CONTRACT LAW OF VIETNAM: AN EVALUATION APPROACHED BY THE TRANSACTION COST THEORY

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Abstract

Freedom of contract is one of three basic elements of the economy, which is only improved its effectiveness in case of being guaranteed by the legal system of contract. According to the Transaction Costs Theory of Ronald Harry Coase (1937), the effectiveness of a transaction will be inversely proportional to the total cost of the transaction. In order to achieve a low-cost transaction and minimize social costs, contract law must guarantee the principle of honesty and the spirit of goodwill between contract parties. In this study, the author did an evaluation on the effectiveness of Contract Law of Vietnam by analyzing elements in the Theory of Coase. Accordingly, the author concluded that the effectiveness of Vietnamese contract law of Vietnam is still limited because there is little support in the law for parties to minimize unnecessary costs when conducting a transaction. In addition, this research also gave cautions and warnings for contract parties in the process of negotiating and signing contracts in Vietnam.

I. Introduction

There are many studies confirmed the significance and importance of the theory of transaction costs in legislative activities, especially in corporate law or contract law. This article emphasizes a simple fact: in order to promote the effectiveness of a contract law, it must first consider core elements of transaction costs, and on that basis, parties in a contract can improvise solutions depending on the legislation of each nation where the transaction has been practiced to bring into a highest efficiency.

Contractual theories and contract law of Vietnam are still in their infancy compared to other countries’ around the world. This can be considered as one disadvantage of

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Vietnamese legislation, but in another perspective, it can also be seen as advantage pro that local lawmakers need to seize. If lawmakers can "educate" the society by orienting individuals and entities toward the habit of considering costs issues and common benefits carefully in every transaction, it will be less complicated for contract law to minimize the social costs and maximize the effectiveness of the law. Meanwhile, parties of contracts should understand the influence of cost issues on either their behaviors or transactions to recognize the helpfulness of respecting and complying with the principle of honesty and good faith when entering into a contract.

A. Coase Theorem and Transaction Costs

Coase Theorem is one of significant economic theory on property, formulated by Ronald H. Coase (1937), and has been applied to many studies by economists and jurists from all over the world. Coase used the term “transaction costs” to refer to costs of communicating, encompassing all of the impediments in bargaining. Given this definition, bargaining necessarily succeeds when transaction costs are zero. In other words, when the parties themselves can agree on issues relating to the transaction and aim to achieve a zero transaction cost, the need of protecting the ownership or compensating for damages according to contract law shall not longer be necessary. And in this situation, an efficient use of resources shall come from private bargaining. Under the contract law’s perspective, Coase Theorem has a special meaning to emphasize the efficiency of maximizing benefits will be achieved when parties have freedom in contracting.

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2 Concept of “Contract” was first legally defined in the first Civil Code of Vietnam promulgated on 10th March, 1883. This Code was a copy of The Code Napoleon as Vietnam was a colony of France at this time.
3 Jean – Jacques Rousseau, The Social Contract, translated by G. D. H. Cole, public domain, Foederis æquas Dicamus leges, Virgil, Æneid xi., 1762, Book 1, Chapter 8, p.34. Rousseau stated: “Youth is not infancy. There is for nations, as for men, a period of youth, or, shall we say, maturity, before which they should not be made subject to laws; but the maturity of a people is not always easily recognizable, and, if it is anticipated, the work is spoilt.”
5 Duong Anh Son - Hoang Vinh Long, Discussing on the nature of contract from the view of economics, Journal of State and Law (Tạp chí Nhà nước và Pháp luật), Việt Hàn lần KHXH Việt Nam, No. 2, 2013, p.298;
Due to we always have to face the commutation, the decision-making process requires comparing benefits and costs in different courses of actions. But in many cases, costs of some actions are not always as clear as their original expression. Economists define cost of something is what you have to give up to get it, including real costs and opportunity costs. Transaction costs are in the group of real costs, and considered as an economic factor which is equivalent to friction in physical systems by Oliver E. Williamson.

There are many definitions of transaction costs which is still being debated. Most researchers give two popular concepts: (1) transaction costs are costs incurred when a transaction is established on the market; and (2) the transaction costs are the costs incurred when an ownership is established and/or generating the necessary of being protected. The determination of which definition is more appropriate only depends on the purpose and which issues are analyzed. Relating analysis of the transaction costs in the context of contractual relations, it is more appropriate to use the concept of transaction costs which are the costs incurred when a transaction is established on the market, accordingly, the transaction costs will include the costs of starting, practicing and controlling contracts (Barzel, 1977).

B. Elements of Transaction Costs

A transaction normally has three steps. The first is looking for an exchange partner, including finding someone who wants to buy what you are selling, or wants to sell things you are going to buy. The second, the exchange partners must come to conclude an agreement. Agreements are reached through successful negotiations, which may comprise the drafting of a contract. And the third, after concluding an agreement, such agreement must be enforced. Executing an agreement includes monitoring the performance of parties

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6 N. Gregory Mankiw, Principal of Economics (Nguyen Ly Kinh Te Hoch, Vietnamese version), NXB. Thong Khe, Hanoi, 2003, Book 1, p. 17;
7 Oliver E. Williamson, 1985, The Economic institutions of capitalism, 1985, The Free Press. Translated by Fulbright Program of the University of Economics, HCMC, p.3;
and sanctions for breach of contract. From there, we can call these three forms of transaction costs corresponding to the above three steps in an exchange are: (1) search costs, (2) bargaining costs (also known as the costs of information - information evaluation), and (3) enforcement costs.\(^\text{10}\)

The first, the search costs, according to general studies,\(^\text{11}\) tend to be higher for unique goods or services (e.g., car, house), and lower for standardized goods or services (e.g., consumer goods, food, drinks).

The second is bargaining costs. Game theorists stated that the information shall be "public" in negotiations when each party knows its value. Conversely, information shall be considered as "private" when a party knows its value while the other does not. If the parties know the value of threats and collaboration solution, they can calculate the appropriate conditions for cooperation. Akerlof, Spence and Stiglitz won the Nobel Prize in Economics in 2001 for the study of Asymmetry Information. In an economy without clear and full information, parties who have more information may abuse its dominant to cause damage to those without or with less information. Therefore, there will be a huge risk in an economy where information is not clear and adequate.\(^\text{12}\)

In general, public information helps parties conclude an agreement easier through allowing them to calculate reasonable conditions of cooperation. As a result, negotiations tend to be simple and easy when information about the value of threats and solutions of collaboration are public. Negotiations tend to be complex and difficult when information about the value of intimidation and collaborating solutions is private.\(^\text{13}\)

Private information hinders the bargain because one has to convert the majority of this information into public information before calculating the appropriate collaborating


conditions. Overall, the more private information required to convert into public information, the more costly the bargain is. For an example, a negotiation of selling a house involves a lot of financial problems, timing, quality and price. House sellers know about the defects of the house more than the buyers, and the buyers know about their financial ability more than the sellers. Each side tries to find out such information from the other party during the negotiation. In some extent, parties may wish to disclose certain information. But they may not want to disclose all of them. The benefit of each party in the cooperative surplus depends partly on whether to retain some private information. In order to conclude the agreement, it is required to convert some information into public. Balancing this conflict may rise some difficulties and costs.

There are many documents about the negotiations, including a large number of experiments carefully built to test the Coase Theorem. One of the most convincible conclusion of this experiment was that the bargainers shall more likely to cooperate when their rights are clearly defined, and inversely tend to disagree when their rights are unclear.\footnote{Robert Cooter, \textit{The Elements of Transaction Costs}, \textit{LAW AND ECONOMICS (ISBN 0-321-20471-9) (Pearson Addison Wesley)}, translated by Nguyễn Thị Xinh Xinh, 2004, p. 93;} Parties’ rights will determine their threat value in legal disputes. One implication of the above results is that the contract law and the law on ownership must facilitate the standards for defining property rights clearly and simply. For example, the system of state registration of ownership on land will avoid many disputes and help to resolve disputes easier. Similarly, it is easy to confirm someone who is actually possessing or using a certain asset. Considering this fact, laws give prominence to possession and utilization in determining an ownership.

It also needs to pay attention to the number of contractual parties. Most examples of bargaining involve two parties. Communication between the two parties is often cheaper, especially when they are close. However, there are many agreements involving three or more than three parties. The bargaining will take more costs and difficulties, especially if parties are far away from each other. Finally, the parties may wish to draft a contract, and
this also cost expenses because there are many unexpected factors may arise that changed the value in the deal. Another obstacle of the bargaining is the hostility. Parties in a dispute may bring concerns about sensitive aspects in a reasonable agreement such as in a divorce. Those who hate each other often disagree about the division of cooperation surplus, whether all relevant facts are public knowledge. However, even if there is no hatred, the bargaining still be capable costly because parties can behave unreasonably, such as they are too focused on their own advantages. One essential aspect of the bargaining is to build a strategy. When developing strategy of a bargain, each party will try to anticipate for what extent the other can make concessions. If the one party miscalculates the level of determination of the other one, they will be surprised to see that the other won’t make any concessions, and the consequence is that the negotiation could fail. The miscalculation likely occurs when parties do not know each other well, or the difference in the culture leads to confusion in communication, or when parties have the different moral concept about the equity.

The third, enforcement costs occur when a contract takes time to complete. A contract which does not need time to complete will not bear enforcement costs, such as an instant exchange in which one gives the other a dollar and takes back a watermelon. In more complex transactions, it will take costs in monitoring behaviors and punishing those who violate the contracts. Generally, the enforcement costs will low in case of the identification of the contractual violence is easy and sanctions applied are less expensive.

In addition, it is necessary to keep in mind reasons why the transaction costs cannot be zero, include: the information is not enough and asymmetric, one party has monopoly position; one party may have more advantages than the other. Coase Theorem assumes that if transaction costs are too high, the parties could not reach an agreement, each party will have to use the rights on property to protect its interests. The division of ownership shall not be important if transaction costs are zero.15 So by saying that, the theorem agrees that when transaction costs are significant, the regulations of the ownership are even more necessary. Thus, the fact that governments nationalize factories and mines seems to reduce transaction costs.

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costs, but actually, it increases transaction costs, because some people will have much more information, and are given more advantages than the others.

Therefore, calculating Transaction Costs is one measurement for the effectiveness of a transaction. A contract is considered to be effective if transaction costs during contract performance are kept at the lowest level. The ownership is just one method to control rights of a business entity, and not a natural right.\textsuperscript{16} The other methods might be agreement or compensation.

Laws and contract law in particular, as the general rules of conduct, impact transaction costs. If legal provisions have a positive influence on the business environment, they will help transactions run smoothly and expand business opportunities. A better regulatory environment will create a greater reliability, and reduce the costs of "skepticism" between parties, or between parties and the government. Administrative procedures are often raises transaction costs.\textsuperscript{17} At the end of the day, all parties have to do is making all their efforts to minimize the transaction costs through contracting. And the most important task of contract law is guaranteeing the freedom of contract reasonably, and minimizes legal methods which interfere the private bargaining of parties. In other words, a successful contract law will not bear more transaction costs for parties through its administrative decisions.

\textbf{II. Evaluation}

\textbf{A. Freedom of contract in Vietnamese contract law}

Freedom of contract is one of the three pillars of the existence and development of an economy. Freedom promotes the creativity of individuals, and motivates the development of business activities. The freedom of contract is interpreted in the law by openly regulate contractual issues into basis principals and protect weaker parties in transactions. The law

\textsuperscript{17} Ronald H. Coase, The Problem of Social Costs, The Journal of Law and Economics, Vol.III, 1960, p.17. Coase stated that “The government is, in a sense, a super-firm (but of a very special kind) since it is able to influence the use of factors of production by administrative decision.”
will not cover all of the contract issues, or give an overall pattern to prevent restricting activities of market trading. However, the freedom of contract must also have their limitation. If leaving the market develops on its own, the competition in such market will be destroyed by the time monopoly takes control. Restricting the freedom of contract aims to (1) protect benefits of the state, society and third parties; (2) protect and defend the rights of those who are weaker in contractual relationships; and (3) protect the honesty and the good faith in such relations.

Contractual freedom was first recognized in the laws of Vietnam from the Constitution 1992, and continued being recorded in the Constitution 2013, which was developed into the detailed provisions of the Civil Code 1995, 2005, and the latest is Civil Code 2015; the Law on Enterprises 1999, 2005, and 2014; The Law on Commerce 1998 and 2005; the Law on Investment 2000, 2005, and 2014. Accordingly, the scope of freedom of contract includes the following contents: (i) the right to be equal and voluntary in contracting, (ii) the right to select partners entering into contracts, (iii) the right to freely make the agreement, change or modify the content of the contracts, (iv) the right to agree on conditions to guarantee contractual performance, and (vi) the right to agree on choosing tribunals and methods of resolving on contractual disputes.

Since Vietnamese government determines to switch the Centrally Planned Economy to the Market Economy with Socialist Orientation (1986), the government changed many economic policies to ensure the development of business activities and the implementation of Vietnam's commitments to international treaties. The State has amended the law on contract in accordance with the general rules, which has made fundamental changes in terms of objects and adjusting methods. On that basis, freedom of contract gradually was recognized and guaranteed in practice. The degree of freedom in contract law of Vietnam is currently relatively high, even though the implementation still has restrictions, which leads to contractual freedom has not promoted its positive role in reducing transaction costs for parties.
a. Freedom to enter into agreements

Freedom to enter into contract is expressed in Vietnamese contract law quite consistently. Accordingly, individuals and entities are free to sign contracts which are not contrary to the laws and social ethics. Besides, in order to be valid, contractual parties must comply with the principals of the voluntary, equality, goodwill, honesty and uprightness in contracts.\(^\text{18}\) The freedom of contracting is also reflected in the provisions on the scope of the subjects who have the right to enter into contracts. Depending on the nature of each type of contract, the scope of contractual subjects in civil and business relationships might be: (i) individuals with legal capacity and capacity for civil acts, legal entities, cooperative groups, household;\(^\text{19}\) and (ii) traders including economic organizations established legally under Vietnamese corporation law, and individuals doing business independently, frequently and having registered at administrative authority.\(^\text{20}\)

However, in some cases, the peer in contracting between such subjects is not practiced. Notably in contracts on supplying exclusive goods or services, where one party is a state companies which are given a monopolistic right to distribute goods or services such as electricity, water, telephone, the other parties who are normal people using these goods or services are forced to conclude sample contracts. In case these state companies violate the contracts or cause damage to the consumers/users, there is also no provision of redeem. For example in electricity supplying contracts, it usually happens when the power supplying companies unreasonably disconnect the power, causing damage for electrical equipments and products being manufactured, consumers and users do not have any foundation to start a lawsuit against such companies for compensation.

Furthermore, the most common example on the restriction of contractual subjects is related to house purchase contracts, especially with buyers who are foreign individuals and organizations. Even though the Law on Housing 2014 has allowed these subjects to buy

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\(^{18}\) Provided in Article 389, The Civil Code of Vietnam, approved by the National Assembly on 14 June, 2005 (herein after mentioned as “\textit{Civil Code 2005}”); and Article 11, Law on Commerce issued by the National Assembly of Vietnam dated 14 June, 2005 (herein after mentioned as “\textit{Law on Commerce 2005}”);

\(^{19}\) Article 14,15,16,17, 84, 106, 111 of Civil Code 2005

\(^{20}\) Paragraph 1, Article 6 of Law on Commerce 2005
houses, conditions and procedures are still very restrictive. At this point, one who is a foreign individual or entity must consider costs to final a successful house purchase transaction. The costs would be very high due to expenses for proving the conditions of subjects, traveling expenses, costs from time spent for performing the procedures, etc. Meanwhile, they are only allowed to have rights of such property in term of 50 years. If we compare the benefits and transaction costs of buying a house with renting one serving for the same purpose, it might be said that the policy of recognizing the right to purchase houses of foreigners is not giving any value for the these individuals and organizations.

b. Freedom to agree on the content of contracts

Freedom to decide and agree on the contents of contracts is fully affirmed a very basic right of business freedom. The parties are free to select goods or services for trading, the price, pricing, payment methods, conditions of delivery, transport, packaging and other contents of a contract on the basis of the harmonization on rights and benefits of both parties. However, it should be noted that freedom to agree on the contents of contracts is limited by the provisions of the law, in order to ensure that public order or benefits that the laws are protecting shall not be harmful. For example, parties could not reach an agreement on a predetermines damages in the contract according the contract law of Vietnam, due to the law is only approved for compensation to actual damage when one party violate the contract. Contractual parties are only allowed to agree on an amount of a penalty, which shall not exceed the maximum limit provided by law (In commercial contracts, the maximum is 8% of the violated value of the contract).

In general, despite being widely recognized and declared to be protected by the law, freedom of contract in Vietnam, in fact, is still restricted quite greatly. These restrictions partially prevent the effectiveness of contracts by bearing more costs for the transactions. In order to overcome these problems, contractual parties should understand clearly and recognize all limitations occurred from either provisions of the contract law or

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22 Article 302, 305 of Law on Commerce 2005.
23 Article 301 of Law on Commerce 2005.
administrative procedures relating to the transaction before any negotiation. Local lawyers who have well knowledge and years experience on legal practice of the country can help giving some advices to parties. It will be more economic to choose a local law firm over an international one. Due to the complication and lack of transparency in administrative procedures, international law firms usually have to hire local lawyers to do the same task with a higher price. Certainly, costs for consulting should also be counted into one of necessary transaction costs.

B. The level of interference from the State to contractual relationships

Applying findings of Ronald Coase on the relationship between transaction costs and property rights, we can evaluate the effectiveness of the Vietnamese contract law by assessing the level of intervention from State’s laws and decisions to contractual relationships. If it is recognized that decisions or provisions of the law are too detailed, the ability to increase transaction costs will be higher than in ordinary conditions, where contractual parties are free to choose the solutions solving contracts’ issues. In this perspective, the contract law of Vietnam, in fact, does not ensure its interference at the lowest level.

This can be seen in regulations on form of contracts in the contract law. It is provided that the good purchase agreements must be expressed verbally, in writing or by specific acts, except for international commodity trading. International purchasing contracts must be made in writing or in another form with equivalent legal value. Meanwhile, the Vienna Convention 1980 on international sale contracts allows this type of contract might be made in diverse forms. Even only with the presence of witnesses, the contracts are also recognized. This limitation is now a barrier hindering the domestic traders in selecting the methods of settlement in contractual disputes. They cannot sue foreign partners when they sign agreements in the form of witnesses who are the brokers. Another case is in

determining the text form of contracts of transportation (including contract of affreightment, voyage charter, etc.). In view of the Vietnamese contract law, the bill of lading is not considered as a contract. It is only recognized as one of the evidence to prove that a contract had been signed.\textsuperscript{27} This regulation cause difficulties for the parties in disputes relating to the responsibility to pay the freight, liability for compensation of damage caused by shipping to a wrong beneficiary.

One of the most common disputes relating to non-compliance of contractual forms leading to an invalid contract is contracts concerning the land and houses. The shortcomings in the procedure of transferring land use rights and house ownership enable any party can take the advantage to break the contract by requesting the Court to declare such contract invalid, in case the parties had failed to comply with the contractual form which must be in written, and must be notarized or authenticated.\textsuperscript{28} For a very long time, The Court resolves this situation by allowing parties to re-establish the contract with the same contents in the form required by law in a term of 30 days from the date of Court’s decision.\textsuperscript{29} However, this solution is not feasible. Once one party consciously wants to break the contract, there is no way for both to agree to go to the registration body to restore the form of such contract. This solution has become useless, causing loss of time and expenses for parties in a long time. Until the new Civil Code 2015,\textsuperscript{30} the Courts will have the authorization to recognize the full valid of a contract which violates form but has been implemented from 2/3 of the contents of the signed contract. The solution once again will raises a problem of determining the amount and degree of completion of a contract, if it is only verbal, and there is not enough evidences to prove the entire contents of the contract.

In another aspect, in the extent of its interference, the contract law of Vietnam also has to solve the problem of limiting relating transaction costs. According to elements

\begin{itemize}
\item \textsuperscript{27} Clause 2, Article 536 of Civil Code 2005.
\item \textsuperscript{28} Article 450 of the Civil Code 2005.
\item \textsuperscript{29} Resolution No. 01/2003/NQ-HDTP dated 16 April, 2003 promulgated by The Judges’ Council of the Supreme People’s Court.
\item \textsuperscript{30} New Civil Code of Vietnam has been promulgated on 8 December, 2015, but only being effective from 1st January 2017.
\end{itemize}
analyzed in part I.B herein, factors that increase transaction costs include: parties are strangers, irrational behaviors, delays, unexpected events, and the high monitoring costs.

*First*, factors which increase transaction costs are the results of *information asymmetry*. Information asymmetry became the problem of all problems. On a free market with imperfect conditions, information asymmetry is an inevitable factor cannot be removed. Due to the merchants are always know best about the products they sell, not the buyers, it cannot eliminate transaction costs arising from information asymmetric. However, by the contract law, we can restrain and reduce such costs by confirming the principle of honesty and good faith in laws, and providing sanctions ensuring that this principle complied by the parties. The contract law of Vietnam is lack of rules which can protect the rights of honest and goodwill parties, and sometimes abetting parties who are less honest.

For example, during the stage of looking for a contractual partner, there will be a case where a party deliberately starts a negotiation with its potential partner without the intention of signing the final contract. Their true intentions might be to prolong or obstruct such partner from entering into a contract with another party. Inherently, this behavior cannot be considered as an act of honesty and goodwill no matter whether the contract is concluded or not. There is no regulation in current Vietnamese contract law protecting the honest and righteous party in this case. In this case, it will be more reasonable if the laws have provisions forcing the party, who started or participated in a negotiation without the intention of signing contract which causes damage to other party, to compensate for such loss and expected profits.

Other examples are regulations relating time-limits in commercial contracts. The time-limit for complaints about the quality of goods and commodities in commercial transactions are six months from the date of delivery or the date the warranty expiration.\(^{31}\) The contract law’s regulations seem to “protect” parties who either have more information or been dishonest in the transaction. The sellers in most circumstances are the parties who understand and know full well about their goods. In a scenario where sellers purposely hide

\(^{31}\) Article 318 of the Law on Commerce 2005.
information relating to the actual situation of goods, buyers or parties who have less information shall be completely crashed into a passive situation when they are implicitly considered to know their rights have been violated or not right from the moment the obligation had been executed by sellers.

Similarly, the time limit for one to request the Court to declare a contract invalid is two years from the date of the transaction is established. 32 The same with the scenario where a dishonest party is too good in hiding information from the other, the honest party cannot have a chance to be protected by law once the prescription of two years has been expired. It will be more reasonable to provide that those prescriptions should be from the date one party discovers that its contractual rights are violated instead from the date transaction has been established. And from this unsound regulation, the New Civil Code 2015 has surmounted this matter by providing that the prescription for one party to request the Court to declare a contract invalid due to misunderstandings or deception shall be two years from the date such party knew and should have known that they entered into the contract by misunderstandings or being deceived. This change can be acknowledged as a progress of Vietnamese contract law.

A contract law which fails to protect the weaker or the honest and good faith will lead parties in the contract strangers trust in each other less and less. As a result, the less honest party will take advantage on irrational behaviors, also the negotiation process will be prolonged due to a longer monitoring process, in order to collecting and confirming information. Even with or without finalizing the contract, all those factors have resonated higher transaction costs. Thus the current contract law of Vietnam has not satisfied effectiveness as expected.

Second, the consistency of provisions of different legal texts in the system of contract law, particularly the provisions on procedures, is also a main factor make transaction costs change. The higher the consistency is, the lower transaction costs will be. Unlike the system of common law, Vietnamese legal system was built by many terraces of legal

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documents and texts promulgated by different authorities and bodies. Under the civil code and laws, there are decrees, circulars, ordinances, decisions, and official letters detailing and guiding regulations of law. And there is an uncomfortable practice that, in most circumstance, specialized management agencies give instructions which are contrasting to each other or even not compatible with the law. In this situation, contractual parties usually have to comply with guiding of those agencies without any reasonable explanation which can be more complicated, bear more costs and prolong transaction’s process for all parties.

We can look at regulations on penalty and damages due to breach of contract as an example. Vietnamese contract law only allow contractual parties to agree an defined amount of penalty in the contract, but a pre-agreed amount of damages, because of the principle of which a compensation must be base on actual damage, not predictable damage. On one hand, the Civil Code 2005 provides that: relating to contracts containing the clauses of penalty, the parties may agree that a party breaching an obligation must pay only a penalty for breach without having to compensate for damage, or must pay both a penalty for breach and compensation for damage. Where the parties do not have an agreement on compensation for damage, the party breaching an obligation shall be required to pay only the penalty for breach. 33 On the other hand, the Law on Commerce 2005 provides that in similar situation, the obligee shall have the right to apply the penalty and force the obligor to pay damages at the same time. 34 Besides, the Civil Code 2005 allows parties to freely agree on the sum of the penalty, while Law on Commerce 2005 fixes the maximum amount of a penalty shall not be higher than 8 % of the violated value of the contract. 35

Take a look at a scenario where parties have agreed on a penalty clause in the contract, and a breach has actually occurred. In this case, will the aggrieved party be forced to pay damages or not if the parties did not agree that the party who violate the contract shall pay penalty and damages at the same time? Or in case where the penalty for breach was far less or higher than the actual damage, might parties renegotiate the amount of the penalty to

33 Article 422.3 of the Civil Code 2005.
34 Article 307 of Law on Commerce 2005.
35 Article 301 of Law on Commerce 2005.
balance benefits and compensate the expecting profits for both party? The contract law of Vietnam still unresolved these cases.

Furthermore, the new Civil Code 2015 included an additional provision where the obligee will have the right to demand the aggrieved party to compensate for spiritual damage. In my opinion, this provision is unreasonable and very risky for parties. For contractual relationship is a based-on fairness and goodwill principal, each party will consider all benefits, risks and costs before they decide if they should sign the contract or not. In case, one party has considered that a breach can bring a better consequence for them than carrying on the contract, they should have the right to terminate their obligations in the contract, as long as they can handle all the compensatory damages and expecting profits for the other party. They are not supposed to be responsible for any “spiritual loss” of a party who has already understood that there will always be a risk in a relationship like a contract. Moreover, in the absence of a basis for determining spiritual damage, the competence to define the damages will belong to the Court, in which the contract law has created a significant loophole for dishonest parties and individuals to perform unrighteous behaviors to cause loss and imbalance contractual situation which parties can not anticipate at the time of negotiating the contract.

The consistency of the contract law of Vietnam is still very low. Where violations occurred, it will take a lot of time and costs for parties and the Court to interpret the meaning of contract law’s provisions and parties true will during the dispute resolution. The longer the resolution takes, the higher transaction costs both parties have to bear. This is the case where all parties are failed in the transaction’s relation.

In summary, from above evaluation, we can see that the efficiency of the Vietnamese contract law is still low. In the need of successfully performing a contract and reducing transaction costs coming from provisions of contract law, parties should guarantee the principal of honesty and goodwill in sharing information from the stage of negotiation. Irrational behaviors and intentional delays shall only bring more costs for both parties.

36 Article 419.3 of the New Civil Code 2015.
And the most important thing is that all parties should be prepared to know well and understand insensible issues of the law where the contract is executed to prevent risks coming from law itself.

III. Conclusion

A good contract law should create favorable conditions for contractual parties to implement transactions at the lowest cost and minimize the chance of fraud. To achieve a low-cost situation for parties, the contract law must guarantee the principle of honesty and goodwill in negotiating and concluding contracts. Making the evaluation on this aspect, the effectiveness of Vietnamese contract law is still very low. Therefore, parties in a contract should take the initiative to clarify information and anticipate all transaction costs and risks before drafting actual clause into the contract. And finally, Vietnamese lawmakers should consider building the contract law of Vietnam upon solving the problems of translation costs for contractual parties.
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