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Performance of Contracts upon the Fundamental Change of Circumstances in Vietnam's Civil Code 2015

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Abstract

While 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 what is 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 as well as the Court in handling the matter of performance of contracts upon the fundamental change of circumstances.

Keywords

contract, contract adjustment, change of circumstances

1. 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 of the contract. Therefore, balancing the principle of pacta sunt servanda and the principle of rebus sic stantibus (the principle that allows the contract to be adjusted upon the change of circumstances) is 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 (Note 1). 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 many confusions to both the judges as well as the parties in the process of dispute settlement. Therefore, the stipulation of the performance of contracts upon fundamental change of circumstances in Article 420 of the Civil Code 2015 is considered a breakthrough.

2. Method

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

3. Results and Discussions

3.1 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 into 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 to perform 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 own 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 (Note 2).

Commercial practice has proven that in contracts, especially long-term contracts, the contracting parties may face risks caused by circumstances such as natural disasters, socio-economic crisis, 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 refer to in international contract law as “hardship” or “change of circumstances” (Note 3), 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 alter the context of the contract. “Change of circumstances” is directly regulated in the Civil Codes of countries that have recently re-codified their law (Note 4), however, due to its novelty and modernity, the clause “change of circumstances” is often developed in case 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, 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 canceled 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 involving parties can avoid the cancellation of the contract by demanding or offering an equitable modification of the contract (Article 1467 (3)) (Note 5). However, these provisions are not mandatory, and the parties may agree not to apply them. Italy’s case law has had ruling on this issue (Note 6).

In addition, Article 258 of the Dutch Civil Code allows a judge to modify the terms of a contract based on unforeseen change of circumstances. The same can be seen in Article 437 of the Portuguese Civil Code (Note 7).

In Germany, before the outbreak of World War I, German law took a strict stance on the possibility of contract modification due to change of circumstances. Accordingly, German law only recognizes the doctrine of impossibility to perform obligation (*unmöglichkeit*) (Note 8). However, the economic situation after World War I, especially hyperinflation, had made many contracts become unreasonable. At that time, the German Civil Code of 1896 did not allow the Court to modify the contract due to change of circumstances. Therefore, the German courts had settled a number of disputes based on the doctrine of impossibility to perform obligation, but had faced objections. After that, Professor Oertmann developed a new doctrine of contractual basis (*geschäftsgrundlage*) (Note 9). 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 clearly informed of this expectation. If there is a change of circumstances after the contract has been made, the basis of the contract (*geschäftsgrundlage*) shall cease to exist and the court may release the parties from the obligation to perform the contract or modify it in order to restore the equilibrium. This doctrine of Professor Oertmann was quickly accepted and applied by the German courts for a long time (Note 10).

In 2002, there was an important amendment to the German Civil Code and the performance of a contract upon the change of circumstances, which was noted in Article 313. Clause 1 Article 313 stated that: If circumstances which became the basis of a contract have significantly changed since the contract was entered into and if the parties would not have entered into the contract or would have entered into it with different contents if they had foreseen this change, adaptation of the contract may be demanded to the extent that, taking account of all the circumstances of the specific case. Clause 3 Article 313 stated that If adaptation of the contract is not possible or one party cannot reasonably be expected to accept it, the disadvantaged party may revoke the contract (Note 11).

In the United States, Article 2-609 of the Uniform Commercial Code acknowledged and allowed the the contract to be renegotiated 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 of the contract was entered into, the obligor may ask the court to declare termination of the contractual relationship due to impracticability”. Article 2.615 of the UCC acknowledged the impracticability of performance (change of obligation upon the change of circumstances) in the sale of goods. Thus, circumstances are considered to be changed if they happen unexpectedly, and the involved parties cannot not foresee nor expect of it, or if they had expected it, they did not think that it could become reality at the time they entered into the contract (Note 12).

In France, the performance of a contract upon the change of circumstances is recognized in Article 1195 of the French Civil Code (Note 13). It states that: If a change of circumstances that was unforeseeable at the time of the conclusion of the contract renders performance excessively onerous for a party who had not accepted the risk of such a change, that party may ask the other contracting party to renegotiate the contract. The first party must continue to perform his obligations during renegotiation. In the case of refusal or the failure of renegotiations, the parties may agree to terminate the contract or by a common agreement ask the court to set about its modification. In the absence of an agreement within a reasonable time, the court may, on the request of a party, revise the contract or terminate it, from a date and subject to such conditions as it shall determine.

“Hardship” has also been codified in many Code of Conduct on International Commercial Contracts with great influent around the world, 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 contract upon the fundamental change of circumstances (hardship) from Article 6.2.1 to Article 6.2.3. It has defined the term hardship as followed: There is hardship where the occurrence of events fundamentally alters the equilibrium of the contract either because the cost of a party’s performance has increased or because the value of the performance a party receives has diminished, and must satisfy the following four conditions: “a. The events occurs or become known to the disadvantaged party after the conclusion of the contract; b. The events could not reasonably have been taken into account by the disadvantaged party at the time of the conclusion of the contract; c. The events are beyond the control of the disadvantaged party; and d. The risk of the events was no assumed by the disadvantaged party” (Note 14).

Article 6.2.1 of the 2010 UNIDROIT Principles establishes general principles for the application of hardship: “Where the performance of a contract becomes more onerous for one of the parties, that party is nevertheless bound to perform its obligations subject to the following provisions on hardship” (Note 15). It can be seen that this provision emphasizes the importance of the principle of *pacta sunt servanda* and does not allow the involved parties to automatically suspend or terminate the performance of their obligations whenever there is a change in circumstances.

Normally, a change in circumstances does not affect the obligation to perform, so the obligor cannot invoke this reason to not 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 will depend upon the circumstances. A change in circumstances that affects (increase or decrease) 50% or more of the total contract value will be considered as a fundamental change (Note 16).

The Principles of European Contract Law-PECL also recognizes a change of circumstances clause in Article 6:111. It states that: “If, however, performance of the contract becomes excessively onerous because of a change of circumstances, the parties are bound to enter into negotiations with a view to adapting the contract or terminating 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 was not one which could 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 the right to make demand to 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, but it complements this principle, in order to eliminate inequities in the proper performance of the contract. 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 interests to both parties instead of one party has to suffer the onerous disadvantages or the termination of the contract. Hardship is also a clause that concretizes 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 own interests but must also take care of the other party’s interests so that both parties of the contract may benefit.

3.2 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 on fundamental change of circumstances for the first time. However, the Code only lists its signs. This includes: a) There is a change to the circumstances due to objective reasons, occurring after the contract is entered into; 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 fulfill the contract without modifying its terms may entail substantial loss and harm to one party; d) The party

whose interests are affected has taken all necessary measures to the best of its ability and appropriate with the nature of the contract but is unable to prevent or mitigate the level of affecting 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 recognizable and have many similarities. These two conditions represent the objectivity and unpredictability of the change of circumstances. These changes must occur after the contract was entered into. When enter into a contract, the parties also could not have foreseen the occurrence of such situation. If the parties were aware of such facts when enter into the contract, it must be taken into account as a basis to enter into the contract, and if such events do occur in the future, no reference to the “fundamental change of circumstances” shall be invoked.

Conditions (c) and (d) are distinctive conditions, closely related to each other and play an important role in identifying fundamental change of 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 not invoked, unless the equilibrium between the contractual obligations is fundamentally altered. A situation is considered to be fundamentally changed when the change is big enough to seriously affect the interests of the affected party, if the parties had known in advance, the contract would not have been entered into or would have entered into but with completely different contents. If the affected party still continue the performance of the contract 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 (đ) is a sufficient condition for the party affected by the change of circumstances to exercise the right to request an modificaion (adjustment) of the contract or to terminate the contract. Under this condition, upon fundamental change of circumstances, the affected party shall endeavor to take all necessary measures to the best of its ability to minimize the effect of the change of circumstances on its own legitimate interests. In the event that 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, 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, in the event there is a fundamental change of circumstances that causes an equilibrium in contractual obligations, the party whose interests are affected has the right to request the other party to re-negotiate the original terms of the contract within a reasonable period of time to better adapt to the new circumstances (Note 17). 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 proclaims the fact that there are fundamental changes of 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 reach to an agreement 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. This situation may occur due to the fact that the unaffected party completely refuses to accept the request for contract renegotiation or the contract renegotiation process which has been conducted in good faith by the parties has not been successful. Thus, it can be seen that 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 violates the obligations of the contract (Note 18). Regarding this provision, a number of issues are worth noting as followed: First, the parties can only ask the court to consider the termination or modification of the contract if they cannot reach an agreement on their own, and all parties enter into the contract are entitled to exercise this right; Second, in the settlement of the involved party's petition, the court must give priority to the application of the contract termination mechanism. 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.

3.3 Some Difficulties Arise in Practical Application of the Provision

Although the Civil Code 2015 has regulated quite detail the conditions to what determine as the fundamental change of circumstances thus leading to the affected party's right to request modification or termination of the contract, but in practice some problems may arise as follow:

First, The Civil Code 2015 does not regulate the exclusion of certain types of contracts by its 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 at a future time. This is a high-risk type of contract, when entering into this kind of contract, the parties are forced to carefully calculate the impact factors of the market. 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, supplementation to the contract.

Third, clause 3 Article 420 of the Civil Code 2015 states that if the parties cannot reach an agree on the modification of the contract within a reasonable time, one of the parties may request the court to modify or terminate the contract. However, the court is only permitted to make a decision on modification of the contract in a case where the termination of the contract will cause loss and damage of an amount higher than the costs for performance of the contract if the contract is modified. The concepts of “damage” and “costs for performance” in this article still need to be clarified. Specifically, to which party will the damage caused by 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 (favor contractus), as the Court should give priority to maintaining the validity of the contract by modifying the contract and only when the modification of 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 recognized the two measures of termination and modification of 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.

Fourth, The Civil Code 2015 is following 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 seems to be understood as the legitimate rights and interests of the parties will always be balanced at the time of entering into the contract. If in the cases where the rights and interests of the parties were not in equilibrium at the time the enter 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 (Note 19).

Fifth, the Civil Code only refers to the jurisdiction of the court, 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, there might be a problem that arise which is if the contract has an arbitration clause, does the Court have the jurisdiction to resolve it or not? According to Article 6 of the Law on Commercial Arbitration 2010: “In case the disputing parties have reached an arbitration agreement but one party initiates a lawsuit at a court, the court shall refuse to accept the case, unless the arbitration agreement is invalid or unrealizable”. Thus, in theory, if the contract has an

arbitration clause, the court will have to refuse to accept the settlement of the contract modification at the request of the parties.

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 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 recognize the authority of both the court and the arbitrator to modify the contract upon the fundamental change of circumstances.

4. 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, for the parties when enter into the contract, they need to be cautious and try to anticipate the possibilities that may occur during the performance of the contract, especially contracts with a long implementation time, contracts that are easily affected by external factors, to negotiate and reach an agree in advance on how to perform and handle unexpected circumstances. 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 responsibilities of the parties if such change of circumstances occur. The fundamental change of circumstances clause always consists of two main parts, the first part speculates when to consider that there is the fundamental change of circumstances and the second part describes the consequences of that speculation. This is also the way that the International Chamber of Commerce-ICC recommends the parties to 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 make the decision on the modification of the contract to main tain the equilibrium of the legitimate rights and interests of the parties due to the fundamental change in circumstances, however, this is not a simple matter. In order to minimize errors in the modification decision, the court should give guide and support to the parties so they can reach to an agreement on their own for the modification plan. If the parties cannot reach an agreement, the

Court will decide on a specific modification plan. When drafting a contract modification plan, the Court must base on the actual situation, the extent of changes in circumstances, and ensure the equilibrium of legitimate rights and interests between the parties.

5. Conclusion

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

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Notes

Note 1. Egidijus Baranauskas and Paulius Zapolskis (2009), The Effect of Change in Circumstances on the Performance of Contract, *Jurisprudence*, Vol. 118, No. 4, p. 198.

Note 2. Ha Thi Mai Hien, Amendment to the Civil Code of Vietnam and the issue of perfecting contract provisions, *State and Law Review*, issue 3/2005 (10-19), tr. 19.

Note 3. European Contract law-Materials for a common frame of reference: Terminology, Guiding Principle, Model Rules; Sellier European law publishers, 2006.

Note 4. For example, see Clause 1 Article 133 of the Yugoslav Law on Obligations, See: Le Minh Hung, Contract modification clause due to fundamental change of circumstances in foreign law and experience for Vietnam, *Journal of Legislative Studies*, Issue 6, March 2009.

Note 5. See: G. Criscuoli and D. Pugsley, *The Italian Law of Contract*, (1991), 211.

Note 6. Cass. civ., sez. II, 20/6/1996, no. 5690 (Roccheri c. Mazzara); Cass. civ., 9/4/1994, no. 3342 (Soc. Arbos c. Com. Piacenza).

Note 7. See also: James Gordley (Edited), *The Enforceability of Promises in European Contract Law*, CUP, Cambridge, 2004, pp. 202 & 204.

Note 8. Article 275 of the German Civil Code, available online at: https://www.gesetze-im-internet.de/bgb/_275.html accessed on 11/11/2022

Note 9. Paul Oertmann (1921), *Die Geschäftsgrundlage—Ein neuer Rechtsbegriff*, Leipzig und Erlangen.

Note 10. BGH MDR 1953, 282.

Note 11. Article 313 of the German Civil Code, available online at: https://www.gesetze-im-internet.de/bgb/_313.html accessed on 11/11/2022

Note 12. Brian A Blum (2007), *Contracts: Examples & explanation*, 4th edition, Wolters Kluwer, NY 2007, p. 492.

Note 13. Article 1195 of the French Civil Code, available online at: <http://fdvn.vn/bo-luat-dan-su-phap-ban-dich/>, accessed on 11/11/2022

Note 14. UNIDROIT (2010), *UNIDROIT Principles on International Commercial Contracts*, p. 213.

Note 15. UNIDROIT (2010), *UNIDROIT Principles on International Commercial Contracts*, p. 212.

Note 16. UNIDROIT (1994), *UNIDROIT Principles on International Commercial Contracts*, p. 147

Note 17. See clause 2 Article 420 Civil Code 2015.

Note 18. See Clause 1 Article 428 Civil Code 2015.

Note 19. Truong Nhat Quang (2020), *Contract law-basic legal issues*, Dan Tri Publishing house, tr.458.