

Prepared for the Encyclopedia of Law and Economics, Gerrit De Geest
(General Editor), 2nd edition, Cheltenham UK, Edward Elgar, 2010

THE CIVIL LAW OF CONTRACT

Ejan Mackaay¹

Contents

Abbreviations	1
Keywords	2
I. Civil law of contract – general observations	2
A. General features of codified law	2
B. The role of contract law	3
C. Good faith	7
II. Formation	12
A. Offer of reward	12
B. Defects of consent	13
1. Error	13
2. Fraud	15
3. Threat of violence or fear	19
4. Lesion	20
C. Cause	22
III. Contents	22
A. Limitation or exclusion of liability clauses	22
B. Penalty clauses	23
IV. Performance	25
A. Excusable non-performance: force majeure	25
B. Contractual remedies: specific performance	27
Conclusion	30
Bibliography	30

ABBREVIATIONS

BGB – *Bürgerliches Gesetzbuch* – German Civil Code

CCF – *Code civil des Français* – French Civil Code

CCQ – Civil Code of Quebec

¹ Emeritus Professor of Law, University of Montreal; parts of this paper have been presented to audiences at the University of Sao Paulo, Brazil, at the 22nd Workshop in Law & Economics, University of Erfurt, Germany, and at the Symposium in honour of Michael Trebilcock, University of Toronto, Canada. Kindest thanks to the participants in these events for comments and suggestions. Particular thanks are due as well to Gerrit De Geest for incisive comments on the full version of the paper.

NBW – *Nederlands Burgerlijk Wetboek* – Netherlands Civil Code; see Haanappel/Mackaay 1990

KEYWORDS

Law and economics – civil law systems – institutions – contract – good faith

I. CIVIL LAW OF CONTRACT – GENERAL OBSERVATIONS

A. General features of codified law

This chapter presents a brief survey of economic analyses performed on contractual institutions and doctrines that are specific to civil law – as opposed to common law – systems (for more detailed analysis, see Mackaay forthcoming). What sets civil law systems apart from common law systems, besides differences in vocabulary, is that their core rules are set out in codes drafted with the aim of covering in principle all relationships within the field of law they govern. All legal problems arising within that field are deemed to be soluble by reference to, and through interpretation of, one or more provisions of the Code.

Whilst codes consolidate in their provisions the solutions found to a great many practical problems that have arisen over time, it would be illusory to expect them to provide ready-made solutions to *all* conceivable problems. To cope with novel or imperfectly foreseen problems, whilst yet maintaining the claim to complete coverage, the Codes need to resort to a small number of open-ended concepts that can be used to fashion appropriate solutions to such problems. Good faith and abuse of rights are some of these concepts.

One of the main objectives of codification in civilian legal systems is to make law accessible: all the law for a given field is in principle to be found in one place – the Code – rather than in a proliferation of individual judicial decisions, so as to make it easier for citizens to know their rights and obligations. To accomplish this, the codes need to be of workable dimension. This entails that the formulas used will have to be concise and often abstract, condensing large ranges of practical solutions, and the code's provisions should be interpreted so as to form

a coherent and seamless whole. One should not be misled by the abstract character of Code provisions or by the idea of the Code as a system. Codes are not systems of abstract logic unconnected with the real world; they are meant to reflect consolidated experience. To work effectively with such tools, civil lawyers need to be (made) aware of the gamut of actual cases each code article is meant to capture as much as common lawyers need to be cognizant of the relevant judicial decisions on a particular point of law.

Once these general characteristics are taken into consideration, one must expect the economic analysis of law to have as much to tell lawyers in civil law systems as it has those in common law systems, and in the American legal system in particular. The Legal Origins movement has forcefully put forth the thesis that common law systems are more conducive to economic growth than are civil law systems (La Porta et al. 1998, 1999, 2008), but this conclusion has been contested (Dam 2006; Roe 2006; Roe/Siegel 2009; Milhaupt/Pistor 2008; survey: Mackaay 2009) and a very recent paper has highlighted how the imposition of the institutions of the French Revolution, including its civil code, on other European nations helped to clear rent-seeking barriers to trade (Acemoglu et al. 2009). On the whole, the jury seems to be still out on the comparative virtues of different legal families.

In what follows we look at a sample of civil law institutions through the lens of the economic analysis of law.

B. The role of contract law

On an economic view, contract is an open-ended institution by which individual actors can exchange resources to their mutual advantage, thereby moving them to higher-valued uses. In the consensualist conception of contract, parties can do this essentially for any object and in any form they see fit. What then is the role of contract law? Parties need no encouragement to enter into profitable deals. But the law may be called upon to avoid mishaps in the contracting process or reduce their seriousness: for instance, one party being taken advantage of by the other, at the time of contracting or later, as a result of unforeseen circumstances; or a division of tasks or risks between the parties which experience suggests is less than optimal.

The first line of defence against mishaps is precaution by the parties themselves. Economic theory predicts that to avoid mishaps in the contracting process each party, being a rational actor, will take all precautions whose cost is

lower than the trouble so avoided, discounted by the probability of its occurrence (Ben-Sharar 2009 explores what happens if for consumers this was the only line of defence). This is the logic of accident avoidance, which forms the basis of the economic analysis of civil liability law. The idea can be expressed equivalently as each party seeking to minimise the sum of the costs of precautions it takes to prevent mishaps and those of the mishaps that it could not profitably prevent and hence must simply absorb. Rational actors will only enter into a contract if these transaction costs can be covered by the gains the contract promises.

Both parties will seek the optimal set-up from their own point of view. They will inform themselves on the prospective contracting partner, on the product contemplated and on the terms on which it is offered. If the information that can be collected on prospective contracting partners is too sketchy for comfort, a party may limit dealings to a smaller circle of people on which more information can be gleaned or who particularly inspire confidence, for instance because of ethnic ties. Where the performance of a contract looks uncertain, a party may insist on being given security or a guarantor or again an express warranty that the product will meet specific requirements. Providing securities or suretyship entails of course a cost, which must be covered by the gains the party providing them expects to realise by the contract. If these or similar precautions are not viable or too costly, given what is at stake, or if they leave too high a margin of residual risk of mishap, a party may take the ultimate precaution of not contracting at all. This entails the opportunity cost of forgoing the net gains of the contract, which, one may surmise, the abstaining party considers to be negative.

During their negotiations, parties may further reduce the risk of mishaps or non-optimal arrangements by exchanging information and shifting burdens or risks between them, allocating these burdens to the one who can take care of them at the lowest cost. When you order a book at Amazon, they will look after the shipping, even though you pay for it: Amazon has access to very considerable scale economies in these matters.

Parties arrive thus at the best arrangement they can fashion between themselves. This may still leave a substantial margin of risks of mishaps and a considerable level of precautions taken to avoid them. Can contract law improve upon this, leading parties to 'lower their guard'?

Corrective intervention through contract law would seem justified whenever the cost of the intervention is more than offset by the savings in transaction costs it generates compared to what the contracting parties could themselves achieve,

in other words whenever it allows parties so to lower their guard that their savings are greater than the cost of the measure itself. Wittman states this idea by the simple formula according to which

‘[i]n a nutshell, the role of contract law is to minimize the cost of the parties writing contracts + the costs of the courts writing contracts + the cost of inefficient behavior arising from poorly written or incomplete contracts.’ (Wittman 2006, 194)

Contract law aims at minimising the overall cost of mishaps and their prevention in contract.

Of the three terms of the Wittman test, the first and the third have already been highlighted in the discussion of the role of contracting parties, with the difference that they are here to be taken not at the level of individual contracting parties, but at the level of society as a whole, for all contracting parties taken together. The first term refers to measures taken by the parties themselves, individually and in negotiation, to find the best arrangement – for instance in allocating risks or other burdens – and to avoid bad surprises. The third term refers to mishaps that the parties are unable to avoid, that is arrangements that looked too costly to prevent beforehand or that, contrary to expectations, turn out to be non-optimal or bad surprises and whose cost must be absorbed; an example would be the opportunistic exploitation of a gap left in the contract.

The middle term implies that public intervention is worthwhile if it reduces the sum of the three terms, that is if its own cost is lower than the savings to which it gives rise in the other two terms. These considerations apply to all contracting parties taken together, rather than at their individual level.

Consider, by way of example, the court system allowing contracts to be enforced. In the absence of such a system, breach of a contract can certainly be punished or avoided up front, by a private system based on arbitration and community sanctions such as blacklisting and exclusion. In such a private set-up, actors only contract with persons they know or against whom community sanctions will be effective. Putting in place a system of public enforcement represents a gamble on the gains resulting from people daring to do business with a wider circle of persons: the gains from more numerous and more widely distributed contracts plus the savings in self-protection measures contracting parties would normally take are sufficient to offset the fixed cost of the public enforcement system plus the variable costs of contracting parties using its enforcement services. Of course, the very presence of a public enforcement

system, even where people do not generally have recourse to it, casts its shadow on the temptation for contracting parties to behave opportunistically and this in itself represents a saving.

To take another example, by instituting a regime of mandatory warranties in the sale of manufactured goods, one implicitly gambles that the savings generated for a large proportion of consumers in lowered self-protection and bad surprises avoided will offset the losses resulting for a smaller proportion of consumers of contracts that are no longer allowed or, because of the inflexibility of the general rule, have to be entered into on less advantageous terms than parties would have liked. Empirically, it may turn out that numbers are different from what proponents of the measure had in mind, as Priest discovered in early studies of mandatory warranties (Priest 1978, 1981).

What are the costs of a legal rule? They vary depending on whether one is dealing with a mandatory rule (public order – parties cannot opt out of it) or with a suppletive or default rule (parties may agree otherwise). A public order rule seeks to counter opportunism; by providing a fixed and enforceable rule, it is designed to allow a substantial proportion of citizens to lower the level of self-protection they consider required in given circumstances, but at the cost of reducing the negotiation space for all, which will particularly hamper those who were willing to assume greater risk in exchange for more advantageous terms, especially price.

The costs of a public order or mandatory rule (*ius imperativum*) include:

1. the cost of framing the rule legislatively or judicially, including the risk of capture by interest groups (rent-seeking) in the case of the political process;
2. the cost for the parties of enforcing their rights using public procedures the rule points to;
3. the opportunity cost of 'sharper deals' forgone because they are prohibited by the rule;
4. the cost of the rule turning out on experience to be ill-suited for the problem it was designed to regulate.

Taken together these costs must be more than offset by the gains the rule generates in terms of people 'lowering their guard' (reducing self-protection), contracting with a wider circle of persons and absorbing residual risk.

In the case of a suppletive or default rule (*ius dispositivum*), the stakes are slightly different because parties are now free to put it aside, but must take the

trouble (and expense) of doing so. Essentially of the four factors listed, the third factor falls away under a suppletive rule. However, this may be illusory if the cost of opting out and framing one's own rule is practically prohibitive, in which case the rule has to all intents a public order character. Since citizens are free to opt out, the fourth factor should now be called 'undue reliance' on a rule that turns out to be ill suited. Usually, default rules propose a solution that experience suggests most parties would have chosen had they taken the time to contract about it explicitly.

Any rule that promises gains from more ample contracting and savings in transactions costs of private parties in excess of its own cost as just specified – net gains, in other words – has a proper place in the law of contract; the Wittman test implies that where several competing rules are conceivable for the same subject matter, the one promising the highest net gain should have preference. One must expect such gains where public authorities have access to greater scale economies in framing and enforcing rules than are open to private actors. A broad principle reflected in many rules is to attribute a burden to the party who can best or most cheaply influence the occurrence or cost of a mishap. Calabresi has proposed the term 'cheapest cost avoider' for this principle (Calabresi 1970, 139 f.; Calabresi/Melamed 1972, 1118 f.). A good deal of civil contract law appears explicable as applications of the 'cheapest cost avoider' principle (De Geest et al. 2002).

The Wittman test would seem to account for more detailed objectives of contract law listed in the literature, such as preventing opportunism, interpolating efficient terms either on a wholesale or a retail basis (gap-filling versus ad hoc interpretation), punishing avoidable mistakes in the contracting process, allocating risk to the superior risk bearer and reducing the costs of resolving dispute (Posner 2007, 99 (§ 4.1); similar lists are given in Cooter/Ulen 2007, 232; Trebilcock 1993, 16-17;).

C. Good faith

Good faith is a key principle in civil legal systems (survey: Litvinoff 1997; Hesselink 2004). It played a major role in late Roman law and in pre-codification French law (Charpentier 1996). Within the modern civil law family, it still plays an important role in French law (arts 1134 and 1135 CCF in particular) and a central role in German civil law ('*Treu und Glauben*' Art. 242 BGB). In Dutch law, the recodification towards the end of the twentieth century recognised as

fundamental principles of civil law the subjective notion of good faith as justifiable ignorance of title defects in the law of property, and the objective notion of good faith as loyalty in contractual dealings, for which the distinctive term 'reasonableness and equity' (*redelijkheid en billijkheid*) was introduced (Haanappel/Mackaay 1990). The Quebec Civil Code of 1994 has given good faith a substantially larger place than it had under the old Code of 1866. In all, 86 articles in the new code use the term good faith. Amongst these, the following stand out:

6. Every person is bound to exercise his civil rights in good faith.

7. No right may be exercised with the intent of injuring another or in an excessive and unreasonable manner which is contrary to the requirements of good faith.

1375. The parties shall conduct themselves in good faith both at the time the obligation is created and at the time it is performed or extinguished.

The European directive on unfair terms refers to good faith in the recitals and in article 3 (1) (Directive on unfair terms). The Unidroit *Principles of International Commercial Contracts* of 1994 provide in art. 1.7 that 'each party must act in accordance with good faith and fair dealing in international trade' and that 'the parties may not exclude or limit this duty.' (Unidroit 1994) and the Vienna International Sales Convention recognises it in article 7 (Vienna Sales Convention 1980). By comparison, English and Anglo-Canadian law is still hostile to the general concept of good faith (Goode 1992; Brownsword 1998; Bridge 1984), though it recognises specific applications of it; in the United States, the Restatement (Second) of Contract explicitly refers to the obligation of good faith in contractual dealings in § 205 (Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.) (Restatement 1979), as does the Uniform Commercial Code, for instance in §§ 1-201, 1-304, 2-103, 2-403 (UCC).

In what follows we deal only with contractual good faith, leaving aside good faith in property law ('subjective good faith'), where it applies, for instance, to the purchaser of stolen goods and to the possessor non-owner of goods who acquires ownership through prescription. Good faith refers here to justifiable ignorance of facts or legal status, in particular defects in one's title. This notion, too, lends itself to an economic analysis, in which one compares the precautions that could have been taken to ascertain the accurate state of affairs to the risk and cost of acting on an erroneous assessment (Mackaay 2001).

To capture the meaning of good faith in contract law ('objective good faith'), legal scholarship resorts to terms such as 'fairness, fair conduct, reasonable standards of fair dealing, decency, reasonableness, decent behavior, a common ethical sense, a spirit of solidarity, community standards of fairness' and 'honesty in fact' (Keily (1999), at 17-18) and their French equivalents: '*loyauté*' (Charpentier 1996), at 305), '*honnêteté*', '*intégrité*' (Pineau *et al.* 2001, at 35), '*fidélité*', '*droiture*', '*véracité*' (Rolland 1996, at 381), '*comportement loyal*', '*souci de coopération*', '*absence de mauvaise volonté*', '*absence d'intention malveillante*' (Cornu 2000, V^o Bonne foi); the absence of good faith signals 'unconscionable' behaviour (Keily 1999, at 17), which in French is characterised as '*blâmable*', '*choquant*', '*déraisonnable*' (Pineau *et al.* 2001, 44). In pre-revolutionary French law, good faith was considered to require 'that consent is valid, that parties abstain from trickery, violence, any dishonesty or fraud; but also that it was plausible and reasonable; and finally that the contract not be contrary to divine law, to good morals, nor to the 'common weal' (*profit commun*)' (Ourliac/de Malafosse (1969), at 83, n^o 67).

All these formulae, intuitively plausible though they may seem, merely translate one general term into other general terms. A formula closer to translation into operational tests is given by Pineau *et al.*: 'one should not profit from the inexperience or vulnerability of other persons to impose on them draconian terms, to squeeze out advantages which do not correspond to what one gives them' (Pineau *et al.* 2001, at 44). This points to the concept of *opportunism*, which in a law-and economics perspective contract law is thought to have a general mission to prevent (for instance Posner 2007, 99). Let us take a closer look at this concept.

Opportunism is regularly mentioned in the economic literature. Specific forms of it have attracted a good deal of attention:

- *free riding* – where a result can be brought about only by the contribution of all but it is not feasible to supervise everyone, the free rider abstains from contributing, yet shares in the spoils; (de Jasay 1989)
- *shirking* in a labour relationship, where the employee gives the employer a lesser performance than promised (Buechtemann/Walwei 1999, at 172);
- *agency problems* also reflect supervision difficulties – where one must pursue one's plans by relying on other persons' good offices without

being able to fully supervise them, the other persons may pursue their own interests at one's expense;

- *moral hazard* – originally in insurance contracts, but with wider application – is also a supervision problem – where the insured, once the insurance contract is written, behaves less carefully than promised or demonstrated when the premium was set.
- *holdout* behaviour is a different kind of opportunism – where a collective project will go forward only with everyone's consent, the hold-out suspends his consent in the hope of securing more than his proportional share of the spoils. The opportunism stems here not from an information (supervision) problem, but from the monopoly power conferred by the veto;
- *hold-up* situations are those in which one party is able to force the hand of the other to get more than its promised or fair share of the joint gains of the contract (Shavell 2007).

Although these specific forms of opportunism have attracted a good deal of attention, one would be hard put to find a proper definition of opportunism in general (Cohen 1992, at 954). Classical economic theory paid little attention to the notions of transaction costs and opportunism, preferring to study markets as if transactions occurred in principle without friction. In contrast, for so-called "institutionalist" economists, these notions play a central role, often in specific reference to the Coase Theorem. Williamson, who has done much to clarify the concept in economic thought, defines it as 'self-interest seeking with guile.' (Williamson 1975, 26 and later works: 1985 and 1996). He contrasts opportunism with trust and associates it with selective or partial disclosure of information and with 'self-disbelieved promises' about one's own future conduct. Dixit adds that it refers to a class of actions that may look tempting to individuals but will harm the group as a whole (Dixit 2004, 1). George Cohen defines opportunistic behaviour in general as 'any contractual conduct by one party contrary to the other party's reasonable expectations based on the parties' agreement, contractual norms, or conventional morality.' (Cohen 1992, at 957)

To sum up, a party to a contract may be said to act opportunistically where it seeks, by stealth or by force, to change to its advantage and to the detriment of the other party or parties the division of the contract's joint gains that each party could normally look forward to at the time of contracting. It tries, in other words, to get 'more than its share.' Opportunism may involve getting a party to enter an

agreement it would not willingly have signed if it had been fully informed (*ex-ante* opportunism); it may also involve later exploiting unforeseen circumstances the contract does not provide for in order to change the division of gains implicitly agreed upon when the contract was entered into (*ex-post* opportunism). In acting opportunistically one party significantly exploits an asymmetry in the relationship amongst the parties to the detriment of the other party or parties. In a prisoner's dilemma game, it would correspond to defection where the other party or parties would choose cooperation.

For opportunism to arise, there must be an asymmetry between the parties, of which one takes advantage at the expense of the other. Asymmetry itself does not signal opportunism: you rely on professionals of various stripe for services they specialise in; life would be difficult without it. Opportunism corresponds to the legal concept of bad faith; it is the exact opposite of good faith, which we can now define as not turning to one's advantage the vulnerability of the other person in circumstances that might lend themselves to it.

Not all forms of opportunism call for public corrective intervention. According to the Wittman test, intervention would not be worthwhile for minor forms, which are best dealt with by persons being normally on their guard: self-protection is here cheaper than the constraints a public mandatory rule inevitably imposes on all actors. The law makes opportunism actionable only where one party takes advantage of an asymmetry to a significant degree, i.e. beyond a certain threshold of seriousness. This explains why puffing and minor exaggerations (*bonus dolus*) are not actionable. The impediments to the functioning of markets would seem here to exceed savings in self-protection.

In a very general sense, one might say that the core of contract law is that all contracts must be performed in good faith and that the task of the courts is to sanction the absence of it. But this would leave far too much discretion to the courts and too much uncertainty for citizens. Hence good faith has had to be particularised in Civil Codes into a number of more specific concepts, each with its own legal tests. Whittaker and Zimmerman provide the following list for civilian systems: *culpa in contrahendo*; *obligations d'information*; *laesio enormis*; the abuse of rights; personal bar; interpretation of the parties' intentions (whether standard or 'supplementary'); the doctrine of 'lawful contact'; laches; unconscionability; *Verwirkung*; *purgatio morae* and *purgatio poenae*; doctrines of change of circumstances or 'erroneous presuppositions'; the notion of a 'burden' (*Obliegenheit*); *force majeure*; *exceptio doli*; mutual mistake; liability for latent

defects; the legal consequences associated with the maxims *nemo auditor turpitudinem suam allegans* and *dolo agit qui petit quod statim redditurus est*, and *venire contra factum proprium*.' (Whittaker/Zimmerman 2000, at 676; also Zimmerman 2001, 172). Since all these concepts are derivative of good faith, one would expect the three general features – asymmetry; exploitation; beyond a certain threshold – identified above to shine through all particularisations (Mackaay/Leblanc 2003). Good faith remains as a residual concept with which to fashion new remedies where no existing one is appropriate (as one may expect for some cyberspace contracts).

II. FORMATION

Under the heading of the formation of contract, civil law doctrine traditionally deals not only with the modalities of consent through offer and acceptance, and other basic requirements of contract such as a legitimate cause and object, but also with defects of consent – error, fraud (*dolus*), violence or threat, as well as lesion – whose presence is analysed as having undermined the contract from the outset and hence requiring the parties to put each other back in the situation they were in before entering into the agreement.

A. Offer of reward

You offer a reward for the return of your cat. Should you be bound to pay the reward even if the person returning the cat did not know of the offer? Some persons – active searchers – may be induced to search by the prospect of the reward; casual finders may return the property if they happen upon it, on the off chance of a reward. The relevant question is how a rule requiring knowledge will affect the two groups: it will encourage active searchers, but may discourage casual finders; one may expect the latter group to be more numerous than the former; but the former group may react more strongly to the incentive of reward than the latter. *A priori* the net effect of a rule requiring knowledge is not obvious; it may be a wash. Given the uncertainty, a rule requiring knowledge reduces the number of claims that could reach the courts, but knowledge may be difficult to prove. By contrast, a public offer of reward may be easier to prove, which would militate in favour of a rule making the reward due once it was publicly offered, whether or not the finder had knowledge of it. The German Civil Code adopts the

latter rule in art. 657, as does the Quebec Civil Code in art. 1395:

The offer of a reward made to anyone who performs a particular act is deemed to be accepted and is binding on the offeror when the act is performed, even if the person who performs the act does not know of the offer, unless, in cases which admit of it, the offer was previously revoked expressly and adequately by the offeror.

The Dutch Civil Code provides in art. 5:10 that the finder is entitled to a reasonable reward.

B. Defects of consent

In a strictly formalist system, such as Roman law was (but see Del Granado 2008), there would be little need for correcting regretted decisions. The formalities would ensure well-considered decisions and exclude ill-advised ones as well as subtle fraud and violence. Prospectively all parties expect to benefit by the projected transaction. Criminal law would take care of cases of outright fraud and violence.

Why abandon formalism? Because it also entails important costs: it increases transaction costs; it limits the range of acceptable contracts. This would slow down markets and may deprive us of innovations the gains of which, taken over all contracts, will surely suffice to offset a few regretted decisions. Modern legal systems rather bet on innovation and hence go by the principle of consensualism, both as to the variety of contracts that can validly be entered into – an open set – and as to the absence of formalism for doing so.

Within the consensualist conception of contract one needs correctives for cases where consent is obviously not enlightened (error and fraud) or free (threat of violence). The correctives one finds in the codes of civil law systems plausibly pass the Wittman test, in that they reduce the precautions the majority of contracting parties might otherwise feel compelled to adopt, whilst not unduly restricting the range of sharp deals some parties might contemplate.

1. ERROR

For a contract to produce a Pareto gain, each of the parties must, at least prospectively, expect to benefit by it. This expectation can only be realistic if the parties are abreast of the essential stakes of the projected contract. Should they be mistaken about them, the contract may not lead to a Pareto gain.

Civil law systems deal with this matter under the heading of error. Where the error is the result of information having been trafficked by the other party or

under its control the special rules of fraud apply because of the opportunism that is clearly involved here.

In setting up rules dealing with mere mistakes, two pitfalls are to be avoided. In refusing to recognise an error, one would sanctify a relationship that does not create a Pareto gain and one needs to consider the incentive effect that will have on the *errans*: lots of precaution next time round; this is costly and slows down markets. If the law is to pursue welfare enhancements in private relationships, the contract better be redone. Conversely, were undoing a contract for alleged error to become too easy, legal certainty would be undermined: a purchaser will hesitate to undertake further transactions with the merchandise just bought if it may have to be returned to the seller; third persons may hesitate to buy it for the same reason. A seller cannot count on the profit made in a sale that the purchaser could easily undo. All of this slows down market operations.

The law draws the line between these opposite forces by providing that only an error concerning the essentials is a cause for the contract to be called into question (1400 CCQ). Essentials are considerations such that had a party been properly informed of them, it would not have contracted at all or only on different terms. That party does not stand to benefit by the contract as it is.

The essentials cover first of all the very nature of the operation (sale or lease) and the object (the house with or without its furnishings). Where one or both parties are mistaken about these elements, the contract is deemed not even to have come into existence. Parties are thus deprived of their preferred option and given an incentive to complete their negotiations.

A party may demand the nullity of the contract on the ground of error, where it is unilaterally mistaken about an essential element of the contract, which was decisive for its consent (1110 CCF). This may concern the object (could the horse purchased be used for horse races?) or the person performing the contract. In either case, the other party must have been apprised of the importance of these factors in the course of the negotiations leading up to the agreement. Where the other party was not made aware, the contract goes forward. This gives the mistaken party an incentive to be quite clear about the features of the object it considers essential.

Where the essential nature of the factor about which one party is mistaken is not in question, that party is given the option of demanding the nullity of the contract or going through with it anyway (relative nullity). By its decision, the party signals whether it expects or not to gain by the contract as is. The other

party, running the risk of being deprived of its preferred option (i.e. the contract does not go forward as is), has an interest in making sure that its opposite is properly informed about any feature flagged as essential.

Other mistakes – about the profitability of the object or minor features, for instance – are deemed inexcusable and do not call into question the validity of the contract. The mistaken party, being deprived of its preferred option, is given an incentive to look after these itself. It is the *cheapest cost avoider* for them. This also holds for inexcusable errors, i.e. those for which the mistaken party has been negligent in not taking cost-justified precautions of checking, considering what was at stake. The opposite rule would invite moral hazard on its part.

2. FRAUD

Fraud or *dolus* consists in one party's manipulating by trickery or by lies the information on which the other bases its consent. It is an example of opportunistic behaviour. Any error based on fraud is deemed excusable and it is open to the mistaken party to call for the nullity of the contract, even where it concerns the profitability of the object sold or the reason for contracting. Economically the opportunist is deemed always to be the cheapest cost avoider.

Classical examples of fraud are the used car seller turning back the odometer of cars to give the false impression that they have been used less than they really have; a seller of immovable property hiding the fact that the projected enlargement of an existing road will eat away part of the land to be sold, the fact that a well on the property does not provide drinkable water or that an order prohibiting habitation has been issued against the property (All real French cases: Civ. 19 janvier 1977, Bull. civ., I, no 40, p. 30; Civ. 13 février 1967, Bull. civ. I, no 58; Civ. 10 février 1999, Contrats Conc. Consom. 1999, no 90; Civ. 29 nov. 2000, Bull. civ. III, no 182, p. 127). Fraud is also considered present when one party gives misleading answers or outright lies to specific questions of the other.

Until recently, accepted wisdom had it that only active behaviour or misrepresentation could constitute fraud; simply keeping silent could not. It would fall to each party to inform itself about all factors it deemed important and about which the other had not provided information. Over the past half century, French law and other civil law systems have moved to the position that it may be fraudulent even to keep silent about an element which is clearly of interest to the other party and about which it appears to be ill-informed. The new rule has

initially found acceptance in the context of a relationship of trust between the parties. It was then generalised to *réticence dolosive*, consciously keeping silent, thereby failing to correct the other party's misapprehensions.

This extension appears to be a remedy complementary to the duty to inform the other party about the essential elements of the projected contract. A recent paper boldly argues that the duty to inform encompasses and can usefully replace the defects of consent of *error* and *dolus*, as well as the latent defects doctrine in sales (De Geest/Kovac 2009, § 2.8 and 2.14, examining in this light articles II-3:101-106, II-7:204, 201, 205 and 207 and II-9:402 of the *Draft Common Frame of Reference* (DCFR 2008, 101). Whether this general doctrine has the required precision in practical applications to provide the certainty law demands, or whether particularisations into specific doctrines remain useful, as we argued for good faith, is a point that warrants further discussion, given the level of detail the scholars drafting the *Draft Common Frame of Reference* needed to go into in order to spell it out.

Art work raises the trickiest problems. It may be interesting to examine, by way of illustration, a few key cases the French courts have had to deal with.

THE POUSSIN CASE. This lengthy saga stretches over the period from 1968 till the final decision in 1983 (Civ. 1er, 13 décembre 1983, Bull. civ. I, no 293, and comments by Fabre-Magnan 2004, nos 108 s., p. 273 s). In 1968, a couple decides to sell a painting they own and to this end have it examined by an expert, who attributes it to the Carrache School (end of the 16th c.), but not to its most famous representative, Nicolas Poussin. Armed with this assessment, they hand over the painting to be auctioned and it fetches 2 200 FF on 21 February 1968. At the end of the auction, the National Museum Association exercises its right to pre-empt the designated buyer and take over the painting – presumably in the national interest – at the price agreed to by the buyer. The painting resurfaces after restoration at the Louvre as a true Poussin, worth several million francs.

The frustrated couple sue to have the initial sale annulled on the ground of error about an essential quality of the object sold. The courts of first instance and of appeal dismiss the case, but the highest jurisdiction in France, the *Cour de cassation*, found in favour of the couple, sending the case back to a different court of appeal for the purpose of determining whether the couple's consent might have been vitiated by the conviction that the painting could not possibly be a Poussin. Unfounded certainty can be a ground for error. It should be added

that there had been numerous instances of counterfeit paintings attributed to Poussin, so the question was of considerable practical importance.

The second court of appeal found that error needed to be gauged according to the information available at the time it was made; yet here all relevant information came to light after the couple made their mistake. This new decision was once more taken up to the *Cour de cassation* and once more reversed, with the court ruling that subsequent information could be used to establish the true state of affairs at the time of sale and to reach a finding of error.

The rule that flows from this saga appears to fly in the face of the incentive logic holding that experts should be able to capitalise on their specialised knowledge by benefitting from the increased value that results from the true nature of the object becoming known. The rule would discourage the discovery and bringing to market of hidden treasures.

One may wonder, however, whether the quality of the buyer implicitly played a role in the decisions of the *Cour de cassation*. Where a public agency exercises its right to pre-empt in the national interest, one may surmise that it suspects an undervalued treasure. Had this hunch been made public beforehand, the painting would have been sold – and hence would have had to be pre-empted – at a much higher price, even if doubt subsisted about the true nature of the painting. Surely the couple would have benefitted of part of that increase, and the ultimate buyer, of the rest. As the case initially unfolded, all of the value increase benefitted the State – hence the community at large. Does the State need special encouragement to make money on the expertise of its servants in the matter of undervalued paintings? The *Cour de cassation's* decision implicitly answered that question in the negative. One may wonder whether the court would have reached the same decision with respect to a private buyer. At all events, owners of 'old' paintings are alerted to the spectacular gains that may await them if they have the paintings evaluated. This may help bring hidden treasures to light. Small consolation. One may wonder whether a better incentive effect would not have been bought by having the frustrated couple seek recourse against the expert whose expertise turned out to be deficient and, if no recourse would lie, to look out for a better expert next time.

THE FRAGONARD CASE (Civ. 1er, 25 mai 1992, Bull. civ. I, no 165, JCP G 1992. I. 3608, 370). Most fortunately the *Cour de cassation* had occasion a few years later to revisit the matter, but now with respect to a private buyer in otherwise similar circumstances. Here a private owner sold for 55,000 FF to an expert a

painting called *Le Verrou*, which an expertise had attributed to the School of Jean-Honoré Fragonard. The expert purchaser, having restored the painting, recognised it as a true Fragonard and sold it to the Louvre for 5,150,000 FF. Once more the original seller sued for annulment of the original sale on the ground of error regarding an essential quality of the object of sale. The lower courts declared the nullity of the contract on the basis of the rule established by the *Cour de cassation* in *Poussin*, but the court itself reversed that decision on the ground that the expert's work had conferred upon the original seller an unjustified enrichment, which should be taken into account. Upon referral, 1,500,000 FF were awarded to the expert and the *Cour de cassation* left that decision undisturbed.

Are the incentives better aligned this time? Some commentators observed that the new rule discourages risk-taking by experts and indeed investment in acquiring expert knowledge in the first place. Hidden treasures would remain hidden. Need one be that pessimistic? After all, the decision confers a substantial fraction of the value increase to the expert as well as to the initial owner. It appears to give signals to both of them, to the owners to have their art work evaluated and (perhaps) brought to market; to the expert to spot undervalued treasures, since they would be rewarded with a fraction of the value they unearth; it would have been disastrous indeed to reward the expert according to the time spent examining and restoring the painting. Altogether it would seem that the rule gives incentives for entrepreneurial behaviour to both parties involved, somewhat like what the Code does in the case of the discovery of buried treasures on someone else's land: splitting the gains half-half (716 CCF; 938 CCQ; 5:13 NBW).

THE BALDUS PHOTOGRAPHS CASE (CIV 1E, 3 MAI 2000, BULL. CIV. I, NO 131, D. 2000. IR. 169, JCP G 2001. II. 10510, NOTE C. JAMIN). The rules developed by the French supreme jurisdiction do not mean that sellers can in all circumstances recover part of the value increase occurring after the sale as a result of circumstances of which they were unaware at the time of sale. This is nicely illustrated by the Baldus photographs case. In 1986, a woman entrusts 50 photographs of Baldus – one of the earliest photographers to make a name for himself in the mid-nineteenth century – to an auction house to be sold by public auction, for 1,000 FF per photograph. They are bought by an expert, who succeeds in reselling them for a multiple of that price. In 1989, the woman contacts the purchaser directly to offer him a second series of Baldus

photographs for which she sets the price again at 1,000 FF per photograph. The purchaser accepts, realising fully well that he can resell them for several times that price. Subsequently, the seller learns (finally!) that Baldus was a famous photographer and seeks to have the sale annulled on the ground of fraud – here fraudulently keeping silent – alleging that she would never have sold the photographs for that price had she been apprised of their true value. The courts, this time with approval of the *Cour de cassation*, dismiss the case, observing that the purchaser was under no duty to inform the seller, given that it was the seller who took the initiative of contacting the buyer and of setting the price.

The decision has the effect of protecting experts seeking to capitalise on their knowledge, where they have done nothing to mislead the seller and the latter sought them out and set the price at which the merchandise was offered, without first ascertaining market value. The decision gives sellers an interest in having their property appraised by an expert before offering it for sale. The amount obtained in the first public auction – 50,000 FF – suggests that this was not an extravagant precaution to take.

Altogether economic analysis of law suggests a reading of these three seminal cases that makes sense in terms of apportioning the various burdens and prospects of gain so as to give the right signals to the parties involved.

3. THREAT OF VIOLENCE OR FEAR

Threats of violence or fear refer to situations of disequilibrium of forces between the parties of which the stronger one opportunistically abuses to its own advantage by ‘twisting the arm’ of the other party or threatening to do so. It corresponds more or less to the common law concept of duress. A contract entered into as result of fear is unlikely to lead to a Pareto gain. Whilst there is an obvious danger of letting go forward contracts entered into under such circumstances, the opposite danger should also be stressed: if it is too easy to get out of a deal on the ground of threat of violence or fear, one may discourage all forms of pressure, even those that break a deadlock and lead to agreement conferring a gain on all parties. The Code provisions should reflect a concern to skirt both of these dangers.

To be actionable, the fear brought to bear on a contracting party may stem from the other party or from a third person, and it should threaten a harm to the person or property of that contracting party or to that of a third person, providing that the seriousness of the threat would be sufficient to impress a reasonable

person, to use the formula of the French Code (1111-1115 CCF; 1402 CCQ). Mere respect for or awe of the other person is not sufficient to have the contract annulled. Moreover, annulment is refused if the victim of the threat subsequently approved the contract, after the threat ceased, or has let the period provided for restitution lapse without acting.

Article 1404 of the Quebec Code deserves to be noted. A person who, whilst aware of the state of necessity of another, in good faith helps the latter to get out of that state need not fear that the contract by which the assistance is provided will be annulled on the ground of fear or violence. The opposite rule would of course discourage persons from providing assistance to persons in danger or distress. Yet it is important to prevent persons providing assistance from opportunistically exploiting the situation to their – excessive – advantage, since this would lead to excessive precautions on the part of potential victims. The use of the term ‘good faith’ appears designed to prevent this form of opportunism.

4. LESION

Lesion is usually presented in civil law scholarship under the heading of defects of consent, although its nature does perhaps not quite comport with that qualification. Since 1994, the Quebec Code provides a definition:

1406. Lesion results from the exploitation of one of the parties by the other, which creates a serious disproportion between the prestations of the parties; the fact that there is a serious disproportion creates a presumption of exploitation. [Prestation is civil law English for the object or service each party must render onto the other]

In cases involving a minor or a protected person of full age, lesion may also result from an obligation that is considered to be excessive in view of the patrimonial situation of the person, the advantages he gains from the contract and the general circumstances.

The difficulty, from an economic point of view, is that things have no ‘natural’ price. Values are essentially subjective. The very fact that something is sold means that it is worth more to the buyer than to the seller. Value depends on circumstances of time and place. The bottle of water I drink when quite thirsty during a hot summer day is worth much more to me than the one I drink routinely in the winter. The second-hand book that completes my collection of a little known author is worth a lot to me, but little to the average buyer. When unfortunate circumstances cause me to have an urgent and unforeseen need for

cash, I may have to let the collection go for far less than it might fetch under normal circumstances.

These examples illustrate the difficulty of determining what would be a disproportion, serious or not, between the prestations of the parties to a contract. This is true as well for the test of seven twelfths of the sale price of an immovable, which the French Code, in art. 1674 and following, indicates as the threshold beyond which a contract is deemed lesionary.

In the absence of objective criteria, could one get a grasp of lesion by looking at the subjective side, i.e. factors that relate to the situation of the victim of lesion or the circumstances under which it is supposed to have occurred? This is no doubt the purpose of the term 'exploitation', which points to opportunism, discussed above. But beyond the cases of defects of consent and the general concept of good faith, it is difficult to see how this concept advances the determination of what lesion is.

The codifiers appear to have been aware of the problem and for this reason have provided that as between capable adults lesion is no ground for annulment of a contract (1118 CCF; 1405 CCQ). Each party is considered the cheapest cost avoider when it comes to looking after its own interest. Lesion is recognised for minors and for incapable grown-ups, in which case it reflects soft paternalism (On paternalism see Buckley 2005). In recent consumer legislation, consumers appear to be treated as incapable adults. In the Quebec *Consumer Protection Act*, the legislature has deemed it wise to further clarify the concept of lesion, applicable to all consumer contracts, by providing that the consumer's obligation must be 'excessive, harsh or unconscionable' (*Quebec Consumer Protection Act*, LRQ P-40.1, art. 8 and 9. <http://www.canlii.org/en/qc/laws/stat/rsq-c-p-40.1/latest/rsq-c-p-40.1.html>). French consumer legislation uses the qualification that the act must have amounted to an abuse of the weakness or ignorance of the person; this appears to refer to the circumstances in which the contract was entered into and implicitly to extend the scope of the concepts of fraud and threat of violence. It is obvious that one attempts here to capture practical applications of the idea of opportunism. These terms do not really resolve the problem, but they do indicate the need to use the concept of lesion sparingly.

Are solutions to these problems to be found in the consideration, put forth by researchers in the *Behavioral Law-and-Economics* tradition, that the average observer would find unfair an agreement that significantly differs from the idea that that person has formed of the reference transaction under similar

circumstances (Jolls 2007)? Further research on the interface of law, economics and cognitive psychology will have to tell.

C. Cause

In canon law, a contract could not be valid unless the prestation of either party constituted a valid reason for the other to enter into the contract, in other words if there was a fair 'counterpart' to one's own prestation. If from the outset this cause was an illusion, the contract would be null. In common law consideration appears still to play a similar role: a contract will not be formed without valid consideration. The common law judge does not inquire into the actual equivalence of the prestations on both sides; the original canon law concept, however, invited precisely this inquiry. If one of the prestations became impossible, the contract would perforce be void.

Some modern civil law systems maintain the concept of cause, but without mandating an inquiry into the actual equivalence of the prestations, save in special circumstances such as lesion. Cause now refers to the existence of a standardised or stylised reason for a party to undertake a contractual obligation: the counterpart in the case of bilateral contracts; liberal intention in the case of gratuitous contracts. Whether the concept still serves a useful function is a moot point. At all events, the French, Belgian, Spanish, Italian and Quebec codes still maintain it (1131 CCF; 1371, 1411 CCQ) (Kötz 1997, 54f). The new Dutch law has abandoned it. German law and the laws of the Scandinavian countries have no *causa* requirement.

III. CONTENTS

A. Limitation or exclusion of liability clauses

Clauses limiting or even excluding liability raise more clearly perhaps than others the spectre of opportunism: to limit liability for the consequences of one's own actions opens the door to moral hazard. Of course, the market itself provides a first range of sanctions: loss of clientele, bad reputation, black listing, boycott. Nonetheless such clauses may not catch the attention of consumers at the time of contracting and may badly hurt some of them in individual cases. In the literature, the matter has been discussed under the heading of signing-

without-reading (See De Geest 2002, examining in some detail whether the Directive on unfair terms of 1993 adequately deals with the matter).

The codes handle the problem by providing that such clauses are in principle valid, so as to allow parties to allocate risks in the best way they can come up with. But their validity is subject to severe restrictions reflecting the danger of opportunism. By way of example, the Quebec Code provides in article 1474 that one cannot exclude liability for physical damage done to another intentionally or through gross recklessness, gross carelessness or gross negligence. For bodily or moral injury no exclusion at all is permitted. In the particular context of sale, article 1732 provides that sellers may not limit warranties to exempt themselves of the consequences of their personal fault. To this, article 1733 adds that no exclusion is allowed where sellers have not disclosed defects of which they were aware or could not have been unaware (professionals and specialised sellers or manufacturers). All in all, if these and similar provisions are looked at as remedies against opportunism, it is striking that they are all the more severe as the risk of damage and of opportunism is greater.

Traditionally, civil law doctrine held that parties could not contract out of their essential obligations under a given contract. The idea is reminiscent of the doctrine of *fundamental breach* in common law. In a recent case, the French *Cour de cassation* arrived at a similar result in the *Chronopost* case (Chronopost, Com. 22 Oct 1996, Bull. 1996 IV no 26; JCP G 1997. I. 4002, obs. Fabre-Magnan; D. 1997. Jur. 121, obs. Sériaux; JCP G 1997. II. 22881, note D. Cohen; Gaz. Pal. 1997-08-16, no 238, p. 12, note R. Martin; Répertoire du notariat Defrénois, 1997-03-15, no 5, p. 333, note D. Mazeaud; JCP G 1997. 924, note J.K. Adom; van Schaik 2004) invoking the absence of cause. Once more, an economic reading of the decision would point to an apparent attempt to curtail opportunism.

B. Penalty clauses

A penalty clause allows parties to spell out at the time of contracting the amount of damages that will be due in case of non-performance or late performance of obligations arising under the contract. The interest of such a clause is to set the amount of damages without the need to prove prejudice in court and the risk of arbitrariness or misperception by the court assessing the damage. Penalty clauses should allow parties better to plan their affairs, in the full knowledge of their rights and obligations should they be unable to perform

the contract as initially agreed.

The amount the penalty clause stipulates may be an estimate of the anticipated damage, but may also stray away from it, either upwards or downwards, in the latter case amounting to a clause limiting liability for damages. Where the clause sets a penalty well above the actual anticipated prejudice, it has a signalling function: it signals the debtor's confidence of being able to perform without a hitch. In the 'market for lemons' story, generous warranties offered in sales signal higher quality wares (Akerlof 1970). For the beneficiary, it represents a sure way of forcing the actual performance of the contract should the debtor prove reluctant. For these reasons penalty clauses have a useful economic purpose.

Yet penalty clauses are open to abuse: a consumer may underwrite them without giving it due attention and live to regret it; conversely, the obligation of one party may be shrunk to virtually naught. In either case there is risk of opportunism.

Common law traditionally distinguishes between liquidated damage clauses and penalty clauses. It admits the former, as a reasonable estimate of actual damage and saving transaction costs, but refuses the latter where the amount set is very different. The reasons given for the distinction should not detain us here; what is of interest is that the civil law traditionally did not make the distinction (see Mattei 1995; Hatzis 2003). From a law-and-economics point of view, the civil law rule allows for the signalling effect, which common law excludes. But what of opportunism? It is interesting to note that the matter has been amply discussed in the law-and-economics literature. The upshot of the debate is that those who would allow penalty clauses see the need for means to control opportunism through such concepts as unconscionability.

Whilst generally in civil law systems penalty clauses are valid, the courts are more and more allowed to moderate their severity. The French code as well as the Quebec code and the new Dutch code, for instance, allow the court to reduce the penalty where the obligation has been partially performed (1231 CCF; 1623 (2) CCQ; 6:94 Netherlands Civil Code). Moreover the French code, in art. 1152, allows the court, even *ex officio*, to reduce or increase the penalty where it appears manifestly excessive or pathetic, stipulations to the contrary being void. The European Directive on unfair terms, in art. 3 (3), sub e, generalises these principles by prohibiting the imposition of a "disproportionately high sum in compensation" on consumers who fail to fulfil their obligations (Directive on unfair

terms 1993).

The Quebec code, in article 1623, provides for the reduction of an 'abusive' penalty, using the same term as in article 1437, where it applies only to consumer contracts, a restriction not applicable to article 1623. No explicit provision is to be found in the Quebec code for increasing penalties that are manifestly insignificant. At most, one may surmise that the courts might arrive at that result by interpreting such a clause as an implicit limitation of liability clause to which article 1474, prohibiting exclusion of gross negligence, is applicable.

All in all, these provisions seem designed foremost to control opportunism in the use of penalty clauses, even as that may reduce their signalling function.

IV. PERFORMANCE

A. Excusable non-performance: force majeure

Force majeure refers to an event making performance impossible, which in terms of article 1470 of the Quebec code is both unforeseeable and irresistible, and lies outside the sphere of events for which the party invoking it is accountable (see also 1152 CCF). Where any of these characteristics is absent, the party in default is liable, which should give it the incentive to take precautions or to underwrite insurance; any other rule would create moral hazard. Where all three factors are present, we face an event over which the non-performing party cannot exert any influence and hence which it would be futile to encourage it to prevent.

In the case of non-performance due to force majeure, civil law provides that the party prevented from performing is liberated from its obligation and does not owe damages. What happens then to the performance of the other party, if that has not become impossible? Civil law doctrine analyses the problem under the heading of the theory of risks. In principle, the party prevented from performing assumes the risk: it will be excused from performing itself, but cannot ask the other party to perform. The opposite rule would create moral hazard.

In contracts that entail the transfer of ownership, the rule is different: the risk falls to the owner, even before delivery. In article 1456 of the new Quebec Civil Code that rule has been changed so as to transfer risk to the new owner only upon delivery; possession now carries with it the burden of the risks. From the

viewpoint of the economic analysis of law, the burden seems thus to have been placed in each circumstance on the party that is the cheapest cost avoider.

All of this is suppletive law – parties may contract around it. An example of such contracting is the clause often encountered in commercial contracts labelled hardship. It provides that where an important change of circumstances of economic or technological nature occurs that seriously disturbs the balance of obligations under the contract, each party may ask that the contract be renegotiated. The hardship clause reflects the idea of unforeseeability, which in most civil law systems is not recognised as a ground for the courts to modify the parties' obligations (Implicitly 1439 CCQ).

The problem for the courts is nicely illustrated by a 19th-century American case, *Goebel v. Linn* (*Goebel v. Linn*, 47 Mich. 489, 11 N.W. 284, 41 Am. Rep. 723 (1882)). Before electricity was commonly available, cooling was provided by means of large blocks of ice, delivered by specialised suppliers who cut the ice at the end of winter and stored them in specially insulated warehouses for use during the summer. In November 1879, a brewer in the State of Michigan had contracted with such a supplier for the regular delivery of ice blocks for the summer of 1880. The ice was sold at \$1.75 a ton, or \$2.00 a ton should a shortage develop. The winter was unusually mild and the brewer, while there was still time to contract with others, took the precaution of contacting its supplier to make sure that the contract would be performed as agreed. The supplier confirmed that it did not foresee difficulties and fully expected to live up to its obligations. But the spring turned out to be even milder than expected, so that far less ice could be cut than was usual. A severe shortage developed.

The supplier contacted the brewer in May 1880, explaining that it could only guarantee delivery of the ice at a price of \$5 a ton. The brewer, fearing interruption of the ice supply with loss of a great supply of beer it had on hand, gave in and the parties settled on \$3.50 over an eight-month period. At the end of that period, the supplier demanded payment under the contract; the brewer refused to pay the supplement, invoking duress. The court granted the action for payment of the full amount, ruling that the price was reasonable under the circumstances; that the supplier had not taken advantage of unforeseen circumstances to drive an unfair bargain; and that the mere threat of not standing by one's initially agreed obligations did not amount to duress.

The case has provoked a wide range of comments, stretching from straightforward support to disapproval as undermining business morality. Posner

opines that if the court had heeded the brewer's insistence on getting the ice at the originally agreed price, the supplier would have gone bankrupt and the brewer would still have had to find ice at the even higher market price. Nothing indicates that the supplier has opportunistically taken advantage of changed circumstances. He approves the result (Posner 2007, 100-101).

Against this others have argued that the courts should not allow contracts to be reopened where changed circumstances give one of the parties a temporary monopoly with which to twist the other party's arm. This does not mean that reopening a contract should never be allowed. In the *Goebel* case one would have to know the frequency of mild winters. If they occur with some regularity, the supplier is best placed to assume the risk (perhaps spreading it through subcontracts), in which case the court should refuse retroactively to reopen the contract. On this view, only if mild winters were extremely rare and totally unforeseeable would the court's decision be justified (Aivazian et al. 1984).

In French civil law, some authors have detected a tendency to allow court revision of contract for *imprevision* in very exceptional circumstances. The ground the courts have used is that to insist in such a case on the original terms would go against the duty of dealing in good faith that parties owe each other. It will be interesting to watch whether this tendency persists and whether it draws the line as suggested above on the basis of economic considerations.

B. Contractual remedies: specific performance

Where one party does not receive the performance to which it is entitled under the contract, while itself performing correctly or offering to do so, it can call on the full might of the law to force the hand of the recalcitrant debtor. What should the frustrated creditor be able to demand? At first blush it would seem normal to allow it to demand the prestation it was entitled to under the contract: specific performance. This would give it the gains it counted on in entering into the contract. In common law systems, however, specific performance is considered the exceptional remedy, the normal one being damages. This rule has an effect similar to that of prohibiting penalty clauses, whilst allowing liquidated damage clauses.

In civil law systems, by contrast, specific performance is considered the first choice at the disposal of the creditor victim of non-performance (1590 and 1601 CCQ; art. 3:296 NBW). Article 1142 of the French Code, providing that non-performed obligations to do or not to do dissolve into damages, is considered no

longer to reflect current law: French courts accept to order the debtor to perform, and to set a penalty (*astreinte*) for every period of time or occasion the debtor does not comply. The obligation to give, which means to transfer ownership, lends itself quite naturally to specific performance, in the sense that the judgment can provide the title of transfer; in the case of immoveables, judgment rendered upon an action in execution of title (*en passation de titre*) can be entered into the registers of real rights (3:300 NBW). The Quebec code explicitly recognises the sanction of specific performance, in cases which admit of it (1590 and 1601 CCQ).

Since American law – the starting place of law-and-economics – admits specific performance only sparingly, a lively debate developed to determine when it actually does so and whether law-and-economics can offer a plausible explanation for it. An initial article by Kronman (Kronman 1978) suggested the matter turned on the distinction between unique goods and those for which ready substitutes are available in the market. For the former, specific performance would normally be granted, not least because the damage would be particularly hard to assess; for the latter market prices would be available and damages would routinely be granted. For services specific performance risks violating the personal freedom of the debtor, and for this reason only damages would be available for non-performance.

The upshot of the debate that followed is usefully summarised in a paper by Eisenberg (Eisenberg 2005). Two fundamental principles should in his view govern the matter, namely the *bargain principle* and the *indifference principle*. According to the first principle, parties are normally the best judges of their own interests and hence their contract should be enforced as agreed, save special circumstances such as defects of consent. The second principle holds that remedies should be chosen and applied so as to render the victim of non-performance indifferent between regular performance and the situation that obtains upon the granting of the remedy.

Specific performance normally accords with both principles. Should it be granted in all circumstances? Some arguments tell against that view. The common law remedy of the injunction is a court order backed by the sanction of contempt of court, which is a criminal offence. Yet here it is applied to a private dispute, which seems awkward. Moreover, injunctions violate individual freedoms.

A second reason for not granting specific performance in all circumstances is

conflict with another common law principle, that of mitigation of damages by the victim of non-performance. Eisenberg gives the example of a municipality contracting for the construction of a bridge. Once the construction is underway, it realises that it will be unable to fund the road leading up to the bridge and advises the builder of its desire to cancel the project. The builder ignores the notice, completes the bridge and sues for payment. The municipality has no use for the bridge – a social waste. It would have been better to halt the project and indemnify the builder for costs already incurred. Completing the bridge needlessly aggravates the waste. The court dismisses the action for payment.

A third reason militating against granting specific performance across the board is that it opens the door to opportunism by the victims of non-performance, which is particularly obvious in the case of wares whose value fluctuates. If the value increases, the frustrated creditor of the prestation might sue for specific performance; should it go down, the creditor might sue for damages as these would be measured at the time of non-performance.

Eisenberg's recommendation is to accept specific performance as the regular sanction save in cases where it would be inappropriate. In the case of moveables readily available in the market, specific performance should not be granted since frustrated buyers can easily procure the objects elsewhere and claim the price difference as damages. Conversely, Eisenberg would not grant specific performance against the buyer of such goods, since the vendor should be satisfied selling to a third person and claiming the price difference, if any, from the initial buyer. For unique goods, for long-term contracts and for purchase and sale of immoveables, specific performance would be apposite in his view. In service contracts one may hesitate about granting specific performance where it interferes with individual freedom, such as cases where one would force the hand of a famous artist or athlete. By contrast, there is no reason not to grant it against an organisation, forcing it, for instance, to reinstate a person who has been unjustly dismissed. These rules seem close to the practices followed in many civil law jurisdictions.

What do we know about how actors in the field actually choose amongst the various remedies? A Danish study (Lando/Rose 2004) finds that businesspersons rarely ask for specific performance, preferring damages instead. This seems to confirm the intuition that once a relationship is spoilt, there is little point in forcing the unwilling debtor to perform; better to claim damages, cut the ties and start again with different persons. Civil legal systems

leave this choice with the victims of non-performance and it will be interesting to see further fieldwork on how they exercise the choice.

CONCLUSION

The general thesis put forth in this paper is that there is no reason to expect the economic analysis of law to be any less applicable to civil law systems than it is to common law systems, once structural differences between the two families are taken into account. Civil law systems aim at bringing together all rules pertaining to a given field in a law code; to keep the code workable, its provisions have to be concise, often using rather abstract language to summarise a broad range of situations encountered in practice. Since codes must in principle cover all legal problems within their purview, they carry an implicit ambition of being complete. As a result, unlike common law systems, they have to rely on some broad and open-ended concepts such as good faith or abuse of rights to fill the gaps and “close” the system. The contents of good faith can be clarified usefully by linking it to the economic concept of opportunism.

In looking more closely at some civil law concepts, one discovers that matters having triggered discussion in common law systems, such as the desirability of limiting penalty clauses or specific performance, are also cause for reflection in civil law systems. Examination of civil law defects of consent shows developments and arguments that are reminiscent of common law discussions, with a different vocabulary. This similarity had already been highlighted in an Anglo-French comparative exercise (Harris/Tallon 1991).

All in all, law and economics provides a useful tool for lawyers in civil law systems at a time when Europe is looking for common principles of contract and delictual responsibility. When one is comparing national legal systems in search of communalities, it offers a functional analysis in terms of which different national systems can, as it were, be put on a common denominator. That is an important asset for doctrinal analysis.

BIBLIOGRAPHY

Acemoglu et al. 2009

Acemoglu, Daron, Davide Cantoni, Simon Johnson and James A. Robinson, *The Consequences of Radical Reform: The French*

EJAN MACKAAY – CIVIL LAW OF CONTRACT

- Revolution*, rapport, CEPR Discussion Paper No. DP7245, 2009; (<http://econ-www.mit.edu/files/3951>)
- Aivazian et al. 1984 Aivazian, Varouj A., Michael J. Trebilcock and Michael Penny, "The Law of Contract Modifications: The Uncertain Quest for a Bench Mark of Enforceability", (1984) 22 *Osgoode Hall Law Journal* 173-212
- Akerlof 1970 Akerlof, George A., "The Market for 'Lemons': Quality Uncertainty and the Market Mechanism", (1970) 84 *Quarterly Journal of Economics* 488-500
- Ben-Sharar 2009 Ben-Shahar, Omri, *One-Way Contracts: Consumer Protection Without Law*, Report, U of Chicago Law & Economics, Olin Working Paper No. 484, 2009, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1484928
- Bridge 1984 Bridge, Michael G., "Does Anglo-Canadian Contract Law Need a Doctrine of Good Faith?", (1984) 9 *Canadian Business Law Journal* 385-425
- Brownsword 1998 Brownsword, Roger, Norma J. Hird and Geraint Howells (eds), *Good faith in Contract: Concept and Context*, Aldershot, UK, Dartmouth Publishing, 1998
- Buckley 2005 Buckley, Frank H., *Just Exchange - A Theory of Contract*, London, Routledge, 2005
- Buechtemann/Walwei 1999 Buechtemann, Christoph F. and Ulrich Walwei, Employment Security Through Dismissal Protection: Market Versus Policy Failures, in: *The Elgar Companion to Law and Economics*, Jürgen G. Backhaus (ed.), Aldershot, UK, Edward Elgar Publishers, 1999, pp. 168-182
- Calabresi 1970 Calabresi, Guido, *The Cost of Accidents – A Legal and Economic Analysis*, New Haven, Yale University Press, 1970
- Calabresi/Melamed 1972 Calabresi, Guido and Douglas Melamed, "Property Rules, Liability Rules, and Inalienability: One View of the Cathedral", (1972) 85 *Harvard Law Review* 1089-1128
- Charpentier 1996 Charpentier, Élise M., "Le rôle de la bonne foi dans l'élaboration de la théorie du contrat", (1996) 26 *Revue de droit de l'Université de Sherbrooke* 300-320
- Cohen 1992 Cohen, George M., "The Negligence-Opportunism Tradeoff in Contract Law", (1992) 20 *Hofstra Law Review* 941-1016
- Cooter/Ulen 2007 Cooter, Robert D. and Thomas Ulen, *Law and Economics*, New York, Pearson Addison Wesley, 2007, (5th ed.)
- Cornu 2000 Cornu, Gérard (ed.), *Vocabulaire juridique*, Paris, Presses Universitaires de France, 2000
- Dam 2006 Dam, Kenneth W., *The Law-Growth Nexus: The Rule of Law and Economic Development*, Washington, D.C., Brookings Institutions Press, 2006
- DCFR 2008 *Draft Common Frame of Reference - Principles, Definitions and Model Rules of European Private Law*, accessible at <http://webh01.ua.ac.be/storme/DCFRInterim.pdf>
- De Geest 2002 De Geest, Gerrit, The Signing-Without-Reading Problem: An Analysis of the European Directive on Unfair Contract Terms, in:

EJAN MACKAAY – CIVIL LAW OF CONTRACT

- Konsequenzen wirtschaftsrechtlicher Normen*, Hans-Bernd Schäfer and Hans-Jürgen Lwowski (eds), Wiesbaden, Gabler Verlag, 2002, pp. 213-235
- De Geest *et al.* 2002 De Geest, Gerrit, Bart de Moor and Ben Depoorter, "Misunderstandings between Contracting Parties: Towards an Optimally Simple Legal Doctrine", (2002) 9 *Maastricht Journal of European and Comparative Law*
<http://www.unimaas.nl/default.asp?template=werkveld.htm&id=HO4L47CN622C36ETJ070&taal=nl>
- De Geest/Kovac 2009 De Geest, Gerrit and Mitja Kovac, "The Formation of Contracts in the Draft Common Frame of Reference", (2009) 17 *European Review of Private Law* 113-132
- de Jasay 1989 de Jasay, Anthony, *Social Contract, Free Ride – A Study of the Public Goods Problem*, Oxford, Clarendon Press, 1989
- Del Granado 2008 Del Granado, Juan Javier, *The Genius of Roman Law from a Law and Economics Perspective*, Berkeley Program in Law & Economics Working Paper 2008
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1293939 ;
<http://escholarship.org/uc/item/09c3b4j9>
- Directive on unfair terms 1993 Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, OJ L 95, 21.4.1993, p. 29
- Dixit 2004 Dixit, Avinash K., *Lawlessness and Economics - Alternative Modes of Governance*, Princeton, Princeton University Press, 2004
- Eisenberg 2005 Eisenberg, Melvin Aron, "Actual and Virtual Specific Performance, the Theory of Efficient Breach, and the Indifference Principle in Contract Law", (2005) 93 *California Law Review* 975-1050
- Fabre-Magnan 2004 Fabre-Magnan, Muriel, *Les obligations*, Paris, Presses universitaires de France, 2004
- Goode 1992 Goode, Roy, *The Concept of "Good Faith" in English Law*, Report, Centro di studie ricerche di diritto comparato e straniero, Roma, 1992, <http://servizi.iit.cnr.it/~crdcs/crdcs/frames2.htm>
- Haanappel/Mackaay 1990 *New Netherlands Civil Code - Patrimonial Law / Le nouveau Code civil néerlandais - Le droit patrimonial* (trilingual edition) (translated by P.P.C. Haanappel and Ejan Mackaay) Kluwer, Deventer, The Netherlands 1990
- Harris/Tallon 1991 Harris, Donald and Denis Tallon (eds), *Contract Law Today: Anglo-French Comparisons*, Oxford [1987], Clarendon Press, 1991, (2nd ed.)
- Hatzis 2003 Hatzis, Aristides N., "Having the Cake and Eating it too: Efficient Penalty Clauses in Common and Civil Contract Law", (2003) 22 *International Review of Law and Economics* 381–406
- Hesselink 2004 Hesselink, Martijn W., The Concept of Good Faith, in: *Towards a European Civil Code - Third Fully Revised and Expanded Edition*, Arthur S. Hartkamp, Martijn W. Hesselink et al. (eds), Nijmegen, Ars Aequi Libri, 2004, (3rd ed.), pp. 471-498;

EJAN MACKAAY – CIVIL LAW OF CONTRACT

- Jolls 2007 Jolls, Christine, Behavioral Law and Economics, in: *Behavioral Economics and Its Applications*, Peter A. Diamond and Hannu Vartiainen (eds), Princeton, Princeton University Press, 2007, pp. 115-155
- Keily 1999 Keily, Troy, "Good Faith & the Vienna Convention on Contracts for the International Sale of Goods (CISG)", (1999) 3 *Vindobona Journal of International Commercial Law & Arbitration* 15-40
- Kötz 1997 Kötz, Hein and Axel Flessner, *European Contract Law, Vol. 1: Formation, Validity, and Content of Contracts; Contract and Third Parties*, Oxford, Clarendon Press, 1997
- Kronman 1978 Kronman, Anthony T., "Specific Performance", (1978) 45 *University of Chicago Law Review* 351-382
- La Porta et al. 1998 La Porta, Rafael, Florencio López-de-Silanes, Andrei Shleifer and Robert Vishny, "Law and Finance", (1998) 106 *Journal of Political Economy* 1113-1155
- La Porta et al. 1999 La Porta, Rafael, Florencio López-de-Silanes, Andrei Shleifer and Robert W. Vishny, "The Quality of Government", (1999) 15 *Journal of Law, Economics, & Organization* 222-279
- La Porta et al. 2008 La Porta, Rafael, Florencio López-de-Silanes and Andrei Shleifer, "The Economic Consequences of Legal Origins", (2008) 46 *Journal of Economic Literature* 285-332
- Lando/Rose 2004 Lando, Henrik and Caspar Rose, "On the Enforcement of Specific Performance in Civil Law Countries", (2004) 24 *International Review of Law and Economics* 473-487
- Litvinoff 1997 Litvinoff, Saul, "Good Faith", (1997) 71 *Tulane Law Review* 1645-1674
- Mackaay 2001 Mackaay, Ejan, Law and Economics: What's in it for Us Civilian Lawyers, in: *Law and Economics in civil law countries*, Bruno Deffains and Thierry Kirat (eds), Amsterdam, JAI Press (Elsevier), 2001, pp. 23-41
- Mackaay/Leblanc 2003 Mackaay, Ejan and Violette Leblanc, The law and economics of good faith in the civil law of contract, European Association of Law and Economics, Nancy, France, 18-20 September 2003; <https://papyrus.bib.umontreal.ca/jspui/handle/1866/125>
- Mackaay 2009 Mackaay, Ejan, Est-il possible d'évaluer l'efficacité d'un système juridique ?, in: *Convergence, concurrence et harmonisation des systèmes juridiques*, Jean-François Gaudreault-Desbiens, Ejan Mackaay, Benoit Moore and Stéphane Rousseau (eds), Montréal, Éditions Thémis, 2009, pp. 21-46
- Mackaay forthcoming Mackaay, Ejan, *Economic analysis of law for civilian legal systems*, Cheltenham, UK, Edward Elgar (forthcoming)
- Mattei 1995 Mattei, Ugo, "The Comparative Law and Economics of Penalty Clause in Contracts", (1995) 43 *American Journal of Comparative Law* 427-444;
- Milhaupt/Pistor 2008 Milhaupt, Curtis J. and Katharina Pistor, *Law & Capitalism: What Corporate Crises Reveal about Legal Systems and Economic Development around the World*, Chicago, University of Chicago Press, 2008

EJAN MACKAAY – CIVIL LAW OF CONTRACT

- Ourliac/de Malafosse 1969 Ourliac, Paul and J. de Malafosse, *Histoire du droit privé - 1/ Les obligations*, Paris, Presses Universitaires de France, 1969, (2nd ed.)
- Pineau et al 2001 Pineau, Jean, Danielle Burman and Serge Gaudet, *Théorie des obligations*, Montréal, Éditions Thémis, 2001 (4th ed.)
- Posner 2007 Posner, Richard A., *Economic Analysis of Law*, New York, Wolters Kluwer Law & Business, 2007, (7th ed.)
- Priest 1978 Priest, George L., "Breach and Remedy for the Tender of Nonconforming Goods under the Uniform Commercial Code: An Economic Approach", (1978) 91 *Harvard Law Review* 960-1001
- Priest 1981 Priest, George L., "A Theory of Consumer Product Warranty", (1981) 90 *Yale Law Journal* 1297-1352
- Restatement 1979 *Restatement (Second) of the Law of Contracts*, American Law Institute, 1979, available here
[http://www.lexinter.net/LOTWVers4/restatement_\(second\)_of_contracts.htm](http://www.lexinter.net/LOTWVers4/restatement_(second)_of_contracts.htm)
- Roe 2006 Roe, Mark J., « Legal, Origins, Politics, and Modern Stock Markets », (2006) 120 *Harvard Law Review* 460-527
- Roe/Siegel 2009 Roe, Mark J. and Jordan I. Siegel, "Finance and Politics: A Review Essay Based on Kenneth Dam's Analysis of Legal Traditions in the Law-Growth Nexus", forthcoming *Journal of Economic Literature*, available at
<http://ssrn.com/abstract=1476043>
- Rolland 1996 Rolland, Louise, "La bonne foi dans le Code civil du Québec : Du général au particulier", (1996) 26 *Revue de droit de l'Université de Sherbrooke* 378-399
- Shavell 2007 Shavell, Steven, "Contractual Holdup and Legal Intervention", (2007) 36 *Journal of Legal Studies* 325-354
- Trebilcock 1993 Trebilcock, Michael J., *The Limits of Freedom of Contract*, Cambridge, Mass., Harvard University Press, 1993
- UCC Uniform Commercial Code, The American Law Institute and the National Conference of Commissioners on Uniform State Laws, accessible at
www.law.cornell.edu/ucc/ucc.table.html
<http://www.law.cornell.edu/ucc/>
- Unidroit 1994 Unidroit *Principles of International Commercial Contracts* of 1994 English text at
<http://www.jus.uio.no/lm/unidroit.contract.principles.1994/doc.html>
French at <http://www.unidroit.org/french/principles/contents.htm>
- van Schaik 2004 van Schaik, A.C., "L'affaire Chronopost (Cour de cassation, 22/10/1996, Banchemreau/Chronopost)", (2004) 2004 *Nederlands Tijdschrift voor Burgerlijk Recht* 282-285 (in Dutch)
- Vienna Sales Convention 1980 United Nations Convention on Contracts for the International Sale of Goods (11 April 1980), accessible at
<http://www.cnr.it/CRDCS/cisg.htm>
- Whittaker/Zimmerman 2000 Whittaker, Simon and Reinhard Zimmerman, "Coming to Terms with Good Faith", in: *Good Faith in European Contract Law*,

EJAN MACKAAY – CIVIL LAW OF CONTRACT

- Reinhard Zimmerman and Simon Whittaker (eds), Cambridge, Cambridge University Press, 2000, 653-701
- Williamson 1975 Williamson, Oliver E., *Markets and Hierarchies: Analysis and Antitrust Implications*, New York., Free Press, 1975
- Williamson 1985 Williamson, Oliver E., *The Economic Institutions of Capitalism - Firms, Markets, Relational Contracting*, New York, The Free Press, 1985.
- Williamson 1996 Williamson, Oliver E., *The Mechanisms of Governance*, Oxford, Oxford University Press, 1996
- Wittman 2006 Wittman, Donald A., *Economic Foundations of Law and Organization*, Cambridge, Cambridge University Press, 2006
- Zimmerman 2001 Zimmerman, Reinhard, *Roman Law, Contemporary Law, European Law - The Civilian Tradition Today*, Oxford, Oxford University Press, 2001