a breach. It also makes recommendations for Vietnamese lawyers when drafting or reviewing a "warranty and representation" clause in contracts.

**HISTORY**

The doctrines of "warranty" and "representation" in contract law originate from the common law system.<sup>2</sup> Traditionally, the common law offered buyers few protections if purchased goods weren't as expected (i.e., it has defects or is of lower value, etc.), except in cases of fraud by the seller. The reason behind is to let the buyer, not the law, decide how to protect itself. This approach reflects the Latin motto "caveat emptor" which means "let the buyer beware."<sup>3</sup> This approach differs from the approach of the civil law tradition in which the seller is often obliged to inform the buyer about

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<sup>1</sup> The two major legal traditions in the world are the common law system and the civil law system. The common law system, also known as the Anglo-Saxon law or case-law based system, is one where laws are developed through judges' decisions in resolving disputes. These decisions become precedents applied to similar future cases. In contrast, the civil law system, also known as the continental law system, relies on codified law – written statutes promulgated by legislators. When a dispute arises, the dispute resolution body refers to these relevant legal provisions to reach a decision. Countries following the common law system include England, the United States (except Louisiana), Australia, Singapore, Hong Kong, etc. Civil law systems are followed in France, Germany, Italy, Russia, China, and Vietnam, among others.

<sup>2</sup> See Section 2 (The Drafting Technique Used) of Part 1 (Introduction) of the ICC Model Mergers and Acquisitions Contract (I – Share Purchase Agreement) ("**ICC Model Contract**"). The ICC Model Contract was drafted and published in April 2004 by the Task Force on Mergers and Acquisitions under the Commission on Commercial Practice of the International Chamber of Commerce or "ICC" for short). Notably, the Task Force on Mergers and Acquisitions is comprised of legal experts from both civil and common law systems.

<sup>3</sup> NEIL SINCLAIR, *SINCLAIR ON WARRANTIES AND INDEMNITIES ON SHARE AND ASSET SALES 1* (8<sup>th</sup> ed., Sweet & Maxwell, 2011).

the characteristics and defects of the object.<sup>4</sup>

The common law solution was to introduce “representations” and “warranties” into contracts. A “representation” is a seller’s statement about the goods’ conditions or legal status, made to induce a purchase. For example, a seller might represent ownership of shares and their freedom from encumbrances. Representations can be written, verbal, or even through gestures (e.g., a nod or smile), and traditionally weren’t included in contracts. However, they are now commonly found in M&A contracts.

A “warranty” goes beyond a representation, acting as a guarantee that a statement is true. Warranties often cover more important matters.<sup>5</sup> For instance, a warranty might ensure a company has fulfilled its tax obligations or isn’t involved in lawsuits. Warranties can address current or future events, such as a company’s ongoing environmental law compliance. Unlike representations, warranties are typically included in the contract.

It is important to note that the distinction between representations and warranties is clearer in the English legal system. In the U.S. legal system, the concepts are often treated similarly.<sup>6</sup>

#### CONSEQUENCES OF BREACHING A REPRESENTATION OR WARRANTY

Under the U.K. Misrepresentation Act 1967 (“**Misrepresentation Act**”), a misleading representation generally allows the buyer to rescind the contract (and claim damages).<sup>7</sup> However, for innocent misrepresentations (those made without intent to defraud or due to negligence),<sup>8</sup> the court or arbitral tribunal may decide to award only damages and allow the contract to stand, considering the nature of the misrepresentation and the consequences of rescission for both parties.<sup>9</sup>

Unlike misrepresentation, there's no specific law governing remedies for a breach of warranty. Case law suggests various options, including repairs, replacements, price reductions, damage compensation, and, in severe cases, contract rescission.

It is important to note that in M&A transactions, where the company itself is being sold, rescinding the contract becomes less practical due to the complexities involved. While theoretically possible, rescinding the sale contract after closing (i.e., the moment when the parties have completed the conditions precedent and the seller has handed over the company to the buyer) would be very

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<sup>4</sup> For example, the previously existing Article 444 of the German Civil Code (Bürgerliches Gesetzbuch or “BGB” for short) stipulated the seller’s obligation to inform the buyer of the legal characteristics of the object, regardless of whether the buyer requested the information. While this provision was repealed in 2001, similar principles are now found in Article 433.1 of the current German Civil Code. Likewise, Article 443 of the 2015 Vietnam Civil Code (“**Vietnam Civil Code**”) addresses the seller’s obligation to provide information and instructions on how to use the object.

<sup>5</sup> Gessel, *Representations and Warranties in Cross-Border Mergers and Acquisitions: The Challenge of Cultural Diversity*, available at <https://gessel.pl/en/publications/representations-and-warranties-in-cross-border-mergers-and-acquisitions-the-challenges-of-cultural-diversity/> (last access on 15 May 2024).

<sup>6</sup> Footnote 1 in Part 1 (Introduction) of the ICC Model Contract.

<sup>7</sup> See Articles 1 and 2.1 of the Misrepresentation Act.

<sup>8</sup> For example, if a seller mistakenly represents that the land plot is 1,000 square meters based on the land area recorded in the title deed, but the actual measured area is only 980 square meters, this would be considered an innocent misrepresentation.

<sup>9</sup> Article 2.2 of the Misrepresentation Act.

difficult because the buyer has likely taken over operations and made new transactions and decisions for the company. Returning the business to its pre-sale state as mandated by the consequence of contract rescission becomes nearly impossible. For this reason, compensation for damages is the more common remedy in M&A disputes arising from breached warranties.

### **SOME NOTES FOR VIETNAMESE LAWYERS**

As mentioned earlier, the doctrines of “representation and warranty” originated in the common law tradition, specifically England. These concepts are foreign to the Vietnamese legal system, and there are no specific legal provisions governing them.

Despite their origin in common law, Vietnamese M&A contracts often include representation and warranty clauses, even though Vietnamese law doesn’t directly address them. This raises the question: what are the consequences of a breach of such a clause in a Vietnamese law-governed contract?

As explained above, “representation” and “warranty” are statements about the accuracy of facts. If a representation or warranty is inaccurate under Vietnamese law, the provisions on “mistake” or “fraud” stipulated in Articles 126 and 127 of the Vietnam Civil Code may be applied.<sup>10</sup>

However, in practice, many situations may not neatly fit into the category of “mistake” or “fraud.” In addition, invoking mistake or fraud law provisions can have unintended consequences, potentially voiding/invalidating the entire contract. For these reasons, when drafting or reviewing a contract with a representation and warranty clause governed by Vietnamese law, Vietnamese lawyers should ensure clear and detailed consequences for a breach of this clause.

We hope our article has been helpful to you. Please feel free to contact us if you have any further inquiries.

### **Scientia**

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<sup>10</sup> Articles 126 and 127 of the Vietnam Civil Code state:

**“Article 126. Invalidity of civil transactions due to misunderstanding**

1. If there is a misunderstanding in a civil transaction that make a party or the parties fails to meet the objectives of the transaction establishment, the mistaken party shall have the right to request a court to declare such transaction invalid, except for the case prescribed in Clause 2 of this Article.

2. A civil transaction having misunderstanding shall not be invalid if the parties may meet the objectives of the transaction establishment or the parties may correct the misunderstanding resulting in the achievement of the objectives of the transaction establishment.

**Article 127. Invalidity of civil transactions due to fraud, threat or compulsion**

Any party entering into a civil transaction as a result of fraud, threat or compulsion has the right to request a court to declare such transaction invalid.

Fraud in a civil transaction means an intentional act of a party or a third person for the purpose of misleading the other party as to the subject, the nature of the object or contents of the civil transaction which has caused the other party to enter into such transaction.

Threat or compulsion in a civil transaction means an intentional act of a party or a third person which compels the other party to conduct the civil transaction in order to avoid danger to the life, health, honor, reputation, dignity and/or property or that of its relatives.”