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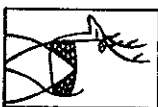
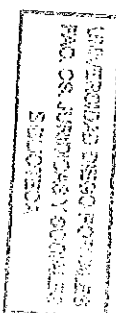
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Comparative Remedies for Breach of Contract

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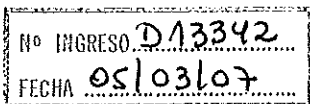
NILI COHEN
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HART
 PUBLISHING

OXFORD AND PORTLAND, OREGON
 2005

Proj. enr. sr. Carlos Pizano (Fondoyt N° 1050882)



Published in North America (US and Canada) by
Hart Publishing
c/o International Specialized Book Services
5804 NE Hassalo Street
Portland, Oregon
97213-3644
USA

© The Editors and Contributors severally 2005
First Published 2005
Reprinted 2006

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WEBSITE: <http://www.hartpub.co.uk>

British Library Cataloguing in Publication Data
Data Available

ISBN 1-84113-453-8 (hardback)

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Typeset by Olympus Infotech Pvt Ltd, India (Palatino, 10/12 pt)
Printed and bound in Great Britain by
Biddles Ltd, King's Lynn, Norfolk

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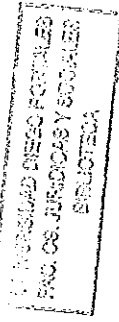
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Introduction

NILI COHEN AND EWAN MCKENDRICK

The book is the product of a conference entitled 'Comparative Remedies for Breach of Contract' which took place at the Faculty of Law, Tel-Aviv University between 4 and 6 June 2002. Most, but not all of the papers in this book were presented at that conference.

The purpose of the conference and the book is to present a theoretical as well as a descriptive picture of contract remedies. This has been done by reference to various legal systems representing the common laws (English, American, Canadian), some continental systems (French, German) and also a mixed system (Israeli). The sphere of inquiry has not, however, been confined strictly to claims which assume the form of a claim for breach of contract. Taking into account the blurred borderlines between contract and torts, we decided to include in the book a comparative work on economic loss, in which consideration is given both to the role of the law of contract and to the law of tort in the recovery of pure economic loss. A legal system which has a conservative law of tort may resort to the law of contract for the purpose of enabling a claimant to recover pure economic loss, and vice versa. Thus there is a need to examine the relationship between the law of contract and the law of torts.

When it is said that the law of contract can best be understood by reference to the remedies it offers, what is often meant is that the law is best examined and evaluated not by reference to its bare, black-letter rules, but rather by reference to their practical application. It is, perhaps, for this reason that the law and economics school has devoted a considerable amount of energy to the study of the law relating to remedies for breach of contract. It can also be important to appreciate that an understanding of the law of contract does not end in the courthouse. Litigation is not the only means of resolving contractual disputes (indeed, in many jurisdictions only a small percentage of contractual disputes end up in court). Today many contracting parties resort to other dispute resolution mechanisms, such as mediation, commercial arbitration and other fori which claim to offer efficiency, creativity and flexibility in the resolution of contractual disputes. Our work does not deal with these trends, nor with their impact on the understanding of contract remedies and contract theory. Rather, it examines the traditional solutions where contract disputes are dealt with

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Multiplicity in Contract Remedies

ROY KREITNER*

I INTRODUCTION

A RECURRENT THEME of contracts scholarship over recent decades has been the effort to solve the problems of contract remedies by applying a single, unified principle. The claim of this chapter is that those efforts are misguided, and distract from the more difficult, if less conceptually satisfying, work of thinking about the range of remedies appropriate to breaches of contract. Perhaps ironically, the inception of the project of unifying the remedies for breach of contract lies in one of the most powerful critiques of the idea of unification, Fuller and Perdue's 'The Reliance Interest in Contract Damages'.¹ Fuller and Perdue's article tore asunder an under-examined and unreflective conceptual unity in the law of damages for breach of contract.² The project of unifying remedies has often been framed as an attempt to reconstruct that lost unity. In this chapter, I argue that the attempts at reconstruction are fundamentally flawed and doomed to failure; that they exist at a level of abstraction more likely to be an obstacle to understanding contract and solving contract problems than to aid in those tasks; and that only an

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¹LL Fuller and WR Perdue Jr 'The Reliance Interest in Contract Damages 1 and 2' 46 *Yale Law Journal* 52 and 373 (1936).

²Peter Benson has recently described *The Reliance Interest in Contract Damages* as the inauguration of twentieth-century theoretical writing on contract. In characterising the attempts of classical legal thinkers who preceded Fuller and Perdue, such as Langbein, Ames, and especially Williston, Benson holds that they were successful in bringing order and internal consistency to the law of contract, but, 'For all that, however, their work remains untheoretical. They simply presuppose the premise that the expectation remedy is a form of compensation without exploring its normative basis and they stipulate the existence of a deep connection between the expectation principle and the basic doctrines of contract formation without explaining its necessity.' P Benson 'Introduction' in P Benson (ed) *The Theory of Contract Law: New Essays* (Cambridge University Press, Cambridge, 2001) 1, 2.

understanding of contract that respects the multiplicity of interests at stake can productively link contract thinking with the practices of contracting parties and the courts.

Abandoning the search for a single unified principle to govern contract damages does not necessarily entail abandoning any search for order in the law. Contract theory should not be conducted under the threat that any deviance from coherence translates into utter chaos: the world does not divide simply into those practices that are theoretically strictly coherent, and those that are conducted on an *ad hoc*, case-by-case basis. In this chapter I suggest that some measure of order, short of logical coherence, can be brought to the law of damages for breach of contract without sacrificing a reasoned explanation for the multiplicity of remedial measures actually employed by the courts in contract disputes. Such a tentative order will be based on distinguishing among *contract types*, with the further suggestion that different purposes inherent in contract law generally take on varying levels of importance with regard to the different types of contract.

A brief chapter cannot offer a fully worked out theory of contract damages, and I will not attempt such a theory here. Instead, I would like to suggest that in some respects, contracts scholars are searching for a theory of damages in the wrong places, and to offer at least one possible direction that might help us find our way. Part I of the chapter maps out some of the leading attempts to articulate a unified principle of damages for breach of contract. It begins by describing examples of unification theory worked out in mainstream contract scholarship. It continues by examining the philosophical versions of unification theory, and concludes in a brief exploration of the economic analysis of law. For each version of unification theory, there are already built-in critiques. Part II of the chapter is an attempt to generalise some of those critiques, and to cast doubt on the appeal of unification theory generally. Finally, Part III elaborates the idea that distinguishing contracts into various types might allow us to retain a tight link among the purposes of contract enforcement and the rules governing damages for breach.

II UNIFICATION THEORIES

American legal realism had an immense impact on the understanding of remedies for breach of contract. Through critical examination of the connection between the purpose of contract enforcement and the rules governing remedies for breach, the realists succeeded in instilling the view that remedies for breach set out to vindicate a range of interests. According to this view, there was no single core principle of contracts from which the rules on remedies could be deduced. Rather, rules on

remedies were to be evaluated by the success with which they advanced the relevant policy considerations. Perhaps the most elaborate extrapolation of this view was Gardner's 'An Inquiry into the Principles of the Law of Contracts',³ published in 1932. Gardner's analysis included no less than twelve principles of decision, laid out in an elaborate ordering that included an attempted hierarchy of application. The goal was to 'examine the laws which determine the relation of the remedy to the promise, the consideration, and the breach,' and the result was first and foremost an acknowledgment of complexity.

The task of the law of contract thus ceases to be the simple one of enforcing bargains and becomes the far more complex one of providing means for conducting a cooperative commonwealth on a voluntary basis, of reconciling group industry and economic justice with individual freedom and individual responsibility for results. To achieve this it is necessary to enforce promises to such an extent that promises may reasonably entrust their fortunes to them, but not to an extent which will permit them to be made instruments of exploitation, multiply the chances of accidental gains or losses, or needlessly restrict the future economic initiative of promisors.⁴

Gardner's heroic grappling with complexity was much discussed in the decade following its publication, but was eventually overshadowed by a rival that offered a more workable model of accommodation for the range of purposes embodied in contract law. That rival, of course, was Fuller and Perdue's 'Reliance Interest'.⁵ I will have more to say on 'Reliance Interest' later, but for now it will suffice to point out that its genuine contribution was not to set up reliance as the true core of contractual obligation or even of contract damages, but rather to offer a more elegant or digestible version of the claim that the purposes underlying contract enforcement were in fact multiple and complex. That claim of multiplicity and complexity became entrenched in the academic understanding of contract. However, in recent years, a growing number of contracts scholars has attempted to overcome the widespread understanding of the complexity of contract remedies and insisted that there is indeed a single unitary principle to govern the law of damages.

The attempts to unify the law of contract damages can be loosely classified into three groups. The first comprises scholars working within the mainstream of contract theory, or 'liberal pragmatism'.⁶ These scholars have critiqued the vision of multiplicity underlying contract remedies

³ GK Gardner 'An Inquiry into the Principles of the Law of Contracts' (1932) 46 *Harvard Law Review* 1.

⁴ *Ibid.* 20-2.

⁵ Above n 1.

⁶ The appellation is borrowed from Ian Macneil. See IR Macneil 'Relational Contract Theory: Challenges and Queries' (2000) 94 *Northwestern University Law Review* 877, 882-3, especially n 28.

primarily by resorting to a reinterpretation of the case law and existing scholarship, and have offered principled visions of why remedies for breach of contract should be conceived of as unified. Their common point of departure, almost without exception, is a critique of 'Reliance Interest'. The second group comprises scholars who have offered a philosophical critique of multiplicity, relying predominantly on the role of coherence in supplying a justification for the institution of contract law. The third group consists of scholars engaged in the economic analysis of law.

It should be noted at the outset that within each of the three groups, and especially among liberal pragmatists and economists, critique of the idea of unification exists alongside unification theory, almost from its inception. Thus, there is no claim here that mainstream contract theory, philosophical contract theory, or the economic analysis of law have, as a whole, adopted a stance propounding unification theory.⁷ My critique of unification theory targets a trend, but focuses on particular pieces of scholarship. Moreover, it builds on critiques first spelled out within each theoretical style, or sub-discipline. I begin with the most accessible versions of unification theory, those stemming from mainstream contract theory.

1 Liberal Pragmatist Unification Theory

Mainstream unification theories of contract remedies begin as the critique of a critique. Almost without exception, they stake their ground in a critique of Fuller and Perdue's 'The Reliance Interest in Contract Damages'. That article posited that contract damages vindicated a range of interests, including what it termed restitution, reliance, and expectation. Expectation, in Fuller and Perdue's terminology, was the interest most closely associated with what was considered the normal contract remedy, ie damages whose goal was to place the injured party in the same economic position he would have occupied had the contractual promise been performed. But the kind of compensation implied in the expectation interest was inadequate as an expression of the purposes of contract enforcement. Like Gardner's analysis that preceded them, Fuller and Perdue's goal was to emphasize that the purposes of contract enforcement were multiple, that such multiplicity manifested itself in actual damages awards by the courts, and that contract theory should offer an explicit accounting for that multiplicity.⁸

⁷ At least as far as liberal pragmatist analyses and economic analysis are concerned, unification theory is a minority position.

⁸ Fuller's letter to K Llewellyn two years after the publication of *The Reliance Interest* makes this point succinctly:

To me it seems clear that no analysis of contract law can be realistic or adequate which does not recognise that there exists a hierarchy of contract interests, which may be sloganised by saying that they extend from restitution through the reliance interest to

Unification theorists reject the proposal that contract law's basic purpose is to vindicate a range of interests. In one of the strongest statements of this position, Friedmann has claimed that 'there is but one genuine contractual interest', and whatever the nature of reliance and restitution, 'they are certainly not contractual interests'.⁹ Rebellious against Fuller and Perdue's appraisal of expectation, and substituting the term performance interest, Friedmann argues that 'performance is the only genuine contractual interest'.¹⁰ The intuition behind the claim is straightforward, and Friedmann articulates it forcefully:

The essence of contract is performance. Contracts are made in order to be performed... This interest in getting the promised performance (hereafter the 'performance interest') is the only pure contractual interest.¹¹

Friedmann's treatment of 'The Reliance Interest' is in essence a resistance to Fuller and Perdue's methodological starting point. While they sought to explain the societal purpose of contract enforcement by examining the range of remedies, Friedmann asserts that the starting point of the inquiry must be the *right*. From Friedmann's perspective, the right is necessarily a right to performance, and all remedial decisions are attempts to bridge the practical gap between the lack of performance (ie the breach) and the closest possible alternatives.¹² The argument turns on the idea that it is the nature of the right that should determine what is required of the remedy, rather than the remedies informing us about the meaning of the expectation interest, with a number of little misstatements, disturbing to elegancia juris, along the way... I consider the contribution made in my article on the reliance interest to lie, not in calling attention to the reliance interest itself, but in an analysis which breaks down the contract-no contract dichotomy, and substitutes an ascending scale of enforceability.

Letter from L Fuller to K Llewellyn (8 December 1938), quoted in RS Summers and RA Hillman *Contract and Related Obligations: Theory, Doctrine and Practice* 3rd edn (West Group, St Paul, Minnesota, 1997) 41.

⁹ D Friedmann 'The Performance Interest in Contract Damages' (1995) 111 *Law Quarterly Review* 628, 632 ('Friedmann, *Performance Interest*'). The entire article, from the title through the content, is a critique of *The Reliance Interest*. Prof Friedmann has recently reiterated the views expressed in the article in a symposium on Fuller and Perdue published as D Friedmann 'A Comment on Fuller and Perdue, the Reliance Interest in Contract Damages' *Issues in Legal Scholarship* (Berkeley Electronic Press, Berkeley, CA, 2001) vol 1, Art 3 ('Friedmann, *Comment*').

¹⁰ Friedmann, *Performance Interest*, above n 9, 632.

¹¹ *Ibid.* 629.

¹² *Ibid.* 634-5. The conflicting starting points for the analysis are clearest when Friedmann ridicules Fuller and Perdue's assertion that we compensate the victim of breach 'for something he never had'. Fuller and Perdue refer to the fact that the victim of breach never had the performance or its value in hand — in that sense he is compensated for something he never had; Friedmann points out that their formulation of this point leaves out the crucial fact that while the victim did not have the performance or its value, he had a right or an entitlement to the performance, and thus he is compensated for something he did have.

the right. For Friedmann, the right is the source of answers to our questions about remedies, whereas for Fuller and Perdue, the remedies were a source of answers to a question about the possible meaning of the entitlement, a meaning that would never be divorced from our questioning about why to enforce contracts in the first place. Friedmann's position is quite nuanced. While the status of the right as the starting point for analysis is axiomatic, the content of the right is not. Indeed, he suggests that the content of the right evolves, and is still evolving, becoming more property-like.¹³

A critique of Fuller and Perdue is common to additional articulations of mainstream unification theory. Two in particular merit mention here: 'The Phantom Reliance Interest in Contract Damages'¹⁴ and 'The Net Expectation Interest in Contract Damages'¹⁵ both reject Fuller and Perdue's framework as more confusing than useful,¹⁶ and both adopt a modified version of the expectation interest as the key to contract damages. In addition, both offer the reduction of complexity of damage rules as the central advance of the theories they propound.¹⁷ In a sense, all a principled core for contract doctrine, a core that was threatened, if not shattered, by the legal realists. One crucial focal point in that reconstruction is the performance or expectation principle, and thus many reconstructive attempts are based on a denial of the centrality of reliance as important to contract remedies.¹⁸

2 Philosophical Unification Theory

Philosophical unification theory, like its mainstream analogue, argues for a singular placement for the expectation principle in understanding and

applying contract remedies. But, while mainstream theories begin from a number of methodological starting points, philosophical theories are generally attempts to deduce the correct remedial principle from the nature of the contractual entitlement.¹⁹ The most popular version of such theory is Fried's *Contract as Promise*.²⁰ Fried famously argues that the core of contract is promise, and that the nature of promising entails that, 'if I fail to keep my promise, it is fair that I should be made to hand over the equivalent of the promised performance'.²¹ Fried goes on, not only to support the expectation principle as the proper remedial principle, but also to deny any fundamental role to reliance. The problem with Fried's position as an argument about remedies, as Craswell has shown, is that there is no necessary relationship between Fried's arguments about the basis for liability and the choice of any particular remedy or even remedial structure.²²

Other scholars have stepped into the breach in order to tighten the relationship between a philosophical account of the nature of contractual entitlement and a proper understanding of remedies. Most recently, Benson has argued that the nature of contractual entitlement entails, as a matter of necessity, a justification of the expectation principle as the sole principle of contractual compensation. Benson's argument rests on the idea that the meaning of contract must be sought in the logic of a transfer of entitlement, a transfer effected by temporally sequenced assents of the parties to a contract.²³ After elaborating the logic of transfer, Benson argues that

[i]f the law of contract can indeed be understood in terms of the logic of transfer, the expectation remedy is the natural and distinctively contractual principle of compensation.²⁴

Two elements of Benson's theory are of interest here. First, the expectation principle is logically deducible from the logic of transfer, which in turn underlies the conception of contract. According to Benson, a contractual transfer of rights is precisely like a present transfer of property with the exception that what is transferred is a right to the property rather than the property itself. For Benson, the contractual right effects a change of ownership, and

¹³ *Ibid.*, 636-7; Friedmann, *Comment*, above n. 9, 4.

¹⁴ M.B. Kelly 'The Phantom Reliance Interest in Contract Damages' (1992) *Wisconsin Law Review* 1755.

¹⁵ D.W. Barnes 'The Net Expectation Interest in Contract Damages' (1999) 48 *Emory Law Journal* 1137.

¹⁶ Only the mystique surrounding the reliance interest and the confusing use of that title to describe several different approaches conceal the remarkable differences between the most scholars agree that Fuller and Perdue's article was path-breaking, I will argue that the ultimate effect of their work was to confuse and complicate the law of contract damages. Barnes, above n. 15, 1138.

¹⁷ Courts need not look backward to find the remedy; they can look forward to find the break-even point. Courts need not administer alternative remedies; a single rule covers all ages offers a system for calculating damages that is easier to understand, easier to implement, and that it simplifies both the conceptual foundation for contract damages and the application of damage rules. Barnes, above n. 15, 1138.

¹⁸ See e.g. R.E. Barnett 'Foreword: Is Reliance Still Dead?' (2001) 38 *San Diego Law Review* 1 ('Barnett, *Still Dead?*); R.E. Barnett 'The Death of Reliance' (1996) 46 *Journal Legal Education* 518; E. Yorio and S. Thel 'The Promissory Basis of Section 90' (1991) 101 *Yale Law Journal* 111.

¹⁹ This is not to say that mainstream theories never use this procedure as well. Prof. Friedmann's *The Performance Interest* uses a similar methodology.

²⁰ C. Fried *Contract as Promise: A Theory of Contractual Obligation* (Harvard University Press, Cambridge, Massachusetts, 1981).

²¹ *Ibid.*, 17.

²² R. Craswell 'Contract Law, Default Rules, and the Philosophy of Promising' (1989) 88 *Michigan Law Review* 489, 517-20.

²³ P. Benson 'The Unity of Contract Law' in *The Theory of Contract Law*, above n. 2, 118, 128-9.

²⁴ *Ibid.*, 137.

[t]his change in ownership takes place at formation. Delivery neither adds to nor affects in any way this juridical situation as between the parties. By putting the promisee into actual physical possession of the thing as promised, delivery merely respects the promisee's already existing right.²⁵

Significantly, Benson does not present this claim in the framework of an argument for specific performance as a primary remedy; instead, the claim is made to account for 'the expectation remedy, whether expectation damages or specific performance', the latter of which remains in its role as exceptional, and appropriate in situations where there is no market for the thing promised.²⁶ The contractual right, on this view, is a proprietary right, valid against a particular individual.²⁷ The nature of this proprietary right, according to Benson, demands that the expectation remedy be available to vindicate the right in case of breach.

The second element of Benson's theory important for our purposes is his view of the status of reliance as a basis for contract enforcement. Any theory attempting to offer a unified basis for remedies around the expectation principle must account in some way for the role of reliance, and perhaps particularly for the doctrine of promissory estoppel. Benson's response is to banish reliance from the contractual realm. He asserts that reliance-based liability is

incompatible with an essential premise of the logic of a transfer of ownership ... Thus, there can be no intrinsic connection between reliance-based liability and the expectation principle, taken as a principle of compensation.²⁸

The error of mainstream thinking about contract, on this view, is in the very attempt to view reliance-based liability as contractual at all. Instead, according to Benson, reliance-based liability generally, and promissory estoppel in particular, are actually not part of contract at all, but should be understood from the perspective of torts.²⁹ Together, these two elements of Benson's theory present the argument for the expectation remedy as necessary (as flowing from the nature of the entitlement) and sufficient (because other bases for enforcement are non-contractual) to explain the remedial aspect of contract.

²⁵ *Ibid.* 135.

²⁶ *Ibid.* 134.

²⁷ The right is proprietary in character ... Moreover, because this right is against a definite individual — the promisor — and, more fundamentally, because the promisee acquires it through the promisor, it is a personal right. The fact that a right is personal does not entail that it is non-proprietary but simply goes to the mode of acquiring it. *Ibid.* 135.

²⁸ Benson, above n 23, 177.

3 Economic Analysis and Unification Theory

Today, for the most part, economic analysis of law is not amenable to unification theories of contract remedies. The initial insights of economic analysis as applied to contract damages yielded a straightforward support for expectation damages as the primary remedy for breach of contract.³⁰ This position grew out of the idea that expectation damages give the promisor an incentive to breach his promise if, but only if, the value of the breach (for the promisor) is greater than the value of the performance to the promisee. More important than the support for expectation damages, however, was the unified mode of questioning. Early examples of economic analysis of contract remedies seem to have assumed that there was one crucial question: how will a remedial rule affect the incentives of a promisor to perform or breach her promise?³¹

However, economic analysis soon discovered a series of additional incentive effects of remedial rules. Perhaps the most important of these problems was the fact that expectation damages would give the promisee an incentive to rely on performance of the promise as if that performance were certain, which could generate inefficient (over-) expenditure on reliance.³² But of course, reliance expenditures are not the only concern for an economically-driven conception of contract damages.³³ Economic analysis has not been able to supply a mechanism for ranking the different areas where damages rules could generate incentives, and therefore, there are no explicit versions of unification theory in economic analysis today.³⁴ At the same time, various particular pieces of research are

³⁰ The founding article in this regard is R.L. Birmingham 'Breach of Contract, Damage Measures, and Economic Efficiency' (1970) 24 *Rutgers Law Review* 273, 284–6, 292.

³¹ For a critique of this 'unduly narrow' vision of what economics could contribute to the analysis of contract remedies, see R. Craswell 'Contract Remedies, Renegotiation, and the Theory of Efficient Breach' (1988) 61 *Southern California Law Review* 629, 630, 640.

³² R. Cooter 'Unity in Tort, Contract, and Property: The Model of Precaution' (1985) 73 *California Law Review* 1, 11–13; R. Cooter and M.A. Eisenberg 'Damages for Breach of Contract' (1985) 73 *California Law Review* 1432, 1464–8.

³³ A partial list of choices (ie opportunities for incentives) that might be affected by the remedy for breach of contract includes: Whether to perform or to breach? How much to rely on contractual performance? How much to invest in precautions guaranteeing the ability to perform? How much information to reveal? How much effort to expend in seeking alternative deals or partners? How much effort to expend on mitigating injuries from breach? Typically, economic analysis is geared toward one particular incentive problem, or the relationship between two discrete problems, with little work having been done on integrating the diverse analyses into a single model. For comments on the diversity of incentives that the rules on contract damages could generate, see R. Craswell 'Against Fuller and Perdue', (2000) 67 *University Chicago Law Review* 99, 108–9 ('Craswell, Against Fuller'); R. Craswell 'Two Economic Theories of Enforcing Promises' in *The Theory of Contract Law*, above n 2, 19, 28–32; Craswell, above n 31, 630–1; Cooter and Eisenberg, above n 32, 1462; E.A. Posner 'Economic Analysis of Contract Law after Three Decades: Success or Failure?' (2003) 112 *Yale Law Journal* 829, 834–9.

³⁴ There is an ambiguity inherent in economic analysis on this point. On the one hand, economic analysis is self-consciously consequentialist and nearly anything could be relevant to

presented as if they could provide the basis for a unified view of damages, leaving the incentive questions that are not the subject of the research far off in the background. Usually, this exclusion is not accompanied by a limitation of the kinds of contracts for which the analysis is pertinent, but rather presented as a general framework for analysing remedies.³⁵

III THE CRITIQUE OF UNIFICATION: RESPECTING MULTIPLICITY

Unification theories of contract remedies have been subject to critique from within the sub-disciplines in which they were generated. But the failings of unification theories can be generalised. In other words, it is possible to identify the common features of unification theories, and on that basis to offer wholesale reasons for rejecting them. That is the task of this part of the chapter.

The main problems with unification theories are two-fold. Telegraphically put, unification theories attempt too much and explain too little about contract remedies. The theories are methodologically unsound because they work on a level of abstraction too high to solve concrete problems, and they are pragmatically weak because they are too rigid, and thus force scholars to narrow the realm of contract, eliminating the consideration of too many problems that are typically considered contractual. I treat these issues in turn.

1 Methodology: The Misconceived Quest for Unifying Principle

Unification theories share an underlying methodological assumption. The assumption is that an overarching principle can yield, through a process

the consequences of legal rules, in terms of the welfare of individuals. Thus, in principle, an economic welfare function could be infinitely complex, and actually take into account a host of competing considerations according to some balancing formula. See L. Kaplow and S. Shavell, 'Fairness Versus Welfare' 114 *Harvard Law Review* 961 (2001). However, when efficiency is equated with wealth maximisation, the result is often a simplification of the factors to be considered, with the implicit claim that questions of fact can guide the normative inquiry in a manner divorced from the balancing of substantive values. This was a central theme of very early economic analysis. For a paradigmatic example, see Birmingham, above n 30. For a critique of economic analysis along these lines, see JW Singer 'Legal Realism Now' (1968) 76 *California Law Review* 465, 522-8 (reviewing L. Kalman *Legal Realism at Yale, 1927-1960*) (1986)).

³⁵ See eg R. Cooter and A. Porat 'Should Courts Deduct Nonlegal Sanctions from Damages?' (2001) 30 *Journal Legal Studies* 401. A recent article on the border between mainstream and economic analysis makes a limited explicit case for unifying remedies in the expectation damages rule, arguing that when administrative concerns are taken into account, only expectation damages lead to efficient results. See MA Eisenberg and BH McDonnell 'Expectation Damages and the Theory of Overreliance' (2003) 54 *Hastings Law Journal* 1335.

of deduction, particular rules of contract law. Another way of putting this is that unification theories rely on conceptualism as their methodological basis. One extended example of the methodology should suffice to clarify the point.

Of all unification theorists, Benson is most straightforward and adamant about his conceptualism.³⁶ Benson claims that the proper concept of contract flows from the logic of transfer, and that once that concept is in place, it should generate by implication answers to all contract problems:

My basic thesis is that the logic of a transfer of ownership that animates present transfers of property is also instantiated in contracts and, more specifically, in the main doctrines of the common law of contract. Indeed, it is their organizing idea.

Crucially, while Benson's essay sets out to lay down the basic structure of contract, he claims that 'virtually any contract rule, including

implied terms and conditions — the law of mistake and non-disclosure, frustration, conditions antecedent and subsequent, fundamental breach, anticipatory repudiation... interpretation... rights of third party beneficiaries

and others are amenable to analysis through his conceptual apparatus:

A public basis of justification aims to be complete in the sense that, through the conception of contract, it ideally is able to answer all or most of the questions that arise in relation to contract formation and breach. The contention is that the conception of contract has the necessary resources to do so. Of course, to answer these questions, it may be necessary to supplement the basic structure of this conception with various presumptions and propositions of law. However, it is important to note that, on the approach I am taking, the latter are not to be introduced *ab extra* and should not take us outside the conception of contract. Rather they are to be understood as implications of that conception when it is suitably specified to address these other questions. Essential to this approach is the idea that a contract does not admit of any gaps once it is understood in terms of the conception of contract.³⁷

³⁶ Perhaps the clearest illustration of Benson's conceptualism could be gleaned from his treatment of consideration, where he begins with a definition and then dissects the definition in order to derive four conditions for consideration to be understood as valid, which in turn contribute to the analysis of the place of consideration in the conception of contract. See Benson, above n 23, 154ff. However, since this essay concentrates on theories of remedies, I will leave the analysis of consideration for another time. At all events, Benson is useful for purposes of illustration because he takes his conceptualism seriously: his theory has the advantage of taking conceptualism close to its logical endpoints, or to extremes, depending on one's perspective.

³⁷ *Ibid.*, 202-3.

The analysis of the expectation principle occupies a central place in Benson's conceptualist scheme. While one goal of his essay is to justify the expectation principle in general, that very principle does the job of explaining the concept of contract. Thus:

To begin, we should recall that from the point of view of contract law the wrong which a breach does to a promisee's right to performance consists in the promisee being deprived of the thing promised, including its value and use. This is made evident by the expectation remedy, whether expectation damages or specific performance, which aims to give the promisee physical possession of the thing promised, including its value at the time performance is due. Money damages accomplish this purpose where the thing promised is not unique but is available to the promisee on a market. Damages represent both the value of the thing promised and the means of payment by which the promisee can obtain the thing, including its value, from the market.³⁸

The logic of transfer, according to Benson, entails that a promisee has a proprietary right of ownership of the thing promised, and that this right vests at formation. That Benson's view departs from traditional understandings of contractual right is unimportant. What concerns us here is that his justification of the expectation remedy as central and exclusive stems from the conceptual framework of the logic of transfer. Benson's goal is to set up an internal and single-focused examination: does a proposed remedy flow from the logic of transfer? The point of the framework is to limit the kinds of considerations that might be relevant to determining the remedy, eliminating, for instance, considerations of policy that are the bread and butter of mainstream treatments of remedies since early in the twentieth century.

The critique of this position requires, then, a justification for what has become the standard practice of thinking about remedies; in other words, the critique consists in presenting the argument for a purposive, as opposed to a conceptualist, view of contract remedies. A brief clarification of the structure of this presentation is in order. A full justification of the purposive view of remedies has two parts. The first comprises an argument for gauging various purposes when deciding whether to apply a remedy and how to measure it, in cases included in what the conceptualist views as the core of the contractual relationship. The second explains why a purposive analysis offers a better account of cases that conceptualist accounts attempt to expunge from contract. That part of the presentation is undertaken in the next section (III(2)) of this essay.

³⁸ *Ibid.*, 134-5. It is worth noting that Benson's analysis offers no principled reason for allowing damages to be the primary remedy, since his language implies that the actual thing promised, or specific performance, is entailed by the logic of transfer. The gap opened up by the choice between specific performance and damages is only one hole in the theory.

Why then, should one adopt a purposive view of contract remedies? Answers are likely to take two forms. First, one might suggest that as long as a purposive view of remedies does not engender too much uncertainty, there is no affirmative reason to exclude the consideration of purposes when gauging remedies. The extreme conceptualist view claims that the concept simply supplies the very meaning of contract, and that any reconsideration of purposes at the level of decision-making undermines this meaning. But the meaning or meanings of contract are precisely at issue,³⁹ and the bald assertion that a particular closed conceptual framework embodies the meaning of contract at the expense of other considerations will necessarily involve a mode of circular reasoning.⁴⁰ As Corbin put the point more than seventy years ago:

The common law does not have any substratum of grand eternal principles on which it rests, except that judicial decision and administrative action should continually be readjusted to the needs and desires of mankind. Argument from 'principle' almost always involves a subtle begging of the question.⁴¹

The second answer involves a somewhat closer inspection of the context of contract remedies. Conceptualist accounts share the conception of a contractual entitlement as a right to the thing promised. And yet, all conceptualist accounts acknowledge that specific performance is not the sole remedy for breach, and indeed, in most jurisdictions, not the primary remedy. Even specific performance, coming long after the time for performance, as it must when the result of litigation, would not actually supply the thing promised as promised.⁴² But the recognition of expectation damages is even further removed from a grant of the thing itself. The predominance of the substitutional remedy is already an indication that the law relies to a great extent on administrative concerns. When we take the investigation beyond the very existence and prevalence of damages and delve into some specific rules, we find a range of competing concerns embedded in the law of remedies.⁴³

³⁹ Circularity is not necessarily a condemnation of the reasoning process. The defense of conceptualism embraces the form of circularity evinced in the quotations from Benson presented above, and from his exposition of the public basis of justification. P. Benson 'The Idea of a Public Justification for Contract' (1995) 33 *Osgoode Hall Law Journal* 273. The idea is that any combination of justificatory considerations (for instance a possible competition among purposes) would lead to the failure of each, and thus to arbitrariness. See E.J. Weinrib *The Idea of Private Law* (Harvard University Press, Cambridge, 1995) 38-42. The question of why a justificatory principle or consideration must be extended to its 'full reach' and govern a particular form of social interaction without interference or interaction with other such principles or considerations in order to maintain some justificatory power is, on my reading, never answered.

⁴⁰ A.L. Corbin 'The Restatement of the Common Law by the American Law Institute' (1929) 15 *Iowa Law Review* 19, 35.

⁴¹ '[The law] never interferes until a promise has been broken, and therefore cannot possibly be performed according to its tenor.' O.W. Holmes Jr. *The Common Law* (Little Brown & Co., Boston, 1881) 300.

⁴² One clarification: the point here is not that every contract question must, as a matter of necessity, raise a number of conflicting considerations. However, almost any contract

The possibility of conflicting considerations is easily viewed when considering the rules for choosing between alternative measures of value (within expectation damages), and in the principles that limit damages. Take for instance the classic problem of deciding whether to award expectation damages based on the cost of completion of work according to the contract terms as opposed to damages based on the diminution of value of the property as a result of breach.⁴³ This problem is not amenable to solution by applying either the logic of transfer of entitlement or any other high-level abstraction about carrying out the parties' wills. Either result, at this level of abstraction, is a plausible interpretation of giving the injured party the value of the thing promised. To decide which interpretation to adopt, however, we must do more.

A reasonable decision-maker will take into account at least two kinds of considerations, each of which offer arguments in both directions. One kind of consideration deals with fairness as between the parties to the dispute: is it fair/just/right to allow the promisor to escape from performing in the manner that the promisee understood the promise? Is it fair/just/right to grant the promisee a windfall money judgment that he is unlikely to use for actual restoration of the property? The second kind of consideration deals with social utility, looking as much to guiding future behaviour (primarily of non-parties) as to the dispute itself: will a rule of cost of completion generate economic waste, and in turn generate performance when neither party has an actual interest in performance? Will a rule of diminution of value generate inefficient breaches, because the promisor can then discount the actual damage to the promisee? With good reason, this problem has become a staple of the first year contracts curriculum, because it forces anyone who thinks about it to grapple with different kinds of considerations, none of which are unambiguous on their own terms. The conceptualist model that counsels ignoring these considerations seems unable to move toward a solution of such a problem in concrete terms.

question might, potentially, raise such considerations, and many actual attempts to determine a rule or decide according to a rule are formulated precisely as contests among conflicting considerations. See D. Kennedy, 'From the Will Theory to the Principle of Private Autonomy: Lon Fuller's "Consideration and Form"' (2000) 100 *Columbia Law Review* 94, 104-6 (describing 'The Conflicting Considerations Model' of legal analysis).

⁴³ The classic formulation comes from *Perryhouse v Garland Coal & Mining Co* 382 P 2d 109 (Okla 1962). More recent cases include *Schneberger v Apache Corp* 890 P 2d 847 (Okla 1994) (adopting the diminution of value award), *Made v Kubinski* 661 NE 2d 1178, 1185 (Ill App 1996) (holding that trial court should 'compare the cost of restoring the land to its previous level of fertility with the diminution in market value at its highest and best use, and award the lesser amount'); *Willie's Construction Co v Baker* 596 NE 2d 958 (Ind App 1992) (adopting cost of completion measure where the remedial construction cost was \$24,000, the diminution of value was zero, and the value of the property was \$70,000).

The limitations on expectation damages offer additional examples of conflicting considerations. Again, we may focus on a classic example of damages limited to loss that is foreseeable as a result of the breach, as laid out in *Hadley v Baxendale*.⁴⁴ Is the question as to whether certain consequences of the breach are foreseeable answerable by reference to the entitlements transferred by the parties at formation, as the conceptualist analysis would assert? This might be the case where the promisor demanded a higher price for her service because of the knowledge that the promisee intended an unusual use, or was subject to unusually great injury. But that only answers the easy case where there is a concrete assumption of risk, something that is not necessary for liability. In fact, the test of foreseeability is not applied in subjective terms, but rather objectively, as a self-consciously normative inquiry. Again, decision-makers are likely to ask whether it would be fair as between the parties to assess damages,⁴⁵ and whether a default rule restricting damages would have beneficial societal effects.⁴⁶ Even the hero of conceptual analysis of contract, Williston, was willing to admit that the attempt to derive the foreseeability requirement from the parties' agreement was a fiction.⁴⁷

A final example for this point may be drawn from the requirement of certainty for the assessment of damages. For instance, plaintiff company contracts to manage a stadium for a municipality for a period of twenty years, before the stadium is built. In fact, the stadium never gets built, and the city breaches its contract. Again, considerations of fairness to the parties and incentives to similarly situated parties will play a

⁴⁴ (1854) 9 Ex 341; 156 ER 145. See further A. Kramer, chapter 12 below.

⁴⁵ This explains the recurrence of language regarding 'disproportionate' damage. The idea is that it may well be unfair, even monstrous, to hold the promisor in a contract worth next to nothing to the damages caused by its breach, even when those are easy to foresee. See Restatement (Second) of Contracts § 351(3).

⁴⁶ I. Ayres and R. Gertner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules' (1989) 99 *Yale Law Journal* 87, 101-2.

⁴⁷ Thus Williston, in discussing limitations on damages, and in particular the implications of the doctrine of *Hadley v Baxendale*.

⁷⁰ To assert then, as is sometimes done expressly or impliedly, that the measure of damages for breach of a contract is based on the terms of the contract is to assert a fiction which obscures the truth and invites misapprehension which may lead to error. One who on borrowing money agrees to pay it the following month does not stipulate for the alternative right to keep the money at legal interest until the lender can get judgment and levy execution, though this is the only remedy the law can enforce. Nor can it be supposed that a seller contracts to be liable for the difference between the contract and the market price, or for consequential damages according as he does or does not know certain facts. Parties generally have their minds addressed to the performance of contracts — not to their breach or the consequences which will follow a breach. The fiction here criticised is a manifestation of the broader fiction that parties contract for whatever obligations or consequences the law may impose upon them.

Williston on Contracts 1st edn (New York, Baker Voorhis, 1920) vol 3 § 1357. Cf. A. Kramer, chapter 12 below.

central role.⁴⁸ Alongside those two types of considerations, a court will also be faced with administrative concerns.⁴⁹ In a world where prediction is not simply an art but a well developed set of sciences, reasonable certainty is primarily a question of money, or of the resources applied: will courts (and possibly juries) be competent to assess the kinds of evidence that are likely to be submitted to fulfill the certainty requirement? will such an investigation on the part of the court require resources the courts cannot or should not spare?⁵⁰

These examples show that typical questions of contract remedies are generally not answerable, or at least generally not answered, with reference only to an overarching principle or to a commitment about the nature of a contractual right. Instead, at least in many cases, a range of purposive considerations will come into play, including fairness as between the parties; social welfare or utility, which is generally geared toward directing behaviour of similarly situated parties; and administrative considerations, generally geared toward assuring that the courts are not overwhelmed by the results of the rules they must apply. Gardner summed up the sentiment years ago:

In short, it gradually becomes apparent, upon a broad survey of the law of remedies, that 'contracts' are not 'enforced' merely because the parties made them, but that the law affords only such remedies for breach of promise as seem most likely to promote the orderly and efficient conduct of the community's economic life.⁵¹

⁴⁸ Fairness considerations are likely to be central where the fact of damage is certain, and the question is what degree of proof will suffice as reasonably certain. Will it be fair, under these conditions, to impose a strict standard of proof, under which the plaintiff, though certainly damaged, remains without remedy? On the other hand, will it be fair to impose on the defendant speculative losses? The same situation implicates considerations of utility: will parties be wary of contracting in situations where losses are difficult to prove? Will potential breachers be too willing to breach because they know they can discount the injured party's losses where those are less than certain?

⁴⁹ In *Kenford Co v Erie County*, 493 NE 2d 224 (NY 1986) the court noted that the plaintiff presented a massive quantity of expert proof that represented industry's most advanced and sophisticated methods for predicting results of future projects. But the nature of the proof, its very sophistication, seems to be one of the factors that led the court to the conclusion that it would be dangerous to consider such proof. The court seems to be protecting itself, or courts generally, from the prospect of facing such unfamiliar territory, or from having to take the word of experts on issues too far from its instincts and common sense. For the opposite position, ie that a court should consider evidence if it offers at least a rational basis for determination of damages, see *Perma Research and Development Co v Singer Co* 402 F Supp 881 (SDNY 1975).

⁵⁰ Some remedial rules are explicitly concerned with administrative costs, and thus require no translation into the arguments for a particular interpretation of the rule. See eg Restatement (Second) of Contracts § 366 (mandating that specific performance will not be granted where it would 'impose on the court burdens in enforcement or supervision that are disproportionate to the advantages to be gained from enforcement and to the harm to be suffered from its denial').

⁵¹ Gardner, above n 3, 32.

2 Narrowing Contract: The Limited Focus of Unification Theories

Unification theories tend to narrow the focus of contract, eliminating consideration of reliance-based liability from the contractual realm. Benson is particularly clear on this point, asserting that, 'Promissory estoppel is not a species of contractual liability ... Reliance-based liability, including promissory estoppel, is best understood as a species of tort, not contractual, liability'.⁵² Friedmann takes a similar, though more nuanced position, claiming that often contract and tort protect the same entitlement and thus reach similar damage measures,⁵³ but noting that if a promise is *binding*, 'it means that the promisee is entitled to its performance (or to the performance damages)'.⁵⁴ One problem with this approach is that it assumes that the nature of the entitlement has determinate consequences upon the remedy, whereas the possibility that a *binding* promise may be binding to varying extents (varying levels of damages, for instance) is precisely the question at issue. Friedmann admits that the law does not comply with his analytical arrangement:

In essence, the difficulty stems from an imprecise definition of the legal right and the corresponding duty or obligation. It would have been avoided if instead of defining the promise as binding, a duty of good faith in negotiation or in making promises had been imposed. In fact, § 90 [of the Restatement of Contracts] deals with different types of entitlements. In some instances in which the entitlement is indeed to performance, it may be regarded as a contractual entitlement. In other instances, in which there is a mere right not to be misled by a promise that is later broken, the remedy is limited accordingly. However, the drafting of § 90 reflects the traditional Anglo-American approach which places the emphasis upon the remedy and leaves the nature of the right in obscurity.⁵⁵

Thus, unification theories, at least in their conceptualist form, distinguish between a genuine contractual entitlement and 'a mere right not to be misled by a promise that is later broken'. But this distinction cuts against

⁵² Benson, above n 23, 177. Benson makes clear that he is demarcating two different types of liability: tort liability for certain promises, as opposed to contractual liability for others (those with actual consideration). The role of promise in tort is categorically different from its function in contract ... There is no intrinsic connection between tort-based promissory liability and the expectation principle. *Ibid.*

⁵³ 'The different results reached in tort and contract derive from the fact that they are usually called on to protect different rights. Where, however, they are invoked to protect the same right, the calculation of damages, which reflect the value of this right, either in tort or in contract will be similar.' Friedmann, *Performance Interest*, above n 9, 639 (emphasis in original). It is hard to square this point, and Friedmann's ensuing detailed analysis of examples, with his earlier claim that there is only one genuine contractual interest. To this reader, at least, his examples demonstrate that contract, in many situations, embodies the tort principle.

⁵⁴ *Ibid.*, 643.

⁵⁵ *Ibid.*, 644.

the grain of common law thinking about contract. If, as the Restatement counsels, a contract is 'a promise... for the breach of which the law gives a remedy, or the performance of which the law in some way recognises as a duty',⁵⁶ then a right not to be misled by a promise that will be broken is, at least in some cases, simply a contractual right.⁵⁷ The traditional view is not limited to definitions. Instead, it manifests itself in a vision of the world of contract that includes a host of problems that conceptualists might like to see analysed under different categorical headings.⁵⁸

The difficulty with the narrow vision of contract is two-fold. First, given current understandings of contractual liability, it is highly artificial, and leaves too many common contract situations unsolved. Second, its supposed conceptual neatness actually complicates the analysis of relatively straightforward problems. A few brief examples should clarify. In reliance on bids of various subcontractors, a general contractor calculates his bid for a tender offer, and on learning of his being granted the tender, the subcontractor claims he made a mistake in calculation, and refuses to perform.⁵⁹ A donee of real estate occupies and makes improvements on the land, and the donor's heirs refuse to finalise the transfer of title. A franchisor and a potential franchisee conduct a series of transactions, each of which is meant to fulfill conditions for the granting of the franchise. When the final condition is fulfilled, the franchisor raises the bar, making complete performance of the agreement impossible.⁶⁰ Is it conceivable that such classic problems have no place in the corpus of contracts materials, because they are 'actual-tort' cases? And if so, why is part of the struggle over their solution centered on the possibility of finding consideration?⁶¹

The artificiality of the distinction proposed by conceptualists may not be crucial. Since the decline of the forms of action and the simplification of pleading, the drawing of boundaries between fields like contract and tort is likely to be of much more importance to the conceptualist than to someone interested in a pragmatic approach to private law.⁶² However,

the distinction has some ill effects on contract thinking more generally, beyond the boundary issue.⁶³ As far as remedies are concerned, the central problem is how to think about damages when the limitations on expectation damages are relevant. Again, two telegraphic examples: in *Kerford Co v County of Erie*,⁶⁴ the plaintiff agreed to manage a sports stadium for the county, but the stadium was never built by the county. Uncertainty and foreseeability posed insurmountable obstacles in *Kerford's* claim for damages. But what if there had been clear expenditures in reliance on the contract? If the 'performance interest' is the only interest protected by contract, how is the plaintiff to recover even his reliance expenditures?⁶⁵ Is it feasible or desirable to treat this case as a tort, just because of the difficulty in proving damages? The second example highlights the problem with this scenario. In *Security Store & Manufacturing Co v American Railways Express Co*,⁶⁶ the plaintiff contracted with a carrier to send a special combination oil and gas burner to an exhibition, where he intended to display it. One package of the shipment never arrived, and the plaintiff recovered his expenses in going to the exhibition and setting up his display, or reliance damages. It is a matter of course that there was a valid contract, and relatively clear that expectation damages would raise a host of problems, ranging from causality to foreseeability and on to certainty. In addition, it is not clear that reliance damages were not considerably higher than expectation, if the latter is limited to the difference between the market value of the goods at the time of delivery and the time when they should have been delivered. But should this be a case of tort? Should the carrier be excused if he was not negligent? Should the plaintiff have to bear the burden of showing negligence? It seems clear that the answer to all of these questions is no, and that the plaintiff should be able to elect to sue for reliance damages without having to show the existence of a tort. And yet, this relatively easy contracts case becomes quite difficult if the contractual interest is narrowly and artificially defined.

they worked within a framework that suggested that the voluntary relationship or undertaking precluded the examination from the perspective of the law of torts. See JH Beale 'Gratuitous Undertakings' (1891) 5 *Harvard Law Review* 222. For a modern explanation of why the boundaries might still matter, see Barnett, *Still Dead*, above n 18, 9-11 (explaining that the determination to uphold the boundary between tort and contract is motivated by a concern for freedom of contract).

⁶³ The wider issue here is the extent to which all the parties' obligations should ostensibly be traced to the moment of contract formation. See D Charny 'Hypothetical Bargains: The Normative Structure of Contract Interpretation' (1991) 89 *Michigan Law Review* 1815.

⁶⁴ 73 NY 2d 312, 337 NE 2d 176, 540 NYS 2d 1 (1989).

⁶⁵ One suggestion is that courts should be willing to assume a fiction, that is, of at least a break even contract, thus awarding reliance damages as a surrogate for the difficult to prove expectation. Kelly, above n 14. This suggestion, along with its fiction, is critiqued as a 'some-what artificial presumption' in Williston, above n 47, vol 3 §1341.

⁶⁶ 51 SW 2d 572 (Mo App 1932).

⁵⁶ Restatement (Second) of Contracts §1 (emphasis added).

⁵⁷ It could be argued that only the promise to engage in an undertaking will trigger contractual liability, but this would not solve the definitional problem raised by conceptualists. The obvious evidence of the mainstream view is Restatement (Second) of Contracts §90, which comes under the heading of 'Contracts without Consideration'. In other words, the common understanding is that the requirement of consideration is not a universal requirement for contractual validity of promises (see §§ 82-90), but that the situations elaborated under the topic heading are contractual.

⁵⁸ Promissory estoppel is a broad heading for some of these problems, but there are others, including firm offers, options, surety, and certain contractual claims for reliance damages.

⁵⁹ See eg *James Baird Co v Gilbert Bros Inc* 64 F 2d 344 (2d Cir 1933); *Dreman v Star Paving Co* 333 P 2d 757 (Cal 1958); *Diamond Enterprises Inc v Della Roofing Inc* 886 SW 2d 157 (Mo App 1994).

⁶⁰ *Hoffman v Red Owl Stores Inc* 133 NW 2d 267 (Minn 1965).

⁶¹ See R Pound 'Consideration in Equity' (1919) 13 *Illinois Law Review* 667.

⁶² In fact, this issue was crucial for late nineteenth century classical theorists. They, however, could not so readily shuffle off problems of promissory estoppel to the realm of tort, because

IV BEYOND UNIFICATION: TOWARD AN ANALYSIS OF CONTRACT TYPES

Unification theories of contract remedies are inadequate to explain the complexities of contractual remedies, and too rigid to guide dispute resolution in the field. By ignoring or at least minimising the importance of context and consequential analysis, they sacrifice too much to conceptual neatness. But the alternative, at least as sketched out here thus far, may leave some critics in discomfort. The realist model that takes into account a range of conflicting considerations in trying to implement the purposes of contract law through its rules offers little guidance on how to gauge the importance of various considerations or purposes. The recognition of conflicting considerations seems to throw judicial decision-making into something of a void of indeterminacy, where often, only the judge's predilections will lead her to a decision. The brave answer to this concern is that, 'certainty generally is an illusion and repose is not the destiny of man'.⁶⁷ The remainder of this chapter, in contrast, is for the faint of heart. My suggestion here is that a provisional grouping of fact situations by contract type will supply some guidance regarding the relative weight of conflicting contract principles. Such groupings will not eliminate the underlying need to consider various purposes advanced by contract law, but they might provide a few rules of thumb, or labour saving devices, which could aid in deciding contract cases according to the considerations that are typically most important in context.

I will begin by noting that classification of contract types according to fact situations is far from a new concept. In fact, it characterises both pre-classical contract law, which was arranged according to typical contractual relationships,⁶⁸ and much of the twentieth-century development of specialised fields of contract. In fact, the spinning off of certain topics from a general field of contracts was one of the pet peeves of paradigmatic conceptualist analysis:

The law of contracts ... after starting with some degree of unity now tends from its very size to fall apart. The simplest applications of fundamental principles of contracts when found in an insurance policy or a contract of suretyship are often considered by writers on those topics as peculiarities of the law of insurance or of suretyship, controlled by no general rules. It

⁶⁷ OW Holmes Jr 'The Path of the Law' in *Collected Legal Papers* (Harcourt Brace & Co, New York, 1920) 167, 181.

⁶⁸ Until the classical scholars began to dominate the field, contract was considered the law of relations: the law of vendor and purchaser, the law of factors or of brokers, of bailor and bailee, of master and servant, of principal and agent, of landlord and tenant, of lessor and lessee, of shipper and carrier and on and on. And the content of the duties or obligations in each of these relations was supplied by law, in accordance with recognised contract types. See J Gordley *The Philosophical Origins of Modern Contract Doctrine* (Clarendon Press, Oxford, 1991) 158-60; IV Orth 'Contract and the Common Law' in HN Schreier (ed) *The State and Freedom of Contract* (Stanford University Press, Stanford, CA, 1998) 44.

therefore seems desirable to treat the subject of contracts as a whole, and to show the wide range of application of its principles.⁶⁹

The existence of labour law, employment law, consumer protection law, sales law, and others, is a testament to the fact that the law is shaped by the context of its application. In what follows, I will not suggest a full-fledged return to a system of contract types, or to the primacy of classification as the most crucial lawyer's tool. Instead, I will offer two extended examples and a few brief suggestions as to why work towards a provisional (and always flexible) typology might help advance our understanding of contract remedies.

1 History: Contracts for Carriage and the Rule in *Hadley v Baxendale*

It is worthwhile to begin with a familiar case, though the analysis may undermine some of that familiarity. *Hadley v Baxendale*⁷⁰ is typically considered the leading case in laying down the rule that consequential damages are limited to the injury that the defendant could reasonably have foreseen at the time of contract formation.⁷¹ The traditional understanding of the rule in *Hadley* is based on the idea that the consequential loss in question must be contemplated by the parties if the plaintiff is to recover. Admittedly, this understanding flows from a highly plausible, even straightforward, reading of Alderson B's speech deciding the case.⁷²

⁶⁹ Williston, above n 47, v 1, iii. However, alongside this statement of purpose, Williston's first edition included chapters on agents and fiduciaries; contracts for the sale of land; contracts for the sale of personal property; contracts of employment and contracts to marry; contracts of bailment and of innkeepers; contracts of affreightment; bills of exchange and promissory notes; and contracts of suretyship. Thus, while Williston's goal was to promote a unitary view of contract, he was still tied to a tradition for which a complete treatment of the field was rooted in particular classes of contracts.

⁷⁰ (1854) 9 Ex 341; 156 ER 145.

⁷¹ The fountainhead of the limitation of foreseeability is the famous English case of *Hadley v Baxendale*, which in 1854 laid down general principles that are still honored today. Farnsworth on *Contracts* 2nd edn (Aspen Law & Business, New York, 1998) §22.

⁷² To recall the facts of the case, plaintiffs were millers, and the crankshaft of the steam engine that powered their mill was broken, and the mill was thus idle. They gave a carrier the broken shaft to deliver to the manufacturer for replacement, and the carrier delayed delivery. The miller sued for lost profits for the period of delay while the mill was stopped. Alderson B said that damages should be:

such as may fairly and reasonably be considered either arising naturally... or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it. Now, if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated.

But the connection between foreseeability or contemplation and actual awareness of special circumstances may not be as straightforward as it seems. On the one hand, there is the repeated reference to the issue of whether the special circumstances were ever communicated to the defendants, with Alderson B assuming they were not. But in direct conflict with this view is the reporter's note preceding the opinion, which explicitly states first that 'The plaintiffs' servant told the clerk that the mill was stopped, and that the shaft must be sent immediately', and second, that upon payment for carriage of the shaft, 'the defendants' clerk was told that a special entry, if required, should be made to hasten its delivery'.⁷³

The real key to understanding the opinion lies not in the question of notice, but rather in the *type* of contract undertaken between the parties. The decision rests ultimately on the consideration of the damage that would 'arise generally, and in the great multitude of cases not affected by any special circumstances, from such a breach of contract'.⁷⁴ In other words, damages will typically be limited to those that arise from a particular type of contract, when both parties know they enter that type of contract, here a contract of carriage. Counsel for defendants made this point explicitly: 'A carrier has a certain duty cast upon him by law, and that duty is not to be enlarged to an indefinite extent in the absence of a special contract'.⁷⁵ *Special contract* is not merely a question of notice, but of a specific undertaking to become liable for damages beyond those typically assumed. Thus, we should pay close attention to Alderson B's statement

[I]f the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated.... For, had the special circumstances been known, the parties might have specially provided for the breach of contract by special terms as to the damages, in that case; and of this advantage it would be very unjust to deprive them.⁷⁶

⁷³*Ibid.*, 147. Further, in argument for the plaintiffs, counsel was presented by Parke B with the question: 'The defendants there [in *Waters v Towers*, 8 Ex 401] must of necessity have known that the consequence of their not completing their contract would be to stop the working of the mill. But how could the defendants here know that any such result would follow?' and he answered: 'There was ample evidence that the defendants knew the purpose for which this shaft was sent, and that the result of its non-delivery in due time would be the stoppage of the mill; for the defendants' agent, at their place of business, was told that the mill was then stopped, that the shaft must be delivered immediately, and that if a special entry was necessary to hasten its delivery, such an entry should be made.' *Ibid.*, 149.

⁷⁴*Ibid.*, 151.

⁷⁵*Ibid.*, 150.

⁷⁶*Ibid.*, 151.

The *special terms* referred to here are simply a contract for extraordinary liability, or insurance. And what is at stake is the nature of a contract for carriage, which does not include such insurance. When parties desire insurance, in other words, they should contract for it specifically.⁷⁷ The concern of the court, in cases like this, is that one party should not receive a contract for insurance for the price of a contract for carriage.⁷⁸ The issue, on this reading, is not whether the parties *actually* foresee or contemplate the damage in question, but whether the *type* of relationship they undertake in the contract entails liability for such damage. Contract types entail a host of duties, among them responsibility for particular kinds of losses. The parties can contract around these duties, but to do so they must exit the typical arrangement, and more than mere notice is required for such exit.

The early development of contract doctrine regarding damages was heavily dependant on specific contract types. Leading examples include the limitation of damages for non-payment of a debt to interest,⁷⁹ and the rule limiting damages against a vendor of real estate who failed to make title to the expenses of the buyer, or what would later be termed reliance damages.⁸⁰ But these examples are only the tip of the iceberg, prominent because they resulted in bright line rules that diverge clearly from the general formula, rather than modifying it delicately.⁸¹ A mid-nineteenth-century

⁷⁷ This is the understanding proposed by defendants' counsel:

Here the declaration is founded upon the defendants' duty as common carriers, and indeed there is no pretence for saying that they entered into a special contract to bear all the consequences of the non-delivery of the article in question. They were merely bound to carry it safely, and to deliver it within a reasonable time. The duty of the clerk, who was in attendance to the defendants' office, was to enter the article, and to take the amount of the carriage, but a mere notice to him, such as was here given, could not make the defendants, as carriers, liable as upon a special contract. (*Ibid.*, 150.)

⁷⁸ This concern is shown in even starker terms during the argument of counsel for the plaintiffs, who relied on the case of *Borradale v Britton*, where the plaintiff recovered for the loss of an anchor occasioned by the breaking of a chain cable, which the defendant had warranted would last two years. Upon bringing up the case, plaintiffs' counsel was quoted by Alderson B: 'Why should not the defendant have been liable for the loss of the ship?' and then by Martin B: 'Take the case of the non-delivery by a carrier of a delicate piece of machinery, whereby the whole of an extensive mill is thrown out of work for a considerable time; if the carrier is to be liable for the loss in that case, he might incur damages to the extent of £10,000'. *Ibid.*, 148. The barons are suggesting that it is implausible that for the price of a contract of carriage, one could insure a huge loss in business, or for the price of a chain cable, insure an entire ship.

⁷⁹ 'Where the defendant is under a unilateral or independent obligation to pay a liquidated sum of money, the ordinary measure of damages for non-performance is the sum of money itself with the interest at the legal rate from the time when it was due. In an action by a creditor against his debtor for the non-payment of the debt, no other damages are ever allowed.' Williston, above n 47, v 3 §1410 (footnotes, citing cases, omitted).

⁸⁰ *Ibid.*, §1399, citing *Firrean v Thornhill*, (1776) 2 Wm Bl 1078, and its American progeny.

⁸¹ Williston's first edition, despite his stated desire to assert the unity of contract law, includes a short chapter on the Measure of Damages for Breach of Contract, and a chapter

writer summed up the importance of contract types for understanding damages by noting that general formulas, for instance the statement mandating that the injured party should be placed in the same situation as if the contract had been performed, are too 'vague and general' to guide practice.

In order that rules thus expressed may be useful and available to the practitioner, they must be attentively considered by him in connection with each respectively of the *leading species* of contracts.⁸²

2 Modern Remedies: The Case of Merger Agreements

The modern law of contract remedies has not abandoned contract type analysis wholesale, despite the fact that there is little discussion of types in the literature. In fact, the fields that have spun off from general contract law often engender specialised remedial principles.⁸³ Employment law and the law of construction contracts are often singled out for special treatment, and of course, the law of sales has generated some specialised remedial principles. The attention that these sub-fields of contracts draw to their particular contexts ought to be generalised and applied to additional fields. As an example of the possible payoff of such attention to context, I offer a brief analysis of remedies for the breach of a merger agreement.

Corporate mergers are particularly complex transactions with high stakes and many opportunities for breakdown. Buyers and sellers in the

three times as long on Application of Rules of Damages to Particular Cases, which includes treatment of contracts of employment; sale of goods; warranty of quality and of title; contracts to pay a sum of money in goods; sale of land; covenants in deeds; landlord's right to rent; covenants in leases; negative agreements; alternative contracts; promises to indemnify; contracts to pay money; contracts to lend money, and others. *Ibid.*, §§1358-417.

⁸² On the Measure of Damages Ex Contractu' (1855) 3 *American Law Register* 513, 516 (excepting an article from (1855) 53 *London Law Magazine* 257 (emphasis added)). The article goes on to analyze, among others areas, special rules of damages for: breach of a covenant to repair; hiring and service; contribution; sales, including non-delivery of goods; sale of real estate; and common carriers.

⁸³ See e.g. Summers 'Effective Remedies for Employment Rights: Preliminary Guidelines and Proposals' (1992) 141 *University Pennsylvania Law Review* 457 (arguing that specialised remedial principles must be developed if employment rights are to be effectively guaranteed); W. Kaniat 'Labor and Lemons: Efficient Norms in the Internal Labor Market and the Possible Failures of Individual Contracting' (1996) 144 *University Pennsylvania Law Review* 1953 (arguing for specialized norms for labour contracts); HC Eglit 'Damages Mitigation Doctrine in the Statutory Anti-Discrimination Context: Mitigating its Negative Impact' (2000) 69 *University Cincinnati Law Review* 7 (arguing that mitigation doctrine should be limited in the employment context). But cf. G. Mundlak 'Generic or Sui-generis Law of Employment Contracts?' (2000) 16 *International Journal Comparative Labor Law & Industrial Relations* 309 (arguing that contract law, and in particular the law of relational contracts, can address employment contracts while adhering to its generic premises).

market for corporate control are acutely aware of the fact that an agreement of sale is only the first step on a hazardous journey toward consummation of the deal. Directors will have to bring the proposal before the shareholders and possibly also before regulators, either of whom might reject the deal, and in the meantime, there is a significant likelihood that competing offers will be tendered. Any of these eventualities may signal the breakdown of the original transaction. Thus, the costs that the original acquirer has incurred in identifying the target company, and in legal, accounting, and financing expenses, are in jeopardy, often for significant amounts of time.

In order to protect these reliance investments, acquirers typically bargain for and obtain deal-protective measures in merger agreements. These protective measures come in many forms, ranging from stock or asset lock-ups to simple termination fees or combinations of these and other measures,⁸⁴ but all share two primary goals. The first is to ensure that if the deal is never consummated, the acquirer will receive some compensation for his efforts leading up to the agreement. The second is to make the target less attractive to potential bidders, thus increasing the chances that the deal will in fact be consummated.⁸⁵ Because of the importance of deal

⁸⁴ For a detailed description of available protective provisions, see JC Coates IV & G Subramanian 'A Buy-Side Model of M&A Lockups: Theory and Evidence' (2000) 53 *Stanford Law Review* 307 (2000). Coates and Subramanian describe the background for the increasing prevalence of lockups in the following terms:

M&A transactions involving public company targets face a (law-derived) risk of non-consummation that is unique (or at least rare) in three respects: (1) the law requires that shareholders of the target be given some opportunity to decide for themselves whether to accept or approve the transaction; (2) compliance with disclosure and other rules regulating the process of obtaining shareholder acceptance or approval entail delay, ranging from a minimum of thirty days up to six months in some situations; and (3) shareholders may decide not to accept or approve the transaction for any reason, including a third-party bid that emerges after agreements for the initial transaction are signed. In effect, an M&A agreement gives shareholders of a public company target the option to accept the deal, and does not effectively bind the target (or its shareholders) to the deal. Lockups have emerged as a second-best way for bidders to protect their expectancy interests in the transaction. Even if bidders cannot be sure to consummate a deal for a given target, they can at least get the consolation prize of a lockup payout...

Three types of lockups can be distinguished. Stock lockups give the acquirer a call option on a specified number of shares of the target at a specified strike price. Asset lockups give the acquirer a call option on certain assets of the target at a specified price. Breakup fees give the acquirer a cash payment from the target if a specified event occurs. An acquirer's rights under each type of lockup are 'triggered' by specified events that vary but usually make completion of the original deal unlikely or impossible. More than one type of lockup may be included in a deal, and in mergers both parties may obtain one or more lockups ('cross' lockups).

Ibid., 310-14 (footnotes omitted).

⁸⁵ Deal protective measures always impose a cost on the target if it does not carry out the original transaction. Since the target (or its successful late bidder) must absorb this cost, the protective measure can make the target that much less attractive to other would-be bidders.

protective provisions for shareholders, their potential to distort the market for corporate control, and because of the potential for managerial self-interest, courts have applied enhanced scrutiny in passing on the validity of such provisions.⁸⁶

Initially, scholarly treatment of the issue confined itself to corporate law questions, and in particular, whether directors of a target corporation had violated their fiduciary duties in agreeing to the lockup or breakup fee.⁸⁷ Recently, however, several scholars have focused on the interplay between contract and corporate law in evaluating lockups and breakup fees.⁸⁸ A number of important insights may be gleaned from such an investigation. First, the specialized context of transfer of control transactions may trigger a conflict between traditional concerns of contract law, for instance protecting party expectations, and traditional concerns of corporate law, for instance safeguarding shareholders' interests in the face of managerial discretion. Second, lockups and breakup fees are analogous to stipulated damages for breach of contract, and one way for courts to weigh the validity of such provisions is through a stipulated damages analysis: in other words, if the provision corresponds to a reasonable estimate of actual damages in case of breach, it should be upheld. And for this estimation to be carried out, a method for calculating the damages must be advanced.

Combining these two points generates a particularly interesting setting for thinking about the proper damages for the breach of a merger agreement. Attention to the context of the agreement shows, along the lines of three types of considerations alluded to above, that expectation damages are particularly inappropriate in this setting. Instead, fairness, social utility, and administrative concerns all point in the direction of compensation at a level lower than expectation damages, and close to reliance damages.

(a) *Fairness* — An inquiry into fairness as between parties to a merger agreement must account for both the acquirer's expectations regarding the agreement, and the interests of the target's shareholders, especially in light of the possible divergence between that interest and that of its management. The concern for fairness to the interests of the shareholders

animates the fiduciary principles that courts have traditionally used to limit the effectiveness of merger agreements. The crucial problem in this setting, for the shareholders, is that lockups or breakup fees may have the effect of preventing them from realizing the true value of their shares, by precluding higher bids. If the lockup is not enforced specifically, but the original acquirer is awarded expectation damages, the same injury is inflicted on the shareholders. Thus, the obvious starting point for the inquiry is that fairness to the shareholders requires some reduction of damages, if damages are to be assessed at all. But fiduciary principles and the public policy they represent are only one side of the fairness analysis. The more difficult question is how to fairly compensate the acquirer for his investments in the transaction when the deal breaks down.⁸⁹ Granting expectation damages, as explained above, is too destructive of the protection of shareholders that corporate law demands. But does this mean that no damages should be assessed whatever? Scholars who have treated the question recently repeatedly revert to reliance damages as the proper mediation of interests, and there is some support for the position in the courts as well. Two reasons from the perspective of fairness have been advanced for the proposition: first, the merger agreement is by its nature preliminary, in that both parties know that it is likely to generate additional bids, and that there are many hurdles to overcome before the agreement takes effect. When the parties realize in advance the preliminary and tentative nature of the agreement, only reimbursements of the costs of entering the tentative agreement seem like a fair result.⁹⁰ Secondly, it has been suggested that

reliance may be the best standard from the perspective of compensation — that is, it better approximates the real consequences of breach to an initial bidder than an expectation measure would.⁹¹

(b) *Social Utility* — Analysis of the incentives provided by rules governing damages for breach of contracts has led to a widespread

⁸⁹ This problem is especially salient from a fairness perspective since the original acquirer has often created a market for the target — the initial attempt at a takeover is what initiates an auction situation, and in fact, some targets may even lure a potential acquirer as a 'stalking horse' in order to generate the highest bid possible.

⁹⁰ When courts are faced with a breach of an agreement to negotiate in good faith, or 'an agreement to agree,' they have often to the conclusion that reliance damages are appropriate. See *Venture Assocs Corp v Zenith Data Systems Corp* 96 F 3d 275 (7th Cir 1996). For the argument about why this might be the appropriate rule even from the perspective of the party held liable when it did not agree to a binding agreement, see R. Craswell, 'Offer, Acceptance, and Efficient Reliance' (1996) 48 *Stanford Law Review* 481.

⁹¹ D.A. Skeel Jr, 'A Reliance Damages Approach to Corporate Lockups' (1996) 90 *Northwestern University Law Review* 564, 596. For an extensive, detailed analysis of the fairness of lockups and breakup fees, including an endorsement of reliance damages as the proper tool of analysis when balancing shareholder interests and acquirers' contractual interests, see Regan, above n 88. Regan's treatment of the analogy to fairness arguments in related contexts of excuse, particularly when dealing with agents and trustees, is especially illuminating.

⁸⁶ See eg *Paramount Communications Inc v QVC Network Inc* 637 A 2d 34 (Del 1994), *Mills Acquisition Co v MacMillan Inc* 559 A 2d 1261 (Del 1989), *Kelton Inc v MacAndrews & Forbes Holdings Inc* 506 A 2d 173 (Del 1986).

⁸⁷ See eg I. Ayres, 'Analyzing Stock Lock-Ups: Do Target Treasury Sales Foreclose or Facilitate Takeover Auctions?' (1990) 90 *Columbia Law Review* 882.

⁸⁸ See eg CR Taylor, 'When Good Mergers Go Bad: Controlling Corporate Managers Who Suffer a Change of Heart' (2003) 37 *University of Richmond Law Review* 57; JF Smeaton, 'Mergers, Agreement, Termination Fees, and the Contract-Corporate Tension' (2002) *Columbia Business Law Review* 573; P.J. Regan, 'Great Expectations? A Contract Law Analysis for Preclusive Corporate Lock-Ups' (1999) 21 *Cordozo Law Review* 1; CR Taylor, 'A Delicate Interplay: Resolving the Contract and Corporate Law Tension in Mergers' (1999) 74 *Tulane Law Review* 561.

acceptance of two propositions: first, the rule of expectation damages will normally give promisors optimal incentives in deciding whether to breach; and second, reliance damages are better suited to inducing the optimal level of reliance expenditures by the promisee.⁹² A decision regarding whether to adopt the expectation or reliance measure is then sometimes framed as a question about which incentives are most important to the kind of transaction in question: incentives regarding the breach/performance decision; or incentives regarding the precaution/reliance expenditure decision. While incentives for these two decisions are often considered to be in tension, in the case of merger agreements both sides of the equation point to the efficiency of reliance damages. The promisee (the acquirer) must make significant investments in identifying the target and in legal, accounting and financial fees, all in the context of an agreement that holds a significant likelihood of falling through before consummation. Guaranteeing his profits as if the probability of consummation is one hundred per cent will give him an incentive to over-rely, and will give him a disincentive to continue to search out better opportunities.⁹³ Moreover, if expectation damages are assessed according to the value of a foreclosing lockup, they will actually have the effect of precluding a more efficient transaction.⁹⁴ But what of the promisor's breach or performance decision? Generally, damages set below expectation damages are thought to allow for inefficient breach, because the promisor may elect to breach by engaging in an alternative contract when the promisee's valuation is higher than the price of the alternative. In the merger context however, such a decision is always the opening patty to an auction situation, in which the original acquirer can change his offer, all the way up to his actual valuation. Thus, the 'breach' will take place only if it is efficient, in the sense that the highest value user will win the auction.⁹⁵

⁹² Technically, optimal incentives for reliance expenditures require a damage measure that is invariant with regard to actual reliance. A reliance measure that aspires to efficient incentives to rely would then have to place a limit on reliance, precisely at the optimal level. Coote, above n 32, 14-16. In fact, 'reliance' here functions as a proxy for damages lower than expectation damages. For a classification of remedies more accurate from the economic perspective, see Craswell, *Against Fuller*, above n 33, 157-61. According to that classification, everything I have to say about 'reliance' in the merger context actually refers to 'remedies below expectation'.

⁹³ On the other hand, eliminating all possibility of compensation for reliance losses will discourage the acquirer from undertaking any expenses, and thus foreclose the possibility of efficient transactions.

⁹⁴ [I]f a termination fee is excessively high, it could artificially increase the price of breaching a merger agreement such that a target is no longer able to efficiently breach a merger agreement with one acquirer to pursue a better opportunity with another. Shneerson, above n 88, 580-1.

⁹⁵ David Skeel has argued that reliance is the better measure of damages in the context of lockups, both from the perspective of compensation, and from the perspective of incentives. Regarding incentives, his analysis is worth quotation at length:

The principal advantage of a reliance measure, as compared to expectation, is its effect on promisee (bidder, in the lockup context) incentives. Because it assures a

(c) *Administrative Concerns* — In many contexts, it is believed that expectation damages are easier for a court to determine than reliance damages. In fact, this administrative concern was one of the original reasons suggested by Fuller and Perdue for why courts adopt expectation damages as the normal rule.⁹⁶ However, the relative difficulty of proving expectation and reliance varies across fact situations. In the context of merger agreements, the performance or expectation interest is notoriously difficult to prove, while most elements of reliance are easily documented. This is especially true if reliance in this context is limited to out of pocket expenses, without including opportunity costs.⁹⁷

(d) *Summary* — The foregoing is far from presenting a definitive case for preferring reliance damages to expectation damages for the breach of a merger agreement. But such a definitive case is not necessary for my argument. Instead, it is enough to show that the particular fact situation implicated in merger contracts tends to yield a special balance of the conflicting considerations that should underlie any examination of remedial

bidder the benefit of the agreement at hand, expectation gives the bidder inadequate incentives to mitigate the consequences of breach by continuing to look for other opportunities....

[I]f there is little reason to be concerned about 'excessive' promisor breach in the lockup context. The agreement between an initial bidder and a target is preliminary by its very nature. If a higher valuing bidder emerges, the parties arguably contemplate — and efficient breach theory would encourage — the target's sale to the higher bidder. While a reliance-based measure might appear to give target managers an incentive to shift to another bidder even in circumstances where the new bidder does not value the target more highly, this possibility is far less problematic with respect to corporate control contests than elsewhere. In contrast to other promises, the lockup bidder does not simply disappear if another bidder emerges. The lockup bidder still can attempt to outbid the new bidder, and it is likely to succeed unless the new bidder places a higher value on the target — precisely the context where 'breach' would be appropriate.

Focusing on a bidder's reliance damages thus can be seen as providing appropriate incentives to both the bidder and the target in the lockup context. Not only does the reliance measure give the bidder an incentive to anticipate and mitigate any losses should the deal with the target fall through, but the incentive that reliance gives a target to shift to another, higher valuing bidder, should one emerge, arguably can also be seen as desirable rather than problematic.

Skeel, above n 91, 596-8.

⁹⁶ The difficulties in proving reliance and subjecting it to pecuniary measurement are such that the business man knowing, or sensing, that these obstacles stood in the way of judicial relief would hesitate to rely on a promise in any case where the legal sanction was of significance to him. To encourage reliance we must therefore dispense with its proof. Fuller & Perdue, above n 1, 62.

⁹⁷ Regan, above n 88, 110-19 (arguing for such a limited reliance award to wholly innocent bidders); Shneerson, above n 88, 623-4 (arguing that expectation should never be granted, and that reliance is better from administrative and efficiency perspectives). See also Skeel, above n 91, 596 (suggesting that opportunity costs in the merger context are in any case negligible); but see Coates & Subramanian, above n 84, 332, n77 (commenting on a case in which opportunity costs were taken into account by the court, and asserting that opportunity costs are significant, even if they do not represent alternative takeover opportunities).

rules. Along the three dimensions of justification, fairness as between the parties, social utility, and administrative concerns, there is at least a prima facie case that reliance damages are better suited to the fact situation than expectation damages. The goal of my argument has little to do with merger agreements per se, and much more to do with generalising the insight provided by the exercise. Such a generalisation would encourage us as contracts scholars to search out particular fact situations and engage in the analysis of the justifications for remedies particularly suited to those situations, rather than relying on a unified principle of remedies. If persuasive, the argument should lead to a shift of the research agenda, away from the search for a unified principle to govern all contract remedies, and toward the examination of particular fact situations and contract types as guides to remedial diversity.⁹⁸

V CONCLUSION

The dominant understanding of remedies for breach of contract takes into account the multiplicity of interests that should be protected by remedial rules. In recent years, there has been a proliferation of theoretical models that attempt to give a new foundation to the law of remedies through a single, unified principle. The argument of this chapter has been that such models are unfounded. Unification theories fail to explain the practice of the courts in granting diverse remedies for breach, and more importantly, they fail to account adequately for justificatory considerations that are and ought to be an inherent part of remedial rules. Beyond the critique of unification theories, I have suggested that contract scholars ought to look to contract types as a guide to further theorisation of remedies. The analysis of contract types offers two distinct advantages over unification

⁹⁸For an example of recent work whose methodological starting point is the fact situation rather than the overarching principle at stake, see MP Gergen 'The Law's Response to Exit and Loyalty in Contract Disputes' (chapter 4 in this collection). An analysis of contract types would advance Gergen's arguments, particularly in regard to *Texas Assoc of Counties County Government Risk Mgmt Pool v Matagorda County* 52 SW 3d 128 (Tex 2000), the case with which Prof Gergen's article opens. On general contract principles, this case looks particularly bad — the trial court, and the dissenting opinion (in the Supreme Court), see it as quite an easy quasi-contracts case, in which someone with no obligation pays another party's debt at that party's request, and thus should have restitution. What makes the majority opinion reasonable is the fact that we are in an insurance situation, and the rule advanced by the dissent might place insurers in a position to manipulate insureds, essentially because of cash-flow issues and risk aversion, precisely the reasons they secured insurance in the first place. Put simply, this case looks bad as a piece of *general contract law* (or *general quasi-contract*, or *unjust enrichment law*); however, it begins to look more plausible as a piece of *insurance law*. Grasping for general contract law in this situation is to my mind (and to that of the Texas Supreme Court) too great a sacrifice to the goddess of conceptual neatness, or 'the unity of contract law'.

theory. First, it gives us a better tool for analysing and understanding the varying results of cases involving contract breaches and the remedies they entail. Second, contract types offer a research agenda that would never divorce itself from the underlying considerations that ought to govern the choice of rules governing contract breach: fairness between the parties; social utility; and administrative concerns. The identification and analysis of particular contract types would liberate scholars from the often sterile work of justifying particularised rules as 'exceptions' and encourage a reasoned examination of a variety of rules appropriate to the wide, but far from limitless, variety of contractual contexts.

Comparative Reflections on the French Law of Remedies for Breach of Contract*

YVES-MARIE LAITHIER

IN A TREATISE that remains, a century after its first publication, a standard reference work for French civil lawyers, ¹ Planiol wrote: the debtor must devote to the performance of his contractual obligations, 'the entirety of his work force, at the risk of ruining his health and endangering his life.'² The tone was set. And this was in striking contrast with the opinion defended, at that same time, in the United States by Judge Sloss, in a well-known case which contributed to the recognition of the notion of impracticability:

a thing is impossible in legal contemplation when it is not practicable; and a thing is impracticable when it can only be done at an excessive and unreasonable cost. We do not mean to intimate that the defendants could excuse themselves by showing the existence of conditions which would make the performance of their obligation more expensive than they had anticipated, or which would entail a loss upon them. But, where the difference in cost is so great as here, and has the effect, as found, of making performance impracticable, the [defendant should be excused from performing].³

What is most remarkable is that, at the dawn of the twenty-first century, the gap between these traditionally different legal systems has hardly been bridged. While the concept of impracticability was introduced in the

*The author would like to express sincere thanks to Horatia Muir Watt for her guidance and to Audrey Bengura and Alessandro Nolet for their translation.

¹For an explanation of this phenomenon which is not indifferent to a comparison between French law and the common law, see, P. Jestaz, C. Jamin, *La doctrine*, (Paris, Dalloz, 2003) 150 *et seq.* Planiol's Treaty (first volume) was published in October 1891.

²M. Planiol, G. Ripert, *Traité pratique de droit civil français, Obligations*, (Paris, LGDJ, 1931) n° 382, 582.

³*Mineral Park Land Co v Howard*, (1916) 156, 458, at 460.

Uniform Commercial Code⁴ and the Restatement (Second) of Contracts⁵, one can still read from the pen of French authors that 'even if the debtor must ruin himself in performing his obligation, there is no *force majeure*, so long as performance remains physically possible'.⁶ Money isn't everything! In fact, many decisions have refused to release the debtor from his obligation simply on the ground that his performance had become more onerous following a change in circumstances.⁷ However, case law is not as straightforward as textbooks may suggest. Indeed the courts have not always given in to the will of the parties, who are presumed to have foreseen the future and allocated their risks when entering into a contract. In any event little attention will, here, be drawn to these cases.

This example reveals the strong attachment of French law — and even more of French lawyers — to specific performance of contractual obligations. There are at least two explanations for this.

The first one stems from the very concept of contract. Briefly, under French law, a contract is conceived as an act of free will. Indeed, no one denies that a contract allows an exchange,⁸ but that is merely one of its roles and not its substance. The contract is conceived of as a meeting of the minds, which materialises through an exchange of assents.⁹ Nothing compels the parties to enter into the contract. But from the moment that they have bound themselves, they must loyally perform their obligations. The most elementary liberal philosophy dictates, in effect, that he who has freely committed himself ought to keep his commitments. This philosophy is corroborated by the moral precept demanding that one who makes a promise ought to keep it. Indeed, French law is frequently imbued with morality,¹⁰ and in the French general theory of contracts, the distinction between contractual obligations and promises is never a clear one. As a result of this conception, the court's role cannot be to modify what the parties have willingly agreed to. Its function is to compel them

to perform their obligations, however circumstances may have evolved. For the contract is at the same time an (autonomous) act of free will and of anticipation.¹¹

This brings us to the second explanation, which consists of the function ascribed to the contract. The contract is a bridge towards the future, a means of managing risks, and of exercising control over the facts; security of business transactions and stability are principles that govern the subject. Accordingly, the contract must be immutable. Neither party is allowed to modify the contract unilaterally if that power had not been previously provided for in the agreement itself. Nor is the judge allowed to modify the contract, either by adding obligations or by reviewing the contract in order to restore an economic balance.¹² This would be insulting for the parties' will and, according to some, would be putting at risk the *'force obligatoire'* or enforceable nature of the contract.

This conception of the contract is not a purely theoretical construction. For many, it corresponds to the rule enacted in Article 1134 para 1 of the Civil Code. This fundamental text states that: 'agreements legally formed have the force of law for those who have agreed to them.' The expression, borrowed from Domat,¹³ is the French version of the Latin maxim *pacta sunt servanda*, itself being the translation of a 'principle of natural law'.¹⁴ In reality the meaning of Article 1134 para 1 of the Civil Code is not as rich. As we shall see, this provision merely prescribes the French rule, known as the *'force obligatoire'*, designed to include contracts within the category of positive legal obligations, thus making contracts legally enforceable. This rule simply means that the debtor and the creditor are bound by an obligation that is subject to the sanction of the law.¹⁵ In other words, it is the basis of all remedies for breach of contract, whether they are provided for by legislation, case law or the agreement itself. The list of remedies available to the creditor, as the victim of the other party's failure

⁴ § 2-615 comment 4.

⁵ § 261: Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is discharged, unless the language or the circumstances indicate the contrary. For further information see eg. J M Perillo, *Calamari and Perillo on Contracts*, 5th edn, (St Paul, West, 2003), § 13.9.

⁶ F Terré, P Simler, Y Lequette, *Droit civil. Les obligations*, 8th edn, (Paris, Dalloz, 2002) n° 582.

⁷ See also P Malaurie, L Aynès, P Stoffel-Munck, *Les obligations*, (Defrénois, Paris, 2003), n° 760. ⁸ Soc, 8 mars 1972, p 340; Com, 31 octobre 1978, GP 1979, I, par 38; Soc, 20 février 1996, *Bull V*, n° 59.

⁹ V J Ghestin, 'Le contrat en tant qu'échange économique', *Revue d'économie industrielle* 2000, 81.

¹⁰ In relation to the distinction between will and assent see, M-A Frison-Roche, 'Remarques sur la distinction de la volonté et du consentement en droit des contrats', *Revue trimestrielle de Droit civil* 1995, 573.

¹¹ The standard reference work being G Ripert, *La règle morale dans les obligations civiles*, 4th edn, (Paris, LGD, 1949). The author makes clear in his foreword that it is Christian morality that is here in question.

¹² See generally, H Lécuyer, 'Le contrat, acte de prévision' *L'avenir du droit. Mélanges en hommage à François Terré*, (Paris, Dalloz, PUF, Juris-Classeur, 1999) 643.

¹³ The decision *Canal de Craponne* is the most famous illustration for that purpose, Civ 6 mars 1876, D 1876, I, 193. This decision is generally cited as the symbol of the judge's déférence before the parties. A subtler analysis, inspired by North-American work, would be to maintain that the decision contains a penalty default rule, that is a rule that is deliberately detrimental in order to bring the parties, who are in a better position to determine their interests, to provide for the specific adjustment mechanisms that they find suitable. See for that matter, C Péres-Dourdou, *La règle supplétive*, foreword G Viney, (Paris, LGD, 2004) n° 588.

¹⁴ J Domat, *Les lois civiles dans leur ordre naturel*, (éd Durand, Paris, 1777) Part I, Book I, Title I, Section II, n° VII, 17: 'agreements being formed, all that has been agreed to has the force of law for those who have agreed to it' Domat, who here intends to rationalise Roman law, is the one who, along with Pothier, has provided the greatest inspiration for the drafters of the Civil Code.

¹⁵ A Sénaux, *Droit des obligations*, 2nd edn, (Paris, PUF, coll Droit fondamental, 1998) n° 42.

¹⁶ See text below, at n 48.

¹⁷ See more generally, Y-M Laithier, *Etude comparative des sanctions de l'inexécution du contrat*, foreword H Muir Watt, (Paris, LGD, 2004).

to perform, is well established. On the other hand, the way in which French authors still present and understand this list is extremely heterogeneous. This is why some have suggested that the study of English law in particular, and the common law in general, would be very instructive.

In an influential article published in 1994, the French comparatist Denis Tallon sharply criticised the way in which French scholars categorise remedies for breach of contract, and in particular for failing to provide this field with the consistency which it had not been given by the Civil Code.¹⁷ Professor Tallon deplores the fragmented presentation of remedies, which results in practical inconvenience for the creditor — who must 'explore the four corners of textbooks to discover the various options that the law provides him with'¹⁸ — and which hinders the growth of a general theory of breach of contract.¹⁹ Moreover, the author stresses the inappropriateness of the treatment given to bilateral contracts, dealt with separately as if they were less common; the conceptualisation of damages as a form of liability and erroneously paralleled with tortious liability; and the lack of detailed analysis relating to the compatibility or incompatibility of the various remedies as between one another. After observing that English law was established through *remedies*,²⁰ Professor Tallon suggests that it could provide valuable inspiration in reorganising and clarifying the state of French law, in order to set up a complete and consistent system, shedding light on the remedies available to the creditor, the defences open to the debtor, and the powers of the court.

This article had the great merit of provoking much thought in France about a subject that is ultimately concerned with the practical aspects of contract. This indeed was what the author wished²¹ and, in that sense, his objective has been fulfilled. The grounds for his position are nevertheless debatable. Admittedly, the often-used notion of *remedy* is seldom rigorously analysed by common lawyers.²² Neither the typology of remedies,²³ nor the meaning of the notion, have been perfectly determined. Save for its medical meaning, similar in both the English and French languages,²⁴ which suggests that the word refers to something

other than punishment, we could enumerate, more or less accurately, no less than five possible legal meanings, which tend to overlap with closely related notions, including (but not limited to) actionable 'rights'.²⁵ Besides, the confusion is such that Professor Birks has expressed the wish to see this expression disappear from English legal vocabulary.²⁶ Furthermore, the fragmentation of the formal presentation of remedies is no less within the common law than it is in France. Thus some time ago Sir Guenter Treitel observed:

One of the most perplexing problems in the English law of contract concerns the remedies which one contracting party has in the event of the other's failure to perform in accordance with the contract. One reason for the difficulty is that discussions of this problem are often widely scattered in the books, with the result that very different solutions are proposed for problems which appear to be basically similar.²⁷

For example, the chapters dealing with remedies do not mention rescission of contract nor clauses limiting or excluding liability; equitable remedies (among which is specific performance) are only dealt with briefly in contract law textbooks and a serious review requires one to turn to specialised material, either completely devoted to remedies, or to Equity. This scattering occurs within every area of the law of obligations. Hence, for want of establishing a connection between contract law and tort law, the breach of a contractual obligation by the debtor with the help of a third party requires that one examine a contract law textbook in order to determine the remedies which may be available against the former, and a tort law textbook in order to determine the remedies which may be available against the latter. Similarly, the implementation of the rules preventing the defaulting debtor's unjust enrichment are to be found within the law of restitution, which again, is treated as an entirely separate subject within the common law.

The above does not of course deprive the proposed comparative exercise of its use. Yet, the comparative study of French, English and American law has more to offer than a new taxonomy of remedies for breach of contract. A first approach would consist in pointing out the similarities (for example, the use and usefulness of clauses limiting liability, the significance of actions for an agreed sum etc) and the differences (for example, the existence of a daily fine for delay in the performance of a contract [*astreinte*] under French law, mitigation of damages and restitutionary damages in English and American law). This first stage of the analysis is both indispensable and fertile. Yet, one can go beyond it in

¹⁷ D Tallon, 'L'exécution du contrat: pour une autre présentation', *Revue trimestrielle de Droit civil* 1994, 223.

¹⁸ D Tallon, *ibid.*

¹⁹ In relation to French authors' persistent trend to establish 'general theories' see P Jestaz, C Jamin, *La doctrine*, n 1 above, 150 *et seq*, 230 *et seq*.

²⁰ D Tallon, n 17 above, 223 *et seq*. ('...') it is the common law system that could help us. For some, it might seem unexpected, the common law not being, in essence, famous for its logical constructs. And yet, it is in England that contract law was established, on the basis of the remedies available to the contracting party who is the victim of the breach: *remedies precede rights*. Thus, it provides a global understanding of what the creditor may do when there is breach of contract.

²¹ D Tallon, n 17 above, 237.

²² P Birks (ed), *English Private Law* (Oxford, OUP, 2000) § 18.01.

²³ S M Waddams, 'Remedies as a Legal Subject' (1983) 3 *Oxford Journal of Legal Studies* 113.

²⁴ The word, of Latin origin, is composed of the prefix *re* and the verb *mederi* (to attend, treat).

²⁵ P Birks, 'Rights, Wrongs, and Remedies' (2000) 20 *Oxford Journal of Legal Studies* 1 at 9 *et seq*.

²⁶ P Birks, *ibid.* 3, 19 *et seq*.

²⁷ G H Treitel, 'Some Problems of Breach of Contract' (1967) 30 *Modern Law Review* 139.

questioning what, in substance, distinguishes these two major legal traditions given that, in our view, the function of comparative law is to complete the understanding of law.²⁸ The aim of this analysis is to discover, sometimes hidden,²⁹ similarities, and bring to light true differences; these differences must be considered for what they are and not as legitimate or illegitimate barriers to the harmonisation or unification of the law.³⁰ What, therefore, should be the chief lesson to be drawn from the comparative study of remedies for breach of contract? The answer is twofold. On the one hand, the understanding of the enforceable nature of contracts is not identical under French, English and American law, knowing, however, that the meaning given to it by most French lawyers is inaccurate. On the other hand, English and American law grant economic considerations far greater importance than does French law. Both aspects are interconnected: the French understanding of enforceability explains its relative, but certain, disregard of the economic efficiency of remedies for breach of contract.³¹ We shall try to illustrate this by showing in the next part of this chapter (Part I) the way in which French law favours specific performance of contractual obligations and, even more importantly, in Part II, by demonstrating the commitment of French law to the continuation of the contract despite the breach.

I A LAW FAVOURABLE TO SPECIFIC PERFORMANCE OF CONTRACTUAL OBLIGATIONS

If French law favours specific performance, it is not in the name of the supposedly underlying economic efficiency of this remedy. The rationale claimed for it is that of enforceability. The following criticism of this rationale (in Part A) will naturally bring us to question the primary attributed to that remedy (in Part B).

A The Alleged Rationale for Specific Performance's Primacy Under French Law

The role attributed to specific performance in France is, above all, the expression of an ideal. For many years, specific performance had been

²⁸ R. Sacco, *La comparaison juridique au service de la connaissance du droit*, (Paris, Economica 1991), 8 et seq.

²⁹ R. Sacco 'Droit commun de l'Europe, et composantes du droit' in M. Cappelletti (dir), *New Perspectives for a Common Law of Europe — Nouvelles perspectives d'un droit commun de l'Europe*, foreword Kolman, (Leyden, Boson Synhoff, 1985), 95, at 105.

³⁰ See P. Legrand, *Le droit comparé*, (Paris, PUF, 1999), 37.

³¹ This thesis is the one developed in Y.-M. Laithier, *Étude comparative des sanctions de l'inexécution du contrat*, n 16 above.

considered for what it is, namely, a means among others to grant the creditor, who is the victim of a breach of contract, satisfaction in the form of the expected benefit, available when an award of damages only seemed unfair. However, a radical change of view occurred around the second half of the nineteenth Century. Specific performance ceased to be a means and became an end in itself. Appealing to reason, it seems correct to state that it is in the very nature of contractual obligations to be specifically performed, this being the only remedy capable of 'fulfilling' both the subjective rights of the creditor and the objective rights created by the contract. It follows that acceptance of the proposition that the debtor may legally be released by paying damages instead of providing the promised performance would amount to allowing him unilaterally to alter the content of the obligation, to transforming any contractual obligation into an alternative obligation and, finally, to denying the very existence of a civil obligation. The pecuniary remedy is therefore not only unfair, but above all 'illogical'.³² Under this approach, performance of the contract can only mean specific performance. Considered as an ideal remedy, justified by the power of each individual to bind himself voluntarily under the contract, specific performance thus bears no limits. If its scope is still in fact limited in certain instances, the reasons lie in the means available to implement that remedy — that is, the fact that measures of enforcement may only affect the debtor's property and not his person. Consequently, nothing prevents the judge from ordering that the debtor of a 'personal' obligation perform what he had promised. Believing the opposite would be to confuse the end with the means; it would also tarnish the idyllic image of the contract's enforceability.

This is no doubt the critical point but lawyers could not content themselves with expressing an ideal. To use Gény's words, they had to 'build' a form of reasoning capable of justifying the solution sought. This reasoning rests on Article 1134 para 1 of the Civil Code. Since Demolombe the relationship between specific performance and enforceability has been explicitly established.

(...) the fundamental principle for the matter is that, agreements legally formed have the force of law for those who have agreed to them (Article 1134); and it is, consequently, the right of the creditor to require, against the debtor, the actual performance of the obligation that he has contracted.³³

The twentieth century has therefore been, with respect to French general contract law theory, that of specific performance. Legal scholars, as a whole, have acknowledged and confirmed the primacy of this remedy, which is

³² C. Demolombe, *Traité des contrats ou des obligations conventionnelles en général*, vol 24, 2nd edn, (Paris, Durand et Hachette, 1870) n° 488, 486.

³³ C. Demolombe, *ibid.*

perceived as the necessary extension of the principle of enforceability. The existence of a right to specific performance is initially affirmed through the courts, before asserting that in the case of a breach of contract any judicial action would, as a matter of principle, have no other purpose than the implementation of this right. Article 1134 para 1 of the Civil Code is then put forward as a reference, considered both satisfactory and sufficient.³⁴ Even then, no further explanation or discussion is provided, since all this seems so obvious.³⁵ The reasoning draws its strength from its apparent simplicity, which is supposed to make any additional explanation superfluous. Is it not 'obvious' that keeping one's word commands, in principle, specific performance of one's commitments? It is, however, unfortunate that this same obviousness could let us forget that general contract law did not contain any explicit provision raising specific performance to the rank of a principal remedy.

In these circumstances, could the 'legal doctrine' have relied on the leading cases and decisions of the *Cour de cassation*? Of course, examples of specific enforcement in casebooks are numerous. Thus one can find orders to: ensure the right of possession of rented property;³⁶ re-do construction work;³⁷ enter into a legal transaction;³⁸ close down a business;³⁹ return the promised subject-matter;⁴⁰ re-instate a lessee⁴¹ or an employee;⁴²

demolish work;⁴³ overhauled a place;⁴⁴ transfer shares;⁴⁵ end an activity;⁴⁶ and deliver the subject-matter⁴⁷ etc. However, the *Cour de cassation* has never entirely backed up the academic reasoning, according to which Article 1134 para 1 of the French Civil Code commands specific performance. More generally, the *Cour de cassation* refuses to state that specific performance is, as a matter of principle, available to a creditor who is the victim of a breach of contract. This is why it approved the decision of a court of appeal which refused to order the demolition of buildings constructed in breach of contract, on the ground that 'it rests with the judge to decide whether the works built in breach of a contract, must or must not be destroyed'. Yet the claim relied solely on Article 1134 of the Civil Code, maintaining that this provision precluded the judge from deciding in equity and that, in rejecting the demolition claim, the appeal court judges had changed the content of the contract and were thus exposed to the censure of the *Cour de cassation*.⁴⁸ That is to say that this well known 'principle' of French law, that is meant to distinguish it from the common law, is, in practice, only didactic, conjured up by academics in order to categorise and influence case law, and is in no way normative. The principle of specific performance, and in particular its primacy, therefore has a purely academic existence. It was created and shaped with the aim to preserve a certain understanding of the enforceability of contracts and, if need be, to strengthen the principle of party autonomy. This justification was supported by the majority of academics. After all, no-one would claim to be 'against' the principle of the *force obligatoire* or the enforceability of contracts. Yet the reasoning is none the less fragile.

The fundamental mistake of French theory in this area lies in confusing a rule with one of its possible remedies. Article 1134 para 1 of the Civil Code enacts the concept of *force obligatoire* or 'enforceability' of the contract. It means that the connection established between the debtor and the creditor is legally enforceable. The debtor who does not abide by his contractual obligations is subject to a sanction, in the same way as any other person who does not respect the law. Because his conduct does

³⁴ Amongst past authors, see, for example, A Colin, H Capitant, *Cours élémentaire de droit civil français*, t. 2, 7th edn, (Paris, Dalloz, 1932) n° 67, 65; L Josseland, *Cours de droit civil positif français*, t. II, *Théorie générale des obligations*, 3rd edn, (Paris, Sirey, 1939) n° 590, 370; M Plantol, G Ripert, *Traité pratique de droit civil français*, op cit, n° 776, 74; amongst contemporary authors, see J Flour, J-L Aubert, Y Flour, E Savaux, *Le rapport d'obligation*, 3rd edn, (Paris, A Colin, 2004) n° 160, 163 in fine; A Sériaux, *Droit des obligations*, op cit, n° 62; F Terré, P Simler, Y Lequette, *Les obligations*, op cit, n° 1110, 1113; G Viney, P Jourdan, *Traité de droit civil* (dir J Ghestin), *Les effets de la responsabilité*, 2nd edn, (Paris, LGD), 2001 n° 19, 43. Contra F Bellivier, R Setton-Green, 'Force obligatoire et exécution en nature du contrat en droits français et anglais: bonnes et mauvaises surprises du comparatisme', *Études offertes à Jacques Ghestin, Le contrat au début du XX^e siècle*, (Paris, LGD), 2001) 91.

³⁵ The allusion is made just as quickly in doctoral theses, see V Loris-Apokouastios, *La primauté contemporaine du droit à l'exécution en nature*, foreword J Mestère, Aix-en-Provence, PUAM, 2003, n° 2, 17, n° 9, 24; M-E Roujou de Boubée, *Essai sur la notion de réparation*, foreword P Hébraud, (Paris, LGD), 1974) 159; P Wéry, *L'exécution forcée en nature des obligations contractuelles non pécuniaires (essai)*, Une réécriture des articles 1142 à 1144 du Code civil, foreword I Moreau-Margryve, (Lège, Kluwer, 1993) n° 71, 93, 150, 206.

³⁶ Com, 23 mai 1964, *Bull III*, n° 260.

³⁷ Civ 1^{re}, 18 janvier 1956, *Bull I*, n° 34; Civ 1^{re}, 5 juillet 1956, *D* 1956, 719; Civ 1^{re}, 14 janvier 1959, *Bull I*, n° 26; Civ 1^{re}, 18 octobre 1965, *Bull I*, n° 546; Civ 3^e, 10 janvier 1990, *Bull III*, n° 6.

³⁸ Com, 31 mars 1952, *Bull*, n° 153.

³⁹ Req, 24 février 1862, *S* 1862, 241 (in an obiter dictum); Req, 7 juillet 1898, *S* 1898, I, 520; Soc, 22 janvier 1979, *Bull V*, n° 67; *adde*, M Plantol, note under Paris, 14 janvier 1889, *D* 1890, II, 289.

⁴⁰ Civ 1^{re}, 20 janvier 1953, *D* 1953 222.

⁴¹ Soc, 8 juin 1956, *Bull IV*, n° 535.

⁴² Soc, 14 juin 1972, *JCP* 1972, II, 17275, note G Lyon-Caen. (The solution is now enacted.)

⁴³ Civ 1^{re}, 13 mars 1963, *D* 1963, somm, p 79; Civ 3^e, 5 février 1974, *Bull III*, n° 56; Civ 3^e, 15 février 1978, *D* 1978, IR, p 414; Civ 3^e, 23 mai 1978, *Bull III*, n° 213; Civ 3^e, 18 février 1981, *Bull III*, n° 38; Civ 3^e, 19 mai 1981, *Bull III*, n° 101; Civ 3^e, 13 octobre 1981, *Bull III*, n° 152; Civ 3^e, 26 novembre 1986, *RD imm* 1987, p 236; Civ 3^e, 27 mars 1991, *Bull III*, n° 106; Civ 3^e, 30 juin 1993, *Bull III*, n° 105.

⁴⁴ Civ 1^{re}, 14 octobre 1964, *D* 1964, p 710; Civ 1^{re}, 26 juin 1967, *D* 1967, p 673; Civ 3^e, 9 décembre 1970, *Bull III*, n° 683; Civ 3^e, 18 novembre 1980, *Bull III*, n° 177; Civ 3^e, 25 janvier 1995, *Bull III*, n° 29; Civ 3^e, 3 avril 1996, *Bull III*, n° 91.

⁴⁵ Civ 3^e, 19 février 1970, *CP* 1970, I, p 282.

⁴⁶ Com, 23 avril 1985, *Bull IV*, n° 123.

⁴⁷ Colmar, 18 octobre 1972, *D* 1973, p 496, note M Cabrillac, A Sebte.

⁴⁸ Req, 18 juin 1883, *D* 1884, V, p 353.

not comply with the norm, the debtor in breach of contract shall be liable to accept the consequences of the infringement.⁴⁹ This is where confusion usually arises, since the rule starts to blend with the remedy. Since contracts are meant to be performed, specific performance is naturally considered to be the primary remedy, which is no longer distinguished from Article 1134 para 1 of the Civil Code. The distinction between the two dimensions fades away as they blend artificially into a single one. Thus, the obligation to perform and the remedy of specific performance appear to follow from the same rule: Article 1134 para 1 of the Civil Code. This confusion is unfortunate. Even if the sanction is inseparable from the legal rule, one cannot deny that it exists in its own right. This is true both as a matter of logic and as a matter of law. The existence of a rule (for example, Article 1134 of the Civil Code) is not dependant upon the efficiency or inefficiency, the perfection or imperfection, the strictness or mildness, or the effectiveness or ineffectiveness of the remedy. Everyone agrees that the nature of a rule does not change according to whether it is complied with or not. How then can one coherently maintain that any remedy which is not specific performance is a failure to recognise Article 1134 para 1 of the Civil Code? Let us stress again that this provision states that the contracting parties are bound under the sanction of the law. This means that, when a breach of contract occurs, a remedy is provided. Yet, the applicable remedy is determined by a separate rule, for example, under general principles of contract law, and concerning specific performance, by Article 1184 para 2 of the Civil Code. One cannot infer from the rule which lays down the enforceability of contract (Article 1134 para 1 of the Civil Code), the kind of remedy applicable when the contract is broken. In other words, to state that non-performance of a contractual obligation is the subject of a legal sanction, is not to suggest that it must always, nor even in principle, be specifically enforced. A statement to the contrary is theoretically incorrect. Let us add that the study of the common law shows that this theoretical distinction is perfectly feasible. English law provides for the enforceability of a contract in a way similar to French law, and specific performance is (rightly) analysed as one of the possible remedies for non-performance; its domain varies according to a multiplicity of considerations, which however, do not include the enforceability of contracts for the reasons enunciated above. This conclusion, however, does not mean that the domain of specific performance is identical in these two legal systems.

⁴⁹ These are defined by Virally, as 'any harm affecting the legal status of an individual, either by creating new obligations or by forfeiture, as a consequence of the infringement of an obligation'; M Virally, *La pensée juridique*, Paris, [LGDJ], Montchrestien, 1960], ed Panthéon-Assas, (LGDJ), 1998) 71.

B The Reach of Specific Performance's Admitted Primacy Under French Law

The scope of specific performance is certainly greater under French law than it is under English or American law. The barrier which Article 1142 of the Civil Code might have raised to specific performance has been circumvented. This text provides that 'every obligation to do or not to do resolves itself into damages in case of non-performance by the debtor.' It seems at first sight to echo Holmes' famous words about liability in contract. In practice, the debtor would have a choice between performing his obligations and offering compensation to the creditor for the damage resulting from the breach.⁵⁰ This result appeared unacceptable or at least unfortunate. The nature of the contractual obligation would be modified and the notion of contract altered. If, as we say, the contract truly binds the debtor to the promised performance, then an obligation to do, or to refrain from doing, something, should not become, through its remedy, an alternative or optional obligation. The contract would be 'distorted'. As a result, after denouncing the legislator's uneasy drafting, scholars have, since the 19th century, undertaken to rectify the meaning of Article 1142 of the Civil Code and to restore it to the rank of an exception to the rule. The 'real' reading would be that the creditor must always be able to claim specific performance. Article 1142 would from now on be read as applying exclusively to 'personal' obligations to do something, defined as those which involve the 'inmost depths of one's personality'.⁵¹

Nevertheless, case law is simply not as plain. For example, a petition before the *Cour de cassation*, claiming that a court of appeal had not properly taken into account the creditor's right to demolition and the closing down of a business opened in breach of contract by providing only pecuniary compensation, has been dismissed on the ground that 'the judges of first instance examining the factual situation, have full authority to determine whether specific performance may be granted to the creditor under Article 1143.'⁵² A similarly enlightened decision was rendered with respect to a breach of a contract for construction work, in which the *Cour*

⁵⁰ Compare G Rouhette, *Encyclopædia Universalis*, V° Contrat, (Paris, 1995), 469 at 472: '(...) more profoundly, the two legal families [civil law systems and the common law] converge on this issue: in case of non-performance imputable to the debtor, the appropriate remedy in principle consists in a corresponding compensation, in an allowance of damages that releases the defaulting debtor. So much, that one could affirm without exaggerating that any contractual obligation is alternative in nature: the debtor has a choice between performing on the one hand, and compensating his failure by paying a sum of money, on the other hand. There is a clear contrast between these individualistic and lucrative views and a social perspective according to which the strength of the contractual bond depends on the interest it represents for the community.'

⁵¹ A Sériaux, *Droit des obligations*, n 14 above, n° 62.

⁵² Civ 1^{re}, 24 mai 1960, *Bull. I*, n° 283.

de cassation approved the court of appeal's refusal to grant specific performance and to award only damages instead. The Court stated that in finding

that the defects were not significant, and that it could not be envisaged to carry out a rebuilding of these works because of the great disturbance it would cause in the premises, [the court of appeal] has, regarding the obligation to do something, justly determined that the building contractor could avoid specific performance, consistently with Article 1142 of the Civil Code, and substitute a pecuniary compensation for the specific performance.⁵³

It is wrong to assert that specific performance is, 'in principle', the primary remedy only because it is feasible and requested by the victim. French case law is far less straightforward than this. To sum up therefore, if the scope of specific performance is more extensive in France than it is in common law systems, this is not as a result of the alleged normative principle.

If the scope of specific performance is greater, this results *inter alia*⁵⁴ from the fact that under French law an order for specific performance is not ruled out on the sole ground that damages would be an appropriate remedy. Leaving aside the historical reasons (the separation of the courts of Common law and Equity), the basis for this difference lies in the extent of the duty to mitigate damages and therewith, more fundamentally, in the importance granted to economic considerations in the implementation of remedies for breach of contract. According to English or American law, when the good or service which is the object of the contractual obligation is available and reasonably accessible on the market, the creditor, who is the victim of the breach of contract, has the ability, in practice, and usually the legal duty to obtain substitute for performance. Traditionally, common law courts consider that, in this case, damages constitute an 'appropriate remedy', since the creditor finally obtains, as rapidly as possible, that which he had originally contracted for, plus, as the case may be, the pecuniary compensation for any resulting loss. The natural result of this approach is that, the courts reject, on the same ground (the appropriateness of damages) any claim for specific performance. Deciding otherwise would amount to an exemption for the creditor from his duty to mitigate,⁵⁵ and at the same time, significantly undermine the practical reach of the doctrine of mitigation.⁵⁶ So for example, the claim of an

advertiser requiring the court to, firstly, order the editor of a woman's magazine to reproduce an advertisement on the back cover, and secondly, to forbid publication of any other announcement in the same space, must naturally be rejected when the advertiser, who is under a duty to mitigate loss, does not demonstrate either that this magazine is unique due to its readership, or that there would be no other advertisement space available.⁵⁷ The scope of specific performance is further limited by the strict approach that is sometimes taken by the courts in determining what can reasonably be expected of the victim of a breach of contract. At times the court will reject the creditor's argument that, at the time of the breach, there were no similar or appropriate goods on the market,⁵⁸ while in other cases the court will reject the argument that the replacement, if ever possible, was unreasonably expensive, justifying such strictness on the ground that damages would compensate the loss sustained by the creditor for any expenditure of additional money.⁵⁹

Conversely, there are some situations where the replacement is impossible or so difficult that it is not conceivable. The creditor is then exempted from the duty to reduce the loss suffered. Damages would then constitute an appropriate remedy and specific performance would then be ordered.⁶⁰ This will be the case if all the other conditions for specific performance are satisfied, since we do not contend that the scope of mitigation of loss strictly overlaps that of specific performance. The overlap is only partial. If specific performance is dismissed when the duty to mitigate loss exists, the reverse is not true: notwithstanding the absence of such a duty, specific performance may be dismissed for other reasons, for example, on grounds relating to the blameworthy behaviour of the creditor or because of the disproportionate cost of the remedy.

The difference with French law is striking. Indeed, according to the Civil Code, replacement is only an optional possibility that the creditor must, in principle, request before the court. At present, no French judge would claim to have the power, even with the aid of Article 1134 para 3 of the Civil Code (requiring performance in good faith), to dismiss a claim for specific performance on the sole ground that the creditor had the possibility, and therefore, the duty to find a replacement for himself; or, following the technique used by English and American judges, on the sole ground that damages constitute an appropriate and sufficient remedy. Introducing a general duty to mitigate damages in contract law would

⁵³ Civ 3^e, 24 juin 1971, *Bull. III*, n° 411.

⁵⁴ For a more detailed comparison see, Y-M Lathier, *Etude comparative des sanctions de l'inexécution du contrat*, n° 16 above, n° 280 *et seq.*

⁵⁵ See also, D Harris, D Campbell, R Halson, *Remedies in Contract & Tort*, 2nd edn, (London, Butterworths, 2002) 168. But contrast L Smith, chapter 10 below.

⁵⁶ See especially, G H Treitel, *The Law of Contract*, 11th edn, (London, Sweet & Maxwell, 2003) 1020.

⁵⁷ *American Brands, Inc v Playtex, Inc*, 498 F.2d 947 at 950.

⁵⁸ *Klein v PepsiCo, Inc*, 845 P.2d 76 at 80.

⁵⁹ *Drouil & Company v Malcom*, 214 SE 2d 356, at 359.

⁶⁰ See eg, *Restatement (Second) of Contracts* § 360: 'In determining whether the remedy in damages would be adequate, the following circumstances are significant: (b) the difficulty of procuring a suitable substitute performance by means of money awarded as damages (...)', and comment c. In English law, G H Treitel, *The Law of Contract*, n° 56 above.

lead to the reverse solution. The court could order specific performance against the debtor, only after having checked that the creditor had, at the date of the breach, no reasonable means to find a replacement for himself; if the replacement was not reasonably feasible, he would at best be awarded damages, thus ensuring that he does not use specific performance as a means to avoid his duty. Legally, the change would be remarkable since it would consist in adding another condition to access this remedy as well as in restricting its scope. All other obstacles are a matter of legal policy, and in particular they touch on the question of the room to be allocated to arguments of economic efficiency within the area of remedies for breach of contract. The answer depends, in part, on the practical consequences of each alternative. From this standpoint, it is not absolutely certain that the results reached by common law courts are manifestly fairer than the mechanism provided by Article 1144 of the Civil Code, pertaining to preliminary judicial authorisation.⁶¹

The French understanding of enforceability does not only explain the favoured position of specific performance. If one considers that the rule prescribed in Article 1134 para 1 of the Civil Code means that the contract must be performed, then it is also opposed to the termination of the contract. Under such an approach, as a matter of logic and of law, the contract must be upheld, even in cases of non-performance.

II A LAW FAVOURABLE TO THE UPHOLDING OF THE CONTRACT

French law is attached to the 'protection of the contract'. Its performance is 'its fate'; it must be accomplished.⁶² A series of provisions aim at preserving the contract in spite of the debtor's faulty or accidental failure to perform. This policy becomes apparent through the omnipresence,⁶³ indeed the omnipotence⁶⁴ of the court, which presides over the destiny of the contractual bond.

A The Court's Omnipresence

The omnipresence of the judge is the direct result, on one hand, of the general rule enacted in the Civil Code and, on the other hand, of the relative weakness of the exceptions to that rule. Under French law, in order to terminate a contract a party is generally required to bring an action before

⁶¹ As amended by the 9 July 1991 Act, and made more flexible by case law

⁶² C. Demolombe, *Traité des contrats*, op cit, n° 490, 471.

⁶³ See Part A below.

⁶⁴ See Part B below.

the court for that purpose. The creditor cannot, however, severe the breach, unilaterally declare that the contract is terminated by addressing a notice to the other contracting party to that effect. Only the judge has the power to terminate the contract. An action in court is thus indispensable. This process results from Article 1184 of the Civil Code. This text does not provide for any exception, to the point that its almost obsessive repetition of the judicial nature of the termination has been pointed out and denounced by numerous academics.⁶⁵

Through this Article, the drafters of the Civil Code wished to pay tribute to the principle of the enforceability of contracts, by giving preference to the specific performance of contracts over termination.⁶⁶ In practice, many legal scholars argue that, since specific performance affects the strength of enforceability, the circumstances for terminating contracts must be reduced. Termination must be judicial so that, once bound, the parties may not set themselves free from the obligations that the contract prescribes. Under the cover of neutrality, it is clear that termination is seen as remedy of last resort. Through its intervention, the court favours performance; it tries, in a word, to save the contract.⁶⁷

However, the theoretical explanation of Article 1184 of the Civil Code is hardly convincing. The reasoning can be split up into the following syllogism: enforceability requires spontaneous or forced performance; termination is opposed to performance; therefore, termination goes against enforceability. Nevertheless this premise is clearly wrong. As mentioned above,⁶⁸ enforceability must not be confused with the remedies for breach of contract. The reverse position is the result of the willingness — concealed behind the use of Article 1134 of the Civil Code — to extend the scope of specific performance as far as possible. In reality, there is no conflict between the principle of enforceability of contracts and termination of the contract. The interaction between Articles 1134 and 1184 is perfectly harmonious. The former allows legally formed agreements to penetrate the sphere of the law; the contract thus becomes legally enforceable. The latter states two of its remedies: specific performance and termination. But Article 1134 is not concerned with determining the scope of either of these remedies.

If the strength of the enforceability principle can be questioned, it is not possible, on the other hand, to deny the importance of the rule set out in

⁶⁵ D. Tallon, 'L'article 1184 du Code civil. Un texte à rénover?', in *Université Panthéon-Assas, Clés pour le siècle* (Paris, Dalloz, 2000) 253 at 258.

⁶⁶ See eg J. Ghestin, C. Jamin, M. Billiau, *Traité de droit civil* (dir. J. Ghestin), *Les effets du contrat*, 3rd edn, (Paris, LGD), 2001) n° 429; C. Jamin, 'Les conditions de la résolution du contrat : vers un modèle unique?' in M. Fontaine, G. Viney (dir.), *Les sanctions de l'inexécution des obligations contractuelles. Études de droit comparé*, (Bruxelles, Paris, Bruylant, LGD), 2001) n° 1, 451 et seq.

⁶⁷ G. Ripert, *La règle morale dans les obligations civiles*, n° 10 above, n° 76.

⁶⁸ See above, n° 49.

Article 1184 of the Civil Code. The *Cour de cassation* has ruled on several instances that the mere failure to bring a claim before the court constitutes *in se* and *per se* fault on the part of the creditor.⁶⁹ The contrast with American and English law is indisputable. It must, however, be put into perspective, because the procedure under Article 1184 is not considered mandatory.

There are, under French law, two ways to escape the judicial nature of the termination of contracts. The first, and most traditional, consists of agreeing on a termination clause. The validity of such clauses has been acknowledged by the *Cour de cassation* since 1860.⁷⁰ Through such a clause the creditor may unilaterally put an end to the contract in case of non-performance. Indeed, the judge will intervene if a dispute arises, but his power is then limited: while under Article 1184 of the Civil Code, it is the judge who actually pronounces the termination of the contract, here, all he can do is take notice of it.⁷¹ This withdrawal of the judge allows the creditor to be released immediately, so that he may create new bonds with third parties and potentially limit his loss. In addition to improving foreseeability, the termination clause allows the creditor to put an end to the contract for the non-performance of any obligation and not merely for certain severe breaches. In other words, the termination clause is not only a means to overcome the judicial nature of termination in French law; it is also a means to extend the scope of termination, which explains why such clauses are present in countries where termination is a unilateral remedy.⁷² These benefits, which greatly outweigh those provided by the procedure under Article 1184 of the Civil Code, explain how (or why) the termination clause gradually became a standard clause.⁷³

The second way to overcome the rule in Article 1184 is a more recent practice and follows directly from a number of decisions of the first civil division of the *Cour de cassation*.⁷⁴ As Professor Sacco has justly noted, 'the

necessity to address a judge is not considered, in France and in Italy, as the application of logic and indisputable principle, and as such, is not fully exercised'.⁷⁵ The creditor may immediately terminate the contract when the conduct of the debtor has become so bad that the continuation of the contractual relationship has become impossible or unbearable. Many decisions have been justified by a state of 'emergency'. This notion was supposed to justify the unilateral termination of the contract and overcome the excessively laborious mechanism contained in Article 1184 of the Civil Code. Nevertheless, a unilateral termination of the contract was justified only if immediately declared. At present, the *Cour de cassation* has dissociated the issues of timing and substance, in order to allow the unilateral termination of a contract in circumstances where neither emergency nor necessity are sufficiently present. Thus in a well-known decision, the *Cour de cassation* dismissed the claim brought by an anaesthetist against the clinic which employed him, which had unilaterally brought an end to his contract of employment with a six month notice period, as a result of the accumulation of 'faults' during fifteen years of practice. The doctor's conduct included consultations outside of the clinic, refusal to practice certain operations which were within his qualifications, lack of availability liable to result in serious consequences for the patients' health, exasperation and brutal treatment of certain patients. The court of appeal was criticised for having, *inter alia*, considered this termination as contrary to Article 1184 of the Civil Code. The *Cour de cassation* stated that 'the seriousness of a contracting party's behaviour may justify the unilateral termination of the agreement by other party, at its own risk and peril, and this seriousness (...) is not necessarily dependant upon there being a sufficient notice period'.⁷⁶ This ruling has recently been reaffirmed by the same division of the *Cour de cassation*.⁷⁷

These two methods of circumventing Article 1184 do not entirely remove the judge's role in the procedure leading to the termination of a contract. Indeed, a line of strict case law requires absolute compliance with both formal and substantive legal conditions in order for termination clauses to be valid, in the absence of which judicial termination under Article 1184 regains control. Moreover, the scope of these clauses is subject to a restrictive reading by the court. The *Cour de cassation* requires that the termination clause be applied only to obligations that have been expressly listed within it, and denies lower courts the power to

⁶⁹ See eg. Com. 25 mars 1991, CCC 1991, n° 162, note: L. Leveneur. 'Re article 1184 of the Civil Code'; Whereas in the case a party to a bilateral contract does not perform her obligations, the party against which the promise has not been performed must, if she demands the termination of the agreement, petition before the court for that purpose; Whereas, to dismiss the company *Panel de France's* claim (*Panel*), which requested damages against the company governed by American law *Performax Systems International (Performax)* to which she approached to have fraudulently terminated, by means of a unilateral statement, the franchise that it had granted her to sell her products, the court of appeal has found that such a termination was justified by the serious contractual default on the part of *Panel* with respect to the failure to pay the price of the products, as well as the failure to keep other commitments; Whereas in deciding so, when *Performax*, not having filed a petition for that purpose, could not unilaterally terminate the franchise agreement that had been entered into for three years, the court of appeal has infringed the text referred to above.

⁷⁰ Civ. 2 juillet 1860, D 1860, I, 284.

⁷¹ See eg. P. Malaure, L. Aynès, P. Stoffel-Munck, *Les obligations*, n° 6 above, n° 888.

⁷² See in English law, G. H. Treitel, *The Law of Contract*, n° 56 above, 778.

⁷³ See P. Malaure, L. Aynès, P. Stoffel-Munck, *Les obligations*, n° 6 above, n° 886.

⁷⁴ For other cases of departure from article 1184 of the Civil Code see Y.-M. Laithier, *Enquête comparative des sanctions de l'inexécution du contrat*, n° 15 above, n° 186 *et seq.*

⁷⁵ R. Sacco, 'Le contrat inexécuté. Conférence introductive', in L. Vacca (dir.), *Il contratto inadempnito*, Torino, G. Giappichelli, 1999, 16.

⁷⁶ Civ. 1^{re}, 13 octobre 1998, *Bull. I*, n° 300; D 1999, 197 note C. Jamin.

⁷⁷ Civ. 1^{re}, 28 octobre 2003, *Bull. I*, n° 211: 'Whereas the seriousness of a party's behaviour may justify the unilateral termination of the contract by the other party, at her own risk, regardless of whether the contract has a fixed term or not.'

acknowledge, particularly at the stage of a preliminary interpretation, the contractual termination of the agreement for non-performance of obligations not formally connected to (or listed in) the clause. In addition to analysing the content of the termination clause, the court will also proceed to review the creditor's conduct when he avails himself of the clause. Indeed, termination clauses may be binding on the court, but they remain subject to the principle of good faith. This phenomenon has been much discussed, to the extent that it is now considered as the typical illustration of the role of Article 1134 para 3 of the Civil Code in contemporary case law.⁷⁸ The creditor's bad faith paralyses the working of the termination clause if he avails himself of it when he is partly or entirely to blame for the breach or, more widely, when he has not facilitated the performance of the contract. A judicial assessment of the equities of termination is surreptitiously introduced at this point, in addition to a review of the legal conditions necessary for termination. This is why one could say that the court is omnipresent: sent out by the door, it comes back in through the window! Case law considers that a brutal change in attitude of a creditor who, suddenly and unpredictably, claims what he is owed, after a long period of inactivity during which he tolerated the extended non-performance of the other party, ultimately reveals his bad faith. The damaging inconsistency of his conduct is thus stigmatised through the requirement of good faith: the creditor cannot avail himself of the termination clause because he invokes it in a way which is contrary to the legitimate expectations of the other contracting party, induced as a result of his own behaviour. This explains the outcome of decisions which have refused to grant the advantage of termination clauses to certain creditors, such as a lessor who had not received rents for eleven years,⁷⁹ a creditor recipient of an allowance who refrained from claiming the payment of an annuity for more than ten years,⁸⁰ or again a banker who requested payment of interest and delay penalties more than six years after the sum was due.⁸¹ As for the unilateral and non-contractual termination of contracts, this does not constitute, at present, a serious limitation to the judge's omnipotence, as in practice the *Cour de cassation* has admitted it only in very few cases. From the standpoint of judicial practice, French law remains extremely distant from American and English law, which allow for unilateral termination of the contract by the creditor, even without a termination clause. This difference explains another one, which is related to the extent of the powers of the court.

⁷⁸ See eg, D Mazeaud, 'Loyauté, solidarité, fraternité : la nouvelle devise contractuelle ?', *L'avenir du droit. Mélanges en hommage à François Terré*, n 11 above, 603 at 613 et seq.

⁷⁹ Com. 7 janvier 1963, *Bull III*, n° 16.

⁸⁰ Civ 3^e, 8 avril 1987, *Bull III*, n° 88; Civ 1^{re}, 16 février 1999, *Bull I*, n° 52.

⁸¹ Civ 1^{re}, 31 janvier 1995, *D* 1995, 389, note C Jamin.

B The Court's Omnipotence

The more the court intervenes at an early stage, the greater its power to protect the unperformed contract. The means at its disposal are of two sorts, according to whether or not it involves a modification of the terms and conditions of the contract.

First of all, the judge may simply dismiss the claim on the ground that the alleged non-performance does not exist, that it has not been established, that it is not serious enough, or that it is actually imputable to the creditor. To this extent, the lower courts merely exercise the fact-finding powers that the *Cour de cassation* has granted them since the 19th century. This dismissal may, depending on the facts, be joined with an order for compensation of the creditor, corresponding to the damage resulting from the breach of contract. Indeed, it is for the court to decide, according to the circumstances of the case, whether or not the non-performance was significant enough for termination to be ordered immediately or whether it would more appropriately be addressed by an order for damages. As Professor Sériaux notes, 'Hence, the judge is provided with an important power to maintain the contractual bond, where there is, in return, pecuniary compensation for the damage incurred by a contracting party as a result of the faulty non-performance of the other'.⁸² This judicial power is all the more efficient if one considers that it is exercised in advance of termination, and that the courts may favour the award of damages rather than the termination of the contract, even if the latter was the only remedy requested by the creditor.⁸³

Secondly, the court can preserve the contractual bond by modifying the content of the agreement. This readjustment may be temporal. In the interests of fairness, Article 1184 para 3 of the Civil Code confers on the judge the power to grant the debtor an additional delay for performance, depending on the circumstances of the case. Since this results in the dismissal of the claim for termination in a case where there may be a serious breach, the judge must ensure that the debtor, to whom he will grant the extension of time, is in good faith and examine the extent of the damage sustained by the creditor as a result. The court will mostly have to ascertain whether performance is still useful. In this respect, it is true that, under domestic French law,⁸⁴ there is no obligation to give 'adequate assurance of due performance',⁸⁵ it is, however, certain that there is a correlation between the probability that an additional delay be granted and the prospects for effective performance. Finally, in order to protect

⁸² A Sériaux, *Droit des obligations*, n 14 above, n° 49, at 198.

⁸³ See eg Reg, 21 octobre 1913, *S* 1914, I, 182.

⁸⁴ See, the Vienna Convention on Contracts for the International Sale of Goods, Art 71.

⁸⁵ Compare UCC § 2-609; Restatement (Second) of Contracts § 251.

the creditor's interests, the *Cour de cassation* has stressed that an extended delay granted under Article 1184 para 3 of the Civil Code is not renewable⁸⁶ and it allows the court order to provide for the termination of the contract if the debtor's failure to perform continues, so as to spare the creditor the need to bring a fresh petition to the court.

These readjustments can be substantial: in effect, the contract is 'remade'. Instead of terminating the contract, the judge remakes it by reviewing its price. Such re-assessment of the price is not the same thing as imposing contractual liability: it is not the result of a judicial trade-off between damages and the stated price. Each remedy has a specific purpose: compensating the foreseeable loss resulting from non-performance, in the case of contractual liability; and restoring the economic balance, when the court remakes the contract. Indeed, there is no necessary correlation between the readjustment of the value of the benefits resulting from the contract and the compensation of the loss sustained. This explains and justifies how the two remedies may be combined. The study of their respective conditions confirms that this distinction is not purely academic. Firstly, judicial remaking of the contract does not depend on the reasons for non-performance, whereas the order to pay damages implies, like any other kind of liability, a failure to perform which is imputable to the debtor. Secondly, as has been mentioned above, the rules respectively applicable to the evaluation of the price reduction and to damages clearly differ. The latter are assessed in respect of the injuries for which the law allows compensation, whereas the former is proportionate to the decrease in value of the agreed benefit. Again, French law is different from American⁸⁷ and English⁸⁸ law, which do not include price reduction among their remedies. But this gap is frequently bridged, both in international sales, which are governed by the Vienna Convention, and in certain domestic sales, through the effect of European law. Indeed, the recent *English Sale and Supply of Goods to Consumers Regulations 2002*, which transpose the 1999 Directive, introduce the possibility of 'remaking' the contract to the benefit of consumers. The new section 48C (1)(a) of the Sale of Goods Act 1979 states: '[the buyer may] require the seller to reduce the purchase price of the goods in question by an appropriate amount (...)'. The issue is whether English courts will distinguish this from the usual method of assessing damages.⁸⁹ Comparative lawyers may well provide them with a helping hand.

⁸⁶ Civ 1^{ère}, 19 décembre 1984, *Bull. I*, n° 343.

⁸⁷ E A Farnsworth, *Contracts*, 4th edn, (New York, Aspen Publishers, Inc, 2004) § 12.9 at 765.

⁸⁸ G H Treitel, *The Law of Contract*, n 56 above, 952.

⁸⁹ G H Treitel, *ibid*.

Modernisation of the German Law of Obligations: Harmonisation of Civil Law and Common Law in the Recent Reform of the German Civil Code

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1 INTRODUCTION

ON 1 JANUARY 2002, the German Statute on the Modernisation of the Law of Obligations became law.¹ If we disregard family law for a moment, this statute changes the German Civil Code more radically than any previous reform since 1 January 1900, when the Civil Code initially entered into force.²

The preparatory works of this reform date back to 1978, when the then Federal Minister of Justice, Mr Hans-Jochen Vogel, announced plans to modernise the law of obligations and asked a group of renowned experts to make concrete suggestions for changes deemed necessary. The expert reports were published in 1981 and 1983³ whereupon the Ministry of

*Prof Heldrich presented this paper at the conference in Tel Aviv University in 2002; Dr Rehm participated in drafting it.

¹ Art 9 (1) Gesetz zur Modernisierung des Schuldrechts, Bundesgesetzblatt/Federal Gazette 2001 I 3138. An English translation of the provisions affected by the reform is available at www.iuscomp.org/gla/index.html. A detailed documentation of law reform articles commenting upon the reform can be found at <http://www.lrz-muenchen.de/~lorenz/schulmod/index.htm>. Many relevant articles are contained in Ernst/Zimmermann (eds) *Zivilrechtswissenschaft und Schuldrechtsreform* (Mohr Siebeck, Tübingen, 2001) and in Mohr Siebeck, Tübingen, 2001). For a brief English introduction to the changes see P Schlechtriem, (2002) *Oxford University Comparative Law Forum 2* at <http://oucl.iuscomp.org/articles/schlechtriem2.shtml>.

² *Dahbier* NJW 2001, 3729.

³ Bundesministerium der Justiz/Federal Ministry of Justice (ed) *Gutachten und Vorschläge zur Überarbeitung des Schuldrechts* (Bundesanzeiger, Köln, 1981, 1983).

Justice constituted a commission on the reform of the law of obligations. This commission sat until 1991 and presented its final report in 1992.⁴ Its conclusions and proposals — to a great deal inspired by the United Nations Convention on Contracts for the International Sale of Goods (CISG) — were one of the main subjects of the German Lawyers' Convention in Münster 1994, where they received general approval.⁵ This brief historic overview suggests that the reform was more thoughtfully prepared than frequently claimed.⁶

Due to a number of circumstances, among them the pending groundwork on the EU directive on the sale of consumer goods,⁷ whose results the legislator intended to include in the reform, but also the legislative attention on the legal prerequisites and consequences of German unity, however, the plans to modernise the law of obligations then lay dormant. In August 2000, the German Federal Government awakened them and announced its intention to combine the reform with the transformation of the EU directive on the sale of consumer goods.⁸ The government's decision to pursue such a 'comprehensive solution' instead of a 'small solution'⁹ that would have merely transformed the EU directives into German law, and its admittedly imperfect initial draft, alarmed the members of the legal profession. After a number of conferences on the topic during which we witnessed some unusually vitriolic attacks against the supporters of the reform and the federal government,¹⁰ and after an expert commission appointed by the former Federal Minister of Justice, Mrs Hertha Däubler-Gmelin, had suggested substantial changes to the initial draft,¹¹ parliament debated the reform and the German Bundestag finally passed the statute on 11 October 2001.

⁴ Bundesministerium der Justiz/Federal Ministry of Justice (ed) *Abschlußbericht der Kommission zur Überarbeitung des Schuldrechts* (Bundesanzeiger, Köln, 1992). See also *Rolland, NJW 1992, 2376*.

⁵ Gutachten und Verhandlungen des 60. Juristentages, Vol. I (Suggestions), Vol. 2 (Discussion) (C.H. Beck, München, 1994).

⁶ For some of the objections of one of the main critics see *Altmeyer*, DB 2001, 1131; DB 2001, 1399; replies by *Cnars* DB 2001, 1815 and *Lorenz* JZ 2001, 742.

⁷ Directive 1999/44/EC of the European Parliament and of the Council of 25 May 1999 on certain aspects of the sale of consumer goods and associated guarantees, Official Journal L 171, 0012–0016.

⁸ See previous note.

⁹ For the advantages of the 'comprehensive solution' compared with the 'small solution' see then Federal Minister of Justice *Däubler-Gmelin*, NJW 2001, 2281.

¹⁰ *Altmeyer* DB 2001, 1131; *Kritzel* NJW 2001, 2519. *Heldrich* NJW 2001, 2521 describes the tense atmosphere at several conferences on the subject.

¹¹ For a brief evaluation of the work of this commission, of which Andreas Heldrich was a member see *Geiger* JZ 2001, 473. *Cnars* JZ 2001, 499 outlines many of the results reached by it.

II THE THRUST OF THE REFORM

1 The Principal Changes

The reform touches a number of central subsets of the law of obligations:

- The rules on statutes of limitation, which German law, contrary to many Common Law systems, qualifies as substantial rather than procedural law. The regular default period of limitation was cut from thirty to three years.¹² The change is, however, less radical than it seems at first glance because the statute of limitation now only commences to run when the creditor learns of the essential circumstances of his claim or ignores them due to gross negligence.¹³ Independent of such subjective element, the claim is finally barred after 10 years.
- The consolidation into the Civil Code of a number of consumer protection statutes¹⁴ and the Statute on General Conditions that proliferated outside the Code and threatened to destroy a Civil Law Code's very idea:¹⁵ to systematise and unite the essential rules applicable to private law relationships in one statute.
- The codification of case law. The German Civil Code now contains legal rules for and definitions of a number of concepts originally developed by the judiciary. This aspect of the reform highlights one point of our subject today because to some degree it shows the similarities of the Civil Law and the Common Law in the law-making process. Contrary to a widely held prejudice, the legislation in Civil Law countries is by no means the only framer of the law: Similar to their Common Law counterparts, courts in Civil Law countries play a decisive role in devising new legal rules and concepts,¹⁶ which — as we can see in this case the legislation sometimes merely adopts and codifies without changing them substantially. The Code now expressly recognises i incidental duties arising from the contractual or pre-contractual relationship of the parties beyond the law of torts,¹⁷

¹² § 195 German Civil Code (hereinafter: BGB).

¹³ § 199 BGB.

¹⁴ Among them the statutes on consumer credit, on distance contracts, on contracts negotiated away from business premises and on contracts relating to the purchase of the right to use immovable properties on a timeshare basis.

¹⁵ K. Zweigert and H. Kötz *An Introduction to Comparative Law* 3rd edn (Clarendon Press, Oxford, 1998) § 10 III discuss the general concept of codification.

¹⁶ Professor Markesinis has rightly pointed out that the practical difference in the lawmaking power of courts in Common Law and Civil Law systems is often overstated, see B. Markesinis, *Foreign Law and Comparative Methodology* (Hart Publishing, Oxford, 1997) 194 et seq, 220 et seq, 362 et seq.

¹⁷ §§ 241(2), 311(2) BGB.

- ii a cause of action for violation of *pre-contractual* duties; the so called *culpa in contrahendo*,¹⁸
 - iii a cause of action for violation of incidental *contractual* duties; the judicial concept formerly called *positive violation* of a contractual duty,¹⁹
 - iv the general right to cancel long-term contracts for an important cause,²⁰
 - v the private law version of *clausula rebus sic stantibus* (*Wegfall der Geschäftsgrundlage*).²¹
- In particular, the codification of the concept of positive violation of contractual duties paved the way to the undoubtedly paramount change of the law of obligations, that touches the concept and consequences of non-performance, or as we would now formulate properly: the violation of a duty as a fundamental and universal prerequisite of a claim for damages.²²

2 The Pre-reform Problems

The need for reform will be recognised after a brief description of the pre-reform rules. German law governing the conditions of and remedies for non-performance was a perfectly versatile instrument of torture in the hands of law professors, but hardly a convincing legal approach. It goes without saying that it was largely out of step with the international trend.

We should mention only a few oddities. Sales law until now distinguished between factual and legal vices of the goods sold and stipulated different remedies and periods of limitation for the two categories of vices. Whereas the claim for a factual vice of an immovable had to be raised within one year, the statute allowed thirty years in the case of a legal vice. The buyer of goods with a legal vice — among others — had a right to

¹⁸ §§ 280 (1), 311 (2), 241 (2) BGB. Numerous court decisions have shaped and extended much further this concept, initially developed by *Herzig* (Heftb 4 (1861) 1 for a much smaller area of application. It has also received wide attention in the German legal literature. For pre-reform overviews see e.g. B. Markesinis, W. Lorenz and G. Dannemann, *The German Law of Obligations*, Vol. I (Clarendon, Oxford, 1997) 65 *et seq.*; MünchKommBürgerlR 3rd edn (C.H. Beck, München, 1994) Vor § 275 n 48 *et seq.*

¹⁹ §§ 280 (1), 241 (2) BGB. Positive violations of a contractual duty (*positive Vertragsverletzungen*) were 'discovered' by *Herrmann, Staub*, Die positiven Vertragsverletzungen und ihre Rechtsfolgen, Festschrift für den XXVI. Deutschen Juristentag (Guttenberg, Berlin, 1902) 29. For an explanation of this concept see B. Markesinis, W. Lorenz and G. Dannemann, above n 18, 418 *et seq.*; MünchKommBürgerlR 3rd edn (C.H. Beck, München, 1994) Vor § 242 n 496 *et seq.* The earliest component of this concept under the German Civil Code is probably *Oertmann*, Die Geschäftsgrundlage (Deichert, Leipzig, 1921), 25 § 280 (1) BGB.

²⁰ § 314 BGB.

²¹ § 313 BGB. For an overview over this concept see B. Markesinis, W. Lorenz and G. Dannemann, above n 18, 516 *et seq.*; MünchKommBürgerlR 3rd edn (C.H. Beck, München, 1994) Vor § 242 n 496 *et seq.* The earliest component of this concept under the German Civil Code is probably *Oertmann*, Die Geschäftsgrundlage (Deichert, Leipzig, 1921), 25 § 280 (1) BGB.

damages,²³ whereas the buyer of goods with a factual vice had such remedy only where the seller had guaranteed a characteristic of the goods or had fraudulently concealed the vice.²⁴ This distinction between legal and factual vices might have been acceptable if it had been based upon convincing criteria mandating such treatment. But what difference does it really make if a person buys a piece of land with the purpose of building a family home only to find out that the plan fails because the municipality does not allow building family homes there or the plan fails because a neighbour has a servitude on the land preventing the erection of family homes? The municipal restriction was considered to be a factual vice²⁵ that generally would not allow a claim for damages and would have to be raised within one year, while the neighbour's servitude would have been a legal vice²⁶ that allows a claim for damages that can still be pursued after twenty nine years.

Further complicating matters, German courts came up with a distinction between a claim for damages arising from the diminished quality of the good sold (so called damages for vice) and a claim for damages caused to the body or property of the buyer (so called damages for consequences of the vice).²⁷ In sales law the courts applied the six-months period of limitation for movable goods to both claims.²⁸ However, this distinction does not seem to have been subtle enough in the law of manufacturing contracts, where apart from the statutory stipulation of different remedies than in sales law, the Federal Supreme Court additionally distinguished between damages for close consequences of the vice and damages for distant consequences of the vice.²⁹

To be honest, we have never quite grasped the difference between close and distant consequences of the vice in manufacturing contracts.³⁰ But the difference must have been an important one because the claim for close consequences of the vice had to be raised within six months, while that for distant consequences had to be raised within thirty years. An illustration will demonstrate the issue. Suppose that a home owner enters into a contract with a carpenter under which the carpenter agrees to manufacture bookshelves. If one of the bookshelves turned out to be defective that would be a factual vice and the homeowner would have a claim for damages against the negligent carpenter to which the six-months period

²³ Former §§ 440, 434, 437, 325 BGB.

²⁴ Former §§ 463, 480 BGB.

²⁵ According to Bundesgerichtshof/Federal Supreme Court (hereinafter: BGH) 7.2.1992 BGHZ 117, 159 public law restrictions on land are usually factual vices.

²⁶ BGH 19.11.1999 NJW 2000, 803 is a typical example of classifying private law servitudes as legal vices.

²⁷ BGH 29.5.1968 BGHZ 50, 200; BGH 2.6.1980 BGHZ 77, 215.

²⁸ BGH 2.6.1980 BGHZ 77, 215.

²⁹ BGH 20.1.1972 BGHZ 55, 85.

³⁰ The former Federal Minister of Justice denounced this distinction as not being justifiable according to any rational criteria. See Daubler-Greinel, above n 9, 2283.

of limitation would apply. Similarly, if the bookshelf collapsed and damaged the homeowner's edition of the *Encyclopaedia Britannica*, the Federal Supreme Court would probably have considered this damage a *close* consequence of the vice so that the homeowner would also have to raise the claim within six months. But if the homeowner were unfortunate enough to happen to sit next to the bookshelf when it collapsed, the same judges would allow the homeowner thirty years to pursue his contractual cause of action for personal injury.

Given such intricacies, the tribulations of German law students can easily be visualised, as can the tomes written on the proper distinction between factual and legal vices, close and distant consequences of the vice and how desperately the courts strove to avoid drastic inconsistencies in the law. Given this situation, the neutral observer should have expected everyone fervently to support improving this sad state of the law. What is good for the students should be good for the country. We have a hunch, however, that many of the numerous law professors who fumed about the reform of the law of obligations that was meant to eliminate some of these inconsistencies, were less motivated by their declared sense of responsibility for the German law of obligations, but rather by their fear of having to rewrite their class material and to invent new problems for exams. Be that as it may: the statute now establishes a largely unitary approach to non-performance. Why is that a symptom of convergence between Civil and Common Law? We will analyse this in the following section.

III THE UNITARY APPROACH TO NON-PERFORMANCE AS A SYMPTOM OF HARMONISATION BETWEEN CIVIL LAW AND COMMON LAW

1 The Elements of the Unitary Approach

As a central element of the reform, the legislator has all but completely discarded the double-track approach to non-performance with respect to conditions and types of remedies. Before the reform, the German Civil Code provided a general system of remedies for impossibility and delay (among them damages or, strictly alternatively, the right to withdraw from the contract) and special remedies for vices in sales law, landlord and tenant law and the law of manufacturing contracts, the areas of the law with the greatest practical relevance. As we mentioned before, to make matters more complicated, the two tracks partially crossed each other. The remedies and thus also the periods of limitation for different types of vices were not identical, the vendor being liable for legal vices under the general regime of the law of obligations but for factual vices only under the specific system of sales law.

The post-reform German Civil Code establishes the principle that the non-performing party — no matter whether performance has become

impossible, the goods to be delivered have a legal or a factual vice or he has violated an incidental duty — is liable for damages.³¹ In sales law and the law of manufacturing contracts, however, the vendor or manufacturer receives a 'second chance' for performance before being liable for damages if the non-performance can be remedied. For example, the buyer of defective goods can claim damages or withdraw from the contract only after the vendor has failed to remedy the defect within a reasonable time period stipulated by the buyer.³² The debtor's right to 'remedial performance', that is intended to give priority to the contract's performance instead of withdrawing from it or claiming damages for non-performance, had previously not been provided for statutorily in sales law, but only in the law of manufacturing contracts.³³ Vendors, however, often reserved this right, a practice that had in principle received the legislative stamp of approval by the statutory stipulation of the vendor's duty to bear the cost of remedial performance.³⁴ Here the reform brings the law more into line with common contractual practice. The specific remedy of '*Wandelung*' in sales law, a remedy similar to withdrawal from the contract, but the root of numerous fruitless debates,³⁵ has been bid farewell into legal history. The concept of impossibility, for the original legislator of the Civil Code the paradigm of its rules on liability for non-performance, has been greatly reduced in importance and now serves almost exclusively as an objection for the debtor. If performance is impossible for the debtor, his relevant duty is extinguished.³⁶ This extinction, however, does not pre-empt a possible liability for non-performance.³⁷

The unitary approach to non-performance is not only visible with respect to the consequences of non-performance, but also with respect to the prerequisites of the remedies. As we mentioned, the legislator has ended the unequal treatment of factual and legal vices and the vendor now has an affirmative duty to deliver the goods sold without any vices.³⁸ Every vice of the goods therefore gives rise to a claim for damages unless the vendor acted without fault. The unitary approach also largely disposes of the distinction between close and distant consequences of the vice.³⁹ In

³¹ § 280 (1) BGB. Furthermore, withdrawal from the contract does not any more exclude claims for damages, § 325 BGB.

³² §§ 437, 634 BGB in its interplay with §§ 281 (2), 323 (2) BGB which provide for the expiry of a time period for remedial performance or its impossibility as a prerequisite for claiming damages or a right to withdrawal, respectively.

³³ Former § 633 (2) BGB.

³⁴ See the former provision of § 476a BGB.

³⁵ See eg Larenz, *Schuldrecht II* 13th edn (C H Beck, München, 1986) 53 for a discussion of the much-debated legal nature of the remedy.

³⁶ § 275 BGB.

³⁷ § 283 (1) BGB.

³⁸ § 433 (1) BGB.

³⁹ It does remain, however, important for questions of the proper basis of a claim (§ 280 or § 281 BGB) and thus the question whether the buyer can only claim damages after unsuccessfully asking for remedial performance, Palandt/Heinrichs, *Gesetz zur Modernisierung des Schuldrechts, Ergänzungsbuch zu Palandt*, BGB, 61st edn, (C H Beck, München, 2002) § 280 n 18.

sum, the new approach integrates the liabilities for vices, non-performance, impossibility, delay or violation of incidental duties under the headline of 'violation of duty'.

In our opinion, the reform will considerably ease the problems which arose from having to deal with all these cases of non-performance, though, as is the case with every reform, it will always create new problems.

2 Aspects of Harmonisation and why the Harmony is not Perfect

Not only has the statute been considerably improved, but the legislator for unmistakably took a step towards a Common Law approach to non-performance. An obvious degree of harmonisation between the Civil Law and Common Law countries, which are member states of the European Union, is, of course, mandated by the requirements of the EU directive on the sale of consumer goods and associated guarantees.

a) Harmonisation

The German legislation has taken several steps in the direction of typical Common Law rules. Instead of the double-track system of specific remedies for certain types of contracts (particularly sales) and the general remedies in the case of impossibility or delay, that was already characteristic of classical Roman law,⁴⁰ the German law of obligations' approach now rests on one important concept: the violation of duty. The violation of duty is the general condition for any remedy in any contract, and in every case of non-performance (with the aforementioned exception of remedial performance) the creditor is entitled to claim damages or withdraw from the contract. Choosing such a general rule is obviously more similar to a Common Law system of non-performance than to a Civil Law system. The authors of the reform, by the way, are not shy to acknowledge the Common Law's influence, particularly their inspiration from the United Nations Convention on Contracts on the International Sale of Goods (CISG),⁴¹ which to a large degree in itself is a compromise between Common Law and Civil Law concepts.⁴² The priority given to remedial performance in sales and manufacturing contracts clearly borrows from Articles 45–51 of CISG. The reformers also kept an eye on international law harmonisation projects such as the drafting of the 'Principles of European Contract Law'⁴³ and of the UNIDROIT 'Principles of

International Commercial Contracts'⁴⁴ that are both characterised by the attempt to combine Common and Civil Law approaches to contract law.

b) Aspects of Non-harmonisation

The harmony between Common Law and Civil Law in the new German law of obligations is, however, not perfect. We did not fully adopt the Common Law concepts of non-performance. A clear and striking difference remains with respect to a requirement of the debtor's subjective responsibility where the claim brought against the debtor is a claim for damages. Common Law systems usually impose a duty to pay damages for non-performance without requiring any kind of fault by the debtor.⁴⁵ By operation of the law, the debtor has to guarantee his or her (proper) performance. German law, in contrast, continues to grant a damages claim only on the condition that the debtor acted with fault, which usually means that he acted at least negligently, unless he has given a guarantee.⁴⁶ The *culpa* principle, the requirement of fault as a condition of a damages cause of action, thus remains one of the main pillars of the German law of obligations.⁴⁷ This theoretical difference between the Common Law and German law may in practice, however, influence the outcome of the case less frequently than it seems because German law presumes the existence of fault⁴⁸ and the debtor will usually have great difficulty in proving his complete innocence. The fault requirement is thus considerably attenuated by the presumption of fault against the non-performing party.

Another conceptual difference remains as a result of introducing the concept of remedial performance, which is foreign to Common Law systems, into German sales law. Even though the UK and Ireland have had to devise similar rules for consumer sales, and the CISG has a similar system, this is certainly a Civil Law rather than a Common Law concept and Germany has even exceeded the requirement of the EU directive on sales of consumer goods by applying it to every category of sale, not only the sale of consumer goods as required by the directive.

The reform did not exactly copy Common Law systems either by codifying the concept of incidental duties in § 241 (2) of the Civil Code that, for example, encompass duties of protection with respect to the body and property of the other party to the contract. Even though Common Law countries do not anymore fully reject a general good faith principle,⁴⁹ on

⁴⁰ For a brief description of the historical background see Staudinger/Honemann, BGB 13th edn. (Sellier/de Gruyter, Berlin, 1995) Vorben zu §§ 459 ff, note 5 et seq.

⁴¹ *Dahbier-Gmelin* above n 9, 2283.

⁴² K. Zweigert and H. Kötz above n 15 § 36 V give a brief account of the CISG's background.

⁴³ O. Lando and H. Beale (eds) *Principles of European Contract Law* (Kluwer, The Hague, 2000).

⁴⁴ UNIDROIT (ed) *Principles of International Commercial Contracts* (UNIDROIT Rome 1994).

⁴⁵ For English law see G. Treitel, *The Law of Contract* 11th edn (Sweet & Maxwell, London, 2003) 840 et seq.

⁴⁶ § 276 BGB.

⁴⁷ *Dahbier-Gmelin* above n 9, 2287 et seq.

⁴⁸ Because of the negative formulation of § 280(1)(2) BGB.

⁴⁹ See eg § 1-203 UCC.

which such duties ultimately rest, they are generally much more reserved towards deriving duties from the pre-contractual or contractual relationship which the parties did not expressly provide for. The recognition of these incidental duties in the reformed German statute thus seems to be a step away from the consensus with Common Law countries. One should not forget, however, that the Common Law systems in practice will often reach similar results by deriving comparable rules from tort law.

A further important systematic difference is the concept of a Code. Whereas Codes in Common Law countries, if they exist at all, often are mere compilations of statutes, the German legislator expressly intended to avoid the further proliferation of private law statutes outside the Code and to preserve the Code's systematic and logical unity for which it has been famed.⁵⁰

IV A NOT STRICTLY LEGAL ASPECT OF HARMONISATION

Finally we will touch on an aspect of convergence between Civil Law and Common Law in the reform that are not of a legal nature in the strict sense. The reform's goal was not only to improve the law as such, but also to strengthen German law on an international scale. Although German law, particularly its Civil Code, undoubtedly has influenced a great many foreign legal systems,⁵¹ German lawyers are usually reluctant to admit this influence or even deliberately to try to obtain it. In particular, US lawyers are usually less inhibited in this respect. It was a certain surprise, therefore, that the Minister of Justice responsible for the reform has openly emphasised that an important goal of the reform of the law of obligations was to re-enter the competition of legal systems with a renewed and understandable law of contracts.⁵² Particularly the codification of so far purely judicial concepts, such as *culpa in contrahendo*, was expressly meant to achieve greater transparency of German law for outsiders (and for students of law, which says a thing or two about the opacity of German law⁵³)⁵⁴ and to render German law at the same time a more attractive alternative for choice-of-law clauses in international transactions. This open-mindedness to the demands and requirements of international trade so far seemed to belong to the domain of the more pragmatic Common Law countries.

⁵⁰ See F. Wieacker, *Privatrechtsgeschichte der Neuzeit* 2nd edn (Vandenhoeck & Rupprecht, Göttingen, 1967) 477.

⁵¹ K. Zweigert and H. Kötz above n 15, § 10 IV.

⁵² Däubler-Gmelin, above n 9, 2283.

⁵³ B. Markesinis, above n 16, 136, 361 with some justification criticises the complex style of German court decisions, rendering them almost inaccessible to foreigners.

⁵⁴ Canaris above n 11, 519.

V CONCLUSION

Looking at the reform as a whole, it might not be perfect. It is, however, decidedly a marked improvement compared with the rules previously applicable to non-performance which we have briefly described. The reform also proves the value of the international legal dialogue that has greatly contributed to finding appropriate solutions in Germany. Drawing on other countries' experience, and in this case that of many Common Law countries, has proven most fruitful for the prudent evolution of German law. The convergence of Civil and Common Law approaches to contracts law seems to indicate that we are internationally on a track towards common convincing solutions in contract law.

The New Approach to Breach of Contract in German Law

DAGMAR COESTER-WALTJEN*

1 INTRODUCTION**

ON 1 JANUARY 2002 the new German law of obligations entered into force.¹ As has already been stated,² the new law should replace the extremely complicated and partly unsatisfactory statutory and judge-made rules³ with a modern unified approach to all kinds of breach of contract following — at least in many though not in all aspects — international trends and models. In particular, the United Nations Convention on the International Sale of Goods (CISG), of which Germany is a member state, has had considerable influence.⁴ In addition, the Principles of European Contract Law (PECL) and the new German law do not differ much with regard to the solutions provided for breach of contract.

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**Abbreviations used in the text and footnotes have the following meaning: PECL = Principles of European Contract Law; BGB = German Civil Code; HGB = German Commercial Code; Unidroit = Unidroit Principles on International Commercial Contracts; CISG = UN Convention on Contracts for the International Sale of Goods; a.F. = *alte Fassung*, old version; BGH = Federal Supreme Court; RGZ/BGHZ = Reports of the decisions of the Federal Supreme Court in civil cases (volume, page); legal periodicals and reports are cited in the usual way (see *Kirchner, Abkürzungsverzeichnis*); the translation of the new provisions of the BGB cited here are by Prof. Dr. Dr.h.c. mult. Werner Lorenz, Munich.

¹As to the background of the reform see H. Schulte-Nölke *The New German Law of Obligations: an Introduction* (www.uniscomp.ag 2002); P. Schlechtriem *The German Act to Modernize the Law of Obligations in the Context of Common Principles and Structures of the Law of Obligations in Europe* (2002) *Oxford University Comparative Law Forum* 2; J. Möllers *European Directives on Civil Law — Shaping a New German Civil Code* (2003) 18 *Italian European & Civil Law Forum* 1.

²AH. Heldrich and GM. Rehm *Modernisation on the German Law of Obligations: Harmonisation of Civil Law and Common Law in the Recent Reform of the German Civil Code* (chapter 6 of this collection).

³See in detail Schlechtriem above n. 1.

⁴The German Act to modernise the Law of Obligations is also closely linked to the implementation of three European directives, among them the most important directive 1999/44/EC on consumer sales which on its part is widely modelled on the CISG, for this see Schlechtriem (above n. 1) II A.1.

In this chapter I would like to concentrate on two remedies for breach of contract, namely termination of contract and damages.

II THE NOTION OF 'VIOLATION OF AN OBLIGATION'

It has to be recalled that the German terminology does not speak of breach of contract but of 'violation of an obligation'⁵ because the rules cover impediments not only to contractual but also to statutory obligations.⁶ Thus, these provisions apply in all cases in which there is a legal relationship between two or more persons⁷ obliging at least one party to perform a certain obligation towards the other party, giving (at least) one party the entitlement to certain benefits or the right to recovery. The provisions apply irrespective of whether only one party is the obligor (as for example the tortfeasor or a party to a unilaterally obliging contract⁸) or whether both parties owe each other a certain performance *vice versa* (as will be the case in most business transactions and in many day-to-day contracts). But there are some provisions which take account of the special situation of reciprocal contracts.⁹

Because of the broad field of application, the rules have a relatively high level of abstraction. In this respect they differ considerably from the Principles of European Contract Law which are less abstract and therefore easier to understand. In addition, the German legislator did not follow the modern tendency¹⁰ to speak of non-performance, but of a violation though he wanted to include also cases where performance is not possible at all.¹¹ The violation of an obligation in the meaning of the new law includes all kinds of non-performance. Therefore, what we are talking about here may consist in a defective performance, in a failure to perform at the time performance is due (either too early or too late),

⁵ H. Schulte-Nölke speaks of 'breach of duty' or 'breach of (an) obligation'.

⁶ During the legislative process there was a vivid discussion about the adequate terminology for §280 BGB, whereby the notion of 'non-performance' was considered as the only possible alternative, cf. *Medicus*, JuS 2003, 521, 527; *Palandt/Heinrichs/BGB*, 63 edn, (Munich, CH Beck, 2004) §280 BGB, Rdn 3.

⁷ Such a relationship is — for example — also contained in the rights and duties assigned by §§742ff BGB, see OLG Brandenburg, FPR 2002, 133, and in the relationship between the administrator in insolvency and the parties involved in insolvency proceedings, see LG Erturk, *Neue Juristische Wochenschrift-Rechtsprechungs Report Zivilrecht* (2003) 49.

⁸ In German law for example all kinds of gratuitous contracts like contracts of donation (§§516 ff BGB), mandate (§§662 ff BGB) are only unilaterally-obliging.

⁹ §§ 320 ff BGB.

¹⁰ Art 8:101 PECL; Art 7.1.1 Unidroit.

¹¹ Though it can be disputed whether there is a violation of an obligation when performance is not possible and the law even says that the debtor is freed from his (primary) obligation when performance is impossible (§ 275 BGB), the non-performance in such a case is nevertheless treated as violation of the obligation (§ 280 BGB), thus the different terminology does not lead to a different treatment of the cases so far, even though this is not so obvious.

non-performance at all and violation of an accessory duty (for example a duty not to infringe the goods of the other party or not to disclose that party's trade secrets). In all these cases there may be a violation of an obligation, whether or not the violation is excused or not excused.

The remedies available may include the right to withhold one's own performance¹² or the automatic discharge thereof,¹³ the right to reduce the price¹⁴ or to terminate the contract¹⁵ as well as the right to damages as the case may be. However, it has to be stressed that independent of these-

¹² §§320 BGB; cf. Art 9:201 PECL, Art 7.1.3. Unidroit.

¹³ §§326 BGB (Release from counter-performance and termination in case of lapse of obligation to perform).

(1) If the debtor is released from performing under §275(1) to (3), the claim to counter-performance is lost; in case of part performance §441(3) shall apply mutatis mutandis. Sent. 1 does not apply in case of non-conforming performance if the debtor need not remedy to perform according to §275(1) to (3).

(2) If the creditor is solely or by far more responsible for the circumstance by reason of which the debtor is released from performing under §275(1) to (3), or if the circumstance for which the debtor is not responsible arises at a time when the creditor is in default of acceptance, the debtor retains his claim for counter-performance. He must, however, deduct what he saves in consequence of release from the performance, or what he acquires or wilfully omits to acquire by a different use of his labour.

(3) If the creditor demands delivery under §285 of the substitute received for the object owed, or assignment of the claim for compensation, he remains obliged to make the counter-performance. This is diminished, however, in accordance with §441(3) insofar as the value of the substitute or of the claim for compensation is less than the value of the performance due.

(4) Insofar as counter-performance has been made which according to this provision was not due, it may be demanded back under §§346 to 348.

(5) If the debtor is released from performance under §275(1) to (3) the creditor may terminate the contract; §323 shall apply mutatis mutandis to such termination, no period of grace being necessary.

¹⁴ §§437 Nr. 2, 441; §§634 Nr. 2, 638; §536 BGB; cf. Art 9:401 PECL, Art 50 CISG.

¹⁵ §323 BGB (Termination of contract in case of non-performance or non-conforming performance):

(1) If a debtor under a mutual contract does not perform when performance has fallen due or does not perform conforming to the contract, the creditor may terminate the contract, provided he has, without success, granted the debtor a reasonable period within which to perform or to remedy to perform.

(2) The period of grace is unnecessary, if

1. the debtor seriously and definitively refuses to perform,
2. the debtor does not perform at the time fixed or within a period of time fixed by the contract and the creditor's interest in the performance is dependent upon timely performance, or
3. there are special circumstances which, upon a balance of interests of both parties, justify an immediate termination.

(3) If the neglect of duty is of such nature that a period of grace is inappropriate, a warning will take its place.

(4) The creditor may terminate the contract even before the performance has become due if it is obvious that the conditions for termination will materialize.

(5) If the debtor has performed in part, the creditor may terminate the entire contract only if he is not interested in part performance. If the debtor has not

remedies the creditor retains the right to performance as long as such performance is possible, be it a monetary or a non-monetary obligation. Unlike most common law jurisdictions the right to specific performance is the first and primary remedy of the creditor — at least in theory. This traditional approach of German law has been sustained and even strengthened by the reform: the creditor may insist on performance and may even enforce this right (except for personal services, §888 II ZPO).¹⁶ In practice enforcement is sought less often for non-pecuniary obligations. The debtor on the other hand in many instances has a right to a second chance to perform. Thus most of the remedies are only available to the creditor after he has given notice of an additional period for performance.¹⁷ This approach adheres closely to the idea of *pacta sunt servanda* which is mirrored also in the Principles of European Contract Law,¹⁸ though (only) the latter but not German law provide exceptions when substitute transactions seem reasonable.¹⁹ In contrast, German law is very rigid with regard to the right to performance and even sets incentives for performance insofar as the creditor can claim the substitute which the debtor would receive through the act making his performance impossible.²⁰ If, for example, the seller bound by contract to give certain goods to A, sells these goods at a better price to B, and thereby makes impossible the performance of his contract with A, he would have to pay A — on A's request — the money he has got from B (or to assign to A his claim against B for that money). Thus, traditionally in German law, even the so-called efficient breach has been made unattractive.²¹

- performed in conformity with the contract, the creditor may not terminate the contract if the neglect of duty is insignificant.
- (6) Termination is excluded if the creditor is either solely or by far more responsible for the circumstance which would entitle him to termination, or if the circumstance for which the debtor is not responsible occurs at a time when the creditor is in default of acceptance.

§376 HGB varies the right to termination in commercial contracts when time is of essence.

¹⁶ §§281 I, 323, 437 Nr. 1, 638 Nr. 1 BGB; cf. Art. 9:101, 9:102 PECL; Art. 7:1.4, 7:2.1, 7:2.2, 7:2.3 *Unidroit*.

¹⁷ *Ibid.*

¹⁸ Arts 8:104, 8:106, 9:101(1), 9:102(1).

¹⁹ Arts 9:101(2)(a), 9:102(2)(d) PECL; similarly Art 7:2.2 *Unidroit*; see also the compromise in Art 28 CISG — enforceability sustained.

²⁰ §285 BGB. (Delivery of a substitute)

- (1) If the debtor, in consequence of the circumstance which according to § 275 (1) to (3) releases him from the obligation to perform, acquires a substitute or a claim for compensation for the object owed, the creditor may demand delivery of the substitute received or assignment of the claim for compensation.
- (2) If the debtor may claim compensation instead of performance, the compensation is diminished if he exercises the right specified in (1) by the value of the substitute received or of the claim for compensation.

²¹ Proponents of the economic analysis of law claim that it would be reasonable from an economic point of view to allow the vendor for example to sell the goods to third parties who are willing to pay more, if the interest of the buyer in the goods does not exceed this price.

III THE ROLE OF IMPOSSIBILITY

From the principle of specific performance it also follows that it is crucial whether performance is impossible or not.²² As long as the debtor (for example the seller) could provide the goods or services promised — even though he might have to undertake special (financial or other) efforts — the performance has not become impossible and a claim for specific performance would be successful (and enforceable).²³

If performance has become impossible — either to everybody or only to the debtor — the debtor's duty to perform is terminated, but not the contract as such.²⁴ Thus, in case of impossibility the relationship between debtor and creditor subsists, but there is a violation of an obligation (i.e. the non-performance) and this might give rise to secondary remedies.

As long as performance is possible (even if it might be more burdensome than the debtor expected), the creditor may ask for specific performance and the non-performance will not be regarded as a case of impossibility.²⁵

Only under very extraordinary circumstances may the debtor claim that the expenses in order to perform are extraordinarily disproportionate to the benefit which the creditor will obtain from performance²⁶ or — in

²² §275 BGB (Termination of the obligation to perform):

- (1) The claim to performance is terminated insofar as performance is impossible for the debtor or for every one.
- (2) The debtor may refuse to perform insofar as this would require an effort which, having regard to the substance of the obligation and the requirements of good faith, would be grossly disproportionate to the creditor's interest in such performance. In determining the effort reasonably to be expected from the debtor it must also be considered whether the debtor is responsible for the failure to perform.
- (3) Furthermore, the debtor may refuse to perform if he has to perform personally and such performance cannot reasonably be expected from him when weighing the impediment preventing him from performing against the creditor's interest in the performance.
- (4) The rights of the creditor are determined according to §§280, 283 to 285, 311a and 326.

²³ Impossibility of performance had played a central role under the former rules, however it had proved not to be relevant in practice. Besides the old law provided a rather complicated system with the distinction between initial and subsequent, imputable and non-imputable, subjective and objective impossibility. Nevertheless the new law carries on this category of dysfunction, however with a few changes, see below and n 60. Schlechtriem characterises the adoption of impossibility in §275 I BGB as 'a step back' towards traditional conceptions which conflicts with the new concept of §311 a I BGB, see Schlechtriem, above n 1, III 2.a.

²⁴ §§275 I, 311 a I BGB; *ibid.*

²⁵ The case of temporary impediments to performance produces special problems, the solution of which the legislator has left to the courts; for the old approach comp. RGZ 158, 331; BGH LM Nr. 4 zu § 275 BGB; for the new law P Schlechtriem (above n 1, III 2.a), with reference to § 308 BGB a.E.

²⁶ §275 II BGB, so called practical impossibility (example: the ring sold has fallen into the sea); see for details: Camarós, JZ 2001, 501; these cases have to be distinguished from a change of circumstances which has led to a considerable disturbance of the balance between the (objective) values of performance and counterperformance (cases of frustration, *Störung der Geschäftsbegründung*, §313 BGB).

1 Kinds of Violations

The first prerequisite is that there has been a violation of an obligation (whatsoever) which need not be a fundamental breach. In this respect, German law differs from many other legal systems which allow termination only in cases of fundamental breach.³³ The German law has the advantage of avoiding the problematic definition of what constitutes a fundamental breach.³⁴ Thus, the violation may consist of delay, delivery of defective goods, delivery of the wrong quantity, of a breach of an accessory duty, or total non-performance.

However, there are some safeguards which serve similar goals as the restriction to fundamental violations or fundamental breach. For example, in cases of part-performance the creditor may terminate the complete contract only if the performed part is of no interest to him.³⁵ If, for instance, the seller has sold six antique chairs but can deliver only four of them because the other two antique chairs have been destroyed, the buyer may terminate the contract with regard to the two chairs and fulfil the contract on his part with regard to the four chairs. If, however, he can show that four chairs are of no interest to him, then he may terminate the complete contract. If the performance has been defective, termination depends on the weight of the defect; minor defects do not give rise to the right of termination.³⁶ In such cases the aggrieved party is principally bound by the contract but may reduce its own performance according to the lesser value of the goods or services received.

If the breach consists of a violation of an accessory duty the contract may be terminated only if the subsistence of the relationship would be unacceptable.³⁷ This applies mainly in situations in which reliance and trustworthiness have been destroyed. If this is not the case the contractual relationship remains unchanged, both parties have to perform, but the aggrieved party may in addition claim damages for the detriments caused by the violation of the accessory duty under §280 BGB.

It seems that these rules provide a fair weighing of the conflicting interests of the aggrieved and the defaulting party, without causing too many problems and too much uncertainty. They make sure that minor violations may not be used as an excuse for terminating the contractual relationship.

³³ See also Art 9:301 PECL, Art 49 CISG; Art 7.3.1 Unidroit; as to this cf P Schlechtriem, above n 1, III.2.b.

³⁴ Cf Art 8:103 PECL.

³⁵ §323 V 1 BGB (above n 15).

³⁶ §323 V 2 BGB (above n 15), cf Art 9:306 PECL, Art 49 CISG.

³⁷ §324 BGB (Termination in case of neglect of duty under §241 II).

If the debtor of a mutual contract neglects a duty under §241(2), the creditor may terminate the contract if he cannot reasonably be expected to abide by the contract any longer.

the case of a contract for personal services — where it is outrageous to ask for performance.²⁷ In these situations the law treats the debtor as if it was impossible for him to perform his contractual obligations; thus he does not have to perform. Instead the creditor may take advantage of the remedies in case of impossibility. The crucial point under the new rules is to distinguish between the different dogmatic principles governing §275 I and §275 II, III BGB.²⁸ Whereas in the case of §275 I BGB the contractual obligation to perform is determined automatically (ie by statutory rule), §275 II, III BGB only lead to the obligor's right of refusal which does not produce any effects until raised. On the other hand the obligor is not forced to invoke this defence, in fact he can decide to perform despite the practical or moral impediment.²⁹

Though specific performance is the first and primary remedy in case of non-performance (as long as performance is possible), in practice most creditors seek the so called secondary remedies whether or not performance is possible.³⁰ Secondary remedies invoked are mainly termination of the contract and damages. Both remedies may (now) be cumulated when the prerequisites of both have been met.³¹

IV THE RIGHT TO TERMINATE

The right to terminate the contract is a remedy at the choice of the creditor. This remedy makes sense only where mutual obligations exist and it is limited to these cases (§§320 seq BGB). There is no automatic termination of the contract³², nor is any judicial pronouncement necessary, nor is any special form required. It suffices that the aggrieved party tells the other that it terminates the relationship, provided it has good cause to do so. Good cause may result from different situations and has several prerequisites.

²⁷ Moral impossibility, §275 III BGB (for example: the clown does not want to appear on stage because his wife is lying on death-bed; or: the employee has to go to his home country for military service, otherwise he will have to fear severe criminal sanctions), cf BAG, DB 1983, 396.

²⁸ The text of which is set out at n 22 above.

²⁹ So-called 'überobligationsmäßige Leistung', see Reischl, JuS 2003, 250, 256; Huber/Faust, *Schuldrechtsmodernisierung* (Münich, CH Beck, 2002) Kap 2, Rdn 12.

³⁰ Though the remedies may differ with regard to their prerequisites depending on impossibility, delay or infringement of rights and may partly depend on the question whether or not the violation is excused, see below.

³¹ §325 BGB: (Compensation and termination) In a mutual contract termination does not preclude the right to demand compensation. Cf Art 9:103 PECL, Art 45 CISG.

³² It has to be noted, however, that the law provides for the automatic discharge of the creditor's obligation in cases where the debtor's performance is impossible (caveat: §326 I 1 BGB, above n 13), and this impossibility is neither due to a fact or circumstance within the creditor's responsibility nor happened during *mora creditoris* , § 326 I 1, II BGB; this has pretty much the same effect as a termination of the contract, cf §326 IV BGB.

2 Additional Period of Time

Secondly, the law requires, in principle, that the aggrieved party must by notice to the other party allow an additional period of time for performance³⁸ to avoid hardship and surprise. But there is no need to serve a notice on the non-performing party in order to put the latter into breach (*Mahnung, mise en demeure*).³⁹ The non-performance as such is the violation of an obligation and suffices for the remedy. The additional period for good performance must be such that the debtor has a fair chance to perform. The duration depends on the circumstances of the case.

Of course, there are situations in which an additional period of time does not make sense — as for example when performance is impossible anyway.⁴⁰ Or has been refused definitely by the debtor.⁴¹ Where the damage has been done already,⁴² or where further delay seems unacceptable.⁴³ In all these cases the law dispenses with this prerequisite.

3 The Role of Fault

The right to terminate is not limited to non-excused impediments of performance.⁴⁴ Even if the non-performance was caused by *force majeure* the aggrieved party may terminate. The only further prerequisite is that the impediment is not caused by the creditor himself or happened after the creditor's wrongful prevention of performance (*non creditors*).⁴⁵ Thus, the buyer may terminate the contract if the seller does not deliver the goods in time, even if time is not of the essence and even if the delay is due to circumstances outside the control of the seller.

The right to terminate ends when the aggrieved party has received the delayed performance or accepted the defective service or goods as

³⁸ This is not only an option for the creditor as provided in Art. 8:106 PECL but a prerequisite to the right to terminate. According to the PECL, the additional period is a prerequisite also if the delay does not constitute a fundamental breach, Arts 9:301, 8:106(3) PECL; similarly Art. 7:1.5 Unidroit.

³⁹ Under the former rules the right to terminate because of delayed performance depended on the *mona* of the debtor and where no exact time for performance had been agreed upon a notice (*Mahnung*) was necessary, §§326, 284 BGB aF. Under the new law notice is still necessary if the creditor wants to avail himself of the consequences (damages for delay, strict liability — §§286, 287, 288 BGB) of *mona* (*Verzug*, late performance).

⁴⁰ §326 V BGB (see above n. 13).

⁴¹ §323 II No. 1 BGB (see above n. 15).

⁴² §324 BGB (see above n. 36).

⁴³ §§323 II No. 2, 3, 324 BGB (see above n. 15 and 37).

⁴⁴ Under the old law termination was only possible in case of '*Verzug*' (*mona*) of the debtor which meant an unexcused delay (but fault of the debtor was presumed, §§285 BGB), §§326, 284, 285 BGB aF.

⁴⁵ §§23 VI BGB (see above n. 15).

performance (possibly by reducing the price⁴⁶). There is no deadline for the exercise of the right to terminate except the general rule of good faith, neither is there any deadline for the insistence on performance (where performance is still possible⁴⁷) outside the statute of limitations except for just-in-time contracts between merchants.⁴⁸

The idea behind this set of rules is the following: The parties consented to the terms of the contract because of the mutual promises to perform. If one side cannot perform in exactly the way promised, then the other party should not be bound to abide by the contract, because the equilibrium of the promises is destroyed. Hence, the aggrieved party should have the choice to decide whether it wants to affirm the contract or whether it wants to terminate the relationship. Insofar, each party bears the risk of its own ability to perform.

4 Consequences of Termination

At termination both parties are released from their obligations. Both parties have the right to recover money paid, property supplied and other means of performance or counter-performance.⁴⁹

If performance cannot be returned — for example in the case of services or when the goods delivered have been consumed or destroyed⁵⁰ — the value of these benefits may be recovered⁵¹ again with some exceptions.⁵² A decrease in the value of the goods just because the goods have been used for the intended purpose need not be compensated. Neither is there a duty to compensate for the value of the non-restorable or damaged goods if the cause of the termination only became noticeable during the processing or conversion of these goods⁵³ or if the party entitled to restoration has caused the damage or distortion of the goods itself.⁵⁴ The same applies if the goods have been destroyed at that party's place⁵⁵ or if this happened without gross negligence or intent of the party who has the right to terminate the contract.⁵⁶ The latter two provisions shift the risk of

⁴⁶ §§441, 638 BGB.

⁴⁷ *Ibid.*

⁴⁸ §376 I 2 HGB — the merchant has to indicate immediately after the time of performance has lapsed that he insists on performance.

⁴⁹ §346 I BGB, cf. Arts 9:307, 9:308, 9:309 PECL, Arts 7:3.5, 7:3.6 Unidroit.

⁵⁰ Inability to restore does not hinder the termination of the contract (any more). For the old law see the problematic rules in §§350-2, 327 BGB aF.

⁵¹ §346 II BGB, cf. Art. 9:309 PECL.

⁵² §346 III BGB.

⁵³ §346 III No. 1 BGB.

⁵⁴ §346 III No. 2 BGB.

⁵⁵ §346 III No. 2 BGB.

⁵⁶ §§ 346 III No. 3, 277 BGB.

accidental loss or damage, the first to a lesser extent than the last. The wisdom of this rule has been doubted because the risk of accidental loss of goods normally passes with delivery of these goods.

This short overview concerning the mechanism of termination already indicates, how complicated and detailed are the legal rules which deal with these questions. This is partly due to the special system of German codification which implies a high level of abstraction, because the rules — as for example those for termination of the contract — apply to all situations of termination, not only for breach of contract, but also if a right to termination has been reserved or results from another situation (like for example the right to revocation in consumer contracts).

V THE RIGHT TO DAMAGES

The aggrieved party may, instead or in addition, ask for damages under the new law. Like the right to terminate the contract, the right to damages may also arise from all kinds of violations (non-performance). But despite the unitary concept of violations of obligations the legal rules on damages differ slightly depending on the kind of non-performance and the kind of damage that has been suffered.⁵⁷ This is not the place to go into too many details; only a general line should be drawn.

1 Different Conceptions

With regard to all kinds of impediments for all kinds of damages the general principle applies that the non-performance must be imputable to the obligor.⁵⁸ The obligor is imputable when he has committed fault⁵⁹ or has entrusted performance to another person who acted with fault.⁶⁰ Furthermore impediments are imputable to the obligor where he had guaranteed his performance or undertaken special risks.⁶¹ With regard to

⁵⁷ §§ 280, 281, 282, 283, 284, 311 a II BGB.

⁵⁸ See also Art 9:501 PECL; Art 7:4.1 Unidroit.

⁵⁹ § 276 I BGB (below n 73).

⁶⁰ § 276 BGB (below n 74); cf Art 8:107 PECL.

⁶¹ § 276 BGB (below n 73); in case of initial impossibility (see § 311 a II BGB, which constitutes an independent basis for a claim) the imputable fact is the knowledge or negligent ignorance of the impossibility to perform and only insofar the debtor is liable to damages. It is here that the former concepts of initial or subsequent impossibility remain important because of the different view on the obligor's liability. Until the conclusion of the contract the obligor is subject to duties to supply information, whereas after this crucial point his duty of correct performance is concerned, compare Räschl, JuS 2003, 250, 255. Contrary to the old rule (§ 306 BGB aF) the contract is valid despite the initial impossibility.

⁶² § 311 a I BGB (Failure to perform due to an impediment existing at the time of conclusion of the contract).

these two latter cases there will be imputability without fault; there is strict liability of the obligor as far as he has accepted responsibility. Thus, non-fault impediments are not always excused impediments. We shall come back to this later. For the moment it suffices to state that the prerequisites of the right to terminate and the right to damages differ especially with regard to the question of excuse or non-excuse for non-performance. The right to terminate exists even where the non-performance is excused, the right to damages does not. Thus, contrary to some other legal systems termination is the device which is more easily accessible, for damages the creditor has to overcome additional hurdles.

In other respects the prerequisites are very similar. Thus, in principle, the right to damages does not depend on a fundamental breach.

2 Different Kinds of Damage Claims

If we speak of damages, three different categories of monetary compensation have to be considered.

The most important category concerns damages for non-performance (or damages instead of performance). Here the claim for damages substitutes or supplements the performance.⁶² Thus, after receiving the

(1) A contract remains effective even though the debtor is released from performance according to § 275(1) to (3), and the impediment existed already at the time of contracting.

(2) The creditor may choose between compensation instead of performance and reimbursement of his outlays as laid down in § 284. This does not apply if the debtor did not know of the impediment and is not responsible for his lack of knowledge. § 281(1) sent 2 and 3 and subsection (5) shall apply *mutatis mutandis*.

See also Art 4:102 PECL.

⁶² § 281 BGB (Damages instead of performance in case of non-performance or non-conforming performance).

(1) Insofar as the debtor does not perform or does not perform in conformity with the obligation after it has become due, the creditor may demand compensation instead of performance according to § 280(1), if he has, unsuccessfully, granted the debtor a reasonable period within which to perform or to remedy to perform. If the debtor has fulfilled his obligation in part, the creditor may only demand compensation instead of full performance if he is not interested in part performance. If the debtor does not perform in conformity with the obligation, the creditor may not claim compensation instead of full performance if the neglect of duty is insignificant.

(2) The period of grace may be dispensed with, if the debtor seriously and definitively refuses to perform, or if there are special circumstances which, upon a balance of interests of both parties, justify the immediate enforcement of the claim for compensation.

(3) If the neglect of duty is of such nature that the granting of a period of grace is not feasible a warning will take its place.

(4) The claim to performance is excluded as soon as the creditor demands compensation instead of performance.

damages the aggrieved party should be in the same financial position as it would have been had the contract been performed exactly in the way promised. Therefore, profits, for example, which the buyer lost, because he did not get the goods promised or because the goods which were delivered were defective or were of a smaller quantity than that for which he contracted, but which he would have gained in case of a perfect performance, will be included. Also included may be the value of the price or counter-performance already paid or made by the aggrieved party (*großer Schadensersatz*⁶³). But it does not necessarily mean that the aggrieved party may not keep the defective goods delivered (provided the aggrieved party did not terminate the contract at the same time) and just claim the balance between good and defective performance (*kleiner Schadensersatz*). It is, in principle, for the aggrieved party, when seeking damages for non-performance, to decide whether it wants damages for complete non-performance (thereby returning goods already delivered) or simply asks for the balance between good and defective performance. In case of lost profits the burden of proof is with the claimant; he need not, however, show that he could in fact have sold the goods for a certain price, but only that according to normal circumstances the market value for retail would have been a certain sum (so called abstract computation of damages).⁶⁴ Yet, according to the prevailing view⁶⁵ this applies only to merchants and the adversary may produce evidence that in the given case the loss has been not so high or that there was no loss at all.

The second category of damages is less complicated: the aggrieved party may ask for simple damages, i.e. that loss which it suffered from the violation of the other party's obligation — independent of the performance as such.⁶⁶ In this case the claim for damages does not substitute the original

- (5) If the creditor demands compensation instead of full performance, the debtor is entitled to reclaim his performance according to §§346 to 348, §282 BGB (below n 88);

§283 BGB (Damages instead of performance in case of termination of the obligation to perform);

If the debtor is released from the obligation to perform according to §275 (1) to (3) the creditor, observing the requirements of §280(1), may demand compensation instead of performance. §280(1) sentence 2 and subsection (5) shall apply *mutatis mutandis*.

⁶³ See OLG Karlsruhe, JBR 2002, 314; damages concerning a building contract.
⁶⁴ §252 BGB (lost profit);

The compensation shall also include lost profits. Profit is deemed to have been lost if it could probably have been expected to be earned in the ordinary course of events, or according to the special circumstances, especially in the light of the preparations and arrangements made.

⁶⁵ BGH, NJW 1980, 1742, 1743.

⁶⁶ §280 I BGB (damages for neglect of duty);

claim for performance, but exists beside the latter.⁶⁷ If for example one party violated an accessory duty (damaged some goods of the other on delivery), the loss caused must be compensated. The same applies — in principle, though under some additional prerequisites — for the loss caused by late performance, §280 II, 286 BGB.⁶⁸ (provided the contract has been or will be performed). In the latter case the claim for (simple) damages is subject to a notice of default (*Mahnung*)⁶⁹ and dependent on the debtor's responsibility for the delay.⁷⁰

Finally there is a third kind of damages in the widest sense: Instead of damages for complete non-performance the aggrieved party may claim frustrated expenses incurred in the expectation of performance.⁷¹ Strictly

- (1) If the debtor fails to comply with a duty incumbent upon him under the obligations entered into, the creditor may demand compensation for the damage done. This does not apply if the debtor is not responsible for the failure to comply with the duty.
- (2) The creditor may only claim damages for delayed performance in accordance with the additional requirements laid down in §286.
- (3) The creditor may only claim damages instead of performance in accordance with the additional requirements laid down in §§251, 282 or 283.

⁶⁷ For the demarcation see *Hirsch, Jura* 2003, 289ff; *Medicus, JUS* 2003, 521, 523.

⁶⁸ §286 BGB (default by the debtor);

- (1) If the debtor does not perform after a warning issued after the debt has become due, he is in default because of the warning. Bringing an action for performance as well as service of a judicial order for payment are equivalent to a warning.
- (2) No warning is required, if
 1. a time for performance is fixed by the calendar,
 2. the performance must be preceded by an event and an adequate time for the performance has been fixed in such a way that after the occurrence of this event it may be reckoned by the calendar,
 3. the debtor seriously and definitively refuses to perform,
 4. upon a balance of interests of both parties special reasons justify an immediate default.

- (3) The debtor of a counter-performance will, at the latest, be in default unless he performs within 30 days after the obligation became due and a bill or a comparable listing of payments was received; in case of a debtor who is a consumer this holds good only if the bill or the listing of payments has drawn special attention to these consequences. If the time of receipt of the bill or the listing of payments is uncertain, a debtor who is not a consumer will, at the latest, be in default 30 days after the debt has fallen due and the counter-performance has been received.

- (4) The debtor is not in default so long as the performance does not take place because of a circumstance for which he is not responsible.

⁶⁹ There are again some exceptions under which such notice is not necessary, for example if the time for performance is set at a certain date, see §286 II, III BGB.

⁷⁰ §286 IV BGB (see n 68); here again there is a presumption of fault, see below n 78.

⁷¹ §284 BGB (reimbursement of futile outlays);

speaking, this is not a claim for damages for non-performance because logically those expenses would have been incurred even if the contract had been performed properly.⁷² This kind of claim is an interesting alternative in cases in which the performance is of non-commercial value (non-profit) to the creditor. If, for example, party A has rented a congress room for non-profit purposes and has invested a lot of money in invitations and in preparations for the event, these (frustrated) investments may be claimed instead of damages for non-performance (which might be insignificant because A would have gained no economic advantage had the landlord performed the lease), if the landlord will not let the room at the agreed date.

3 The Role of Fault

As already stated above damages will be awarded only if the violation of a duty is imputable to the obligor.⁷³ In general, German law does not impose strict liability; each party is held responsible (only) for his own intentional and negligent acts. In some relationships only gross negligence will count. In addition to his own acts the obligor is responsible for the negligent acts of those persons who had been acting on his behalf or for his benefit in the process of performance.⁷⁴ However, there are also situations of strict liability. A debtor who has to pay money is always under strict liability.⁷⁵ The same applies, if by statutory rules or by

Instead of claiming damages in lieu of performance the creditor may demand reimbursement of any outlay justifiably made in reliance of receiving performance, unless such outlay would have been useless even if the debtor had not breached the duty.

⁷² Such a claim gains special importance in and is thought for situations where the performance would not have redeemed those additional costs (because other values would have been at stake) and therefore the loss by the non-performance does hardly exceed the price.
⁷³ §276 BGB (responsibility of the debtor):

- (1) The debtor is responsible for wilful conduct and negligence unless a more severe or a more lenient responsibility has either been laid down or may otherwise be derived from the substance of the obligation, especially from undertaking a guarantee or a risk of procuring performance. The provisions of §§ 827, 828 shall apply *mutatis mutandis*.
- (2) A person who does not exercise ordinary care acts negligently.
- (3) A debtor may not be released beforehand from responsibility for wilful conduct.

⁷⁴ §278 BGB (responsibility for persons employed in performing obligation):

A debtor is responsible for the fault of his legal representative and of persons whom he employs in performing his obligation to the same extent as for his own fault. The provision of §276(3) does not apply.

⁷⁵ BGHZ 107, 92, 102.

contract the obligor has to bear the respective risk. For example, the law provides that the obligor during a delay, which is imputable to him, is under strict liability;⁷⁶ in case of non-acceptance of the creditor, on the other hand, the risk of the obligor is limited to intent and gross negligence.⁷⁷ Strict liability also applies if the obligor has guaranteed his performance or guaranteed a certain quality of the goods or the services. The courts apply high standards for such a guarantee because of the severe consequences that can flow from a failure to meet the standard set out in the guarantee. On the other hand a party promising to get certain goods is held to have undertaken the risk for all impediments of the market (but for example not for disturbances by war, death etc.). This principle comes close to, but is not identical with the rule in Art 79(1) CISG, because in the case of a guarantee a party may be liable even if the failure was due to an impediment beyond his control and he could not reasonably have been expected to take this impediment into account.

Though German law applies the principle of fault in general and strict liability only under special circumstances, the difference between the German solution and those legal systems which adhere to the strict liability concept is not as big as it might appear at first sight, because there is a presumption of fault in German law. The debtor has to prove that the failure or defect in performance was not imputable to him. He bears the full burden of proof.⁷⁸ If he cannot discharge this burden he will be held liable. For discharge he has to prove his non-imputability in such a way that the court is fully convinced. In case of a *non liquet* he will not be discharged.

If the debtor is liable according to these rules, his liability may be reduced by the contributory negligence of the other party.⁷⁹ The opponent

⁷⁶ §287 BGB (liability during default):

A debtor is responsible for any negligence during his default. He is also responsible for the performance in case of accident, unless the damage would have arisen even if he had performed in due time.

⁷⁷ §300 I BGB (effects of creditor's default; limiting of liability; passage of risk):

- (1) During the default of the creditor the debtor is responsible only for wilful conduct and gross negligence.
- (2) If a thing described by class (ie unascertained goods) is owed, the risk passes to the creditor from the moment at which he is first in default by not accepting the thing offered.

⁷⁸ §280 I 2 BGB (above n 65); an exception to this general concept is stated in §619 a BGB, see for example Lorenz/Richm *Lohnbuch zum neuen Schuldrecht* (Munich, CH Beck, 2002) Rdn 184.
⁷⁹ §254 BGB (contributory fault):

- (1) If any fault of the injured party has contributed to causing the damage, the obligation to compensate the injured party and the extent of the compensation to be

might have contributed (by a negligent act) to the causation of the violation of a duty or might have failed in mitigating the loss resulting from this violation. As by now in most legal systems, contributory negligence in either form does not impair the claim altogether but simply causes a reduction in the damages payable.

4 Special Prerequisites for Damages Instead of Performance

When damages instead of performance are sought, this remedy (as the right to termination) depends on the lapse of an additional period of time for performance⁸⁰ except where this would be without sense or unacceptable.⁸¹ The debtor should have another chance to perform correctly, even though his first performance was late or defective. The situation is exactly the same as in case of the right to terminate. The second chance — before the performance may be substituted by a secondary right (the claim to damages) — is very characteristic of German law. This right of the debtor corresponds with the creditor's right to specific performance and stresses the principle of *pacta sunt servanda*. Detriments caused to the creditor until performance finally takes place might be compensated by a claim to (simple) damages for delay.

There are again situations in which the additional period of time does not make any sense and therefore this rule either does not apply or can be dispensed with. This is the case when the performance has become impossible⁸² or — because of the debtor's violation of accessory duties — unreasonable.⁸³ The time allowance is dispensable if the debtor has denied performance definitively and seriously.⁸⁴ With regard to defective services or goods the details of 'remedial performance' to be allowed to the seller/undertaker are set out in the respective chapters of the law.⁸⁵

made depends upon the circumstances, especially upon how far the injury has been caused predominantly by the one or the other party.

- (2) This applies even if the fault of the injured party consisted only in an omission to call the attention of the debtor to the danger of unusually high damage which the debtor neither knew nor should have known, or in an omission to avert or mitigate the damage. The provision of §278 applies *mutatis mutandis*.

See also Art 77 CISG.

⁸⁰ §281 BGB (above n 62).

⁸¹ §§281 II, 282, 283 BGB (above n 62, below n 88).

⁸² §283 BGB (above n 62).

⁸³ §282 BGB, (below n 88); for an example see *Medicus*, JUS 2003, 521, seq.

⁸⁴ § 281 II BGB (above n 62).

⁸⁵ §§437 No 1, 439; 634 No 1, 635 BGB; the separation of those rules which apply only to certain kinds of contracts and those which apply to all debtor/creditor relations (§§275ff BGB) becomes visible here. Though this is systematically consequent, it does not make orientation easy for outsiders.

As in case of termination, damages instead of full performance can only be asked for if in the case of part-performance the performed part is not of interest to the aggrieved party,⁸⁶ in the case of defective performance the defect is not only a minor one⁸⁷ and in the case of violation of an accessory duty where it seems to be unacceptable to the aggrieved party to receive performance.⁸⁸ Thus, though the violation need not be a fundamental one, not every minor violation results in the creditor's right to demand damages instead of the full performance; in these cases the claim to damages only supplements (but does not substitute) the performance.

If the aggrieved party has asked for damages instead of full performance (and can do so) any (part or defective) performance already delivered has to be returned or compensated for according to the above-mentioned rules for the termination of the contract.⁸⁹

5 Damages in Case of Delay

Delay in performance is a violation of an obligation as already pointed out above. In consequence, the rules on termination⁹⁰ as well as the rules on damages⁹¹ may apply (even if time is not of the essence). With regard to damages the distinction between (simple) damages and damages instead of performance have to be observed, because they serve different goals and have different prerequisites.

In case of delay 'damages instead of performance' mean that — after the additional period of time for performance has lapsed and the debtor has lost his right to perform — the creditor may ask for compensation of the loss he suffered because he did not get performance at all. 'Simple damages' according to §§280 II, 286 BGB concern (only) compensation for the loss the creditor suffered because he did get the performance at a later stage (*Verzögerungsschaden*). For both kinds of claims the debtor has to prove that the delay is not imputable to him if he is not to be liable in damages. The delay must be imputable to the debtor according to the principles of §§276, 278 BGB.⁹² For simple damages — subject to some

⁸⁶ §281 I 2 BGB (above n 62).

⁸⁷ §281 I 3 BGB (above n 62).

⁸⁸ §282 BGB (damages instead of performance in case of neglect of a duty under §241 (2)).

If the debtor neglects a duty under §241 (2) the creditor, observing the requirements of §280(I), may demand compensation instead of performance if he cannot reasonably be expected to accept performance from the debtor.

⁸⁹ §281 V BGB, see above Section IV.4.

⁹⁰ §§283 BGB (above n 15).

⁹¹ §280ff BGB.

⁹² For damages instead of performance: §§281 I, 280 I 2; for simple damages: §280 II, 286 IV.

exceptions — a notice to perform (*Mahnung*) must have been issued whereas damages instead of performance can be asked for after an additional time for performance has been given. Though in many instances in practice the act of the creditor may meet both requirements, there is a slight difference between them, because a notice to perform does not necessarily give an additional period of time and the additional time allowance does not necessarily meet the standards of a notice to perform. This is unfortunate because it complicates the law unnecessarily and it may mislead the persons concerned. On the other hand the new law has the advantage for the creditor that he can liquidate the contractual relationship according to §281 BGB without having to prove the formal prerequisites of §286 BGB, especially the fact that performance is still possible.⁹³

6 Scope of Damages

Instead of going into detail about the scope of damages two points should be stressed which seem characteristic to German law on recovery of damages after the reform as well as before. First, unlike many legal systems and contrary to an international trend⁹⁴ damages are not limited to losses which the non-performing party had or could have reasonably foreseen, and secondly non-pecuniary loss is recoverable only in certain cases.

To the first issue: In principle, every pecuniary loss caused by non-performance may be recovered. Instead of foreseeability the principle of adequate causation applies and every kind of loss which — from the standpoint of an objective experienced observer at the time of the imputable act — could occur not only in extraordinary accidental circumstances will be regarded as adequately caused.⁹⁵ To limit the concept of causation there is an additional controlling device: The harm suffered must be within the protective purpose of the rule violated (*Schutzzweck der Norm*⁹⁶), ie that the loss is not outside the *mischief* the undertaken duty was designed to prevent. Though this rule does not limit the area of responsibility to the same extent as the foreseeability test, it is

⁹³In this sense *Raschl*, JuS 2003, 250.

⁹⁴See Art 9:503 PECL, Art 7:4.4 Unidroit, Art 74 CISG.

⁹⁵See *Träger Der Kausalbegriff im Zitiell- und StRG* (Marburg 1904) 159. There is adequate causation if an event had in a general and appreciable way enhanced the objective possibility of a certain consequence — taking into account all the circumstances of an 'optimal' observer at the time the event occurred and all the circumstances known to the debtor.

⁹⁶This rule was elaborated by Rabel *Das Recht des Warenkaufs* (Berlin, de Gruyter, 1936) §95ff.

relatively easy to handle, produces foreseeable and fair results and has not led to an enormous increase in the damages awarded.

Now to the second issue: Non-pecuniary loss has been recoverable in German law only where the statute said so expressly.⁹⁷ Up to recently this has been — outside tort law — the case only for wasted holidays where a supplier of travel facilities violated his contractual duties⁹⁸ and for discrimination in labour law⁹⁹ — both provisions induced by EU Directives.¹⁰⁰ In tort law moral damages could be awarded in case of injuries to health, body, liberty and sexual self-determination by negligent acts,¹⁰¹ in addition serious infringements of the right to privacy could produce the right to moral damages.¹⁰² But now a new law entered into force on 1 August 2002. According to the new rule, compensation will be granted for non-pecuniary loss in case of injury to the body, health, sexual self-determination, and in the case of deprivation of liberty. This applies within statutory relationships (like tort) as well as in contractual relationships.¹⁰³ Outside such injuries (which are at least not typical consequences of non-performance), the infringement of privacy and the two special provisions mentioned above, non-pecuniary loss cannot be awarded. However, already under the old law a device has been developed to convert non-pecuniary loss into pecuniary loss by taking into account the expenditures involved for the enjoyment of the goods in question.¹⁰⁴ The deprivation of enjoyment of a good of general and central importance for living — such as a car — has been regarded as economic loss with regard to frustrated expenditure.¹⁰⁵

VI COMBINATION OF THE DIFFERENT REMEDIES

A party may insist on specific performance and in addition may ask for compensation for the loss it suffered until the performance was correct. For example, the creditor of a delayed performance may claim damages

⁹⁷§253 I BGB; see the more general approach in Art 9:502 PECL, Art 7:4.2 Unidroit.

⁹⁸§651 II f BGB.

⁹⁹§611 a II, III BGB.

¹⁰⁰For §611 a BGB see Council Directive (EEC) 76/207 [1976] OJ L39/40; for §651 of BGB see Council Directive (EEC) 90/314 [1990] OJ L158/59.

¹⁰¹§847 BGB as in force until 31 July 2002.

¹⁰²This has been (and will be still in future) judge-made law (BVerfG NJW 2000, 2187) focusing on Arts 1, 2 German Constitution; B Markesinis and H Unberath *The German Law of Torts* 4th edn (Hart Publishing, Oxford, 2002) 924; D Coester-Waltjen 'Der Ersatz immaterieller Schäden im Deliktsrecht' 2001, *Jura* 133.

¹⁰³§253 II BGB.

¹⁰⁴BGHZ 71, 234; BGHZ 98, 212.

¹⁰⁵BGH, NJW 1986, 2037 (holiday cottage); this commercialisation has not been accepted in case of deprivation of enjoyment of fur-coats, motorboats, trailers.

in respect of losses which have been suffered by reason of the delay until the late performance takes place. The violator of an accessory duty may have to compensate that violation and still perform the contract. Thus, specific performance and simple damages are combinable. If the aggrieved party wants specific performance it cannot at the same time exercise its right to terminate the contract. However, as long as performance has not been completed the creditor may switch to termination (if the prerequisites for the right to termination are fulfilled).

The request for specific performance is not possible any more if the aggrieved party has asked for damages instead of performance¹⁰⁶ or has declared the termination of the contract, §349 BGB.

In principle, termination of the contract and all kinds of damages¹⁰⁷ are compatible, §325 BGB.¹⁰⁸ The fact of termination will, however, influence the computation of the damages. In most cases termination of the contract will not be asked for by the creditor when he can claim damages instead of performance because the latter remedy will give him full compensation. However, if the contract had been already partly or fully performed from his side — for example by the transfer of a certain good — and he wants not only the value of his performance back, but the delivered good itself, then he should be advised to terminate the contract and ask for his goods back and at the same time he may claim damages instead of performance, for example the profits lost because of non-performance.

Termination of contract and simple damages can be combined, but this is less likely to happen, because if the debtor has been imputable for the violation (which is the prerequisite for all damages), and if the prerequisites for termination are fulfilled then the aggrieved party will normally ask for damages instead of performance. At the time, however, it is not completely clear whether the damages instead of performance may include damages caused to other goods of the aggrieved party by the defective performance of the other (so called *Mangelfolgeschäden*). If one excludes these damages, then the combination of termination of contract and simple damages makes sense. Simple damages and damages instead of performance may also be combined, but the claim to frustrated expenditures takes the lieu of damages instead of performance.

¹⁰⁶§321 IV BGB (above n 61).

¹⁰⁷The only exception: If A asks only for the difference between the value of the fully correct performance and the part or defective performance (*Reiter Schadensersatz*), termination at the same time would make no sense.

¹⁰⁸Under the old law, termination of contract and the claim for damages were incompatible, §§325, 326 BGB aF. As the claim for damages was — in the majority of cases — more beneficial for the creditor, the courts were often faced with the problem how to interpret a declaration of 'termination', cf. Derleder, *Neue juristische Wochenschrift* 2003, 998ff.

VII CONCLUSION

This roughly drawn picture of German law for breach of contract may suffice for the moment. There are other interesting problems — such as the duties arising from precontractual relationships,¹⁰⁹ frustration of contract (*clausula rebus sic stantibus*)¹¹⁰ — which deserve detailed analysis. Nevertheless the new law has achieved a considerable improvement in

¹⁰⁹See §241, 311 BGB.

¹¹⁰§241 BGB (duties inherent in an obligation):

- (1) The effect of an obligation is that the creditor is entitled to claim performance from the debtor. The performance may consist of refraining from acting.
- (2) An obligation may oblige each party, having regard to its substance, to take into consideration the rights, legally protected interests and (other) interests of the opposite party.

§311 BGB (obligations arising from legal transactions and from obligations similar to legal transactions):

- (1) For the creation of an obligation by legal transaction and for any modification of the substance of an obligation, a contract between the parties is necessary, unless otherwise provided by law.
- (2) An obligation with duties under §241(2) will also arise from

1. the beginning of contract negotiations,
2. initiating the conclusion of a contract whereby one of the parties, having regard to a possible contractual relationship, either grants the other party the possibility of affecting his rights, legally protected interests and other interests, or entrusts the other party with them, or
3. similar business contacts.

- (3) An obligation with duties under §241(2) may also arise in relation to persons who are not meant to become contracting parties. Such an obligation will come about especially where the third party takes special advantage of confidence, thus exercising considerable influence on the contract negotiations or the conclusion of the contract.

¹¹⁰See §313 BGB (collapse of the basis of the transaction and absence of the basis of the transaction):

- (1) If circumstances which have become the basis of the contract have changed fundamentally after the contract was concluded, and the parties, had they foreseen this change, would not have made this contract or would have made a different contract, adaptation of the contract may be demanded insofar as one of the parties, considering all circumstances of the particular case and having regard especially to the contractual or statutory distribution of risk, cannot reasonably be expected to abide by the unchanged contract.
- (2) It is equivalent to a change of circumstances if essential assumptions which have become the basis of the contract turned out to be wrong.
- (3) If adaptation of the contract is not possible or would be too hard on one of the parties, the aggrieved party may terminate the contract. In continuing contracts termination is replaced by giving notice.

the legal rules: it is not too complicated but at the same time it does not impose uniform solutions but makes distinctions between different situations and, finally, it achieves a fair balance of the interests of debtors and creditors. But the law is far from being perfect; it could be drawn up in a less complicated fashion, with fewer exceptions and clearer principles. But there is always the hope for improvement — perhaps next time by a European legislator.

8

Remedies for Breach through the Lens of the Third Party Beneficiary

NILI COHEN

I CONTRACT FOR THE BENEFIT OF A THIRD PARTY: THEORETICAL AND PRACTICAL JUSTIFICATIONS

A CONTRACT FOR the benefit of a third party expands the boundaries of contract. It has both theoretical and practical justifications. From the point of view of the contracting parties such a contract is a manifestation of the principle of freedom of contract. Contracts increase the economic welfare of the parties. A contract enables the parties to plan ahead and to rely on it. If the parties wish to confer upon a third party a benefit under their contract, there is no reason why not to implement their wish as long as it does not jeopardise the free will of that other party.

From the point of view of the beneficiary a contract for the benefit of a third party — if duly limited with regard to its coercive power on the third party — expresses the legitimate expectations of the beneficiary and protects her interest. Since such a contract operates for the benefit of the third party, the presumption is that the third party would be willing to accept its benefit. Yet she will not be coerced to accept it. As the contract may be concluded even without the knowledge of the beneficiary, she is, as a matter of Israeli law, given the right to repudiate the benefit.¹

The third party is not an active participant in the contract, and she might not even know about it at all. But her autonomy of will is sustained retrospectively after the creation of the contract. She can either approve of the benefit or reject it. She is not required actively to approve it. It suffices that she does not reject the contract. Silence is regarded as an approval.

¹ Section 35 of the Contracts (General Part) Law 1973 (27 LSI 117) provides: 'The beneficiary's right to demand fulfillment of the obligation becomes void retroactively if within a reasonable time after one of the parties to the contract informs him of the right he informs one of them of his repudiation thereof'.