



PERFORMANCE OF CONTRACTS UPON THE FUNDAMENTAL CHANGE OF CIRCUMSTANCES IN VIETNAM'S CIVIL CODE 2015

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Abstract: *While the performance of contracts upon the fundamental change of circumstances is not a new matter in the laws of developed countries, it is newly regulated in the 2015 Civil Code of Vietnam. Only now, Vietnam has had guiding documents from competent state agencies on this matter, so the application in practice is still inconsistent, especially in determining the fundamental change of circumstances. Therefore, on the basis of clarifying the concept, legal status, and practical application problems, the article will also make some recommendations for the contracting parties and the court in handling the matter of performance of contracts upon the fundamental change of circumstances.*

Keywords: *contract, contract adjustment, change of circumstances.*

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Introduction

Pacta sunt servanda (principle of the binding nature of a contract) is one of the fundamental principles of contract law. However, in some cases, the rigid application of this principle may lead to irrationality or unfairness for a party to the contract. Therefore, balancing the principle of pacta sunt servanda and the principle of rebus sic stantibus (which allows the contract to be adjusted upon changing circumstances) is a great concern. Many legal systems around the world have even regulated cases when circumstances have changed to the point that the obligor is unable to perform his/her obligations, also known as "force majeure", as one of the grounds to exempt the other party's liability for failure to perform his/her obligations [3, p.198]. In addition, there are cases when circumstances change, although not to the extent that one party cannot perform their obligation, but may cause the cost of performing the obligation to increase excessively, causing unfairness to the other obligee. This situation is often



referred to as a “fundamental change of circumstances”. However, in current legal systems, there are still various views on the performance of a contract upon the fundamental change of circumstances.

In Vietnam, for a long time, the lack of provisions to adjust situations when the change of circumstances leads to obvious damage to one party if they continue to perform the contract as the original agreement has caused much confusion to both the judges as well as the parties in the process of dispute settlement. Therefore, stipulating the performance of contracts upon fundamental change of circumstances in Article 420 of the Civil Code 2015 is considered a breakthrough.

1. Method

It is normative legal research using secondary data, such as academic articles, normative legal documents, reports, journal articles, conference papers, and other documents correlating with contract law and the Performance of Contracts upon the Fundamental Change of Circumstances. The data were collected using library research, and then the legal interpretation method was employed to analyse the data.

2. Results and Discussions

2.1 Definition of performance of contracts upon fundamental change of circumstances

The principle of *pacta sunt servanda* is a fundamental principle of contract law. When both parties enter the contract, they have expressed their commitment and desire to be bound by their own will to the contractual obligations. Therefore, the parties will be responsible for performing the obligations even if the performance costs may increase. This confirms the role of the contract as a tool for the parties to manage their plans and decisions. However, just as the principle of free will has certain limits, the principle of mandatory validity is also not absolute. During the performance of contracts, certain circumstances may arise, and the parties need to reconsider [6, p.19].

The commercial practice has proven that in contracts, especially long-term contracts, the contracting parties may face risks caused by natural disasters, socio-economic crises, and market circumstances, thus leading a party to encounter excessive difficulties in performing their obligations. Circumstances that fundamentally alter the equilibrium of such contractual obligations are referred to in international contract law as “hardship” or “change of circumstances” [4], however, the term “change of circumstances” shall be mentioned frequently in this article.

“Change of circumstances” is a concept established to shift contractual risks and is designed as rules to resolve conflicts of interest when circumstances change, or unexpected situations arise, thus completely altering the context of the contract. “Change of circumstances” is directly regulated in the Civil Codes of countries that have recently re-codified their law [10], however, due to its novelty and modernity, the clause “change of circumstances” is often developed in the case of law by explaining and detailing the principle of good faith. Hence, the principle of good faith shall be applied to restore the relative equilibrium between the parties when performing the contract.

In some legal systems in Europe, by law or case law, it is generally accepted that a contract can



be terminated or altered when the preservation of the original contract may result in unacceptable consequences, is incompatible with the law and is unjust.

The Italian Civil Code appears to be the first to adopt the theory of “fundamental change of circumstances”, a mechanism that has influenced a number of later systems, especially in Latin American countries. According to Article 1467 to Article 1469 of the Italian Civil Code, contractual commitments can be cancelled upon the occurrence of a sudden, unusual, unpredictable event after the contract has been signed and before the performance of the contract; and this event makes it extremely difficult for one party to perform the contract. The involved parties can avoid the cancellation of the contract by demanding or offering an equitable modification of the contract (Article 1467 (3)) [5, p.211]. However, these provisions are not mandatory, and the parties may agree not to apply them. Italy's case law has had a ruling on this issue [2].

In addition, Article 258 of the Dutch Civil Code allows a judge to modify the terms of a contract based on unforeseen changes in circumstances. The same can be seen in Article 437 of the Portuguese Civil Code [9, p.202].

In Germany, before the outbreak of World War I, German law took a strict stance on the possibility of contract modification due to a change of circumstances. Accordingly, German law only recognises the doctrine of impossibility to perform obligation (*unmöglichkeit*) [8]. However, the economic situation after World War I, especially hyperinflation, made many contracts unreasonable. At that time, the German Civil Code of 1896 did not allow the court to modify the contract due to a change of circumstances. Therefore, the German courts had settled a number of disputes based on the doctrine of impossibility to perform the obligation but had faced objections. After that, Professor Oertmann developed a new doctrine of contractual basis (*geschäftgrundlage*) [11]. According to this doctrine, the expectation of one party on the performance of the contract must coincide with that of the other party, or the other party must be informed of this expectation. Suppose there is a change of circumstances after the contract has been made. In that case, the basis of the contract (*geschäftgrundlage*) shall cease, and the court may release the parties from the obligation to perform the contract or modify it to restore the equilibrium. The doctrine was immediately adopted and implemented by German courts for a long period.

Article 313 of the 2002 German Civil Code amended contract performance under changing circumstances. Clause 1 of Article 313 states: If conditions that formed the foundation of a contract have materially altered. If the parties would not have entered into the contract or would have entered into it with different terms if they had anticipated this change, the contract may be modified to the degree that, considering all the facts of the individual instance. Clause 3 of Article 313 allows the disadvantaged party to cancel the contract if adaptation is impossible or one party cannot fairly be expected to accept it [8].

In the United States, Article 2 - 609 of the Uniform Commercial Code acknowledged and allowed the contract to be re-negotiated due to the change of circumstances. Accordingly, “if the actual costs



of performing the obligation have changed substantially, by more than 10 times the costs expected at the time the contract was entered into, the obligor may ask the court to declare the termination of the contractual relationship due to impracticability". Article 2.615 of the UCC acknowledged the impracticability of performance (change of obligation upon changing circumstances) in the sale of goods. Thus, circumstances are considered to be changed if they happen unexpectedly, and the involved parties cannot foresee nor expect it, or if they had expected it, they did not think that it could become a reality when they entered the contract [1, p. 492].

Article 1195 of the French Civil Code allows contract fulfilment upon change of circumstances [7]. It provides that: If an unanticipated change of circumstances makes performance unduly onerous for a party who had not accepted the risk of such a change, that party may ask the other contractual party to re-negotiate the contract. Renegotiation requires the first party to keep his promises. If renegotiations fail, the parties may cancel the contract or seek the court to modify it. If a party requests it, the court may amend or cancel the contract from a date and under certain circumstances if no agreement is reached within a reasonable period.

"Hardship" has also been codified in many codes of Conduct on International Commercial Contracts with great influence worldwide, such as the UNIDROIT Principles of International Commercial Contracts and the Principles of European Contract Law.

The UNIDROIT Principles of International Commercial Contracts 2010 has regulated the performance of the contract upon the fundamental change of circumstances (hardship) from Article 6.2.1 to Article 6.2.3. It defines hardship as follows: Hardship occurs when circumstances fundamentally affect the contract's equilibrium, either by increasing the cost of a party's performance or decreasing its value [13, p. 213].

Article 6.2.1 of the 2010 UNIDROIT Principles sets hardship guidelines: Notwithstanding difficulty, a party must fulfil its contract commitments [13, p. 212]. This article emphasises *pacta sunt servanda* and prevents parties from immediately suspending or terminating their duties when circumstances change.

Normally, a change in circumstances does not affect the obligation to perform, so the obligor cannot invoke this reason not to perform its obligation unless a change in circumstances affects the principle of equity and mutual interests of the contract. Whether a change is considered "fundamental" in a given case depends on the circumstances. A change in circumstances that affect (increase or decrease) 50% or more of the total contract value will be considered a fundamental change [13, p. 147].

The Principles of European Contract Law- PECL also recognises a change of circumstances clause in Article 6:111. It states that: "If, however, the performance of the contract becomes excessively onerous because of a change of circumstances, the parties are bound to enter into negotiations to adapt the contract or terminate it, provided that: (a) the change of circumstances occurred after the time of conclusion of the contract, (b) the possibility of a change of circumstances could not reasonably have been taken into account at the time of conclusion of the contract, and (c) the risk of the change of



circumstances is not one which, according to the contract, the party affected should be required to bear".

Thus, it can be seen that the clause that modifies the contract when there is a change in circumstances is for the event of a fundamental change in circumstances due to objective reasons that severely affect the equilibrium of the contract, as well as the interests of one party and cause the performance of the contract extremely difficult and expensive. Hence, the law allows the parties to demand the court (or arbitrator) to adjust the contract. If it cannot be adjusted, the contract will be terminated to ensure the equilibrium of interests between the parties in the contract.

The clause that regulates a contract when there is a fundamental change in circumstances is not inconsistent with the principle of *Pacta sunt servanda*. However, it complements this principle to eliminate inequities in the proper contract performance. On the one hand, this helps to ensure the interests of the involved parties, while on the other hand brings a solution to promote economic development since this helps the contract to continue to be performed and yields interest to both parties instead of one party having to suffer the onerous disadvantages or the termination of the contract. Hardship is also a clause that concretises the principle of good faith when there is a change in circumstances that lead to an excessive imbalance of interests between the parties of the contract, whereby the parties not only have to care about their interests but must also take care of the other party's interests so that both parties of the contract may benefit.

2.2 Adapting contract upon the fundamental change of circumstances in Vietnamese law

The 13th National Assembly of Vietnam approved the Civil Code of 2015 on November 24th 2015 and codified the provisions for a fundamental change of circumstances for the first time. However, the Code only lists its signs. This includes: a) Objective factors affect the situation after the contract; b) The parties cannot anticipate the change of circumstances when the contract is signed; c) The conditions changed so much that the contract would not have been signed into or would have had different terms if the parties had anticipated it; d) Continuing to fulfil the contract without modifying its terms may entail substantial loss and harm to one party; d) The party whose interests are impacted has taken all required precautions to the best of its abilities and appropriate with the nature of the contract but is unable to avoid or minimise the degree of impacting the interests. Upon looking at these conditions, it can be seen that it is quite similar to the provisions on "hardship" in the Principles of International commercial contracts.

Of the 5 conditions above, conditions (a) and (b) are quite recognisable and have many similarities. These two conditions represent the objectivity and unpredictability of the change of circumstances. These changes must occur after the contract is entered into. The parties could not have foreseen such a situation when entering into a contract. If the parties were aware of such facts when entering into the contract, it must be taken into account as a basis to enter into the contract. If such events occur in the future, no reference to the "fundamental change of circumstances" shall be invoked.

Conditions (c) and (d) are closely related and play an important role in identifying fundamental



changes in circumstances. Not every change should be seen as a fundamental change of circumstances. If the change of circumstances does not affect the obligation to perform the contract, then this provision is only invoked if the equilibrium between the contractual obligations is fundamentally altered. A situation is considered to be fundamentally changed when the change is big enough to affect the interests of the affected party seriously. If the parties had known in advance, the contract would not have been entered into or would have been entered into but with a completely different content. If the affected party continues the contract's performance without adjusting the contract contents, they will receive serious damage. When there is a fundamental change of circumstances, the party with affected interests must apply necessary measures to the best of its ability to prevent or mitigate the level of the impact on its interests. If these necessary measures are not taken, and the interests are affected, this provision shall not be invoked.

Condition (d) is sufficient for the party affected by the change of circumstances to exercise the right to request a modification (adjustment) of the contract or terminate the contract. Under this condition, upon fundamental change of circumstances, the affected party shall endeavour to take all necessary measures to the best of its ability to minimise the effect of the change of circumstances on its legitimate interests. If the affected party fails to take the necessary (while possible to perform) measures and if these measures were to be applied, the extent of the impact would have been prevented or mitigated, and this party loses the right to request the modification or termination of the contract.

According to Clause 2 Article 420 of the Civil Code 2015, if a fundamental change of circumstances causes an equilibrium in contractual obligations, the party whose interests are affected has the right to request the other party to re-negotiate the contract within a reasonable time to better adapt to the new circumstances [15]. The request for contract renegotiation by the disadvantaged party and the conduct of the two parties in the contract renegotiation process must comply with the principle of good faith. The disadvantaged party must be honest when proclaiming that there are fundamental changes in circumstances and may not demand renegotiation as a tactic. The party with affected interests may bring up options to modify the contract to adapt to the circumstances and balance the interests of both parties. The other party may accept or not accept the plan proposed by the affected party. If the parties can agree on a new plan, the contract shall continue to be performed. If no agreement can be reached, one of the parties may ask the court to settle the contract by terminating the contract at a certain determined time or modifying the contract to balance the legitimate rights and interests of the parties due to a fundamental change in circumstances. Thus, the request for modification or termination of the contract in the event of a fundamental change in circumstances is not a unilateral right of the party affected by the change in circumstances. The mechanism to exercise this right is completely different from the mechanism to exercise the right to unilaterally terminate the performance of the contract due to one party seriously violating the contract's obligations [15]. The court may only decide to modify the contract in cases where the termination of the contract will cause far more damage than the costs to perform the contract if it is modified. This provision raises the following issue: in case the involved parties only file a request to modify the contract, does the court have the right to decide



the termination of the contract?; Third, the request to modify or terminate the contract in the event of a fundamental change in circumstances is not a unilateral right of the affected party with the change in circumstances, therefore during the negotiation process to modify or terminate the contract while the court settles the case, the parties must continue to perform their obligations under the contract, unless otherwise agreed upon by the parties.


2.3 Some difficulties arise in the practical application of the provision

First, The Civil Code 2015 does not regulate the exclusion of certain types of contracts by their nature or by custom, thus leading to the situation where a party may not be able to modify or terminate when there is a fundamental change of circumstances. For example, with a forward contract for the sale of goods, the seller commits to deliver, and the buyer commits to receive the goods in the future. This is a high-risk type of contract, when entering into this kind of contract, the parties are forced to calculate the impact factors of the market carefully. Therefore, in the event of strong market fluctuations (fundamental change in circumstances), can a party petition to modify or terminate the contract or must bear the risk?

Second, The Civil Code 2015 does not regulate that the party affected by the change of circumstances must be completely free of mistakes in the performance of the contract to be able to petition for a modification or supplementation to the contract.

Third, in case the parties are unable to agree on the modification of the contract within a reasonable amount of time, one party may petition the court to modify or terminate the contract. However, the court may only rule on the modification of the contract if the termination of the deal will result in greater loss and harm than the expenses of fulfilment of the contract if the contract is modified. This article's concepts of "damage" and "costs for performance" still need to be clarified. Specifically, to which party will the damage caused by the termination of the contract be compared with the costs of performance of the contract? Does it take into account the costs and benefits of a third party? In addition, the settlement regulated in the Civil Code 2015 may not be consistent with the principle of maintaining the validity of the contract (favour contracts), as the court should give priority to maintaining the validity of the contract by modifying the contract and only when the modification of the such contract is impracticable or unreasonable for the other party should the court terminate that contract. Approaching from a comparative perspective, while Article 6.2.3 of the 2010 UNIDROIT Principles also recognised the two measures of termination and modification of the contract, it did not specify the order of priority. However, in the comments on the 2010 UNIDROIT Principles, researchers have debated that, to a reasonable extent, contract modification should take precedence over it.

Fourth, The Civil Code 2015 follows the direction that when the court modifies the contract, the court must ensure that the modification must maintain the equilibrium of the legitimate rights and interests of the parties due to the fundamental change of circumstances. This provision is understood as the legitimate rights and interests of the parties will always be balanced when entering into the contract. If, in the cases where the rights and interests of the parties were not in equilibrium at the time they



entered into the contract when a fundamental change in circumstances arises, it is not entirely clear that the court has the right to modify the contract in the direction of maintaining the equilibrium of legitimate rights and interests between the parties [12. P.458].

Fifth, the Civil Code only refers to the court's jurisdiction but does not mention the arbitrator's authority to consider and resolve requests for contract modification or termination when there is a fundamental change of circumstances. However, a problem might arise: if the contract has an arbitration clause, does the court have the jurisdiction to resolve it or not? Article 6 of the Law on Commercial Arbitration 2010 states, "In case the disputing parties have reached an arbitration agreement, but one party initiates a lawsuit at a court, and the court shall refuse to accept the case unless the arbitration agreement is invalid or unrealisable". Thus, if the contract has an arbitration clause, the court must refuse to accept the contract modification settlement at the parties' request.

Arbitration jurisdiction to settle disputes as prescribed in Article 5 of the Law on Commercial Arbitration 2010: "A dispute shall be settled by arbitration if the parties have an arbitration agreement". However, according to the provision in Clause 3 Article 420, the arbitrator has no jurisdiction. Thus, with this clause, if there is an arbitration clause in the contract, there will be no competent authority to deal with the issue of contract modification upon a fundamental change of circumstances.

While studying the two sets of principles on international commercial contracts, the Unidroit Principles on International Commercial Contracts 2004 and the Principles of European Contract Law, it can be seen that both of these principles recognise the authority of both the court and the arbitrator to modify the contract upon the fundamental change of circumstances.

3. Some suggestions

We advise improving Vietnam's civil law in the context of internationalisation based on theoretical and practical study on the Execution of Contracts upon the Fundamental Change of Circumstances in Vietnam's Civil Code 2015, specifically:

Firstly, the parties should exercise caution when entering into contracts and make an effort to foresee potential issues that might arise during their performance, particularly with contracts that take a long time to implement and are susceptible to outside influences. They should also discuss and come to an agreement ahead of time on how to carry out their obligations under the contract and deal with unforeseen events. The parties should list some (but not all) possible events as a condition of the fundamental change in circumstances and their consequences, and what are the parties' responsibilities if such a change of circumstances occurs. The fundamental change of circumstances clause always consists of two main parts, the first part speculates when to consider a fundamental change of circumstances, and the second part describes the consequences of that speculation. This is also how the International Chamber of Commerce - ICC recommends the parties do when establishing the clause on the fundamental change of circumstances in the contract.

Secondly, when there is a change in circumstances during the performance of the contract, it should be clarified whether the change is a fundamental change or not. To do so, it is necessary to consider the



relevance of such changes to the specific contents of the contract, their impact on the performance of the contract; the loss of interests the parties have to suffer if they continue to perform the contract; the extent of damage, especially in the equilibrium between the parties.

Lastly, as for the court, although the Civil Code allows it to decide on the modification of the contract to maintain the equilibrium of the legitimate rights and interests of the parties due to the fundamental change in circumstances, this is a complex matter. To minimise errors in the modification decision, the court should give guidance and support to the parties so they can reach an agreement on their own for the modification plan. If the parties cannot agree, the court will decide on a specific modification plan. When drafting a contract modification plan, the court must base it on the actual situation and the extent of changes in circumstances and ensure the equilibrium of legitimate rights and interests between the parties.

4. Conclusion

Article 420 of the Civil Code 2015 is a provision that shows the progressiveness in the legislative process and the study of the international experience of Vietnamese legislators; this also meets practical needs and ensures the interests of the disadvantaged party in the performance of the contract. However, this still needs to be clarified. There has yet to be any guidance and explanation from competent state agencies on provisions related to the fundamental change of circumstances in the Civil Code 2015. There is also no case law on this issue. Commercial contracts often do not regulate this issue. However, the parties will rely on the general provisions of the law to exercise their rights when there are fundamental changes in circumstances. This issue needs to be further studied and verified in law practice.

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