European University Institute

DEPARTMENT OF LAW

The Regulatory Function of Contract Law:

A Comparative Law and Economics Approach

Lyubomira Gramcheva

Thesis submitted for assessment with a view to obtaining
the degree of Doctor of Laws of the European University Institute

Florence, 17 December 2015

European University Institute
Department of Law

The Regulatory Function of Contract Law:

A Comparative Law and Economics Approach

Lyubomira Gramcheva

Thesis submitted for assessment with a view to obtaining
the degree of Doctor of Laws of the European University Institute

Examining Board

Prof. Giorgio Monti, European University Institute (Supervisor)
Prof. Hans-Wolfgang Micklitz, European University Institute
Prof. Antonina Bakardjieva Engelbrekt, Stockholm University
Prof. Hugh Beale, University of Warwick

This thesis has been submitted for language correction.

Abstract

This thesis challenges the traditional view of national contract laws as facilitative regimes and argues that contract law on the national level has been progressively re-oriented to perform an efficiency-driven regulatory function. To develop the argument the thesis studies the contract law remedial regime of two common law and one civil law jurisdiction – the US, England and Bulgaria, in two specific contracts – the sale-of-goods and the construction contract. The introductory chapter puts the main theme in context and outlines the project. Exploring the limits of promissory theory and neoclassical economics, the second chapter develops an innovative interdisciplinary methodology joining the new institutional economics with the comparative law method. The third, fourth and fifth chapters offer taxonomies of remedies, types of contracts and remedial effects to set the stage for a meaningful comparison across the different legal traditions. Since economic theory has advanced most in the study of incentives generated by damages, the third chapter focuses on the latter remedy and shows that the common law classification of damage measures (expectation, reliance, restitution), on which traditional law-and-economics accounts are based, can be applied to study a civil law jurisdiction like Bulgaria. Distinguishing discrete and long-term contracts and demonstrating that the differentiation between sale-of-goods and construction contracts in the compared national legal systems does not necessarily go along the lines of the discrete/long-term distinction in economics, the fourth chapter argues that the positive comparison should be made with an eye on the market for substitute performances even if the compared factual scenarios are classified under different legal categories in the different jurisdictions. For the uninitiated, the fifth chapter reconstructs and criticises the standard economic model rationalising damages as incentives. The final chapter applies the approach developed here to contractual termination. The exemplary analysis identifies trends in the compared legal systems and suggests that all of them converge in charging the termination remedy with a regulatory function. Finally, I generalise to make some bolder claims about contract law.

Table of Contents

Chapter I Introduction

Remedies are usually placed at the very end of a signed agreement only after the parties have enumerated their contractual obligations. Moreover, many contracts exhaust only the actions which constitute performance, leaving out the effect on parties' duties of a number of (sometimes quite probable) contingencies or the consequences of various forms of non-compliance. Indeed, parties write incomplete contracts and often omit negotiations over delicate matters. Often they try first to deal with a problem arising in the course of a transaction amicably, and keeping lawyers out of it. Why then is it important to look at contracts through remedies?

'In one sense, every legal dispute is about remedies.'[1] A party is much more concerned with how much money he[2] will have to pay if he loses the case or how much he will collect if he wins than with questions such as whether there was a breach of contract. To be precise, remedies may be imposed even if it turns out that parties are not bound by an enforceable contract. In fact, we call the consequences of breach "remedies" precisely because contracts are incomplete. If they were to specify what should happen in each and every state of the world, there would be no reason to speak of their performance and breach. After all, such contracts would fully describe all possible contingencies and all steps that should follow them. Still, in some cases when it comes to commercial transactions that are not routine, in which large sums are at stake and sophisticated players are involved, parties try to plan attentively and as completely as possible. Contracts providing for such transactions are often distinguished for subtle, ingenious schemes and carefully spelled out governance mechanisms, by which parties attempt to control their fate. Partners do not simply describe their rights and obligations, they make an effort to regulate their relationship by incentivising

---

[1] Benjamin Hermalin, Avery Katz and Richard Craswell, ‘Contract Law’ in A. Mitchell Polinsky and Steven Shavell (eds), *Handbook of Law and Economics*, vol 1 (First edn, Amsterdam/London: North-Holland 2007) 99.

[2] For the sake of simplicity, throughout the thesis a contractual party will generally be denoted as 'he', which, depending on the circumstances, may mean an individual, a firm, or a firm's decision maker. In this sense, 'he' will often substitute 'she' or 'it' for the sole purpose of consistency. In addition, by a 'promisor' I mean a contracting party who is or may be in breach while by a 'promisee' I mean a party who is or may be harmed by breach. In the course of the thesis they will also be referred to, respectively, as 'breacher' and 'non-breacher'. For the sake of clarity, the promisor/breacher will be denoted as 'he' and the promisee/non-breacher as 'she'. The parties to the contract for sale of goods will be referred to as 'seller' and 'buyer' and the parties to the construction contract – as 'constructor' and 'client'. In both of these contracts, as in the majority of contracts, one party is required to provide a commodity (good or service) while the other party is required to pay money. For this reason, I will refer to a party who provides a commodity as 'Seller' and to a party who pays money – as the 'Buyer'.

one another to do or to refrain from doing something. In the parties' endeavour to attune their behaviour, remedies can serve as valuable instruments creating a number of effects on the players' interaction.

Remedies are of central importance to contract law also on a larger scale. Since the seminal Coase theorem it became clear that liability rules can be used as tools for assigning property rights in a way that maximises societal welfare. With costless transactions the initial allocation of rights cannot affect the operation of the economic system since resources will always travel to their most efficient use. Yet in the real world, transaction costs may often be sufficiently high to exceed the eventual gains and therefore to prevent bargaining altogether. In such cases, the property right, so to speak, sticks where it hits and determines the behaviour of market actors. Thus, in a world of positive transaction costs the challenge becomes to construct the "rules of the game"[3] (or, in the language of the thesis, *remedies*) that correct deficiencies without the cost of intervention outweighing the benefit. This challenge has already emerged on the European level where until recently the approach to the harmonisation of contract law was not remedy-oriented. Generally, the *acquis* tackles only specific problems in cross-border trade leaving enforcement to the national contract laws of Member States. The Commission's Proposal for an optional Common European Sales Law, however, purported to offer "a self-standing and complete set of rules for sales transactions",[4] including rules on remedies. This begs the question of how remedial rules in European contract law should be structured.

The research also focuses on remedies for methodological reasons. In the analysis of diverse legal systems remedial rules supply the concept of property rights with real meaning. The organisation of property rights and remedies fluctuates from one legal system to another. Different arrangements of property rights may be protected by the same remedy or the same property rights may be shielded by different remedies affording a different degree of protection depending on whether they are structured as (in the language of Calabresi and

---

[3] Douglass North, *Institutions, Institutional Change and Economic Performance* (First edn, Cambridge: Cambridge University Press 1990) 4.

[4] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. A Common European Sales Law to Facilitate Cross-Border Transactions in the Single Market, COM(2011) 636 final, Brussels, 11.10.2011, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0636:FIN:en:PDF 7 (hereafter "Communication for Common European Sales Law").

Melamed)[5] property rules or liability rules. Thus, remedies become a means of exploring various institutional environments characterised by different property right structures. No matter the legal tradition, in which property rights are embedded (common law or civil law), remedies provide them with actual content, define their limits and give them value permitting a more rigorous comparison. With the abundance of national legal arrangements, remedies offer the chance for a deep look at the very operation of a legal system, a look that goes beyond the façade of the doctrinal discourse.

The thesis digs into the law of monetary damages, the primary remedy for breach of contract in common law systems and a subsidiary but still widely used remedy in civil law systems. Depending on the interest protected, on the mode of calculation and on their applicability by default or by a clause in the parties' agreement, damages are denoted with different names in the different jurisdictions.[6] Yet the concept is the same, the party does not receive what he bargained for but does receive compensation, usually in the form of a certain monetary amount. The key reason to choose damages as the main subject of the research is that they allow us to see the problem of enforcement not only through the desirability of the promised behaviour but also through the joint effect of a broad set of incentives that affect the parties' conduct.[7] In addition, the thesis juxtaposes damages to specific performance in light of the different weight given to each remedy in civil law and common law systems.

The starting point of the project is that contract law can be viewed not only as a facilitative but also as a regulatory device. In this sense remedies for breach of contract perform not only a market-building function but also contribute to market regulation. The thesis aims at comparing the remedial schemes of three legal systems in the contract for sale of goods and the construction contract in order to uncover the balance between the facilitative and regulatory role of remedies struck in each jurisdiction. The goal is to understand better the reasons for the differences in the national remedial allocation and to highlight particular problems which could be overcome by transplanting foreign solutions. Another aim of the project, related to the first one but still separate and independent from it, is to formulate

---

[5] Guido Calabresi and Douglas Melamed, 'Property Rules, Liability Rules, Inalienability: One View of the Cathedral' (1972) 85 Havard Law Review 1089.

[6] For the different measures of damages, see in detail *infra* Section C. of Chapter III.

[7] Richard Craswell, 'Two Economic Theories of Enforcing Promises' in Peter Benson (ed), *The Theory of Contract Law New Essays* (First edn, Cambridge, UK: Cambridge University Press 2001).

guidelines for a scheme on the European level recognising and incorporating both functions of contractual remedies.

This chapter is structured as follows. Section A sets out the background on the basis of which the entire project is designed. Section A.1 and Section A.2 are devoted to contract law's function to create and, respectively, to regulate a market. Section A.3 concentrates on the specific character and reinforced regulatory function of European contract law. After these introductory points Section B turns the focus to the research project at hand. Section B.1 outlines the scope of the project in terms of the types of contract compared. Section B.2 justifies the choice of the selected jurisdictions. The chapter then concludes and outlines the way forward.

A. Background

Before indulging in the empirical analysis, some preliminary matters require attention. To compare the contract damages and specific performance in the considered national jurisdictions and to evaluate the similarities and differences as well as the possibilities for designing a remedial model on the European level, it is first necessary to draw the background picture against which the thesis should be read. In this respect, it will be helpful to set out the different functions of contract law in order to determine a common viewpoint when exploring the different legal systems.

1. Contract law's function to create a market

The traditional view holds that the very raison d'être of contract law is to facilitate trade. If exchange generates gains not only for the parties taking part in it but also for society, the role of contract law should be to maximise the number of contracts, to make contractual transactions so habitual that their amount constructs an operating market. The fundamental principles of modern contract law embodying this market creation function are freedom of contract and the binding force of contract. They are the starting point expressing the basic approach to contract as a manifestation of the free choices of the parties which will be enforced by the law. Yet, though essential, these categories of principle tell us little about the mechanism by which contract law fulfils its function to foster trade and create a market.

When it comes to a simultaneous exchange, contract law is of little relevance. Such spot transactions (commercial or consumer) allow parties to enjoy the gains from trade and resources to move to a more valued use without the need of a formal contract. This, however, changes when instead of exchanging goods or services for money, parties exchange promises with regard to their future behaviour. If transactions are characterised by such an intertemporal element, contracts become valuable for three reasons: coordination, implementing deferred exchange, and encouraging specific investment.

Coordination

By coordinating their behaviour, commercial players can achieve more than on their own. The road to cooperation, however, is paved with doubt, distrust, and uncertainty. In a deferred exchange, self-interest dictates non-performance either because there is no guarantee your partner will perform, or because once he has performed, you will be better off not fulfilling your own promise. In this sense, it is the role of contract law to provide a stable framework which changes the parameters of the game and encourages parties to coordinate where coordination does not emerge spontaneously. Trust alone is not sufficient to create a market when it comes to large, open communities in which the fear of social exclusion cannot prevent uncooperative behaviour.[8] In this respect a contract remedy rule acts as a correlating device.[9] It specifies to all players that in the particular environment of non-instantaneous exchange, the gain is higher if they cooperate rather than appropriate.[10] Sharing a belief that it will be more beneficial to foreclose the latter opportunity, parties consider each other's promises credible. Thus, by making promises enforceable, contract law fosters cooperation. Bound to honour their commitment, parties overcome the prisoner's dilemma and engage in trade.[11]

---

[8] On the importance of trust, see Stewart Macaulay, 'Non-Contractual Relations in Business: A Preliminary Study' (1963) 28 American Sociological Review 55, 58-59; Ian Macneil, 'Contracts: Adjustment of Long-Term Economic Relations under Classical, Neoclassical and Relational Contract Law' (1978) 72 Northwestern University Law Review 854, 858. For a more recent argument in socio-legal studies emphasising the role of trust, see Hugh Collins, *Regulating Contracts* (First edn, Oxford/New York: Oxford University Press 1999) 102-111. Collins himself admits that trust alone will rarely be sufficient to form a market, especially considering that the level of social trust in some countries is traditionally low. Yet, he asserts that it is the combination of trust and non-legal sanctions that is crucial in market creation.

[9] Herbert Gintis, *The Bounds of Reason: Game Theory and the Unification of the Behavioral Sciences* (Princeton, NJ: Princeton University Press 2009).

[10] Robert Cooter and Thomas Ulen, *Law and Economics* (Fifth edn, Pearson/Addison-Wesley 2008) 206.

[11] Douglas Baird, 'Self-Interest and Cooperation in Long-Term Contracts' (1990) 19 The Journal of Legal Studies 583.

In a non-laboratory environment, contracts achieve much more stable results with regard to coordination than focal points[12] or the announcement of intentions.[13] Certainly, the presence of formal contracting does not automatically mean that state enforcement (awarding damages or specific performance) is always necessary. Many agreements are self-enforcing[14] or can be enforced by reputational sanctions.[15] In addition, in societies that are not built on the rule of law, illegal remedies such as intimidation and physical aggression, as practiced by mafia or racketeer groups for example, play a similar role. This account, however, deals with court enforcement which facilitates contracting in the anonymous market where self-enforcement and reputation fail[16] and which, compared to extra-legal and illegal arrangements, entails at least two advantages: the ability of the enforcer to expropriate the profit is constrained by rule of law and the costs of enforcement are distributed among all society members.[17]

---

[12] Focal points are solutions people will be inclined to resort to in the absence of communication. They indicate "each person’s expectation of what the other expects him to expect to be expected to do." Thomas Schelling, *The Strategy of Conflict* (Fifth edn, Cambridge, MA: Harvard University Press 1976) 57.

[13] It is suggested that in case of cheap talk, *i.e.* communication between players which does not directly affect their payoffs, coordination can be achieved if parties announce their intentions in advance. Joseph Farrell, ‘Cheap Talk, Coordination and Entry’ (1987) 18 The Rand Journal of Economics 34.

[14] Even if reciprocity is suggested to extend the self-enforcing range of contracts, experimental scholars conjecture that as a contract enforcement device, it works only in two-person experiments with perfect information while losing its effect in a similar-to-market environment with information deficiency. See Robert Scott, ‘A Theory of Self-Enforcing Indefinite Agreements’ (2003) 103 Columbia Law Review 1641; Colin Camerer, *Behavioural Game Theory: Experiments in Strategic Interaction* (New York: Russel Sage Foundation; Princeton, New Jersey: Princeton University Press 2003). Despite parties' reliance on self-enforcing arrangements, formal contracting still matters since contract terms facilitate the work of self-enforcement mechanisms (the threat that the contractual partner will terminate the relationship and no longer do business with the breacher). See Benjamin Klein, ‘The Role of Incomplete Contracts in Self-Enforcing Relationships’ in Eric Brousseau and Jean-Michel Glachant (eds), *The Economics of Contracts: Theories and Applications* (First edn, Cambridge/New York: Cambridge University Press 2002).

[15] To stimulate performance, however, reputational sanctions also presuppose relatively small business communities or industries with established trade associations able to stigmatise a disreputable contracting behaviour. See Alan Schwartz and Robert Scott, ‘Contract Theory and the Limits of Contract Law’ (2003) 113 Yale Law Journal 541, 557.

[16] In short, self-enforcement mechanisms and reputation sanctions are not effective when the expected gain from breach exceeds the losses from retaliation and ostracism. For example, the losses of social expulsion tend to pale where the community is small compared to the size of the market. Eric Brousseau, ‘Contracts: From Bilateral Set of Incentives to the Multi-Level Governance of Relations’ in Jean-Michel Glachant and Eric Brousseau (eds), *New Institutional Economics: A Guidebook* (First edn, Cambridge, UK/New York: Cambridge University Press 2008) 63. In addition, self-enforcement and reputation are constrained by the costs associated with them. Hostages are costly as they have to be chosen not to incentivise opportunistic behaviour on the side of the hostage taker and are particularly expensive when they need to be sufficiently valuable to prevent large-scale deviations. Retaliation by a party who, unlike a judge, does not have authority to resolve disputes may be difficult to tolerate and, hence, may entail costs related to upsetting the cooperative equilibrium. Also, information asymmetries exist even within business communities where information dissemination is, too, imperfect. Robert Scott, ‘Conflict and Cooperation in Long-Term Contracts’ (2009) 75 California Law Review 2005, 2039-2040, 2043; Brousseau 63.

[17] Brousseau 38-39.

Implementing deferred exchange

Contract law promotes trade not only because it spurs cooperation where suspicion in the partner's strategy thwarts it. It also facilitates exchange where its value depends on future uncertain states of the world. Such a transaction cannot take place on the spot market and mandates some advance commitment.[18] The typical example is an insurance agreement which may be beneficial for both parties at the time of contracting but not at the expiration of the agreement. While the main motivation to execute an insurance agreement is that a risk-averse party transfers risk to a less risk-averse player, the very need to contract for future delivery does not depend on parties' sensitivity to risk. For example, it might be that risk-neutral parties enter into a forward agreement, each party believing that the market price will change in its favour. In case a drastic change of the price ensues, at the time of performance one of the parties will prefer not to have executed the transaction at all. The fact that parties are bound by an enforceable commitment, however, makes trade possible when future contingencies can alter their *ex post* utility from the transaction. In the more general case contract law facilitates exchange any time when one of the parties performs before his partner. Structuring trade so that it consists of separate instalments, the time of delivery of which is matched with a respective payment from the counterparty, raises transaction costs and may not always be possible.[19]

Of course, constraining one's behaviour for the future and drafting a forward agreement is also costly. Yet, even when the market is thick and economic players will be able to purchase the desired good or service in a spot transaction, they still engage in transactions for future delivery whenever their disruption costs outweigh the costs of contracting. When the stakes in a transaction are large enough that an adverse development can put the promisee out of business, the enforceable contract provides him with an insurance against unfortunate events in volatile markets.[20]

Encouraging specific investment

Contract law also encourages trade by allowing parties to make advance investments which will enhance the value they will obtain from exchange. Neither of the parties will be willing

[18] Hermalin, Katz and Craswell 9.
[19] Ibid 10.
[20] Schwartz and Scott 562-565.

to sink in resources, which he cannot recoup, if he is not sufficiently assured that the other party will perform. If the Seller has not received the Buyer's enforceable promise, he will hardly invest in tailoring commodities to the Buyer's needs, even though in this way he can increase his profit. The specific investment would give the Buyer an incentive to demand a renegotiation of the price in order to extract a greater portion of the contractual surplus and the Seller would be forced to agree. Otherwise, not being able to resell on the spot market, he would lose even more. Thus, the absence of an enforceable contract ensuring that the Seller will recover his sunk costs may stop him from investing and consequently prevent trade from taking place at all.[21]

The Buyer can also invest in the envisaged exchange in order to enjoy fully his utility from the transaction. But when these investments are relation specific, the Buyer will not make them without having struck an enforceable deal since he would not want the Seller to take advantage of his reliance and force less favourable terms afterwards.[22] A remedy which compensates the Buyer for his accrued investment will incentivise him to take steps to increase his gain. Thus, contract law motivates parties to make value enhancing investment[23] which on in its own turn augments the volume and intensity of trade.

In sum, contract law makes the risk of loss acceptable to economic players. By reducing it to a level which is lower than the probability of profit, they stimulate parties to overcome their fear of opportunism and to enter voluntarily into transactions. Removing to a great extent the uncertainty impeding trade and permitting the production of specialised products, enforceable contracts allow parties and society to enjoy the benefits of exchange. Trade becomes widespread and a market, *i.e.* a forum where exchange takes place, is created. Besides playing a crucial role in facilitating exchange, contract law can also contribute to its regulation. I address this function below.

---

[21] In this model, the investment made by the seller is not taken into account upon renegotiation since at that time it has already been sunk. There is some evidence that in bargaining individuals do not completely ignore sunk costs which increases the investing party's payoff and consequently his incentive to invest. In addition, a dynamic bargaining game suggests that in the absence of an enforceable contract, staging investment raises a party's incentive to invest. This experimental evidence is yet to be confirmed. Even if without an enforceable contract the possibility for hold-up might not always result in underinvestment, it still occurs often enough to make a strong case in favour of contractual remedies. Ibid 561.

[22] Hermalin, Katz and Craswell 10-11; Schwartz and Scott 559-562.

[23] See in this sense also Steven Shavell, *Foundations of Economic Analysis of Law* (First edn, Cambridge, Massachusetts: Belknap Press of Harvard University Press 2004) 362.

2. The contract law's function to regulate a market

In both Europe and the US the traditional stance envisages a strict separation between private law and regulation. In Europe private law is seen as protecting established individual rights by securing property entitlements and enforcing private arrangements while regulation is constrained to promoting certain economic and social policies, the latter protecting particular social groups. In the US the Chicago school posited contract law as a basic precondition for the creation and sustenance of a free market. Any public regulation is viewed as apt to misbalance the efficient market and, therefore, should be employed solely to correct market failures which contract law proved to be unable to address.[24] In the eyes of private lawyers, both in Europe and across the Atlantic, contract law and regulation use profoundly different governance techniques: the former is general, private, facilitative, decentralised and operates *ex post*, the latter is particularistic, public, directive, centralised and operates *ex ante*.[25]

<u>New developments, new perspectives</u>

The viewpoints, described above, however, omit mounting evidence about the progressive blurring of the rigid public-private divide, starting in the last quarter of the 20th century.[26] This blurring has entailed a two-way process: on one side, market-based mechanisms are increasingly being used to correct market failures;[27] on the other side, a considerable body of

---

[24] Hugh Collins, 'The Alchemy of Deriving General Principles of Contract Law from European Legislation: In Search of the Philosopher's Stone' (2006) 2 European Review of Contract Law 213, 216-217. Collins, *Regulating Contracts* 7, 57. Hugh Collins, 'Governance Implications for the European Union of the Changing Character of Private Law' in Fabrizio Cafaggi and Horatia Muir-Watt (eds), *Making European Private Law: Governance Design* (Cheltenham: Edward Elgar 2008) 276-277. Wolfgang Kerber, 'European System of Private Laws: An Economic Perspective' in Fabrizio Cafaggi and Horatia Muir-Watt (eds), *Making European Private Law: Governance Design* (Cheltenham: Edward Elgar 2008) 67-69.

[25] Anthony Ogus, *Regulation: Legal Form and Economic Theory* (First edn, Oxford: Clanderon Press 1994); Collins, 'The Alchemy of Deriving General Principles of Contract Law from European Legislation: In Search of the Philosopher's Stone' 216-217.

[26] Fabrizio Cafaggi and Horatia Muir-Watt (eds), *Making European Private Law: Governance Design* (Cheltenham: Edward Elgar 2008).

[27] For the relationship between civil liability in tort and administrative regulation as complementary regulatory devices, see Fabrizio Cafaggi, 'A Coordinated Approach to Regulation and Civil Liability in European Law: Rethinking Institutional Complementarities' in Fabrizio Cafaggi (ed), *The Institutional Framework of European Private Law* (First edn, Oxford/New York: Oxford University Press 2006). In the field of contract law, specific principles for the protection of weaker parties and for particular types of agreements such as consumer, employment and standard form contracts were developed. Collins, 'Governance Implications for the European Union of the Changing Character of Private Law' 278.

private regulation, either complementing, or substituting public regulation, has evolved.[28] As an implicit rebuttal of the traditional public-private opposition, a number of innovative modes of governance, mixing in a different manner state law, private regulation and market solutions have developed.[29] As a result, gradually, the Pigouvian model of centralised regulations and the Coasian model of decentralised enforcement of property rights by courts have come to be seen not as alternative but as complementary models of institutional control, the scope of which varies from jurisdiction to jurisdiction. It became clear that no legal system exclusively uses one or the other approach to steer the market. Rather each legal system relies on a different combination between the two models with a number of institutional factors determining the specific mixture.[30]

This has led to the insight that contract law may also be viewed as an instrument to regulate markets.[31] Within this approach regulation is defined as a functional concept meaning any system of rules intended to govern the behaviour of its subjects which performs the essential functions of all regulatory systems: standard-setting, monitoring and enforcement.[32] Truly, on the national level this aspect of contract law's character continues to be contested.[33] Yet, a close look at, for example, the legal doctrines of fraud, mistake, lack of capacity, duress, or

---

[28] For the role of private regulation in European contract law, European tort law and unfair competition law, see Fabrizio Cafaggi, 'Private Regulation in European Private Law' EUI Working Papers, RSCAS 2009/31, Robert Schuman Center for Advanced Studies, Private Regulation Series-01 .

[29] Kerber 70-72. See also Fabrizio Cafaggi, 'Rethinking Private Regulation in the European Regulatory Space' in Fabrizio Cafaggi (ed), *Reframing Self-regulation in European Private Law* (The Hague: Kluwer Law International 2006).

[30] Ugo Mattei, *Comparative Law and Economics* (First edn, Ann Arbor: The University of MIchigan Press 1997) 63-67.

[31] Collins, *Regulating Contracts*; Hugh Collins, 'Regulating Contract Law' in Christine Parker and others (eds), *Regulating Law* (First edn, Oxford: Oxford University Press 2004) For an argument against adopting such an approach Jane Stapleton, 'Regulating Torts' in Christine Parker and others (eds), *Regulating Law* (First edn, Oxford: Oxford University Press 2004).

[32] Collins, *Regulating Contracts* 7, 65. Black also defines regulation as a "sustained and focused attempt to alter the behaviour of a subject according to identified purposes with the intention to produce a broadly identified outcome or outcomes which may involve mechanisms of standard-setting, information-gathering and behaviour-modification." Julia Black, 'Regulatory Conversations' (2002) 29 Journal of Law and Society 163, 170. On the different definitions of regulation, see Collins, *Regulating Contracts* 7; Collins, 'The Alchemy of Deriving General Principles of Contract Law from European Legislation: In Search of the Philosopher's Stone' 216; Terence Daintith, 'Chapter 10 Regulation' in Richard Buxbaum and Ferenc Mádl (eds), *International Encyclopedia of Comparative Law* vol XVII State and Economy (First edn, Tübingen: J. C. B. Mohr (Paul Siebeck); Dordrecht/Boston/Lancaster: Martinus Nijhoff Publishers 1997) 3-5.

[33] Both Hans Micklitz and Norbert Reich bring up the German debate on the nature of contract law. Hans-W. Micklitz, 'Regulatory Strategies on Services Contracts in EC law' in Fabrizio Cafaggi and Horatia Muir-Watt (eds), *The Regulatory Function of European Private Law* (Cheltenham/Nothampton: Edward Elgar 2009); Norbert Reich, 'Transformation of Contract Law and Civil Justice in the new EU Member Countries: The Example of the Baltic States, Hungary and Poland' in Fabrizio Cafaggi (ed), *The Institutional Framework of European Private Law* (First edn, Oxford/New York: Oxford University Press 2006).

undue influence reveals that they can all be interpreted as substantive limitations on freedom of contract, which remedy situations of market failure.[34] The regulatory function is also said to be encoded in general clauses related to 'good morals' and 'public policy'.[35] From this standpoint what differs between jurisdictions is the degree to which contract law is charged with a regulatory function, not its presence or absence.

Such a perspective is also adopted by this thesis where the regulatory function of contract law is defined as its ability to address market failures.[36] Three types of market failures have been distinguished in the literature: (i) market power; (ii) information asymmetries; and (iii) externalities.[37] Nowadays, situations of weak competition are typically cured by competition law. Due to the principle of privity, in the case of externalities the affected third parties generally cannot rely on contract law remedies but must resort to devices provided by tort, property, criminal law or by the traditional business regulation measures. Thus, in national contract law information asymmetries are the most important.[38] In this respect, the research starts from the assumption that the rules of contract in unregulated markets can be used as regulatory instruments. The regulatory dimension of the body of contract rules developed within regulated markets (energy, telecommunications, banking, *etc.*) remains beyond the scope of the project. Even if I do not think that the regulatory function is the prevailing or the sole function of contract law, I believe the application of a regulatory lens is an intelligible and promising activity[39] which expands the dominant understanding of contract law exclusively as a facilitative device. In this respect, remedies with their ability to allocate losses and gains and to rank property rights by means of the offered degree of protection appear as a productive ground for research.

---

[34] Collins, *Regulating Contracts* 59. Hermalin, Katz and Craswell 52-57.
[35] Reich 272.
[36] Cafaggi and Muir-Watt, *Making European Private Law: Governance Design* 2. This definition differs from the definition adopted by Hugh Collins who associates the regulatory function of private law with distributive justice. See Collins, 'The Alchemy of Deriving General Principles of Contract Law from European Legislation: In Search of the Philosopher's Stone' 219. For an argument in the American doctrine that US contract law also has regulatory role in the sense that it reflects not only the pursuit of individual autonomy but broader social concerns such as fairness, decency, trust and cooperation, see Jean Braucher, 'Contract versus Contractarianism: The Regulatory Role of Contract Law' (1990) 47 Washington and Lee Law Review 697.
[37] Cooter and Ulen 226-231.
[38] Private information allows resources to be allocated efficiently and motivates exchange. In this sense asymmetric information is not harmful per se. After all, enforcement of contracts based on information asymmetries incentivises discovery of productive information. Ibid 296. However, when a party to the contract systematically cannot acquire information or can acquire it only at prohibitively high costs (*e.g.* consumers), resources cannot move to more productive uses and measures correcting the asymmetry are justified.
[39] See Stapleton 126 who argues that Collins' arguments do not warrant the adoption of regulatory perspective to private law.

The regulatory function of remedies seems much more established in the field of tort[40] where there was a debate regarding the appropriate type of liability rule: strict liability or negligence. A similar debate did not take place in contract law, where scholars never advocated that the breacher be excused from liability in case of efficient breach. Instead they relied on the fact that enforcement of the promise may not involve performance of the promised actions but the payment of damages and argued for, so to speak, strict liability of the non-performing party no matter whether his breach was justified by an increased cost of performance or not.[41] The threat of such a monetary award, especially if based on the proper damage measure, would give the breacher the incentive to perform only when it is efficient. Law and economics, however, has long since moved beyond this initial model in which the efficiency of contract enforcement depends solely on the efficiency of the promised actions. The most recent economic theory considers remedies for breach of contract as inducing a whole set of incentive effects on the parties' behaviour and evaluates enforcement with respect to the joint effect from the alteration of all these incentives.[42] Such a view of remedies as incentives and not as sanctions[43] challenges the positivistic understanding which has exerted a profound influence on both civil law and common law systems. Yet, it fits nicely with the regulatory approach considering contracts as subjecting parties to a number of legal rules (agreed, default and mandatory) that modify their incentives just like any other regulatory regime does.[44]

Default rules and mandatory rules

It might seem odd that default rules, as the bulk of legal rules in contract law are, can exercise a regulatory function. Usually, for private lawyers, it is mandatory rules that are associated with pursuing regulatory goals while defaults are viewed as a device meant to minimise transaction costs leading to contractual incompleteness.[45] But besides the negative

---

[40] Guido Calabresi, *The Cost of Accidents: A Legal and Economic Analysis* (Fifth edn, New Haven: Yale University 1977); Steven Shavell, 'Liability for Harm versus Regulation for Safety' (1984) 13 Journal of Legal Studies 357; Cafaggi, 'A Coordinated Approach to Regulation and Civil Liability in European Law: Rethinking Institutional Complementarities'.

[41] See in this sense Craswell 22, 23.

[42] Ibid 28, 30-32.

[43] Hans Kelsen, *General Theory of Law and State* (New York: Russel and Russel 1961).

[44] Craswell 33.

[45] This is the conventional justification for the existence of contract defaults. Parties write incomplete contracts because their costs to negotiate and draft a contractual term often exceed the gains from solving the particular contractual problem (especially when the risk of the contingency materialising is small). Devising an efficient

cost/benefit balance, informational asymmetry is another reason for which parties leave gaps in their contracts. Asymmetric information prevents actors from conditioning the contract on such important variables such as the cost and value of performance[46] and often information is purposefully suppressed by a player to gain a strategic advantage towards his contractual partner.[47] In addition to mandatory rules,[48] default rules, called "penalty defaults",[49] which provide stimuli for efficient disclosure of information, are also summoned to combat this market failure. They are deliberately attuned to what the majority of the parties would disfavour in order to incentivise the informed party to negotiate around the default, thus disclosing information which would be relevant for the counterparty *ex ante* when he has to decide on entering into the contractual relationship. A default with such an "information-forcing"[50] effect is the rule which provides that in case of breach a party can recover only the damages that are foreseeable to the other party. This default gives an incentive to the promisee to disclose the magnitude of his loss to the promisor.[51] In this way the latter can take efficient precautions against breach and set the price more accurately.[52] Penalty defaults can also be purposefully devised to encourage the disclosure of information which would be

---

term, the parties bear the cost but would likely not reap the full gain since other agents would probably copy the term. Where contracting costs prevent parties from writing complete contracts, it is efficient that lawmakers supply them with contract terms because the costs of their creation will be smaller than the total social gain from their use in many transactions. In large markets, economic actors' heterogeneous preferences imply that publicly supplied contract rules should be defaults so that parties who dislike them are still able to devise their own solutions. Schwartz and Scott 595-596; Alan Schwartz, 'The Enforcement of Contracts and the Role of the State' in Fabrizio Cafaggi, Antonio Nicita and Ugo Pagano (eds), *Legal Orderings and Economic Institutions* (First edn, London/New York: Routledge 2007) 109-110.

46 Informational asymmetry is present when the information is either unverifiable (*i.e.* a party can observe it but cannot verify it to a third party such as a court at a cost lower than the gain derived from proving it) or unobservable (*i.e.* a party cannot observe it at all). Schwartz and Scott, 'Contract Theory and the Limits of Contract Law' 605. With information asymmetry writing an incomplete contract is a better alternative for the parties than disclosing information (cost and value) they want to keep private or having enforcement depend on facts that are not observable or verifiable in court.

47 If by not revealing information to his contractual partner, the party remains pooled with a larger class of parties wrongly considered by his partner to be similar, the party manages to negotiate a price that is cross-subsidised by the class of players to which he does not belong. Disclosing information and separating from the cross-subsidising pool will reduce the informed party's portion of the contractual surplus, so the party may prefer to forego the increase in value resulting from the efficient equilibrium in order to keep his share of the surplus larger. Ian Ayres and Robert Gertner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules' (1989) 99 Yale Law Journal 87, 94, 99-100.

48 Such mandatory rules are present within the doctrines of fraud, failure to disclose, frustration of purpose, mutual mistake. Cooter and Ulen 228-230.

49 Ayres and Gertner.

50 Hermalin, Katz and Craswell 88.

51 Ayres and Gertner 101-104.

52 Parties themselves can also create penalty defaults. For example, by inserting in the proposed contract a clause which disclaims consequential damages, the promisor induces the promisee to negotiate away the disclaimer and thus disclose the extent of consequential damages she would suffer in case of breach. Schwartz and Scott, 'Contract Theory and the Limits of Contract Law' 598, footnote 116; Schwartz, 'The Enforcement of Contracts and the Role of the State' 115, footnote 3.

relevant for courts *ex post* when they interpret the contract. In this case, they deter inefficient gaps in contracts, penalising the parties for externalising their negotiation costs on courts when having the court decide a dispute would be more costly than explicitly agreeing on an issue *ex ante*.[53]

It should be kept in mind that a penalty default will not foster disclosure of information when the penalty it imposes is too small compared to the value generated by the rent-seeking behaviour of the informed party. The party may particularly appreciate his informational advantage when he does not have bargaining strength in a bilateral monopoly setting,[54] when disclosure would reveal valuable private information related not only to the particular contract[55] or when disclosure along one dimension would also allow inferences about other unverifiable or unobservable matters.[56] In addition, penalty defaults may also have a negative effect on parties' incentives to search for and collect information.[57] In any case, what is important at this preliminary stage of the research is that when the adopted regulatory strategy is not command-and-control but rather incentive-based, contract default rules can also perform a regulatory function.[58]

---

[53] In such cases, defaults refusing to enforce the parties' agreement and thus set against both parties appear more efficient than defaults disciplining only one of them. In addition to being easy to enforce and to incentivising both players to reveal information, non-enforcement defaults do not induce opportunism. In contrast, a penalty default directed against only one of the parties stimulates opportunistic behaviour by the other who may try to bind the party subject to the penalty in an unfavourable contract. An example of a penalty default designed to incentivise both parties to negotiate on an issue *ex ante* in order to save the larger litigation costs *ex post* is UCC § 2-201(1) according to which if the parties have not determined the quantity of the goods sold in their contract, the latter is not enforceable. Ayres and Gertner 95-98. Unless otherwise indicated, the thesis refers to the official text of and comments to the Uniform Commercial Code, which is current through the July 2011 meeting of the National Conference of Commissioners and the May 2011 meeting of the American Law Institute.

[54] Jason Johnston, 'Strategic Bargaining and the Economic Theory of Contract Default Rules' (1990) 100 Yale Law Journal 615.

[55] Omri Ben-Shashar and Lisa Bernstein, 'The Secrecy Interest in Contract Law' (2000) 109 Yale Law Journal 1885.

[56] Barry Adler, 'The Questionable Ascent of Hadley v. Baxendale' (1999) 51 Stanford Law Review 1547.

[57] Ayres and Gertner 107.

[58] Besides penalty defaults, other types of default terms can also have regulatory function. The default interpretation by which courts fill the gap when they strike down a contractual term, intended to mute a mandatory rule, has a deterrent effect when it imposes a penalty worse than the mandatory term itself. Such penalising default interpretation may prove to alleviate a possible under-deterrent effect of a mandatory term considering that the number of litigations involving similar contracting-around endeavours is far from the actual number of agreements in which mandatory terms are simply neglected. In addition, the so-called "strong defaults", introducing specific formalities which must be followed to contract out of them, are intended to dissuade economic players from escaping them. Courts can also create strong defaults by requiring parties to use specific language to contract around a default term without stating what this language is. When courts have continuously refused to recognise parties' attempts to reach a contractual outcome that differs from a default without indicating the sufficient conditions, the cost to contract out of a default becomes so large that the default turns out to be a quasi-mandatory rule. Compelling the use of specific language, courts can force a party to

If this is the case, the question arises of how the law should intervene: by a default or by a mandatory rule considering that the latter's principal rationale is to regulate.[59] A default rule has some deterrent effect since due to transaction costs many parties stick with it even if they would have been better off contracting out. For example, it has been argued that parties do not opt out of defaults (or standardised terms) as a result of cognitive and socio-psychological limitations[60] as well as network externalities, the latter determining the value of standardised terms in business by the number of their users.[61] This is the idea upon which rests the so-called "central-command approach", which advocates that defaults should be set so that they are substantively efficient.[62] While sticky, default rules can still be altered by parties who want to create their own terms, so they have been supported as a softer regulatory method to alleviate problems of bounded rationality.[63]

In this respect, a distinction between business-to-business and business-to-consumer transactions should always be borne in mind. Mandatory rules can be justified when one of the parties is not sophisticated.[64] For such a party it is, generally, inefficient to sink resources into becoming acquainted with all contractual details when the expected gain from understanding a contract clause concerning an unlikely event is smaller than the cost of understanding, (*i.e.* the time and effort spent in reading and comprehending the provision or the amount spent for a consultation with a lawyer). In this case, the offeror will be better off inserting in the contract a clause that maximises his own benefit but not the contractual

---

divulge information to his counterparty and to the courts themselves. Such explicit language can alert the less informed party about his legal rights. It can also drive economic players to separate in different groups where only the group of those receiving sufficiently high gains will not be discouraged from contracting around the default. Ibid 120-127.

[59] Mandatory terms are called upon to correct market failures. The prohibitions of fraud and duress can be viewed not only as being based on informational asymmetry concern but also on externality concern since the party uses them to extract a bigger portion of the contractual surplus, externalising the enforcement costs of this redistribution to society. The doctrine of unconscionability tends to be invoked in the context of situational monopolies or information deficit. Schwartz and Scott, 'Contract Theory and the Limits of Contract Law' 609-610; Cooter and Ulen 230-231.

[60] Russel Korobkin, 'The Status Quo Bias and Contract Default Rules' (1998) 83 Cornell Law Review 608.[60] It has recently been argued that Korobkin's endowment effect is not relevant with regard to commercial transactions in which sophisticated, experienced business parties exchange goods for money, both specifically held for the purpose of trade. Schwartz and Scott, 'Contract Theory and the Limits of Contract Law' 596-597, footnote 113.

[61] Marcel Kahan and Michael Klausner, 'Standardization and Innovation in Corporate Contracting (Or the Economics of Boilerplate)' (1997) 83 Virginia Law Review 713.

[62] Hermalin, Katz and Craswell 87-88.

[63] Colin Camerer and others, 'Regulation for Conservatives: Behavioural Economics and the Case for Asymmetric Paternalism' (2003) 151 University of Pennsylvania Law Review 1211.

[64] Russel Korobkin and Thomas Ulen, 'Law and Behavioural Science: Removing the Rationality Assumption from Law and Economics' (2000) 88 California Law Review 1051.

surplus. Since the offeree will not invest in understanding the provision, there is no point in the offeror stipulating a term that is more favourable to the offeree; in any case, the latter will not appreciate such benevolence.[65] In comparison with consumers, however, firms are more able to allocate resources in order to alleviate cognitive limitations and to ensure a detailed review of contracts. Also, they are not pure contract-takers but can bargain to achieve more favourable contractual terms. In this sense, firms are not as inadequate as individuals in protecting their interests. For this reason, a rigorous use of mandatory rules to shield them against the challenges of business cooperation may incentivise them to under-invest in their contractual arrangements instead of leading to efficient contracting.[66] That is why, the softer method of regulation supplied by defaults may be more appropriate in business-to-business relationships.

In any case, mandatory rules should be used carefully. Restricting party autonomy as well as the variety of offers on the market, they limit the means of the parties to maximise contractual surplus. They also imply a trade-off between the correction of the market failure and the costs associated with the regulatory measure. Thus, mandatory rules should be brought into play only in case of positive cost/benefit balance and when the problem in the market mechanism cannot be adequately resolved by default rules.[67]

Setting a good default depends on the purposes for which the default is provided: to save on parties' cumulative transaction costs, in which case the default should be designed according to what the majority of parties wants,[68] or to pursue regulatory goals such as inducing information revelation, in which case the default should be devised as a penalty default. But whatever the rationale of the particular default, it must be drafted either as a standard or as a rule.[69] The choice between the two implies certain trade-offs which are relevant for the level of generality with which defaults should be formulated.

---

[65] Melvin Eisenberg, 'The Limits of Cognition and the Limits of Contracts' (1995) 47 Stanford Law Review 211; Hermalin, Katz and Craswell 42-45.

[66] Brousseau 49-50.

[67] Filomena Chirico, 'The Function of European Contract Law - An Economic Analysis' in Filomena Chirico and Pierre Larouche (eds), *Economic analysis of the DCFR: the Work of the Economic Impact Group within CoPECL* (München: Sellier European Law Publishers 2010) 24.

[68] On the "transaction-cost-reducing approach", advocating majoritarian defaults, see Charles Goetz and Robert Scott, 'The Mitigation Principle: Toward a General Theory of Contractual Obligation' 69 Virginia Law Review 967, 971; Schwartz and Scott, 'Contract Theory and the Limits of Contract Law' 596-597.

[69] The content of a rule is specified in advance. In contrast, the content of a standard is specified only *ex post*. Louis Kaplow, 'Rules versus Standards: An Economic Analysis' (1992) 42 Duke Law Journal 557. For example,

Because of their precision, default *rules* rarely fit various sets of contracting parties. The cost of creating *ex ante* efficient rules for all party types, however, would prove so large that it would deplete the primary cost justification for setting defaults in the first place. With party heterogeneity, broad default *standards* are easier to design since they would apply to many contexts and the drafting cost would likely not exceed the social gain.[70] Multi-factored standards are also apt to accurately reflect the underlying legal principle. Bright-line rules, on the other hand, may prove to be under- or over-inclusive: not capturing conduct that is in compliance with the underlying rationale or inviting strategic behaviour which formally satisfies the rule's requirements.[71] Yet, despite their advantages with regard to *ex ante* cost and accurateness, standards are difficult to administer *ex post*. Unlike rules, they do not give clear guidance to parties and courts, which makes them costly to interpret and apply. As the policing of opportunism becomes harder, standards encourage strategic behaviour by the parties for whom the market changes unfavourably and increase the likelihood of judicial error due to the complicated factual inquiry and the large discretion delegated to the court. Thus, the correct *ex ante* expression of the underlying principle may be offset by the frequency of *ex post* process errors, the risk of which is especially high when the correct application of the standard depends on facts that are not observable or verifiable to a court.[72]

In short, the development of new market-based regulatory techniques, as well as the evolution of economic and regulatory theories, led to the inference that contract law has not only a facilitative but also a regulatory function. Inducing incentive effects on market actors, the role of contract law goes beyond creating a market and stretches to the direction of the latter, *i.e.* to correcting its failures. Acting as tools by which contract law operates as a regulatory

---

what is "reasonable" in the particular circumstances is decided by court after the controversy has already arisen. An example for a rule would be a default term requiring a contract breacher to pay damages equal to the difference between the contract and market prices. See UCC § 2-713. Buyer's Damages for Non-Delivery or Repudiation.

[70] Schwartz and Scott, 'Contract Theory and the Limits of Contract Law' 598-601.

[71] Robert Scott and Jody Kraus, *Contract Law and Theory* (Fourth edn, Matthew Bender & Co 2007) 259-260, 383-384, 691.

[72] Schwartz and Scott, 'Contract Theory and the Limits of Contract Law' 601-608; Scott and Kraus, *Contract Law and Theory* 383-384. The difficulty to create efficient default rules and the problems related to default standards have driven Schwartz and Scott to proclaim the legal default project unsuccessful. As commercial parties contract around existing default standards, transaction costs increase instead of the other way around. For this reason, Schwartz and Scott argue that the state should sharply decrease the supply of defaults in order to force parties to draft more complete contracts. Schwartz and Scott, 'Contract Theory and the Limits of Contract Law' 594-609. It must be pointed out, however, that their argument concerns only commercial parties and is based on evidence originating solely in the US. In the case of diversity of contracting parties, Ayres and Gertner, on the other hand, argue in favour of penalty defaults. Ayres and Gertner 116-117.

instrument, both mandatory and default rules exhibit particular weaknesses, constituting limitations to contract law's regulatory capacity. In this respect, the received wisdom makes a distinction between rules and standards as well as between consumer and business transactions. Still, considering that in the last century the world has continuously swung between heavy market regulation and intense liberalisation, it is important that we improve our comprehension of the available less interventionist techniques to steer the market and of the regulatory tools provided by contract law itself. This need becomes imperative with regard to the reinforced regulatory function of European contract law and the recent ambitions of the Commission to push the Common European Sales Law through the bureaucratic and political labyrinths of the European Union.

3. The regulatory function of European contract law

While the regulatory function of contract law at the national level is still contested, there is a growing consensus among scholars about the regulatory function of European contract law (ECL).[73] The concept of ECL first emerged at the end of the 20th century[74] and since then the body of rules encompassed by it has been evolving particularly fast. Today ECL is defined as including the European (primary and secondary) legislation and case-law, private international law and the common legal traditions of Member States concerning contract law matters.[75] The substantive scope of ECL is not identical to that of national contract laws. ECL embraces business-to-business and business-to-consumer transactions, but not transactions between parties who both act in non-professional capacity. On the other hand, it comprises consumer protection, which in some Member States stays out of the ambit of contract law, as well as public interest business regulation that affects contract formation and content (*e.g.* block-exemption regulations, rules in public procurement, intellectual property).[76]

That the relationship between ECL and regulation is different than in national legal systems is indicated by the very organisation of ECL. While in national regimes contract, together with

---

[73] Fabrizio Cafaggi and Horatia Muir-Watt (eds), *The Regulatory Function of European Private Law* (Cheltenham/Nothampton: Edward Elgar 2009).
[74] Conor Quigley, *European Community Contract Law* (First edn, London: Kluwer Law International 1997); Stefan Grundmann, *Europäisches Schuldvertragsrecht - das Europäische Recht der Unternehmensgeschäfte (nebst Texten and Materialen zur Rechtsangleichung)* (First edn, Berlin: Walter de Gruyter 1999).
[75] Cafaggi and Muir-Watt, *Making European Private Law: Governance Design* 290.
[76] Stefan Grundmann, 'The Structure of European Contract Law' (2001) 9 European Review of Private Law 505, 511-512.

tort and property, constitutes a core field of private law, European private law is designed according to policy areas: consumer protection, banking, telecommunication, *etc.* This is coupled with the purposive character of the rules of ECL, in which harmonisation legislation is adopted with the goal to improve the functioning of the internal market,[77] to build consumer confidence.[78] Establishing the internal market, the four freedoms expanded private autonomy and market freedom across borders. But when their negative integration effect proved to be inadequate, the focus shifted to secondary law, positive integration measures.[79] The European regulations and directives all bear the characteristics of the regulatory technique: they are particularistic (applying only to particular sectors or only to consumer transactions) and goal-oriented (consistently emphasising the need to reduce barriers to cross-border trade).[80] The objective set out by harmonisation measures can be readily translated into a goal to remedy market failures.[81] In business-to-business transactions European rules fight restrictions of competition (*e.g.* in the anti-trust field, in public procurement and legal protection of computer programmes).[82] Many sector and non-sector specific directives, on the other hand, aspire to correct information asymmetries in business-to-consumer contracts.[83] The policy

---

[77] See *e.g.* Directive 99/44/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 171/12 of 07.07.1999 (hereafter "Consumer Sales Directive"); Directive 2005/29/EC of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Directives 84/450/EEC, 97/7/EC, 98/27/EC and 2002/65/EC and Regulation (EC) No 2006/2004 (Unfair Commercial Practices Directive), Official Journal L 149/22 of 11.06.2005.

[78] Ibid. See *e.g.* also Communication from the Commission to the Council and the European Parliament. Prospects for the internal gas and electricity market, COM(2006) 841 final, Brussels, 10.01.2007 (2.6.2).

[79] Grundmann, 'The Structure of European Contract Law', 510, 517-518.

[80] See in this sense Collins, 'The Alchemy of Deriving General Principles of Contract Law from European Legislation: In Search of the Philosopher's Stone' 217.

[81] Grundmann, 'The Structure of European Contract Law' 515, 518-521; Stefan Grundmann, 'European Contract Law(s) of What Colour' [2005] European Review of Contract Law 184, 193-194. Hans Micklitz also understands ECL as a tool by which the Commission strives to shape the market order rather than implement distributive concerns, see Hans-W. Micklitz, 'The Concept of Competitive Contract Law' (2005) 23 Penn State International Law Review 549.

[82] See *e.g.* Commission Regulation 461/2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices in the motor vehicle sector, Official Journal L 129/52 of 28.05.2010 Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts, Official Journal L134/114 of 30.04.2004 Directive 2009/24/EC of the European Parliament and of the Council of 23 April 2009 on the legal protection of computer programs, Official Journal L 111/16 of 05.05.2009.

[83] See *e.g.* Council Directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours, Official Journal L 158/59 of 23.06.1990 (hereafter "Package Travel Directive"); Council Directive 85/577/EEC of 20 December 1985 to protect the consumer in respect of contracts negotiated away from business premises, Official Journal L 372/31 of 31.12.1985 Directive 97/7/EC of the European Parliament and of the Council of 20 May 1997 on the protection of consumers in respect of distance contracts, Official Journal L 144/19 of 04.06.1997; Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive

design and the aim-rooted, instrumental nature of the ECL legislation allow us to infer its far more intense regulatory function than that of national contract law.[84]

In the name of completing the internal market, the Commission identifies the cases of market failure and sets about remedying them through harmonisation. Carried through the Member States' legal orders, these ECL measures restrict party autonomy and in practice re-regulate the national contract regimes.[85] Ironically, the preambles of consumer directives often explicitly state that they by no means impinge on domestic contract rules.[86] Yet, they often regulate topics covered by classic contract law such as mistake, fraud, duress, duties to inform, *culpa in contrahendo*,[87] non-conformity of goods sold,[88] *etc.*[89] The fact that the ambiguous constitutional foundations of the European Union's competence in the field of contract law[90] make the Commission put forward the legislative measures as technical and regulatory cannot hide their interference with areas habitually regulated by national contract regimes. In addition, the lack of public/administrative competence on the European level promoted the adoption of regulatory mechanisms based on private law tools, particularly contract. Thus, an abounding body of contract law was developed in regulated markets to ensure more efficient provision of public goods and services.[91] ECL has also led to the extraction of contracts in financial markets from national general contract law.[92] What is

---

2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, Official Journal L 145/1 of 30.4.2004 (hereafter "MiFid Directive").

[84] Fabrizio Cafaggi and Horatia Muir Watt, 'The Making of European Private Law: Regulation and Governance Design' EUROGOV Working paper, 20 March 2007 <http://www.ihs.ac.at/publications/lib/ep13.pdf> accessed 17.09.2012.

[85] Grundmann, 'The Structure of European Contract Law' 514, 516.

[86] See *e.g.* Consumer Sales Directive; Unfair Commercial Practices Directive.

[87] Unfair Commercial Practices Directive; Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, Official Journal L 95/29 of 21.04.1993 (hereafter "Unfair Terms Directive").

[88] Consumer Sales Directive.

[89] See in this sense Collins, 'The Alchemy of Deriving General Principles of Contract Law from European Legislation: In Search of the Philosopher's Stone' 215.

[90] Stephen Weatherhill, 'Reflections on the EC's Competence to develop a "European Contract Law"' (2005) 13 European Review of Private Law 405; Stephen Weatherhill, 'European Private Law and the Constitutional Dimension' in Fabrizio Cafaggi (ed), *The Institutional Framework of European Private Law* (First edn, Oxford: Oxford University Press 2006) 79-106.

[91] See *e.g.* Directive 2003/54/EC of the European Parliament and of the Council concerning common rules for the internal market in electricity, Official Journal L 176/37 of 15.07.2003 Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC, Official Journal L 176/57 of 15.07.2003.

[92] See MiFid Directive; Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, Official Journal L 241/26 of 02.09.2006 and Commission Regulation (EC) No 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment

more, besides the overt harmonisation through secondary legislation, an indirect and not so evident harmonising process takes place through spill-overs from a harmonised field of national law to another field that is not affected by the obligation of transposition but is still reorganised for the sake of coherence.[93] A salient example is the copying of the order of remedies as established in the Consumer Sales Directive in German law for all sales contracts and even for general contract law.[94] In other words, although on their face unharmonised areas of contract law are not subject to scrutiny under the fundamental freedoms, in regulating market failure, ECL encroaches on facilitative law allegedly left entirely to domestic contract regimes.

To be sure, despite being regulatory in character, ECL still has market freedom as its starting point.[95] It vests private parties with much power to organise their relationships and sets the limits to national regulation with respect to cross-border transactions. It is also increasingly moving toward issues of contract formation, standards of performance and breach of contract, *i.e.* issues traditionally dealt with by national contract default rules in order to enable contracting.[96] Still, it has been claimed that it reshapes the concept of private autonomy as it appears in the different Member States and reinforces the trend toward materialisation of contract freedom. A hypothesis viewing European Private Law (including ECL) as an emerging "self-sufficient private legal order, enshrining a new order of values" and oriented towards a "gradual substitution of national private legal orders", has come into being.[97] This hypothesis fits nicely with the developments in private law on the European level: the calls of the European Parliament to draft a European Code of private law,[98] the drafting of a Common

---

firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive, Official Journal L 241/1 of 02.09.2006.

[93] For more on this issue, see Walter Van Gerven, 'Bringing (Private) Laws Closer at the European Level' in Fabrizio Cafaggi (ed), *The Institutional Framework of European Private Law* (First edn, Oxford: Oxford University Press 2006).

[94] On this issue, see Stefan Grundmann, 'Regulating Breach of Contract - the Right to Reject Performance by the Party in Breach' (2007) 3 European Review of Contract Law 121.

[95] Grundmann, 'European Contract Law(s) of What Colour' 194-196.

[96] Consumer Sales Directive; Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market ('Directive on electronic commerce'), Official Journal L 178/1 of 17.07.2000 .

[97] Hans-W. Micklitz, 'European Regulatory Private Law: The Transformation of European Private Law from Autonomy to Functionalism in Competition and Regulation' European Regulatory Private Law Project; http://blogseuieu/erc-erpl/ accessed 18.09.2012.

[98] Parliament Resolution of 26 May 1989, Official Journal C 158/400 of 26.06.1989; Parliament Resolution of 6 May 1994, Official Journal C 205/518 of 25.07.1994.

Frame of Reference and revision of the *acquis communautaire*,[99] the proposal for a regulation on an optional Common European Sales Law (CESL).[100]

For the first time on the European level, the proposed regulation on CESL contained a full-blown regime of a particular contract type integrating facilitative defaults and regulatory concerns. The very title of the 2011 Communication of the Commission stated the intention that CESL **facilitated** cross-border transactions in the single market.[101] This time the Commission did not focus its efforts on specific information and competitive weaknesses of the market, nor did it limit itself to a particular sector or to business-to-consumer transactions.[102] Pointing out that the various differences between national legal systems increased information and negotiation costs for businesses and consumers, discouraged them from entering into cross-border transactions, and reduced the range of products available to consumers, the Commission stated that legal diversity in the many unharmonised areas of contract law constituted a barrier that hindered cross-border trade. In other words, the concept of market failure was expanded to reach also conventional market freedom issues, and the solution proposed was an optional "single set of uniform and comprehensive contract law rules" which would stand as an alternative to domestic contract regimes.[103]

For the first time CESL also contained a fully developed system of contractual remedies. Until the CESL proposal, remedies were not at the centre of European legislation. Substantive

---

[99] Communication from the Commission to the Council and the European Parliament on European contract law COM(2001) 398 final, Official Journal C 255/1 of 13.09.2001; Communication from the Commission to the European Parliament and the Council - A more coherent European contract law - An action plan, COM(2003) 68 final, Official Journal C 63/1 of 15.03.2003 Communication from the Commission to the European Parliament and the Council - European Contract Law and the revision of the acquis: the way forward, COM(2004) 651 final, Not published in the Official Journal; Commission Report of 23 September 2005: First Annual Progress Report on European Contract Law and the Acquis Review, COM(2005) 456 final, Not published in the Official Journal Commission Report of 25 July 2007: Second Progress Report on the Common Frame of Reference [COM(2007) 447 final - Not published in the Official Journal], all available at: http://europa.eu/legislation_summaries/justice_freedom_security/judicial_cooperation_in_civil_matters/l33158_en.htm.

[100] Green Paper on policy options for progress towards a European Contract Law for consumers and businesses, http://ec.europa.eu/justice/news/consulting_public/news_consulting_0052_en.htm; Opinion of the European Economic and Social Committee on the Green Paper from the Commission on policy options for progress towards a European contract law for consumers and businesses COM(2010) 348 final, Official Journal C 84/1 of 17.03.2011; European Parliament resolution of 8 June 2011 on policy options for progress towards a European Contract Law for consumers and businesses (2011/2013(INI)), http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P7-TA-2011-0262; Communication for Common European Sales Law; Proposal for a Regulation of the European Parliament and of the Council for a Common European Sales Law, COM(2011) 636 final, Brussels, 11.10.2011, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0635:FIN:en:PDF.

[101] Communication for Common European Sales Law.

[102] Note that even the Consumer Sales Directive was interpreted as containing mainly information rules.

[103] Communication for Common European Sales Law 2, 7.

rules in this respect have been limited mainly to withdrawal and cancellation rights. The Consumer Sales Directive imports replacement and repair rights as well as price reduction but only to the extent that this would improve the position of consumers on the Single Market. With regard to liability between sellers in the value chain, it refers to remedies under national law.[104] The Unfair Commercial Practices Directive does not comprise a system of remedies at all, again relying on the one(s) provided on the national level. Damages have been squarely excluded from the ambit of harmonisation measures with the exception of incidental mentions that Member States shall ensure compensation.[105] Due to the instrumental character of the rules, until the proposed regulation on CESL no general approach to remedies had been developed in ECL.

Although currently withdrawn, the proposed optional CESL put on the table the issue of introducing an entire, horizontal scheme of remedies on the European level. Supposedly such a remedial scheme should reflect the fact that it makes inroads in an area traditionally reserved for national contract acts and at the same time aims at solving European market deficiencies. In the broader debate on making ECL, it has already been suggested that the differences between the regulatory and the classical private law technique can be overcome by generalisation of *acquis* rules.[106] That proposition, however, has met with criticism on the ground that an automatic translation of rules found in consumer and sectoral measures may turn exceptional solutions into general ones.[107] The discussion points at the difficulty of designing rules that incorporate both the facilitative and the regulatory function of contract law. This challenge loomed large with respect to the remedial rules of the CESL and has not receded despite the announced scaling down of the project.

The process of construction of ECL is under way and so is the process of its reconceptualisation. The instrumental nature of the rules adopted to achieve certain goals

---

[104] See Art. 3 and 4 of the Consumer Sales Directive. Note also that the directive omits any details about the measurement of the price reduction remedy leaving these to the national laws of the Member States.

[105] See Art. 5 (1) and (2) of the Package Travel Directive: "Member States shall take the necessary steps to ensure that the organizer and/or retailer party to the contract is liable to the consumer for the proper performance of the obligations arising from the contract…" "With regard to the damage resulting for the consumer from the failure to perform or the improper performance of the contract, Member States shall take the necessary steps to ensure that the organizer and/or retailer is/are liable unless…"

[106] Grundmann suggested the rules in the Consumer Sales Directive and the Electronic Commerce Directive can be generalised in the process of development of ECL. See Grundmann, 'European Contract Law(s) of What Colour' 201-204.

[107] Collins, 'The Alchemy of Deriving General Principles of Contract Law from European Legislation: In Search of the Philosopher's Stone' 220-221.

together with their organisation around policy fields rather than traditional private law areas determine the growing academic consensus about the intense regulatory function of ECL. A new complementarity between contract law and regulation, differing according to the regulated activity, has emerged on the European level. Under the overarching goal of reducing barriers to cross-border trade, the regulatory strategies on the European level have departed from the conventional demarcation between enabling and mandatory rules and have been progressively approaching matters traditionally covered by facilitative contract law on the national level. The expansive interpretation of the concept of market failure has led the Commission to propose an optional horizontal measure like the CESL dealing not only with issues of market deficiency but also of market freedom. This put forward the challenge of integrating default rules with regulatory objectives.

B. Project in focus

National and European contract law are often characterised as fundamentally different: the former – based on private autonomy and freedom of contract, the latter – grounded in remedying the failures of the internal market. While I do think that there are major differences between ECL and national contract laws, I also consider this view to overstate the dissimilarities between the functions of contract law on the domestic and the supranational level. Another stance accepts the mentioned interpretation of ECL but sees national private laws as having moved towards distributive justice.[108] My hypothesis is that in correspondence to the crisis of the regulatory state, contract law on the national level has been progressively reoriented to perform efficiency-driven regulatory functions.[109] A historical analysis will search to identify whether such a change in function has ensued. Where each jurisdiction finds different equilibrium between the facilitative and the regulatory function of contract law, the research, as a matter of description, will explore, through the role of damages and specific performance, the balance struck between the two functions in each of the analysed legal systems. As a normative claim, I advocate the use of contractual remedies as a regulatory

[108] Alessandro Somma, *Temi e problemi di diritto comparato*, vol IV: Diritto comunitario vs. diritto comune europeo (First edn, Turin: Giappichelli 2003) Collins, 'The Alchemy of Deriving General Principles of Contract Law from European Legislation: In Search of the Philosopher's Stone'.

[109] For such a hypothesis, see also Fabrizio Cafaggi, 'The Making of European Private Law: Governance Design' in Fabrizio Cafaggi and Horatia Muir-Watt (eds), *Making European Private Law: Governance Design* (First edn, Cheltenham, UK; Northhampton, MA, USA: Edward Elgar 2008) 295.

response to the failures of the European market and draw guidelines for a remedial scheme employing both contract law functions to promote a competitive market.

The analysis starts from the different facilitative and regulatory effects damages and specific performance can have on the contractual relationship and then tests the hypothesis by analysing case-law of the chosen jurisdictions. Among the market failures, the focus is on asymmetry of information. The examination is carried out along the distinction between business-to-business and business-to-consumer transactions, asking the question of whether in the national court practice the two remedies can be rationalised not only as facilitative but also as regulatory devices. Another important issue to be investigated is how contract law performs its functions through standards,[110] considering their lack of specificity as well as the judges' lack of specialised expertise and lack of information to choose between alternative legal standards.[111] Exploring the case-law on damages and specific performance, the project aims at identifying the driving forces behind intra-jurisdictional changes and inter-jurisdictional differences of remedial allocation. It also seeks to discern principles that could be used and problems that could be avoided in devising the structure of remedies in ECL. The scope of the project will be further elaborated by identifying the types of contract (Section B.1) as well as the jurisdictions that will be scrutinised (Section B.2).

1. Types of Contract Compared

The project brings under the spotlight damages and specific performance in sales of goods and construction contracts. The types of contract compared are not chosen at random.

The sale transaction has great importance both legally and commercially. Starting from Roman times many founding issues of contract law, including liability for defects, have been modeledmodelled with reference to the contract for sale. In both civil law and common law systems it has served as the basis for the development of remedies for defective performance in contracts for work and labour of which construction contracts are a typical

[110] See *supra* Section A.2. Default rules and mandatory rules of this Chapter.

[111] Judges do not have the capacity to undertake the profound inquiry necessary to evaluate the functioning of the market. Moreover, they are presented with a highly distorted picture of its operation since they can observe how it works and responds to the legal regime in force only through the legal disputes initiated before them. Also, the self-referential feature of the legal reasoning process constrains them whenever, as a result of non-compliance or change in the economic and social conditions, adjustments are needed. See in this sense Collins, *Regulating Contracts* 65-66, 82-85.

representative.[112] The commonness of the contract for sale of goods and its significance in economic terms has led to considerably detailed regulation and abundant court practice on the national level as well as to early international efforts toward harmonisation. The most recent example of these efforts is the already mentioned Commission's Proposal for CESL.

The other type of contract under comparison, the construction contract, is also intentionally selected. Most legal systems had encountered difficulties in distinguishing contracts for sale of goods from contracts for work and labour where the object to be delivered was to be produced by the promisor himself. And as already mentioned, the two types of contract bear a close relationship with regard to defects liability. Yet, there are also important differences between them. While in lawyers' minds, the sales contract usually describes a one-shot exchange that is settled more or less immediately, the construction contract habitually implies continuous obligations. The prolonged length of the transaction entails different duties related to the provision of information and cooperation as well as the high risk of price increase and difficulties to determine in advance the extent of the work and the quantities of materials necessary for its execution. In addition, the contract for sale of goods and the construction contract differ with regard to the time when the remuneration of the contractor is due and the risk allocation in case of destruction or deterioration of the work. Thus, it can be expected that in both common law and civil law systems these substantial dissimilarities between the two types of contract have also been reflected in the remedies of damages and specific performance.

Construction contracts also belong to a broad class of contracts, the service contracts, that has recently begun to emerge as antithetical to sales contracts. At this point a note on terminology needs to be made. In this work the term "construction contract" is used with its classical meaning as a contract under which one of the parties, the constructor, undertakes to construct or repair or in any other way improve a building or other immovable. Construction contracts fall into a generic category of contracts, generally referred to, on the international level, as

[112] Although originating in sales law, the remedies of contract cancellation and price reduction have been transferred to contracts for work and labour in those legal systems which, like the Bulgarian one, have been strongly influenced by Roman law. The same is valid for rules relating to the seller's warranty against defects of quality in common law systems. See in this sense Werner Lorenz, ‘Chapter 8 Contracts for Work on Goods and Building Contracts’ in Konrad Zweigert (ed), *International Encyclopedia of Comparative Law Specific Contracts*, vol VIII (First edn, J. C. B. Mohr (Paul Siebeck), Tübingen, and Sijthoff & Noordhoff, Alpen a/d Rijn 1980) 56-57.

"contracts for work and labour",[113] a term that serves to unify the diverse and sometimes inconsistent terminology used in the national legal systems.[114] In EU law, however, due to the vocabulary developed in relation to the four freedoms, contracts for work and labour were assimilated by the concept of service contracts. Consequently, in this thesis they are also termed "contracts for services". Nevertheless, it must be acknowledged that at present service contracts are regulated on the European level by a number of scattered provisions that do not amount to comprehensive harmonisation but cover only specific questions.[115] As a result, the concept remains fairly blurry. Since no positive definition is set out, the notion of services is rather defined by exclusion: it entails economic operations that do not constitute sale of goods or employment.[116] Thus, the category of service contracts in EU law appears particularly broad, often broader than the category of contract for services under national law. While a similar trend toward generalisation can be observed in Anglo-American law,[117] in Bulgaria contracts for work and labour, encompassing the construction contract, are distinguished from contracts for services under which the contractor is not obliged to achieve a certain result but merely to perform a particular job.[118] From the perspective of comparative analysis, such

---

[113] Ibid; Axel Metzger, 'Contract for Work and Labour' in Basedow Jürgen and others (eds), *The Max Planck Encyclopedia of European Private Law*, vol I (First edn, Oxford: Oxford University Press 2012) 383-385.

[114] Under Bulgarian law the construction contract is a type of manufacture contract (*договор за изработка*). In English law a construction contract is classified as a "contract for work and labour" (*Atkinson v. Bell* (1828) 8 B & Cr 277, 108 ER 1046) or "contract for work, labour and materials"(*Clark v. Bulmer* (1843) 11 M & W 243, 152 ER 793). The same is true for US law where the construction contract is also referred to as a "mixed contract" for goods and services (*Langhals v. Holt Roofing Co.* 47 Ohio App 3d 114, 547 NE2d 401 (6th Dist Lucas County 1988)).

[115] See Art. 56, 57 (ex Art. 49, 50 TEC) of Treaty on the Functioning of the European Union, Official Journal C 115/70 of 09.05.2008; Art. 5(1)(b) of Council Regulation (EC) No 44/2001of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, Official Journal L 12/1 of 16.01.2001; Art. 4(1)(b) of Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations, Official Journal 177/6 of 04.07.2008; Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market, Official Journal L 376/36 of 27.12.2006; Book IV, Part C "Services" of Christian von Bar and others (eds), *Principles, Definitions and Model Rules of European Private Law; Draft Common Frame of Reference (DCFR) Outline Edition* (First edn, Munich: Sellier 2009), (hereafter "DCFR" or "the Draft").

[116] See in more detail Florian Möslein, 'Service Contracts' in Jürgen Basedow and others (eds), *The Max Planck Encyclopedia of European Private Law*, vol II (First edn, Oxford: Oxford University Press 2012) 1548-1551.

[117] See UK ST 1982 c. 29 The Supply of Goods and Services Act 1982 in force in England; Richard A. Lord, 'Chapter 26 The Statute of Frauds: Contracts for the Sale of Goods V. Exceptions and Exclusions from the Statute' in *9 Williston on Contracts § 26:20 Contracts for Services* (Fourth edn, Thomson Reuters 2011).

[118] Decision №1560 of 13.02.2007, adm. c. №9860/2006, VI adm. d. of the Supreme Administrative Court; Decision №1332 of 06.02.2006, adm. c. №11484/2005, VI adm. d. of the Supreme Administrative Court; Decision №756 of 06.04.2010, adm. c. №4232/2009 of Administrative Court – Sofia. The usual examples given are the contract for medical services and the contract for legal services whereby the doctor, respectively the lawyer, receive remuneration no matter whether the patient is cured or the court dispute has a favourable outcome. See in the same sense Polya Goleva, *Law of Obligations* (Sofia: Feneya 2008) 250-251. Occasionally Bulgarian courts use the terms "contract for work and labour" and "contract for services" interchangeably (Decision №4862 of 09.05.2006, adm. c. №1000/2006, VI adm. d. of the Supreme Administrative Court;

conceptual distinctions are by no means unimportant; yet, this is not the proper time to go into the specifics. What is relevant for the purposes of the research at this stage is that the choice of the construction contract as a subject of investigation is also determined by its affiliation with a category of contracts that is perceived as opposing the contracts for sale.

Such opposition also has economic dimensions since services appear to have surpassed goods in their overall proportion of economic activity. According to the most recent data provided by the European Commission, the service sector, including construction, "is contributing more to economic growth and job creation worldwide than any other sector."[119] Within the EU alone the services sector accounts for three-quarters of the GDP and for over three-quarters of the jobs.[120] From this point of view the all-inclusive, or almost all-inclusive, concept of services contracts that has emerged on the European level seems to be in line with a more general tendency in the economic development of the Western world. This tendency implies a transformation of the very tissue of capitalist economies which are woven less and less of one-time purchases of property and more and more of long-term leasing of an increasing number of services.[121] This begs a deeper research of service contracts and their remedial devices.

I must admit some other problems of the day have also directed my attention to construction contracts (as a sub-type of contracts for services). The current financial debt crisis was preceded by a boom in real estate development and construction. A great deal of the economic growth in young developing market economies (such as my home country Bulgaria) was generated not by the financial but by the construction sector, which naturally performed its activity on the basis of construction agreements executed on a daily basis. The subsequent credit crunch and decline in real estate prices forced the construction industry to face the

---

Decision №10530 of 28.1.2005, adm. c. №8807/2004, I adm. d. of the Supreme Administrative Court) or refer to a broader notion of services contract (Decision of 07.12.2010, c. c. №3317/2010 of Regional Court – Plovdiv) thus blurring the professed distinction. Still, with regard to construction contracts, it is universally accepted in Bulgarian law that they are contracts for work and labour and no particular issues with regard to their delimitation from contracts for services arise. On the other hand, the contract for services must not be confused with the employment contract since the service provider is not employed in the enterprise of the counterparty and cannot be imposed with a disciplinary sanction. See Decision №1332 of 06.02.2006, c. c. №11484/2005, VI adm.d. of the Supreme Administrative Court. The same distinction applies in English law between contracts for the supply of services and contracts of service. See Part II Section 12(2) of The Supply of Goods and Services Act 1982.

[119] See the European Commission's website http://ec.europa.eu/trade/creating-opportunities/economic-sectors/services/, (Last updated on 01.08.2007. Last accessed on 01.08.2012)

[120] Ibid.

[121] Jeremy Rifkin, *The Age of Access: The New Culture of Hypercapitalism, Where All of Life is a Paid-for Experience* (First edn, New York: J. P. Tarcher/Putnam 2000).

challenge of cutting transaction costs and increasing efficiency. In this respect it will be interesting to see whether the current state of contract law and the prescribed contractual remedies in different jurisdictions adequately respond to these problems encountered by business.

In short, the contract for sale of goods and the construction contract were selected for comparison because historically the former has influenced the shaping of the latter's remedial scheme but nevertheless the two types of contract manifest a sufficient number of differences that should be reflected in the remedial allocation. In addition, the economic significance of the contracts also played a role.

2. Jurisdictions under Comparison

Subject to comparison will be the law of the United States, England and Bulgaria. It is evident from the outset that the jurisdictions under comparison are not chosen along the lines of the legal family doctrine. It is thus important to point out the considerations which played a role when selecting them.[122]

[122] In recent years the doctrine of legal families has attracted a great deal of criticism especially after the wooden way in which it was used in the Legal Origins strand of the New Comparative Economics School. See Rafael La Porta and others, 'Legal Determinants of External Finance' (1997) 52 Journal of Finance 1131; Rafael La Porta and others, 'Law and Finance' (1998) 106 Journal of Political Economy 1113; Rafael La Porta and others, 'The Quality of Government' (1999) 15 Journal of Law, Economics and Organization 222; Rafael La Porta and others, 'Judicial Checks and Balances' (2004) 112 Journal of Political Economy 445. The doctrine was inspired by the taxonomic project in biological sciences but comparative scholars have achieved little agreement on the criteria of classification. Perhaps the most well-known set of distinctive factors, defining the style of legal families, are the ones identified by Zweigert and Kötz: historical background and development, the predominant and characteristic mode of thought in legal matters, distinctive institutions, legal sources and the way they are handled and ideology. Konrad Zweigert and Hein Kötz, *Introduction to comparative law* (Third rev. edn, Oxford: Clarendon Press; New York: Oxford University Press 1998). Yet, the number of the classifications made proves that separation of legal systems into legal families is a static exercise which cannot capture the development and interaction of legal systems and which is extremely prone to self-centred attitudes. The taxonomic difficulties are perfectly exemplified by the Bulgarian legal system, which as it will be seen below, cannot be allocated in its entirety to the Romanic or to the Germanic legal family. The existence of mixed legal systems also constitutes a challenge to the legal family doctrine. For this reason, one of the most prominent scholars, working on the classification project, pointed out that legal families are solely "didactic devices" which are meant to enable a better understanding of beginners but which an experienced comparatist may either not use, or use with great caution. René David and John Brierley, *Major Legal Systems in the World Today* (Third edn, London: Stevens 1985). From this perspective it might be better to speak of legal traditions as intertwining flows of normative information that shape dynamic, multi-layered legal systems remaining far from ideal types. H. Patrick Glenn, 'A Concept of Legal Tradition' (2008) 34 Queen's Law Journal 427; H. Patrick Glenn, 'Chapter 12 Comparative Legal Families and Comparative Legal Traditions' in Mathias Reimann and Reinhard Zimmermann (eds), *The Oxford Handbook of Comparative Law* (First edn, Oxford: Oxford University Press 2006). A note on terminology might be useful at this point. Besides "legal family" and "legal tradition", the concept of "legal culture" has also recently achieved much popularity. However, as a term, it is quite fuzzy and

Since the two main legal traditions of the Western world, common law and civil law, exhibit remarkably different attitudes toward remedies, both of them need to be represented in the comparative exercise. The main focus on damages, determined by the number of induced incentives affecting market players'' behaviour, tilted the choice in favour of common law countries which employ damages as their primary remedy. Yet, despite the fact the origin of US law can be traced to the English legal system, they have subsequently taken distinct historical paths, developing "deep-level structural differences".[123] In this sense, divergence in their approach toward contractual remedies can also be expected. On the other hand, it has been suggested that European and US legal culture can be distinguished in terms of values, with Europe having a less instrumental view of law, a more strongly autonomous private law, stronger protection for the weaker party in contract law, and a stronger accent on human dignity and privacy.[124] From this perspective, a juxtaposition between two common law systems, one American (the US) and one European (England), and a civil law system (Bulgaria) may reinforce the idea that when scholars generalise distinguishing between more and less efficient legal systems, it is more appropriate to differentiate between the US and Europe, rather than between the common law and the civil law tradition.

The choice of Bulgaria as a civil jurisdiction under comparison is determined not only by the fact that this is the legal system I know best and the absence of a language barrier permits me to consult the primary sources.[125] In the process of its evolution, modern Bulgarian contract

---

employed in relation to different issues. Sometimes the three mentioned concepts are even used interchangeably creating some confusion in the literature. Most often "legal culture" denotes the aggregate of values, ideas, attitudes, practices, *etc.* which underlies a society's outlook toward its law. Ralf Michaels, 'Legal Culture' in Jürgen Basedow and others (eds), *The Max Planck Encyclopedia of European Private Law*, vol II (First edn, Oxford: Oxford University Press 2012). This is the meaning with which the notion of legal culture will also be used in this thesis.

[123] Stefan Vogenauer, 'Common Law' in Basedow Jürgen and others (eds), *The Max Planck Encyclopedia of European Private Law* vol I (First edn, Oxford: Oxford University Press 2012). In Vogenauer's opinion the pronounced disparities between US and English law make it particularly misleading to speak about 'Anglo-American law'. After comparing the case law, the legislative techniques, the role of the judge and advocate and the legal training, Atiyah and Summers also reached the conclusion that the differences in legal reasoning between US and English law are so great that the English legal system with its much more formal style is closer to the continental civil law systems than to that of the US. Patrick Atiyah and Robert S. Summers, *Form and Substance in Anglo-American Law - A Comparative Study of Legal Reasoning, Legal Theory and Legal Institutions* (First edn, Oxford: Clanderon Press; New York: Oxford University Press 1987).

[124] Michaels 1061.

[125] Bulgaria is the only Eastern European country which does not have a civil code. The attempts of drafting one date back to the 1930s but for various reasons the idea has never been carried out to a successful end. During the 1950s the codification work came to a halt because it had to wait for the socialist reorganisation of the economy to be finalised. It was feared that a code would be difficult to adapt to the fast changing economic relations and would become an obstacle to economic development. As this was seen as a transition period, separate statutory acts codifying the law of property, obligations and contracts, family law and the law of succession were adopted.

law has become the intersection point of heterogeneous legal traditions which makes it a particularly intriguing subject for research. Most of the provisions of the former 1892 Act on Obligations and Contracts[126] ("1892 Contracts Act") constituted a literal translation of the 1865 Italian *Codice Civile*, the latter itself inspired by the French *Code Napoléon*.[127] The

---

It is also not without significance that at the time the role of the Parliament as the supreme legislative organ and of the statute as the primary regulatory act was to a great extent degraded. Due to the experimentation with new economic mechanisms the government preferred fast and flexible legislation which was largely adopted by the Council of Ministers in the form of acts which did not have the rank of statutes and many of which were not even promulgated in the State Gazette. In addition, the Bulgarian codification was postponed so that it conforms to the new civil code, being prepared in the USSR, which was supposed to become a model for the civil codifications in all socialist countries. There was resurgence of the work on a civil code in the 1960s but no entire draft was produced. Priority was given to preparation of the new 1971 Constitution with which the civil code subsequently had to comply. The construction of the new economic system also continued to be under way. A draft of a civil code, preceded by a broad academic discussion, was finally brought into being in 1978 by a group of prominent Bulgarian civilists organised by the Ministry of Justice. However, the draft was not introduced in the Parliament since the adoption of an Economic Code (ultimately not prepared) was considered to be more important for the country. Although renowned Bulgarian scholars continued to argue in favour of a civil code, no concrete steps were taken until 1999 when the Ministry of Justice put forward for discussion a new (and for now the last) draft of a civil code. Yet, the latter had been put together very hastily and was not welcomed by the academic circles due to its bad structure and editing as well as its lagging behind the civil theory and legislation in the developed western jurisdictions. A civil code is still perceived as a necessity among many Bulgarian legal scholars; yet, currently no organised efforts are being made in this direction. The previous failures of the codification work, the doubtful quality of a great deal of the legislation adopted after the democratic changes in 1989, the attitude among the new generation of Bulgarian legal scholars, who often feel the time of civil codifications has passed, and among the legal practitioners, for whom the adoption of such a fundamental legal act will create a lot of costs, have shaped a critical mind-set towards the idea. For more on the historical development and the current discussion on a civil code in Bulgaria, see Vladimir Petrov, 'Development of the Idea on Civil Law Codification in the Republic of Bulgaria' in Malina Novkirishka-Stoyanova and Tencho Kolev (eds), *Roman Law and Modern Codifications* (First edn, Sofia: "St. Kliment Ohridski" University Press 2008); Tsanka Tsankova, 'Civil Code? Let Us Start a Discussion' in Malina Novkirishka-Stoyanova and Tencho Kolev (eds), *Roman Law and Modern Codifications* (First edn, Sofia: "St. Kliment Ohridski" University Press 2008) Still, despite the absence of a civil code, there is a broad academic agreement on the system of Bulgarian civil law as it currently stands. Although many of the parts of the system are dispersed among several legal acts, the Bulgarian civil law clearly follows the *Pandektensystem*. It has a general part including the general provisions on persons and on civil relationships, then property law, law of obligations, law of intellectual and industrial property, family law and succession law. Currently commercial law is contained in a separate statute and is not embedded in the general obligations act. See Vitali Tadjer, *Civil Law of National Republic of Bulgaria. General Part*, vol 1 (First edn, Sofia: Science and Art 1972); Mariya Pavlova, *Civil Law. General Part* (First edn, Sofia: Sofi-R 2002).

[126] Act on Obligations and Contracts, promulgated State Gazette №268 of 01.01.1892, repealed State Gazette №275 of 22.11.1950.

[127] It has been claimed that the reason for which the Bulgarian legislator chose the Romanic legal tradition was that the latter coincided better with the level of social development of the country. In 1892, when the first Contracts Act was passed, Bulgaria had just asserted its independence from the Ottoman Empire and was predominantly a rural country. Thus, preferences naturally went to the Romanic legal family which, and especially the Italian *Codice Civile*, largely reflected the interests of farmers, unlike the German civil code, which was directed to the interests of businessmen. Dimitur Tokushev, *History of the New Bulgarian State and Law 1878-1944* (First edn, Sofia: Sibi 2008) 177-178. That such a consideration played a role is, of course, highly probable but most likely it was not the only determinative factor. In fact, while preparing the 1892 Contracts Act the Bulgarian legislator could not really draw on a German model of unified civil code since the BGB had not been passed, yet. At that time only the First Draft of the German civil code had been published, and this, being fairly technical, complex and abstract, was probably not very attractive to Bulgarian jurists who had not yet been exposed to the influence of the German Pandect school. Rather, the choice was to be made between the French *Code Civil* and the Austrian Civil Code, the other influential codification existing at the

currently effective Bulgarian Act on Obligations and Contracts[128] ("Contracts Act") also largely copied the legal solutions of the 1942 Italian Civil Code, which remained closely connected to French law; yet, it was also affected by the German legal tradition due to its major influence on the Bulgarian legal scholarship of the time.[129] In force as of 1951, the Contracts Act, however, was also bound to integrate the principles of socialist law and planned economy.[130] After the beginning of the democratic changes in 1989, the Contracts

---

time. Of these two, *Code Civil* was distinguished for its clear, intelligible and succinct language as well as for embodying the revolutionary ideals of freedom and equality, which were very appealing to a small nation emerging from five centuries of foreign oppression. In addition, the Romanic legal family was possibly preferred because Bulgarian merchants had already been familiar with the Ottoman Commercial Code, itself based on the French Code de Commerce. Deeply rooted in *Code Civil*, the Italian *Codice Civile* of 1865 was considered one of the most modern codes of its time. It had all the civilizing and linguistic advantages of the French prime source, which made it very appropriate for a young state such as Bulgaria that was still building its own institutions. As a result, the 1892 Contracts Act straightforwardly copied the Codice, adopting the principles of freedom of contract and *pacta sunt servanda*, as well as the consensual principle of transferring ownership and risk at the time of concluding the agreement irrespectively whether the thing sold was actually handed to the buyer. More likely than not, the choice was also motivated by political considerations. Avoiding direct transplantation of the Austrian or French codification, and borrowing the code of the new Italian kingdom, the Bulgarian legislator circumvented the political risks that could have arisen from potential exasperation of Russia, or any other of the Great Powers, which were particularly sensitive towards their spheres of influence. Valentin Braykov, *The Sale Contract - Companion of Civilization* (First edn, Sofia: Sibi 2014) 20-35.

[128] Act on Obligations and Contracts, promulgated State Gazette №2 of 03.01.1950, in force since 01.01.1951, last amended State Gazette №50 of 30.05.2008.

[129] In particular the rules on non-performance of the Contracts Act occupy a middle ground between the French and the German legal traditions. The institutions of preliminary contracts, right of retention, representation, default of the creditor follow the German model.

[130] The proclaimed aim of the Contracts Act was to contribute to the construction of socialism and to the execution of the state economic plan (former Art. 1). Three main principles, which decisively differentiated socialist civil law from that of the western capitalist states, were interwoven in the provisions of the Contracts Act. First, civil relationships had to conform to society's interest. The primacy of societal interest meant that citizens could exercise their contractual rights only for the satisfaction of their needs and not in contradiction to the interest of the socialist society (former Art. 4). Secondly, closely connected to this principle was the principle of social justice which served as a criterion for the interpretation of legal norms. Contractual rights and obligations were to be exercised in conformity with the socialist morals based on the requirements of social justice. Thirdly, under the principle of state planning of contractual relations, the planning acts were a source of contractual obligations (former Art. 5, 6, 7). Contract had the function to assist the execution of the plan which constituted the basis and the limit of the contract content. Contracts not conforming to the economic plan were null and void (former Art. 26 (1)) and socialist organisations had to exercise their contractual rights in conformity with the plan (former Art. 3). See Tadjer 37-40 It must also be mentioned that the Contracts Act revoked the Commercial Act effective until 1951 to pronounce the end of dual regulation in Bulgarian private law. Differentiation between persons (citizens and socialist organisations) was carried out within the Contracts Act with socialist organisations enjoying some privileges on the basis of the principle of supremacy of state property. Yet, the principle of private law unity was not pursued consistently. Besides the Contracts Act applicable to all persons, special laws were passed regulating particular contracts between socialist organisations: *e.g.* the Act on Contracts between Socialist Organizations with regard to contracts for sale, contracts for work and labour and for services, Regulation on Capital Construction with regard to the construction contract. Ibid 25-27 Act on Contracts between Socialist Organizations, promulgated State Gazette №85 of 01.11.1963, revoked State Gazette №18 of 02.03.1992; Regulation on Capital Construction, promulgated State Gazette №44 of 01.06.1951; Regulation on Capital Construction, promulgated State Gazette №98 of 11.12.1973, revoked State Gazette №55 of 15.07.1980; Regulation on Capital Construction, promulgated State Gazette №55 of 15.07.1980, revoked State Gazette №16 of 27.02.1987. In addition a special state arbitration court was created to resolve contractual disputes between socialist organisations. The aim was to

Act was not repealed in its entirety. Based on classic civil code models, its reform was limited to the elimination of socialist elements without touching on the main legal institutes.[131] In this sense the strong influence of Italian law continues to this day.

Throughout the 20th century the foreign influence on Bulgarian contract law was not confined solely to the Romanic legal tradition. German law inspired a number of amendments to the former 1892 Contracts Act and somewhat indirectly also affected the current Contracts Act. Its impact, however, is most visible on Bulgarian commercial law.[132] The Bulgarian Commercial Act of 1897[133] literally reproduced the provisions of the Hungarian Commercial Act (1875) and the Hungarian Act on Bills of Exchange (1876), which followed the German precedent. Only some of its parts were borrowed from the Romanian Commercial Act (1887) which in its own turn replicated the Italian Commercial Act (1883).[134] The influence of

---

achieve quick, business-like settlement of any disagreements as well as to endorse the principle of planning and contractual discipline. Despite its law enforcement competences, the state arbitration court was not included in the general court system and its acts were not subject to control from the Supreme Court. Act on State Arbitration, promulgated State Gazette №127 of 31.05.1950, revoked State Gazette №85 of 15.10.1991; Dimitur Tokushev, *The Judiciary in Bulgaria: from Antiquity to the Present* (First edn, Sofia: Sibi 2003) 318-320; In other words, despite the refutation of dualism, differentiation of economic legislation from civil legislation was initiated but in the end not fully implemented. Although in 1984 the State Council took a decision for the preparation and adoption of an Economic Code which was never drafted. Lyubomir Popov, 'Forty Years Of Socialist Civil Law' (1984) 4 Legal Thought 34.

131 The amendments of the Contracts Act comprised mainly three groups of issues. First, the possibility for external interference, including administrative and court interference, in the process of conclusion of the contract, its content and consequences was sharply limited. All references to the state plan as an act regulating the economy as well as all provisions on contracts concluded in execution of the plan were deleted. Secondly, freedom of contract was expanded. The borders of party autonomy are now determined by the law and the good morals. The plan no longer sets its limits. Morality continues to be a criterion for the validity of contracts but the term (previously "socialist morals") is liberated from its class connotation. Thirdly, the unequal treatment of citizens and enterprises was done away with. The Contracts Act is shaped as general civil law since a separate Commercial Act is promulgated. In this sense the unified contract system is obliterated and separate contract models are differentiated depending on the legal position of the parties: merchants or non-merchants. The regime of certain types of contracts (such as the commission and the spedition contracts, the contract of carriage, the insurance contract) as well as of negotiable instruments is removed from the Contracts Act and is incorporated in the Commercial Act. See Ognyan Gerdjikov and Tanya Buzeva, 'The Amendments and Supplements to the Act on Obligations and Contracts' (1993) 2 Contemporary Law 15; Krasen Stoychev, 'Change in Trends or Trends towards Change in Contractual Legislation?' (1995) 3 Legal Thought 49; Act on Amending and Supplementing the Act on Obligations and Contracts, promulgated State Gazette №12 of 12.02.1993

132 The debate on the choice between a unitary or dual model is common in most civil law jurisdictions during the 20th century. In contrast, such a debate did not take place in common law jurisdictions. Since the English law merchant was integrated into the common law as early as the 18th century, common lawyers do not draw the distinction between general private and commercial law. Still, in the US the commercial law on sale of goods was taken out of the judge-made common law and codified in the Uniform Commercial Code. See in this sense Jan Peter Schmidt, 'Code Unique' in Basedow Jürgen and others (eds), *The Max Planck Encyclopedia of European Private Law*, vol I (First edn, Oxford: Oxford University Press 2012).

133 Commercial Act, promulgated State Gazette №114 of 01.01.1897, revoked State Gazette №78 of 28.09.1981.

134 Most of the provisions in Part I "Merchants", Part IV "Commercial Books" and Part XII "On Cheque" as well as the entire part on bankruptcy were borrowed from the Romanian Commercial Act. Tokushev, *History of the New Bulgarian State and Law 1878-1944* 203-204.

German commercial law was particularly strong in the process of drafting the currently effective Commercial Act,[135] although the law of France, Spain and the European directives also played a role.[136]

Last but not least, in the frame of its obligations as an EU candidate, Bulgaria was obliged to harmonise its contract law with the *acquis* and transplant the EU consumer protection directives in the national legal system. Thus, in 2006 Bulgaria adopted the Act on Protection of Consumers[137] which has since has undergone a number of amendments in order to stay in line with the evolving European secondary legislation in the field. As a result, the Contracts Act remains the *lex generalis* in Bulgarian contract law and applies to the extent the Commercial Act and the Act on Protection of Consumers do not prescribe anything to the contrary.[138] In sum, Bulgarian contract law of today has emerged under the influence of at least four different legal models – the Romanic, the Germanic, the socialist and the supranational European one. Needless to say, the symbiosis of the various borrowed legal solutions is a slow ongoing process that does not develop without tensions and irritations but, alas, so far remains in the shadow of the dynamics in more prestigious legal systems.

---

[135] Commercial Act, promulgated State Gazette №48 of 18.06.1991, in force since 01.07.1991, last supplemented State Gazette №22 of 24.03.2015 supplemented, in force as of 01.01.2017.

[136] As the current French Code de Commerce, the Bulgarian Commercial Act has chosen a mixture of the objective system (under which applicability is determined by the nature of the legal transactions) and the subjective system (where the parties' status as merchants is decisive). The Commercial Act is applicable to certain transactions which are regarded *per se* as commercial, no matter whether the protagonists are merchants or not (Art. 286 (2)). In addition, it is applicable to commercial transactions entered into by a merchant in the course of his business (Art. 286 (1)).

[137] Act on Protection of Consumers, promulgated State Gazette №99 of 09.12.2005, in force since 10.06.2006, last amended State Gazette №18 of 01.03.2011. The idea of consumer protection came to Bulgaria in the 1980's but was not immediately reflected in the legislation. Until the adoption of the Act on Protection of Consumers, the remedies available to consumers were those provided for in the Contracts Act. Indirectly, the interests of consumers were also protected by the Act on Standardization, promulgated State Gazette №48 of 19.06.1964, revoked State Gazette №55 of 18.06.1999, in force since 19.09.1999; the Act on Contracts between Socialist Organizations and other legislative acts that did not have the rank of a statute. In this sense, see Zlatka Sukareva, *Civil Law Protection of Consumers* (First edn, Sofia: Feneya 2001) 42-43.

[138] This means that the Contracts Act has subsidiary application to commercial transactions (Art. 288 of the Commercial Act). For example, the provisions on performance and non-performance of the Contracts Act apply to commercial transactions to the extent the Commercial Act does not contain a special provision (as for example on liquidated damages). An inverse relationship also exists between commercial law and general contract law. A number of legal solutions located in the Commercial Act also find application in general contract law (*e.g.* on force majeure, on economic impossibility). It must also be pointed out that the Commercial Act regime applies to both parties even if the transaction is commercial only for one of them (Art. 287). When one of the parties is a consumer the provisions of the Act on Protection of Consumers are also applicable. In case of conflict between the Commercial Act, the subsidiary Contracts Act and the Act on Protection of Consumers, the act ensuring a higher level of protection to consumers applies (§1 of the Act on Protection of Consumers).

Although Bulgaria joined the EU in 2007, it remains a largely under-researched legal system which was not adequately covered even by the latest comparative projects within the Union. Bulgarian academics started participating in the drafting process of the DCFR only in 2007 when the project was already well under way. Bulgaria is hardly mentioned in the comparative notes following the Draft's articles, which means that it only had limited involvement in the comparative work preceding the Interim edition. Nevertheless, it belongs to the group of Eastern European countries whose contract regimes can be demarcated within the larger tradition of the continental civil law countries as such, which only recently developed their commercial and consumer protection law and consequently miss (or have underdeveloped) court practice on a number of legal issues that have long been debated in the Western countries. Since the variety of European legal systems[139] makes indulging in a comprehensive comparative exercise increasingly difficult and even impossible to undertake in a single doctoral thesis, the choice was made to direct attention to an unexplored civilian system instead of to the usual civil jurisdictions which have already been intensively researched.[140] As a legal system that has become a crossroads for diverse legal influences from the civil law tradition, on one hand, and from national and supranational models, on the other hand, and as a young market economy with needs that are different to those of developed markets, the Bulgarian jurisdiction is particularly fit to be compared with established contract legal systems that are and radically different in their approach contract legal systems, regulating much more mature and sophisticated markets. It can be expected that its inclusion in the comparative analysis may help in contrasting the role of remedies not only between the US and Europe but also within Europe between English law and a continental legal system of a new Member State.[141]

Relying on the English/continental law, old/new Member State distinctions, the comparison includes EU jurisdictions that – in the context of European contract law – can be presumed to

---

[139] Four types of national contract regimes can be distinguished within the EU on the basis of common history, the sources of law recognised and the predominant mode of legal thought: common law systems (England, Ireland, Cyprus), traditional civil law countries (within this group there are jurisdictions with a code based on the Code Napoleon and jurisdictions with a code more based on the German model), the Scandinavian Member States (Denmark, Sweden and Finland) and the Eastern European countries. See in this sense Jan Smits, 'Diversity of Contract Law and the European Internal Market' in Jan Smits (ed), *The Need for a European Contract Law* (First edn, Groningen: Europa Law Publishing 2005) 156-157.

[140] Ironically, in an informal conversation Prof. Andras Sajo once said that Bulgaria was not an "academically recommended country". Presumably he meant that the lack of rigorous academic research regarding the jurisdiction made it a difficult subject for a young researcher.

[141] Vogenauer.

be as far removed as possible with regard to their approach to remedies. The market data also shows that Bulgarian and UK businesses stand far apart with regard to their capacity to avail themselves of the internal market.[142] A European horizontal contract law instrument, on the other hand, would offer a single set of contract rules precisely in order to overcome the legal barriers impeding citizens and businesses from taking full advantage of the single market.[143] Setting aside the controversy about the actual impact of legal diversity on cross-border trade[144] and assuming that the common legal framework affects the businesses' propensity to trade abroad and the product choice available to consumers, England and Bulgaria appear as appropriate dissimilar laboratories to study remedies in order to make inferences about the way they should be structured on the European level.

Once the argument proceeds with regard to the EU level, the choice of the US as one of the jurisdictions under comparison becomes less straightforward. In terms of size the US is the economy which can be best compared to the EU. The Uniform Commercial Code (UCC) constitutes a regional sales regime which has led to substantial uniformity in the commercial laws of the different states.[145] It is not surprising that in the Communication for CESL as well

---

[142] According to the Eurobarometer surveys, Bulgaria is among the countries in which businesses are the least likely to be involved in cross-border business-to-business and business-to-consumer transactions while the UK is among the countries in which businesses are most inclined. 82% of Bulgarian companies said they were not likely to be involved in selling or buying cross-border while 39% (well above the average) of the British companies, participating in the survey, are trading with more than three countries. See Hungary The Gallup Organization, *Flash Eurobarometer Series #320. European Contract Law in Business-to-Business Transactions. Analytical Report Conducted Upon the Request of the DG JUSTICE-A-2: Civil Law and Contract Law* (http://eceuropaeu/public_opinion/flash/fl_320_enpdf, 2011) 13-14. Bulgarian companies are also the least likely to be involved in cross-border retail sales (64%). In UK, on the other hand, 57% of the companies are already trading with consumers in more than three countries. Hungary The Gallup Organization, *Flash Eurobarometer Series #321. European Contract Law in Business-to-Consumer Transactions. Analytical Report Conducted Upon the Request of the DG JUSTICE-A-2: Civil Law and Contract Law* (http://eceuropaeu/public_opinion/flash/fl_321_enpdf, 2011) 15-16.

[143] Communication for Common European Sales Law; European Commission - Fact Sheet, Questions and answers – Digital Single Market Strategy, 06.05.2015, available at: http://europa.eu/rapid/press-release_MEMO-15-4920_en.htm. Last accessed on 25.09.2011.

[144] The survey carried out by the Oxford Institute for European and Comparative Law in collaboration with Clifford Chance was indicative of the relevance but not conclusive on the magnitude and weight of transaction costs stemming from legal diversity for cross-border trade. *The Harmonisation of European Contract Law: Implications for European Private Laws, Business and Legal Practice* (Stefan Vogenauer and Stephen Weatherill eds, First edn, Hart Publishing 2006) See Smits for a sceptical view on the importance of private law difference for the imperfect functioning of the internal market. While noting the inconclusiveness of the above-mentioned survey Gomez and Ganuza, on the other hand, are of the opinion that the transaction costs from legal fragmentation are not so negligible. Fernando Gomez and Juan-José Ganuza, 'The Economics of Private Law Harmonised Law-making: Mechanisms, Modes and Standards' in Roger Brownsword and others (eds), *The Foundations of European Private Law* (First edn, Oxford and Portland, Oregon: Hart Publishing 2011).

[145] Truly, the UCC has brought about strong convergence between the contract law systems of the different States but it also allows each State to meet the local circumstances by modifying the official text.

as in the press releases,[146] the Commission refers to the UCC as the legal act which makes the economic area of the 50 states much more an internal market than the aggregate of EU Member States is.[147] In this sense, the UCC can provide lessons for structuring the remedial provisions on the European level. These lessons may not be limited to appreciation of particular efficient legal solutions and recommendations for their borrowing. They may also contrast the context of the two sales regimes in order to enable conclusions about the ways by which a European measure can offer new attractive advantages to traders. A new equilibrium between the facilitative and regulatory function of remedies could be such an advantage.

In short, the choice of jurisdictions gives the opportunity for comparison which contrasts an American and a European common law jurisdiction, a European common law jurisdiction and an unexplored civil law jurisdiction as well as the US and the European legal tradition. In this selection of jurisdictions England and Bulgaria serve as national legal systems embracing the tradition on which a European sales regime should be designed. The UCC, on the other hand, is an external yardstick, a competitive regime from which a sales measure on the European level should learn and differentiate.

Conclusion and the way forward

In the ongoing process of developing European Contract Law, there continues to be a large gap between the traditional view of national contract laws as facilitative regimes and the European vision of contract law as an enterprise of a more regulatory nature. This project aims at bridging these two sharply different understandings and building a basis on which a European scheme of contractual remedies can emerge. The main question the thesis seeks to answer is to what extent contractual remedies should be used as regulatory devices on the European level. Breaking with the illusion that contract law is apolitical, the account comprises both positive statements and prescriptive policy proposals but unlike the Principles of European Contract Law, the *Acquis* Principles and the DCFR, it strives to keep them clearly separated. The normative claim is argued for only after extensive descriptive-comparative scrutiny of the remedies in the selected legal systems. In addition, the empirical study strives to capture both tradition and change. On one hand, it pays tribute to the national

---

[146] European Commission, *Common European Sales Law to Boost Trade and Expand Consumer Choice. Press Release* (Justice Newsroom http://ec.europa.eu/justice/newsroom/news/20111011_en.htm Last updated on 03/02/2012. Last accessed on 04/08/2012 2011).
[147] Communication for Common European Sales Law 2, footnote 1.

English and Bulgarian tradition, on which ECL should grow, and contrasts the US tradition, which comprises an influential competing contract regime. On the other hand, it considers the changes that took place in contract law during the 20th century: its materialisation and employment as a regulatory tool. Thus, taking on board different relevant aspects, the project moves on to meet the challenge of drawing guidelines for a European remedial scheme. Despite its reliance on primary texts and court decisions, the project employs the innovative interdisciplinary methodology of comparative law and economics which allows going beyond the surface of judicial discourse and thus differentiates this study from previous research.[148] Recognising that in the case of Bulgaria judges traditionally do not overtly discuss policy reasons, the research builds on the lessons of New Institutional Economics in order to assess the actual local impact of legal mechanisms. In this way the thesis incorporates not only century-old divergent legal traditions but also the modern paradigms of today's contract law: commercial and consumer contracts, spot and long-term contracts. It does not only point at differences among legal systems but also looks for arguments outside comparative law to suggest a manner in which to deal with these differences.

Still, such concise statements require further elaboration on the way the adopted methodology relates to the objective of the thesis. For this reason, having described the project in detail, I move on to Chapter II in which I elucidate the reasons for the choice of comparative law and economics as well as its basic premises. The thesis then unfolds as follows. Chapter III juxtaposes damages across jurisdictions to show that the damage measures, analysed by economists in terms of incentives, are common to the three legal systems under comparison. Chapter IV turns to the sale-of-goods and construction contracts, investigates the factors which determine their position on the spot/long-term spectrum and links the latter distinction to the issue of damages. Chapter V illuminates in detail the effects generated by damages only to conclude that, though enlightening, the economic model of incentives is inadequate from both a positive and normative perspective. Chapter VI, then, sets out on applying the methodological approach, defended by the thesis, to the termination remedy. It explores the

[148] By contrast, Collins relies heavily on the actual wording of English court decisions and argues for the development of a hybrid form of legal reasoning which combines assessment of individual rights and consequentialist policy considerations. Collins, *Regulating Contracts* 50-53; Collins, 'Regulating Contract Law' 22-23; Collins, 'The Alchemy of Deriving General Principles of Contract Law from European Legislation: In Search of the Philosopher's Stone' 223; Collins, 'Governance Implications for the European Union of the Changing Character of Private Law' 277.

relationship between the Seller's incentive to meet his obligations as to quality and the scope of the Buyer's right to terminate the contract. The thesis then concludes.

However, let us start with the methodological issues.

Chapter II Comparative Law and Economics

The research employs the comparative law and economics method.[1] So far, comparative studies on remedies have not used economic analysis.[2] Or if they have relied on law and economics, they have focused almost entirely on American law, not benefiting from a comparative element. In the absence of examples applying such methodology to the selected subject matter, particularly when it comes to such ambitious work,[3] it is essential to spell out the reasons that justify this choice. The justification below develops in several steps: in Section A the easier question of why another approach has not been chosen is answered; in Section B the recourse to efficiency as an evaluative standard is accounted for; in Section C the preference for a particular economic school of thought is clarified; and in Section D the important role comparative law has in the research is illuminated. The chapter then concludes.

A. Why not promissory theory of contract?

As already explained, the evaluation of remedies will be carried out not only across jurisdictions but also across types of contract. From a legal point of view, the contract for sale of goods and the construction contract represent classic examples of relationships with, respectively, simultaneously discharged obligations and continuous obligations. It is no surprise that future contracts, as opposed to such in which simultaneous exchange takes place, bring up different and more difficult legal problems. Their diffusion in modern times has spurred a substantial amount of legal literature which focuses on the promissory basis of contract (a promise made in return for a benefit or another promise), theorises on the reasons

---

[1] Ugo Mattei and Fabrizio Cafaggi, 'Comparative Law and Economics' in Peter Newman (ed), *New Palgrave Dictionary of Economics and the Law*, vol 1 (London: Macmillan Reference 1998); Mattei, *Comparative Law and Economics*; Florence Faust, 'Comparative Law and Economic Analysis of Law' in Mathias Reimann and Reinhard Zimmermann (eds), *The Oxford Handbook of Comparative Law* (First edn, Oxford: Oxford University Press 2006).

[2] Guenther Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' in Arthur von Mehren (ed), *International Encyclopedia of Comparative Law*, vol VII Contracts in General (First edn, The Hague: Mouton; Tübingen: J. C. B. Mohr (Paul Siebeck) 1976).

[3] Indeed, studies on remedies from a comparative law and economics perspective have been carried out only with regard to particular remedy (*e.g.* penalty clauses) without encompassing the entire institutions of damages and specific performance across types of contracts. See Mattei, *Comparative Law and Economics*, Chapter 7 Second Study on Comparative Efficiency: Penalty Clauses.

for engaging in promises and the justification of their enforcement by law.[4] A promissory theory of contract has also been used as the starting point that determines a common angle for comparing the remedial rules in sale of goods law of jurisdictions in the civil and common law tradition.[5] Arguably the most important, and certainly the most prominent, systematic work of this body of philosophical contracts scholarship is Charles Fried's *Contract as Promise*.[6] However, despite the intuitive appeal and unifying force[7] of Fried's piece, this thesis will not rely on it since economic analysis fits better the objective of the project. This is true not only with respect to the general task that each of the theories sees as its own but also with respect to the particular methodological features that distinguish promissory and economic theory. To unpack this general statement I first start with the overall agenda of each theory and then turn to the more concrete methodological differences.

It was already pointed out that the objective pursued by the thesis is to make normative suggestions for the design of a remedial scheme on the European level, a scheme that is so far missing but which the Commission started devising with the proposed CESL. In this respect, law and economics provides a systematic way of thinking about law reform. For the latter to be carried out in a consistent and non-fragmented way, legal rules should be structured in view of the incentives they are going to produce. These incentives will change human behaviour and if attuned properly will lead to the desired results. Such a consequentialist analysis allows more informed decisions about the nexus between the options on hand and the outcome sought. It raises awareness about the consequences and trade-offs that follow from a policy choice and therefore is capable of providing answers to my normative question of to what extent contractual remedies should be used as regulatory devices on the European level.

The promissory theory, on the other hand, has not been developed with legal reform aspirations. Fried's primary goal is rather to justify contract law as a morally and politically

---

[4] Patrick Atiyah, *Promises, Morals and the Law* (Oxford: Clanderon Press 1981); Charles Fried, *Contract as Promise: A Theory of Contractual Obligation* (Cambridge, Massachusetts: Harvard University Press 1981). Other deontic theories have been developed by Peter Benson and Randy Barnett. For an excellent comparison between Fried's and Benson's theories with economic contract theories, see Jody S. Kraus, 'Philosophy of Contract Law' in Jules L. Coleman and Scott Shapiro (eds), *The Oxford Handbook of Jurisprudence and Legal Theory* (New York: Oxford University Press 2002).

[5] Vanessa Mak, *Performance-Oriented Remedies in European Sale of Goods Law* (First edn, Oxford and Portland, Oregon: Hart Publishing 2009) 7-14.

[6] Fried.

[7] Fried claims that the promissory principle establishes contract law as an integrated, distinct body of law, separate from other private law areas. Ibid 5-6.

legitimate institution and to prove its distinctiveness from other areas of law.[8] According to him, a contracting party is morally obliged to keep his promise simply because he has voluntarily and intentionally undertaken it. Inspired by the Kantian injunction to treat human beings as ends in themselves and not as means, Fried grounds this obligation in the respect for individual autonomy and in trust. In his view, the legal enforcement of this moral obligation justifies contract law and determines it as a coherent body of law situated in the domain of liberal individualism.[9] In this sense, Fried implicitly denies any instrumental outlook on law. With personal autonomy as the paramount value, his promissory theory entails that individuals are free to define their obligations and their rights should not be subordinated to collective ends.[10] From this perspective, it *a priori* rejects the possibility to invest contract law with regulatory goals. That is why, law and economics with its underlying consequentialist logic matches better the objective of this thesis.

The above fundamental difference between Fried's promissory theory and economic theory translates into concrete methodological traits that further justify the choice of economic analysis with regard to this project. These derivative dissimilarities are: first, the different emphasis on positive analysis; secondly, the different attitude towards borders between areas of law; and thirdly, the perspective taken on shaping legal rules.

First, though seeking to answer a normative question, the research will contain a substantial positive part analysing the structure of contractual remedies (damages and specific performance) in the selected jurisdictions, detecting differences and similarities between legal systems and explaining the reasons for them. In this sense, the envisaged case studies in the thesis will compare different remedial arrangements and collect knowledge of their impact in diverse institutional environments. This intention coincides with the central task of positive law and economics to investigate which of the available legal alternatives induces the incentives and, respectively, behaviour that will lead to the desired results. Only then, on the basis of this scrutiny and assuming the achievement of an optimal level of contracting as a goal, will existing legal rules be criticised and normative suggestions made. The positive/normative distinction in legal-economic analysis fits well with the project idea to

[8] In this sense see Kraus 703-705.
[9] Fried 5, 35.
[10] Ibid 5, 35.

build the remedial scheme on the European level based on the experience already obtained on the national level.

Fried, on the other hand, degrades the positive task with respect to the normative one. Once he has found the promise principle as the justificatory principle of contract law, he examines classic contract cases to see whether the doctrine invoked can be understood in its terms. Any doctrine that can constitute a counter-example to his contract-as-promise claim is neutralized either as a doctrine that is not genuinely contractual,[11] or as one that is inconsistent and therefore not subject to explanation by any theory.[12] Preoccupied with defending contract law from the legacy of legal realism and of critical legal studies, from claims about its assimilation to tort and from communitarian attacks, Fried posits it as the emanation of certain values and dismisses any contract doctrines (and their cases) that cannot be explained as exclusively devoted to defending them. In this way he limits the pool from which he draws his legal data disallowing the falsification of his claim. Refusing to deconstruct the incompatible contract doctrine and look beyond its plain meaning, he fails to search for alternative principles that would explain the court cases decided under it. To be sure, such an approach does not create the appropriate atmosphere for devising a law reform. It underrates the role of positive analysis as a tool which could reveal the rationale behind seemingly inconsistent court decisions and renders the empirical testing of the normative principle unconvincing. Certainly, law and economics also fails to explain all the legal data available but, still, it appears to cast a broader net since it does not reject whole contract doctrines as unfit.[13] Thus, the more balanced ratio between positive and normative in legal-economic analysis greatly influenced my methodological choice with respect to this research.

Secondly, disowning the doctrines (and the cases under them) that do not fit his account, Fried draws rigid boundaries between law areas. This does not coincide with the starting point of the thesis implying increasing dilution of the borderlines between private and public, between contract law and regulation. Legal-economic analysis, on the other hand, is not obsessed with doctrinal distinctions. It does not seek to establish the different justificatory principles that distinguish different bodies of law. It uses legal doctrines as a starting point to sort the abounding legal data but then deconstructs them to search for the underlying

---

[11] According to Fried, when in promissory estoppel recovery is limited to reliance damages, this is not liability in contract but in tort. Ibid 24.
[12] This is Fried's conclusion in relation to the consideration doctrine. Ibid 35.
[13] In this sense, see also Kraus 713, footnote 54.

economic logic without much regard to legal classifications. To which area of law (*e.g.* contract or tort, private or public law) the rule belongs, inducing a particular incentive, is a question that remains largely irrelevant as the principle of efficiency may very well bring together rules from traditionally distinct areas of law.[14] If some authors contend that contract doctrines should not be used to regulate, *i.e.* to correct market failures such as monopoly power or imperfect information, this is because, in their opinion, contract law cannot supply efficient rules in this respect,[15] and not because employing the doctrines for such purposes violates so fundamental a principle of contract that they can only be associated with another body of law. Since economic analysis proves more flexible and does not rule out from the outset the premises that contract law may be viewed as a regulatory instrument, it appears more suitable for the project than promissory theory.

Thirdly, another methodological commitment of law and economics is also particularly attractive with regard to this research: the *ex ante* perspective which allows the shaping of legal rules in order to affect the actors' prospective behaviour. In fact, the *ex ante*/*ex post* distinction is pointed as a characteristic divide between economic theory and deontic theories. From an *ex post* perspective (looking at contract law after the dispute has occurred), a remedial rule would be selected on the basis of the litigants' pre-existing rights and with regard to its effect on the allocation of existing burdens and losses between the parties in the concrete dispute. By contrast, from an *ex ante* perspective (before any disagreement has materialised) the legal rule would be designed with regard to its prospective effect on incentives and the social desirability of one's conduct in response to these incentives. As Fried's theory embraces an *ex post* perspective, it has been accused of failing to provide guidance for formulating the content of default rules.[16]

---

[14] In this sense, see also ibid 691-694, 699-700.

[15] Schwartz, 'The Enforcement of Contracts and the Role of the State'; Schwartz and Scott, 'Contract Theory and the Limits of Contract Law'.

[16] Richard Craswell, 'Contract Law, Default Rules and the Philosophy of Promising' (1989) 88 Michigan Law Review 489. Craswell reasons that in case of a contractual gap the parties have simply not agreed on their rights and duties. Thus, the *ex post* perspective, implied by Fried's theory, cannot provide directions to a court as to the content of the default rule which should fill the incomplete agreement. Ibid 515-516. In other words, the critique relates to the perspective courts should adopt in adjudication when there is a gap in the parties' contract (an issue which this thesis does not purport to resolve) and not to the standpoint (taken in the thesis) with regard to reforming existing contract regimes or devising a new one. In the context of legal reform which has prospective effects, an *ex ante* perspective is not problematic. Fried himself concedes that gap-filling defaults can be subject to change, but to protect individual autonomy such change can only relate to the future. Nevertheless, on a more general basis, the *ex ante/ex post* distinction concerns the two ways contract rules can be evaluated and designed. Thus, the issue has implications with regard to the positive analysis of national remedial rules as well as the

To be more accurate, despite its general *ex post* perspective, contract-as-promise theory is not so inadequate in instructing the choice of default rules. According to Fried, the promise principle governs the content of **interpretative** default rules while the content of **interpolative** ones is directed by non-contract law.[17] The problem is rather that he simply proscribes the pursuit of any other value besides respect for the parties' individual rights.[18] Even when he finds that an issue is in the domain of non-contract law, Fried endorses the *ex post* perspective so that the legitimate expectations of the parties are not upset by collective ends such as efficiency, altruism, or redistribution. Such considerations can be taken into account only in the process of interpolation and only if the *ex ante* perspective is compelled by the background conventions against which parties form and pursue their subjective intent.[19]

In other words, Fried's vision admits the *ex ante* perspective only exceptionally and thus prohibits any consequentialist principles from entering the picture. In this sense, Fried's theory does not have direct implications for the direction legal change should take[20] and thus does not fit with the central idea of this project. In contrast, economic analysis entails the tools necessary to analyse national remedial rules and to make the normative suggestions with regard to structuring the European rules in view of certain regulatory effect.

---

normative suggestions on the European level. In the positive part of the thesis the national rules will be evaluated from an *ex ante* perspective with regard to their impact in the particular institutional environment in order to build or reject the normative claim regarding the regulatory function of European remedial rules.

[17] In this sense, see Kraus 718-725. In her opinion, the key lies in Fried's notion of a gap which is not the same as that of Craswell. While Craswell sees the need for genuine gap-filling and the need for interpretation as essentially the same since both require the application of default rules, to Fried these problems are fundamentally different. Which of the two is faced by the court in every particular dispute depends on "background conventions and understandings" that provide evidence regarding the formation and the content of parties' subjective intent. If these conventions indicate that the parties have reached a subjective agreement about the disputed issue but the contractual terms are not sufficiently clear, the court should **interpret** the contract in light of the parties' subjective intention. The basis for the **interpretation** process is provided by the promise principle. For example, even if the parties have not explicitly agreed on the remedy in the contract, Fried considers they have subjectively intended expectation damages. Fried 17. But when the background conventions do not inform about such subjective intent or about its content beyond the plain meaning of the contractual terms, there is a genuine gap in the contract which requires filling by means of **interpolation**. This is the case for example when the contract lacks an explicit term with regard to mistake and impracticability. Ibid 89. Since in such a case the promise principle runs out, the necessary **interpolation** can be carried out only by referring to principles external to contract law. For example, whenever the parties' manifestations of objective intent do not give adequate evidence of their subjective intent, the liability imposed on the basis of objective intent is non-contractual. Ibid 61, 66-67. For a more detailed interpretation of Fried's theory in this sense, see Kraus 715-730.

[18] Fried 85.

[19] For example, according to Fried, the 'mailbox' default rule is justified by considerations of "convenience." ibid 52. See also Kraus 728-730.

[20] Kraus 727.

To put it briefly, my methodological choice excluded Fried's promissory theory since the latter rejects any perception of contract law as an instrument in the pursuit of certain social aims. Founded on the concept of autonomy, it has limited value with regard to shaping default rules in order to achieve certain regulatory goals. Legal-economic methodology, on the other hand, corresponds very well to the strong emphasis on positive analysis in the thesis, to my assertion about dilution of the borders between private law and regulation and to the adopted *ex ante* perspective of shaping legal rules. From this viewpoint, law and economics has the resources to inform changes in contractual remedies in the explored jurisdictions as well as guidelines for building a European remedial regime. Yet, if a standards-based approach is selected to inform this research, why is the standard chosen that of efficiency and not that of justice?[21]

B. Why efficiency?

Clearly, it is the economic line in the chosen interdisciplinary methodology that sets efficiency as the principal concern. Law, on the other hand, has traditionally been engaged with issues of justice and fairness. This disparity often causes a great deal of tension on both sides of the interaction. It is not rare that legal scholars equate such change in value focus with ethical bankruptcy and dethroning law from its position of autonomous discipline. Many economists, on the other hand, insist that the concepts of justice and fairness disguise matters of distribution, *i.e.* questions that are political and not scientific. Conventionally, efficiency and justice are understood as conflicting objectives which require difficult trade-offs between optimal resource allocation and equitable solutions.[22] I side neither with the argument that lawyers should not be concerned with efficiency, nor with the view that the latter standard should be the one and only goal of the efforts of legal scholars and practitioners. Indeed, I also do not see efficiency and justice as antithetical concepts, but rather as types of legal argument that are often complementary rather than alternative.

There is nothing *a priori* improper in relying on efficiency as a criterion of assessing and designing legal rules. Whether we like it or not, legal doctrines have important efficiency implications. Every time lawyers assign rights (whether by contract, statute or court decision)

[21] Barnett distinguishes between party-based theories, process-based theories and standards-based theories of contract, the latter having efficiency or substantive fairness as standards of evaluation. See Randy Barnett, 'A Consent Theory of Contract' (1986) 86 Columbia Law Review 269.
[22] Ronald Dworkin, 'Is Wealth a Value?' (1980) 9 Journal of Legal Studies 323.

they make a decision on an economic problem in a world of scarcity. Why then decide intuitively instead of in an informed way? Why deliberately close our eyes to the effect of alternative legal institutions and rules instead of proceeding with awareness about their impact? Why miss the opportunity to enrich our understanding of law and legal change for fears that opening up to the economic instrumentarium might inflict loss of prestige? Truly, the world of facts and the world of norms are closely interrelated and the starting point of the positive analysis undoubtedly influences normative judgments.[23] I will not pretend that law and economics is neutral. Yet, such criticism can also be directed to any methodology based on a theory of justice. So the more important question is how to carry out a better economic analysis, how to enhance it and infuse it with context, not whether we do so at all. Fortunately, nowadays, more and more European legal scholars, including among those criticising law and economics, would agree that this approach cannot simply be ignored and should be one of the perspectives considered in the course of decision-making.

That the issue of efficiency and the issue of distribution are separated questions is, however, highly misleading. It is the neoclassical claim that efficiency is about the size of the pie and distribution about its division; therefore, private law should be left alone to maximise the pie whereas public (tax) law should be engaged in its fair distribution without any interference into the pie's creation.[24] Yet, disregarding that a legal rule affects both allocation and distribution of resources is problematic. In a bargaining game the production of surplus is determined by the players' cooperation, which in its own turn depends on the players' agreement about the surplus division. In the absence of a competitive price, parties may not be able to agree on the distribution of the stakes. In this sense non-cooperative outcomes are possible, in which case the surplus will be lost.[25] Even the efficiency-only regulation in pure coordination games has distributive effects.[26] Moreover, it has also been shown that in the ultimatum game the division of the surplus affects the accepting party's incentive to produce the surplus. If the latter perceives the division as unfair, he does not reason as *Homo*

---

[23] See in this sense, though in a different context Jürgen Neyer, 'Europe's Justice Deficit: Justification and Legitimacy in the European Union' in Jürgen Neyer and Antje Wiener (eds), *Political Theory of the European Union* (First edn, Oxford: Oxford University Press 2011), 169. Ugo Mattei also engages with this philosophical argument and considers it to have been overemphasised: Mattei, *Comparative Law and Economics* 10.

[24] Louis Kaplow and Steven Shavell, *Fairness versus Welfare* (First edn, Cambridge, MA: Harvard University Press 2002).

[25] Robert Cooter, 'The Cost of Coase' (1982) 11 Journal of Legal Studies 1, 17.

[26] Dennis Mueller, *Public Choice III* (First edn, Cambridge, UK; New York: Cambridge University Press 2003).

economicus and rejects the offer, even though technically the Pareto-optimality still holds.[27] In other words, once we leave the world of zero transaction costs, the issue of distribution invariably comes up. Even if efficient, every legal rule generates some winners and some losers in terms of welfare and there must be some criterion determining who falls in which category. Therefore, efficiency cannot be the sole standard in assessing and shaping legal rules.

Yet, how to combine efficiency and justice in the same analysis still needs to be worked out. Although prominent economists have approached the issue of justice,[28] there is no consensus formed among economics scholars on the way to address simultaneously both allocative and distributive considerations. So far contract law theory has also been unable to produce a meta-norm which would guide lawmakers in prioritising and balancing between conflicting legal principles.[29] The ambitions of this research also do not strain to developing a multi-value approach in different breach of contract situations. As the development of national private law from a distributive justice perspective has already been analysed,[30] the thesis will stay solely within the efficiency paradigm. This does not mean that in the process of creation of European contract law the distributive implications of legal rules should be discarded.[31] Yet, I leave to others the development of a coordination approach.

It is also worth emphasising, however, that there is considerable evidence that efficiency and justice are not always in competition. It is not uncommon that a law-and-economics analysis endorses as efficient a solution that is also supported as just by more traditional accounts. For example, both economic and justice-based investigations of tort liability rules favour negligence as the general standard of liability with strict liability covering only specific cases

---

[27] A great many ultimatum game experiments (including cross-cultural) have been done during the years with robust results consistently deviating from the predictions of game theory. The most common offer is for a split of 50:50. Proposals for unfair splits (*e.g.* 70:30) are more likely to be rejected. See the discussion in Ken Binmore, *Playing for Real. Game Theory* (First edn, New York: Oxford University Press 2007) 545-546.

[28] Daniel Hausman and Michael McPherson, 'Taking Ethics Seriously: Economics and Contemporary Moral Philosophy' (1993) 31 Journal of Economic Literature 671; Amartya Sen, *On Ethics and Economics* (Oxford, UK; New York, NY, USA: B. Blackwell 1987); Amartya Sen, *The Idea of Justice* (First edn, London: Allen Lane 2009).

[29] In an attempt to counter the criticisms directed at unitary normative theories, whether based on autonomy, efficiency or fairness, pluralist theories endorse all of these principles to be used in determining contractual rules. The difficulties caused by the lack of metric pointing at the decisive value in the face of conflicts are demonstrated by Eisenberg. See Melvin Aron Eisenberg, 'The Theory of Contracts' in Peter Benson (ed), *The Theory of Contract Law: New Essays* (First edn, Cambridge: Cambridge University Press 2001).

[30] Somma.

[31] For a similar view, see Cafaggi, 'The Making of European Private Law: Governance Design' 295.

in which the injurer is undoubtedly in a better position to prevent the accident.[32] The convergence of the principles of the law of takings (public need and compensation at market value) in many western legal systems (the US, UK, Germany, Italy, Bulgaria and others) can be viewed as both efficiency- and equity-driven.[33] It has also been shown that the birth of a whole set of remedies (injunctions, specific performance, tracing, etc.) in England can be explained both by the equity and the efficiency rationale.[34] In fact, in different historical moments and institutional environments both equity and efficiency have argued against rigid application of legal doctrine, infusing it with a considerable degree of flexibility: *e.g.* equity – overcoming the English stringent writ system, efficiency – moving the reasonableness consideration in US nuisance disputes from the balancing of harms to the selection of the remedy.[35] From this perspective, efficiency and justice cease to be mutually exclusive notions. From conflicting ideas they turn into powerful legal arguments which often point in the same direction and complement each other.

This is the way I also look at the concepts of efficiency and justice – as seemingly opposing but often compatible persuasive techniques, the relationship of which has to be examined on a case-by-case basis.[36] In this sense, the efficiency analysis is just another line of reasoning which may make the case for a particular course in shaping European contractual remedies and which does not necessarily negate justice.

C. Which economics?

The choice to apply economic methodology to the analysis of remedial rules, however, does not answer the question of which economic theory will be used. In my view, the hostility towards law and economics results to a great extent from the fact that its opponents identify it exclusively with the Chicago school.[37] Its major contribution is the development of a systematic approach entailing application of a consistent body of economic theory (price theory) to legal rules. In this sense, Chicagoans drew the interest of economists to law as a

---

[32] See in this sense Robert Cooter, 'The Future of Law and Economics' in Fabrizio Cafaggi, Antonio Nicita and Ugo Pagano (eds), *Legal Orderings and Economic Institutions* (First edn, London and New York: Routledge 2007) 29.
[33] For a more detailed explanation, see Mattei, *Comparative Law and Economics* 17-19.
[34] Ibid 11-13.
[35] In this sense ibid 13-16.
[36] See in this sense ibid Chapter 1 Efficiency and Equity 1-25; Cooter, 'The Future of Law and Economics' 29.
[37] See *e.g.* Barnett, 277-283. According to him the attempt of economic analysis to provide a normative theory in the field of contract law is "fundamentally flawed".

crucial institution in policy making. Yet, since its birth, law and economics has experienced considerable branching out and it is by no means mandatory that economic analysis be based on neoclassical economics.[38] Although taking post-neoclassical frictionless models as a starting point, the thesis will steadily pursue their enrichment with the methodology of New Institutional Economics, which aims at more subtle and down-to-earth economic analysis.[39] Three differences between the Chicago tradition and New Institutional Economics lead me to rely heavily on the latter school in relation to this research: first, the degree of realism achieved by economic analysis; second, the more subtle position taken with regard to the deregulation/regulation dichotomy; and third, the developed dynamic framework.[40] These methodological differences turn out to be not negligible at all as they lead to a different understanding of efficiency and to the specific take comparative law and economics has on the standard.

First, based on very strict premises, the Chicago approach created a sort of "economic nirvana"[41] which has little to do "with what happens in the real world."[42] In this approach, individuals, being rational maximisers of their satisfaction, respond, in the context of perfect markets, to price incentives embedded in the legal rules, the latter devised with an efficiency purpose. Wealth-maximisation and the search for the means to achieve it also lie at the core of New Institutional Economics;[43] yet, the latter has moved well beyond the neoclassical and even the post-neoclassical paradigm. It is not only that the introduction of the concept of

---

[38] Mercuro and Medema distinguish Chicago Law and Economics, Public Choice Theory, Institutional Law and Economics, New Institutional Law and Economics, New Haven School, Modern Civic Republican School. Nicholas Mercuro and Steven G. Medema, *Economics and the Law. From Posner to Post-Modernism and Beyond* (Second edn, Princeton and Oxford: Princeton University Press 2006). In addition, Behavioural Law and Economics took off during the 1990's of the last century.

[39] On Coase and Williamson criticising Posner's views, see Richard Posner, 'The New Institutional Economics Meets Law and Economics' (1993) 149 Zeitschrift für die GesamteStaatswissenschaft (Journal of Institutional and Theoretical Economics) 73; Ronald Coase, 'Coase on Posner on Coase: Comment' (1993) 149 Zeitschrift für die GesamteStaatswissenschaft (Journal of Institutional and Theoretical Economics) 96; Oliver Williamson, 'Transaction Cost Economics Meets Posnerian Law and Economics' (1993) 149 Zeitschrift für die GesamteStaatswissenschaft (Journal of Institutional and Theoretical Economics) 99; Ronald Coase, 'Concluding Comment' (1993) 149 Zeitschrift für die GesamteStaatswissenschaft (Journal of Institutional and Theoretical Economics) 360.

[40] On the fundamental building blocks of the Chicago approach and of New Institutional Economics, see Mercuro and Medema 102-126; 241- 276.

[41] Antonio Nicita and Ugo Pagano, 'Law and Economics in Retrospect' in Éric Brousseau and Jean-Michel Glachant (eds), *New Institutional Economics: A Guidebook* (First edn, Cambridge, UK; New York: Cambridge University Press 2008).

[42] Ronald Coase, 'The New Institutional Economics' (1998) 88 The American Economic Review 72, 73.

[43] Ronald Coase, 'The Problem of Social Cost' (1960) 3 The Journal of Law and Economics 1; Oliver Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* (New York: Free Press, London: Collier Macmillan 1985) 23.

transaction costs to economic analysis[44] pointed at the illusory comfort of the world in which mainstream economists lived – an ideal world in which there are no costs of search, negotiation, monitoring and enforcement.[45] Post-Chicago scholars are also aware of the importance of transaction costs and the need to take economic thinking beyond the idea of perfect markets.[46] It is not only that the assumption of full rationality is relaxed in order to base the new institutional analysis on the concept of bounded rationality.[47] Some post-Chicagoans also realise the need to integrate a more realistic model of behaviour in their approach.[48] The true progress made by New Institutional Economics, I think, is rooted in the very procedure of analysis which makes the latter less abstract and more sensitive to the actual facts.

At the beginning of the analysis is always the Coase theorem.[49] In a world of zero transaction costs, law does not matter since parties will always bargain for the one efficient outcome. Our world, however, is a world of positive transaction costs and in it, law has important efficiency implications.[50] In the imperfect human universe parties will bargain not until the right reaches its most valued user but until the expected gains exceed the expected costs. So how the particular right is initially assigned determines its final place. Therefore, law should be efficient, *i.e.* it should structure property rights in a way which minimises transaction costs and maximises society's wealth.[51] So far, so good; Chicagoans and New

---

[44] Ronald Coase, 'The Nature of the Firm' (1937) 4 Economica 386; Coase, 'The Problem of Social Cost'.
[45] Ronald Coase, *The Firm, the Market and the Law* (First edn, Chicago: University of Chicago Press 1988) 7.
[46] See *e.g.* Goetz and Scott.
[47] Herbert Simon, *Administrative Behaviour* (Second edn, New York: Macmillan 1961) 24. Some new institutional economists even strive to go beyond the concept of bounded rationality. Exploring how humans decipher the environment through pre-existing mental constructs, they aim at explaining the institutional choices made and the effect of these choices on the economy. North; Douglass North, 'Prologue' in John Drobak and John V.C. Nye (eds), *The Frontiers of the New Institutional Economics* (First edn, San Diego: Academic Press 1997) 11 In this aspect the new institutional economic literature intersects with experimental-behavioural law and economics.
[48] Eric Posner, 'Economic Analysis of Contract Law after Three Decades: Success or Failure' (2003) 112 The Yale Law Journal 829 865-868, 875-877. To be more correct, although Erik Posner is conscious of problems with the rationality assumption, he is also very sceptical of the capacity of bounded rationality models to better inform economic analysis of contract law.
[49] In fact Coase, himself, did not expressly state the Coase theorem. It can be induced from Coase, 'The Problem of Social Cost'.
[50] It is often the case that only one of the assumptions, on which the Coase theorem rests, is emphasised – that of zero transaction costs (including information costs). For this reason it will be useful here to recall the other two assumptions which are just as important: (1) that the rights over the resources are fully defined, and (2) that the legal rights are alienable. Mercuro and Medema 110, 113. For more on these two assumptions, see *infra* Section D. of this Chapter.
[51] This is known as the Coase lesson. For a detailed proof and interpretation of the Coase theorem, see ibid 107-119.

Institutionalists would not, I think, disagree on this.[52] But what are the concrete steps to be taken in the process of finding the efficient solution? Here is where the most significant differences start.

The logic of the Chicago analysis roughly proceeds as follows: An optimal contractual model is constructed under the assumption of zero transaction costs. The hypothetical legal rule enabling the parties to achieve the outcome in the optimal model is pointed to. The existing legal rule is then compared to the optimal one: if it is the same, the effective law is efficient; if it differs, then it is criticised as a rule that does not lead to an optimal result and, therefore, should be changed. The exercise may also include changes in the assumptions of the zero-cost model to discern different rules that are efficient under different conditions. Then again it will be seen whether the real-life rule fits any of the efficient ones.[53] New Institutional Economics, however, sets on a different route of analysis (again roughly described): The different real-life institutional solutions to a problem are identified. Then the institutional framework is inquired into in order to discover the factors determining transaction costs and the types of transaction costs associated with each of the solutions. Further, the different institutional arrangements are compared in terms of costs. The appropriate institution then becomes the one that implies the lowest level of transaction costs.[54]

Obviously, both schools aim at getting as close as possible to the Coasean zero-transaction-cost world. Why then is the methodological procedure of New Institutional Economics to be preferred? The problem with the Chicago approach is the continuous, invariable emphasis on the optimal model. In the Chicagoan vision, the ideal world should be approximated by imitation, by replicating it as if it actually exists. If parties cannot reach the efficient allocation of property rights as a result of transaction costs, the law should provide for it to help them attain the outcome as if there were no barriers to exchange. Costs are minimised by assuming zero costs and assigning rights and liabilities as if this assumption were correct. The rights go to the party that would have purchased them as the highest value user; the

---

[52] For this reason Coase is considered a founding father of both schools. It is also for this reason that Mercuro and Medema view New Institutional Economics as being in many respects consistent with the Chicago approach. Ibid 243.

[53] This description of the Chicago thinking follows to a great extent the description in Posner, 'Economic Analysis of Contract Law after Three Decades: Success or Failure' 833-834.

[54] This rough description is distilled from the methodological account in Chapter 1 *Transaction Cost Economics* of Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*.

liabilities go to the party that would have assumed them as the least cost avoider.[55] Yet, the assumption is not correct since no matter how much transaction costs are reduced, they are never completely eliminated and there will always be costs of defining and enforcing property rights.[56] So we cannot arrive at the ideal world by imagining we are actually there.

In other words, the mistake of Chicagoans is that in trying to approximate the desired state of the world, they reason as if it is possible to actually achieve it. New Institutionalists, on the other hand, have accepted that this is unfeasible so the emphasis is on where we are now, not on where we want to be. They study existing alternative governance institutions and aim at economising on transaction costs by endorsing the institution which governs exchange at the lowest cost level. Saving takes place not by mechanically reproducing the situation parties would be in if transaction costs were absent but by choosing the real-life workable arrangement that is the most cost advantageous. In this way, New Institutional Economics moves away from the "economic nirvana" and adopts an analytical technique that enables accurate conclusions.

This does not mean that the Chicago models are useless. On the contrary, they represent an important analytical and educational tool which provides important information on the incentives affected by a legal institution and the trade-offs involved by stimulating one incentive or another. This is the reason why this thesis also starts from the received neoclassical wisdom.[57] Yet, once the potential of optimal models is exhausted, it is necessary to step into the real world since much of the insight can be gained not by keeping hold of the model but by examining the imperfect environment. Often (post-) neoclassical models leave out important variables either because the latter do not appear as crucial within the ideal world, or because the scholar is focused on coming up with clear-cut recommendations. Other, more sophisticated models include the relevant variables but can lead to definite conclusions only if there is statistical data which can be punched into the model to make it operative.[58] In contrast, New Institutional Economics investigates in detail the sources of transaction costs in particular contexts and attenuates the quantification difficulty by

---

[55] The same reasoning stays behind the efficient breach principle under which the promisor should be allowed to breach the contract if the gains from the breach exceed the costs.
[56] Steven Cheung, 'On the New Institutional Economics' in Steven Cheung (ed), *Economic Explanations: Selected Papers of Steven Cheung* (First edn, Hong Kong: Arcadia Press Ltd. 2005) 248-250; Cooter and Ulen, *Law and Economics* 94; Cooter, 'The Cost of Coase' 11.
[57] See *infra* Chapter V.
[58] See in this sense Posner, 'Economic Analysis of Contract Law after Three Decades: Success or Failure'.

comparing the costs of diverse institutions. Instead of being paralysed by the absence of data on the magnitude of costs, it draws conclusions from their difference. Without being too much preoccupied with computation problems, lawyers can make a substantial contribution in this analytical procedure as they are well-trained to recognise the transaction costs depending on the national legal system. Therefore, this research will also employ comparative institutional analysis as developed by New Institutionalists.

Second, the Chicago school invariably insists on the necessary connection between efficiency and the market. If the efficient allocation of property rights can be reached by parties' contracting, the reasoning goes, the law should facilitate exchange by providing for maximum tradability of property rights at low cost. It should ensure the conditions for achieving the efficient outcome by excluding any restrictions on freedom of contracting and by "mimicking the market". Such an interpretation of the Coase theorem is easily translated into the normative recommendation of minimum regulation. Public regulation is viewed as an additional source of transaction costs, obstructing the operation of competitive markets and generated, among other things, by regulatory capture.[59] To this prescription also contributes the view of the efficiency of common law (broadly understood as judge-made law).[60] According to Posner, the common law incentivises players to "channel their transactions through the market" or, in case of high transaction costs, simply reproduces the outcome that would have been obtained, had costs not impeded market operation.[61] Its efficient legal doctrines make state intervention through statutory regulation unnecessary, all the more that the legislative process does not have the means to produce efficient results, whether these means are the party's choice between settlement and adjudication,[62] an evolutionary mechanism, driven by the utility-maximising decisions of litigants,[63] or the utility function of judges as determined by the institutional structure of the adjudicative

---

[59] George Stigler, 'The Theory of Economic Regulation' (1971) 2 The Bell Journal of Economics and Management Science 3.

[60] Richard Posner, *Economic Analysis of Law* (First edn, Boston: Little, Brown 1972); George Priest, 'The Common Law Process and the Selection of Efficient Legal Rules ' (1977) 6 Journal of Legal Studies 65; Paul Rubin, 'Why Is the Common Law Efficient?' (1977) 6 Journal of Legal Studies 51; John Goodman, 'An Economic Theory of the Evolution of Common Law' (1982) 7 Journal of Legal Studies 393.

[61] Richard Posner, *Economic Analysis of Law* (Fourth edn, Boston: Little, Brown 1992) 252.

[62] Coase, 'The Problem of Social Cost' William Landes, 'An Economic Analysis of the Courts' (1971) 14 Journal of Law and Economics 61.

[63] Rubin; Priest.

system.[64] In short, the decentralised decision making of the free, self-correcting market generates efficiency and if a market failure occurs, it is sufficient to rely on the common law to bring about the efficient outcome.

Such a view, however, does not coincide with the hypothesis of this thesis which entails an increasing regulatory role of contract law. Truly, such a hypothesis suggests a diminishing importance of public regulation but, still, it also implies that the market does not always function efficiently and that market failures need correction. The starting point entails a trend from a command-and-control to incentive-based regulation, not a trend toward deregulation as advocated by the Chicago school. From the above short account of the Chicagoan viewpoint it is clear that the origin of the market bias lies in the way Chicagoans construe the Coase lesson. In their view, the role of law should only be to define property rights and to assign them to the party who values them most since this would be the result from the market operation in the zero-transaction-cost world. Yet, as explained, such a laissez-faire attitude would lead to efficiency only if it actually brings about the ideal world, an outcome that is highly unlikely.[65]

The source of market favouritism, however, can also be found in the natural law model of property rights which is at the basis of neoclassical economics. This is the model on which Adam Smith, defying mercantilism, grounded his theory of the invisible hand.[66] Setting out to formalise Smith's doctrine, the Chicago school embraced the natural law definition of property rights, implying a sovereign dominion of the individual, in which he is free from any government intervention and has an unrestricted bundle of rights over certain resources

[64] Richard Posner, 'What Do Judges Maximize (The Same Thing Everybody Else Does)' (1993) 3 Supreme Court Economic Review 1.

[65] For such an argument, see also Simon Deakin and Frank Wilkinson, 'Labour Law and Economic Theory: A Reappraisal' in Gerrit De Geest, Jacques Siegers and Roger van den Bergh (eds), *Law and Economics and the Labour Market* (First edn, Northampton, MA: Edward Elgar 1999); Simon Deakin, 'Law *versus* Economics? Reflections on the Normative Foundations of Economic Activity' in Megan Richardson and Gillian Hadfield (eds), *The Second Wave of Law and Economics* (First edn, Sydney: The Federation Press 1999).

[66] Smith's *Wealth of the Nations* was a reaction against the mercantilist policies dominating at the time. Under them the State, enacting many protectionist command-and-control regulations, became deeply involved in the economy. At that time the natural law framework was already introduced in England by Sir William Blackstone. William Blackstone, Sir, *Commentaries on the Laws of England*, vol 4 (Oxford: Clarendon Press 1765-1769). In Smith's view, a property rights structure such as the one delineated in the natural law model, made the heavy government intervention, advocated by mercantilists, unnecessary, as the invisible hand of the free market, would automatically channel the efforts of self-interested individuals toward socially desirable ends. Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of the Nations* (First edn, 1776), available at: http://www.gutenberg.org/ebooks/3300. For a more detailed interpretation of the historical context in which Adam Smith developed his invisible hand doctrine, see Mattei, *Comparative Law and Economics* 40-46.

(property). Developed by civil lawyers, the natural law concept was divorced from the idea of obligation, necessary to control externalities, and any property right limitation was equated with limitation to freedom. Such absolute property rights were to be assigned by private law with any constraints contained only in public law regulation.[67] This model remained largely an intellectual product and never underlay in its pure form the property rights structure in any legal system.[68] Yet, it became the background against which mainstream law and economics developed its theory, placing great emphasis on the free market and perceiving any restraint on it as exogenously imposed.[69]

Even after Coase had reconnected property rights and liability,[70] mainstream economists did not re-examine the property right concept which continued to encompass a zone of "liberty over things" and to disregard the fact that in any legal system right-holders also have obligations.[71] Searching for new methods to fill the void, opened by Legal Realism,[72] the US legal scholars who became part of the law and economics movement[73] adopted economic insights without critically questioning them. Economic theoretical concepts were espoused without explicitly dispelling the natural law assumption, but as Coase had opened the door to real-world legal institutions, the analysis was directed to US law. Thus, the deregulation idea supported by the natural law model, received a new resurgence by the institutional structure of the American legal system, allotting an important role to courts and much less faith in centralised decision-making. In this sense, the already existing misconception was not dismissed but another layer of confusion was added – the home country bias.[74]

Nevertheless, Coase's "The Problem of Social Cost" paved the way for a genuine shift in the

---

[67] On the natural law model in civil law, see Mattei, *Comparative Law and Economics* 33-38.

[68] Although influential, the model was subsequently challenged and discarded by civil lawyers. Ibid. In the common law tradition, it found its way in scholarly writings, particularly in Blackstone's Commentaries, but was never adopted by common law judges. Consequently, it never infiltrated the very roots of the legal system. On the common law model, see Mattei, *Comparative Law and Economics* 39-40.

[69] For a more elaborate account of the natural law misconception in neoclassical economics, see Mattei, *Comparative Law and Economics* Chapter 2 The Economist's Legacy to Law and Economics: The Natural Law Misconception in Historical and Comparative Perspective 27-67.

[70] Coase, 'The Problem of Social Cost'.

[71] Robert Cooter and Thomas Ulen, *Law and Economics* (Sixth edn, Boston: Pearson Education, Inc. 2012) 73-74.

[72] On the disillusionment with law's autonomy caused by Legal Realism and the growth of numerous "law and'…" movements as a search for means to re-legitimate law, see Mercuro and Medema 14-19. For a similar argument, see also Mattei, *Comparative Law and Economics* 57.

[73] The Law School at the University of Chicago was very active in establishing the law and economics tradition. Mercuro and Medema 95-99.

[74] For more on the home country bias underlying law and economics, see *infra* footnote 120 and the text accompanying it in Section D. of this Chapter.

way legal-economic analysis is carried out. Coase rejected the zero-transaction-cost world as an ideal place in which the absence of costs makes any institutions, even markets, useless. [75] Bringing actual, existing law into the analysis, he made the first step of moving away from the natural law model, which is at the root of economic theory. In addition, his account showed that along with the *ex ante* centralised model of regulation, the only one imagined by economists until then, there exists a functionally equivalent *ex post* decentralised model, operating through the imposition of remedies in private causes of action.[76] Truly, the shift in the established paradigm turns out to be long and difficult since the Coase theorem continues to be misread as ruling out state intervention.[77] One reason for this is that New Institutionalists have not yet come up with a theory on the choice between public and private law.[78] But they have made a great progress in digging out the available options of institutional control and retreating from the automatic recommendation that the market should be left to do its job.

What makes New Institutional Economics valuable for this research is its premise that the institutional framework, of which the legal framework is a part, matters for economic performance.[79] Institutions determine the level of transaction costs both at the micro-level of contracting between private parties and at the macro-level of the economy as a whole.[80] When talking about efficient markets, the logic unfolds, economists already assume a complex set of institutions which on balance promote the efficient operation of the market.[81] That is, the market is not efficient *per se*, its efficiency depends on the institutional structure, so improvement in economic performance requires investigation of the way different institutional frameworks enhance efficiency.[82] In this investigation the optimal, though not perfect solution may be provided by whatever real-life arrangement is found to exist: *ex ante*

---

[75] Coase, *The Firm, the Market and the Law* 7. "The world of zero transaction costs has often been described as a Coasian world. Nothing could be further from the truth. It is the world of modern economic theory, one which I was hoping to persuade economists to leave." ibid 174.
[76] Later Williamson directed the attention also to private regulation. Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*.
[77] Cooter called the confusion about the generalisations which follow from the Coase theorem "the cost of Coase". Cooter, 'The Cost of Coase'.
[78] Thomas Ulen, 'The Future of Law and Economics' in Fabrizio Cafaggi, Antonio Nicita and Ugo Pagano (eds), *Legal Orderings and Economic Institutions* (First edn, London and New York: Routledge 2007) 33.
[79] Institutions constitute "the rules of the game in a society", they are "the humanly devised constraints that shape human interaction" by structuring "incentives in human exchange, whether political, social or economic". North, *Institutions, Institutional Change and Economic Performance* 3.
[80] Ibid 61-69.
[81] Ibid 64 -66.
[82] See also for such an understanding of the New Institutional Economics theory Mercuro and Medema 241-245.

or *ex post*; statutory law, judge-made law or private ordering; or any combination between them. In this sense, in the world of transaction costs, market solutions are only one of the possible alternatives among others, with the range of possibilities including command-and-control as well as responsive regulation.[83] The superiority of any alternative can be claimed only after careful comparative institutional analysis revealing the pros and cons of each of the options.[84]

Separate from the market, efficiency becomes a theoretical concept dependent on the institutional context. With law being a vital part of this context,[85] a legal researcher may proceed with his mind clear and eyes wide open about comparing different legal institutions in different jurisdictions. Considering the choice of jurisdictions in this particular work, it is not difficult to suppose that the amount of relevant statutory law (*i.e.* interventionist public regulation from neoclassical perspective) is much bigger in Bulgaria compared to the US and England, that specific performance and damages have different weight in the three jurisdictions, and that in all three of them the two types of remedies strike a different balance between facilitation and regulation. Yet, as there is not one single efficient solution, it cannot be said from the outset which country's legal institutions are more efficient. Such a conclusion requires an in-depth examination of the types of transaction costs generated by the legal-economic environment in each jurisdiction. What is more, as efficiency no longer constitutes an absolute yardstick for comparison, recommendations will probably differ with regard to each of the countries. Thus, the higher subtlety of the positive institutional analysis will most probably lead to more subtle and dissimilar normative prescriptions.[86]

---

[83] For such an interpretation of the Coase theorem see Deakin, 'Law *versus* Economics? Reflections on the Normative Foundations of Economic Activity'; Deakin and Wilkinson, 'Labour Law and Economic Theory: A Reappraisal'.

[84] In this respect Coase was most explicit. See Coase, 'The Problem of Social Cost' 18-19; Coase, *The Firm, the Market and the Law* 117-118; Ronald Coase, 'Law and Economics and A. W. Brian Simpson' (1996) 25 Journal of Legal Studies (Oxford University Press, Oxford, UK, January 1996) 103.

[85] Institutions include formal rules (constitutions, laws, regulations) and informal constraints (conventions, norms of behaviour, self-imposed codes of conduct). North, *Institutions, Institutional Change and Economic Performance* 4.

[86] This account of the advantages of New Institutional Economics, of course, does not mean that all research, which builds on the claim that institutions matter and uses inter-jurisdictional comparative analysis of legal institutions, automatically avoids all theoretical and methodological problems. Thus, the studies associated with the New Comparative Economics school have been subjected to fierce criticism from the legal community. Using statistical methods, the Legal Origins strand of New Comparative Economics seeks to assert a clear link between the origins of a jurisdiction's legal system, on one side, and, on the other side, the content and enforcement of its legal rules, as well as its economic performance. The large-scale studies offer far-reaching conclusions that do not discriminate between origin and recipient countries or between the ways in which legal transplantation has taken place (involuntary imposition, voluntary emulation, *etc.*). That is, although on the face

Third, Chicago legal-economic analysis is remarkably static.[87] With models omitting the dynamics of the economic and the legal system, neoclassical theory is able to draw a picture concerning only a particular point of time. Relying solely on an *ex ante* comparison between the costs and benefits of the introduction of a rule, the Coase model also misses the dimension of legal-economic change. Thus, for example, a legal rule compensating externalities may preclude the rise of welfare-enhancing business in the short run, but in the long run it may encourage competitors to search for innovative, less harmful ways of production, thus actually increasing well-being.[88] Trying to develop a long term vision, in the 1970's and 1980's of the 20th century, the Chicago school advanced a hypothesis which saw the development of common law as a steady evolution toward efficiency.[89] However, empirical time-series studies have already produced evidence that does not sustain this hypothesis in the commercial area.[90]

With regard to the development of a dynamic theory, New Institutional Economics has set foot on a much firmer ground. The theory is built on a model of institutional change, which New Institutionalists see primarily as an incremental process, though change in a discontinuous manner is not excluded, either.[91] In the model, law is no longer some exogenous, human addition to the market, the latter appearing as an ever-existing divine creation. On the contrary, both law and the market are institutions which, set in a larger and complex institutional environment, evolve together, each exerting pressure on the other and

---

the Legal Origins theory recognises the importance of institutions for economic growth, it seems to proceed on the basis of the assumption that the disparate institutional environment makes no difference with regard to the effects of transplanted legal institutions. The Institutional Possibilities Frontier strand of the same school also does not engage in a disciplined comparative institutional analysis. It does not analyse the pros and cons of judge-made law, self-regulation and market solutions in developing countries but refers only to the disadvantages of public regulation, jumping to the conclusion that efficiency requires developing jurisdictions to employ less regulation. In this sense and a for a more detailed methodological critique of New Comparative Economics, see Antonina Bakardjieva Engelbrekt, 'Toward an Institutional Approach to Comparative Economic Law' in Antonina Bakardjieva Engelbrekt and Joakim Nergelius (eds), *New Directions in Comparative Law* (First edn, Cheltenham: Edward Elgar 2009) See *supra* footnote 122 of Chapter I for studies from the Legal Origins strand. For studies from the Institutional Possibilities Frontier strand, see Simeon Djankov and others, 'The New Comparative Economics' (2003) 31 Journal of Comparative Economics 595.

[87] Coase regrets that the static framework of neoclassical economics never underwent the transformation experienced by evolutionary biology after Darwin, though for his theory he had also drawn inspiration from Adam Smith. Coase, 'The New Institutional Economics'.

[88] Stefan Grundmann, 'Transaction Costs and Economic Theory' in Stefan Grundmann, Hans-W. Micklitz and Moritz Renner (eds), *Grand Theories of Private Law* (forthcoming).

[89] Posner, *Economic Analysis of Law*; see also Priest; Rubin.

[90] According to a study based on a data set of 461 US state court appellate decisions, issued from 1970 to 2005 and involving the economic loss rule in construction disputes, the law did not converge to any stable resting point and evolved differently in different states. See Anthony Niblett, Richard Posner and Andrei Shleifer, 'The Evolution of a Legal Rule' (2010) 39 Journal of Legal Studies 325.

[91] North, *Institutions, Institutional Change and Economic Performance* 6.

affecting its development.[92] In contrast with the neoclassical vision which pictures a relentless advancement toward a stable efficient equilibrium, New Institutionalists tell a much more sophisticated story of change, in which convergence and divergence intermingle in a complicated fashion. While North does not deny that some convergence can be observed within the Western industrial world, he shows convincingly that, even in this case, national stories of evolution diverge, with the gap growing sharply when the analysis is extended beyond these limits.[93] He explains the general process of convergence as a movement toward efficiency. Yet, he acknowledges simultaneously that worldwide inefficient property rights structures abound (with competitive pressures not eliminating them) and societies vary greatly in their economic performance. He rationalises this puzzling – from the mainstream viewpoint – observation with the constraining nature of institutions, which condition organisations' choices, incentivising maximising behaviour that in fact perpetuates the existing institutional structure. The way to understand the process of institutional stability and change as well as the convergent/divergent evolution of institutions across jurisdictions is to retrace the historical context in which national institutional matrixes have grown.[94]

North's observations on convergence and divergence between countries' economic performance do not radically differ from the convergence/divergence tendencies perceived by comparative lawyers. Rethinking comparative law classifications, more and more often they emphasise the so-called Western legal tradition (*versus e.g.* Islamic legal tradition, *etc.*), which, despite the important differences between the encompassed common law and civil law jurisdictions, is considered roughly homogeneous.[95] This analogy in discourse has made me frame the hypothesis regarding legal change of contract law in the selected jurisdictions (all within the Western world) as a movement toward efficiency. New Institutional Economics forces lawyers to recognise that introducing a new legal solution means expending scarce

---

[92] The use of institutional theory by New Comparative Economics is flawed in this respect too. In the studies of the Legal Origins strand, legal origin is viewed as exogenous – transplanted through conquest or colonisation. Under the assumption that the development of a legal system cannot be linked to a country's political and economic environment, legal origin is used as an instrumental variable to test the claim that legal rules systematically affect economic performance. The questionable rigid exogeneity of legal systems, the omission of changes in legal rules and different legal influences over time make extremely problematic any decisive conclusions about an existing consistent causal relationship between the common law/civil law distinction and economic outcomes. In this sense see Simon Deakin, *Law and Economic Growth* (Presentation, European University Institute March 2011).

[93] North, *Institutions, Institutional Change and Economic Performance* 6, 130.

[94] Ibid Preface, 6-7, 73-82.

[95] Mattei, *Comparative Law and Economics* 95, 224-226; Pier Giuseppe Monateri, 'Methods in Comprative Law: an Intellectual Overview' in Pier Giuseppe Monateri (ed), *Methods of Comparative Law* (First edn, Cheltenham: Edward Elgar Publishing 2012) 10.

resources and thus does away with any traces of economic nirvana that may be left in comparative law.[96] But what is more important, by exploring the kind of conditions that account for institutional change toward (in)efficiency across time, the historical branch of the New Institutional school can greatly enrich comparative research on legal transplants.[97] This is essential considering that despite having collected abounding evidence on the occurrence of legal change, comparativists know very little about its causal factors, to which they continue to refer only by the vague notion of prestige.[98]

In examining history, the concepts of path dependency and institutional complementarity become crucial for understanding long-run legal and economic change. The increasing returns of past institutional choices underpin the evolution of legal institutions and markets on a particular path and reversal of direction often comes only through changes in the polity or technological shocks.[99] From this perspective, the very mode of change (*e.g.* choice of regulation by contract law or by administrative intervention) may be determined by a strong path dependency. On one hand, such dependency enables predictions about the probable response of a legal system to a new challenge in conditions of continuity; on the other hand, it influences the effects generated by a new legal rule in a particular jurisdiction.[100] In addition, the choice of one type of institutional arrangement in the economic domain makes a fitting institution viable in the legal domain and vice versa. Such institutional complementarities create the possibility for multiple self-perpetuating equilibria, all of which

---

[96] It has been asserted that the positivistic perspective of domestic lawyers is supported by the neoclassical economic nirvana, in which consistency of the hierarchical system of legal norms, is achieved without any limitations on rationality and transaction costs. Nicita and Pagano; Fabrizio Cafaggi, Antonio Nicita and Ugo Pagano, 'Law, Economics, and Institutional Complexity. An Introduction' in Fabrizio Cafaggi, Antonio Nicita and Ugo Pagano (eds), *Legal Orderings and Economic Institutions* (First edn, London and New York: Routledge 2007) 1-2. The comparative scholarship on legal irritants and legal fragmentation, however, implies some understanding of the constraints, termed by economists as transaction costs and bounded rationality. Gunther Teubner, 'Legal Irritants: Good Faith in British Law, or How Unifying Law Ends Up in New Divergences' in Francis Snyder (ed), *The Europeanisation of Law: the Legal Effects of European Integration* (First edn, Oxford: Hart Publishing 2000). Yet, to the extent some lawyers still automatically equate borrowing and harmonisation with the introduction of the "best" solution, even comparative analysis has not completely broken free from economic nirvana assumptions.
[97] New Comparative Economics is convincingly criticised with respect to the necessary conditions it identified for successful legal change. It has been submitted that the effect of transplanted legal solutions is determined to a greater extent by the degree of their domestication, achieved in the receiving country, rather than by the legal family from which they were borrowed. Daniel Berkowitz, Katarina Pistor and Jean-François Richard, 'Economic Development, Legality and the Transplant Effect' (2003) 47 European Economic Review 165; Daniel Berkowitz, Katarina Pistor and Richard Jean-François, 'The Transplant Effect' (2003) 51 American Journal of Comparative Law 163.
[98] In this sense, see Alan Watson, 'Comparative Law and Legal Change' (1978) 37 Cambridge Law Journal 313, 320; Mattei, *Comparative Law and Economics* 129.
[99] North, *Institutions, Institutional Change and Economic Performance* 112.
[100] Mattei and Cafaggi, 'Comparative Law and Economics' 348-349.

may be equally optimal or sub-optimal, but which may also result in a Pareto-inferior outcome.[101] Therefore, convergence of legal systems toward efficiency is possible but in no way guaranteed, and divergences may mean inefficiencies but not necessarily.[102] Different equally efficient or inefficient development trajectories are also feasible. Thus, emphasising the local historical conditions and the interdependence between the legal and economic domains, New Institutional Economics rejects the universal evolutionary path of law envisaged by the Chicago school. Instead, it provides this research with a framework to analyse legal change which allows for a trend of convergence but also accounts for the diversity of national laws and for the dissimilar ways transplanted legal solutions play out in different legal systems.[103]

The different analytical procedure (i), the view of the market as not efficient in itself (ii) and the development of convincing theory explaining change over time (iii) constitute real methodological differences between the Chicago school and New Institutional Economics which ultimately translate into a different stance with regard to the concept of efficiency. In neoclassical theory efficiency is understood as the ideal solution in the Kaldor-Hicks sense, which can be brought about by the free market and with which common law comports. New Institutional Economics, on the other hand, does not have such an absolute view of efficiency. It is not obsessed with the idea of devising the ideal solution. It rather looks for the second-best but feasible solution which is to be chosen from the set of identified, functionally equivalent alternatives according to the level and types of transaction costs. Transaction costs themselves depend on the institutional environment in which the alternative options are embedded.[104] Efficiency, thus, becomes a relative, dynamic notion, not equated with the unique, optimal state of the world to which law, in the Chicagoan vision, is bound to converge in the long run. Efficiency is contingent on the institutional framework, the latter in turn determined by the historical path on which it has evolved.

It is this context-dependent, dynamic concept of efficiency that is embraced by comparative

---

[101] Masahiko Aoki, *Toward a Comparative Institutional Analysis* (First edn, Cambridge, Massachusetts; London: MIT Press 2001). For a formal definition of institutional complementarity, see Ugo Pagano, 'Legal Positions and Institutional Complementarities' in Fabrizio Cafaggi, Antonio Nicita and Ugo Pagano (eds), *Legal Orderings and Economic Institutions* (First edn, London and New York: Routledge 2005) 65-66.
[102] In the same sense, see Mattei, *Comparative Law and Economics* 129, 133-134.
[103] See in this sense Nicita and Pagano.
[104] Oliver Williamson, *The Mechanisms of Governance* (First edn, New York: Oxford University Press 1996).

law and economics[105] and also by this particular research. Such understanding of efficiency implies that for the same legal problem one contract remedy may turn out to be efficient in one legal system and inefficient in another or that different contract remedies may prove to be equally efficient in different national laws.[106] That is why, the thesis studies no national legal solution by itself but evaluates the efficiency of each one only within the particular legal-economic environment. Consequently, with regard to any normative recommendations, efficiency is viewed as a category which is to be implemented in different ways in the different legal systems.[107] Having clarified the choice of economic methodology and the controversial issue of efficiency from a theoretical perspective, I now turn to the important role of comparative law in the selected interdisciplinary approach.

D. The role of comparative law

As both New Institutional Economics and comparative law employ the comparative technique and the functional method of comparison, they naturally merge in the comparative law and economics approach. In the past comparative lawyers have often slipped into merely descriptive exercises in which they observe similarities and differences between legal systems without providing convincing theoretical explanations for them. From this point of view, comparative law can gain from the mature economic framework, providing it with a possibility to rationalise better the collected evidence as well as to measure more accurately the common core and the dissimilarities between national laws.[108] Also, unlike lawyers in the common law tradition, who master inductive analysis, economists tend to engage in deductive thinking: on the basis of certain assumptions they construct models which they then test against empirical data in order to draw conclusions.[109] In this sense, legal scholars can benefit from economic reasoning which forces them to understand and make explicit their own systemic assumptions about law. No doubt, starting from abstract legal norms and overarching principles, civil lawyers are accustomed to deductive analysis.[110] This, however, does not mean that they are proficient in spelling out their premises. On the contrary, largely

---

[105] Mattei, *Comparative Law and Economics*; Mattei and Cafaggi, 'Comparative Law and Economics'.
[106] Paraphrased from Mattei and Cafaggi, 'Comparative Law and Economics'347. See in the same sense Mattei, *Comparative Law and Economics* 133-134.
[107] In a similar sense, see Mattei, *Comparative Law and Economics* 22.
[108] In this sense, see Mattei and Cafaggi, 'Comparative Law and Economics' 346-347; Mattei, *Comparative Law and Economics* 97, 124-125.
[109] Mercuro and Medema 41-43.
[110] Zweigert and Kötz 69.

determined by legal tradition, these premises are often taken for granted and thus remain tacit in the reasoning of civil lawyers. In addition, the increase in legislation of technical character as well as in the standing of the judiciary progressively stimulates inductive legal thinking in civil law jurisdictions. Thus, continental legal scholars can also take a lesson from economists in clarifying their presuppositions when searching for the correct answer to a problem.

Economic analysis enriches comparative law; yet, the latter's contribution to law and economics should also not be underestimated. Comparative law brings in an inexhaustible pool of alternative solutions to legal problems, making economics less abstract, more engaged with the real world and simultaneously more capable of generalising about the working of law, not as local background but as universal social phenomenon.[111]

Opening the door to an opulent variety of existing property rights structures, none of which matches the natural law model, comparative law shows the necessity of moving beyond the unrealistic template on which mainstream law and economics bases its analysis.[112] Appreciation of the wide range of "jural relations" (rights, liberties, powers, immunities, duties, liabilities and disabilities)[113] will permit a better understanding of the reasons for which legal systems have different combinations of remedies, allow different leeway for judges in awarding them and employ a different model (centralised or decentralised) for remedial distribution.[114]

Yet, the merger with comparative law is also about surpassing the wisdom received from New Institutional Economics. The economic nirvana of zero transaction costs,[115] which New Institutionalists manage to overcome, depends on a "legal nirvana",[116] sustained by the positivistic view of law as a united, hierarchical system of legal norms, whose frictionless

111 In this sense: Mattei and Cafaggi, 'Comparative Law and Economics' 346, 348; Mattei, *Comparative Law and Economics* 27-28, 70.
112 On the natural law misconception of neoclassical law and economics, see *supra* Section C. of this Chapter.
113 Daniel Cole and Peter Grossman, 'The Meaning of Property "Rights": Law vs. Economics' (2002) 78 Land Economics 317.
114 Mattei, *Comparative Law and Economics* 58, 63-67.
115 On the economic Nirvana of Chicagoan law and economics, see *supra* Section C. of this Chapter.
116 Nicita and Pagano; Cafaggi, Nicita and Pagano, 'Law, Economics, and Institutional Complexity. An Introduction' 1-2. The authors convincingly illuminate the way in which the economic and the legal nirvana feed and depend on each other. On one hand, the zero-transaction-cost world hinges on the assumption of frictionless, consistent legal system, enforced by fully rational actors. On the other hand, the positivistic legal vision ignores any constraints resulting from scarcity of resources, bounded rationality, transaction costs. See also *supra* footnote 96 of this Chapter.

consistency is derived from the authority of one single source.[117] This legal nirvana has not yet faded away in new institutional research as the latter continues to assume well-defined, tradable property rights over all valued attributes of goods and services, for which rights there always exists a market and an enforcement system, producing efficient resolution to economic conflicts.[118] New institutionalist economists simply take the system of setting and enforcing property rights as given. In their analysis, the interrelationship between transaction governance and law does not affect the level of transaction costs.[119] That is why, the conjugation with comparative law can be especially insightful. With its interest in many, simultaneously valid legal orders comparative law naturally rejects the legal nirvana, persevering in new institutional economic analysis. In one stroke, it also cures the home country bias, another particular expression of positivism, inherited from American legal scholars working in law and economics.[120] The ample variety of legal arrangements brought in by comparative law in a way confirms, on one hand, their importance for determining the *ex ante* and *ex post* transaction costs and, on the other hand, the problem of using one single legal system as a background for drawing fundamental conclusions on the effect of legal institutions.

Economic tools can be applied to any legal system and it is a matter of comparative knowledge, not of *a priori* economic impotence, to factor the different legal solutions across jurisdictions in the analysis. The functional method[121] allows comparativists to pierce the legal systems' doctrinal veil, which obstructs understanding of the way legal rules operate. Carried out on the basis of factual scenarios, functional comparison ignores the conceptual disparities between national laws and identifies the applicable legal rules solving the same problems in each legal system. Such a functional exercise in the thesis will enable detection of similarities and differences across jurisdictions regarding the available type of remedy and the calculation of damages. It will penetrate possible differences in legal taxonomies such as

---

[117] Kelsen.
[118] Nicita and Pagano; Cafaggi, Nicita and Pagano, 'Law, Economics, and Institutional Complexity. An Introduction' 1-2.
[119] For an example of disregarding the influence of law, see Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*. For the importance of uncovering the relationship between economic systems and law, technology, culture, see Coase, 'The New Institutional Economics' 74.
[120] On the home country bias, see *supra* the text accompanying footnote 74 in Section C. of this Chapter. Instead of correcting this bias, legal scholars, who introduced law and economics in Europe, supported it by not making any adjustments to the particular legal context. On the need to do away with legal positivism in law and economics, see Mattei, *Comparative Law and Economics* Chapter 3 The Distinction between Common Law and Civil Law: Doing Away with Legal Positivism 69-99.
[121] Zweigert and Kötz 34.

contract/tort, public/private law in order to analyse the effect of legal rules on individual behaviour. Yet, the transaction cost analysis will be impoverished if the work remains at the stage of functional comparison and completely disregards the differences in the conceptual frameworks.[122] Once the legal solutions that are functional substitutes across jurisdictions are identified, the relative efficiency of each of them will become clear only by juxtaposing them within the context of each of the selected legal systems. At this point the specific taxonomic and conceptual structures become important again since they can turn out to be sources of transaction costs that have to be taken into consideration.

From this perspective comparative law has accumulated a tremendous amount of knowledge that can help in distinguishing the real and false differences between common law and civil law countries, between the US and European jurisdictions. It has much to say about the diverse legal traditions and the possible hurdles generated by them that may preclude legal change in the direction of efficiency.[123] Translated in economic terminology such hurdles constitute *ex ante* transaction costs in the definition of property rights, an issue on which economic analysis has made very little progress.[124] Comparative law can also explain the reasons for which functionally equivalent legal solutions may prove to be grounded in contract in one legal system and in tort in another. It can illuminate the diverse allocation of institutional roles across jurisdictions and thus justify the different weight attributed to private law and public law devices. The different nature of the legal arrangements and the transaction costs imposed by legal tradition may suggest a modification within the existing legal solution without changing its assignment between different areas (contract or tort, private or public law).[125] Comparative research also implies that the development of a legal system may strongly depend on the degree of influence of the professional groups, framing the law, in the different legal contexts. Hence, determined by factors such as power and

[122] For arguments in favour of purposes and concepts going hand in hand in the comparison of legal rules, see also James Gordley, 'The Functional Method' in Pier Giuseppe Monateri (ed), *Methods of Comparative Law* (First edn, Cheltenham: Edward Elgar Publishing 2012) 110-114. In reality, despite the good results the functional method produces, more often than not, comparative legal scholars supplement it with another approach (historical, philosophical, etc.) depending on the focus of their research. Vernon Valentine Palmer, 'From Lerotholi to Lando: Some Examples of Comparative Law Methodology' (2004) 4 Global Jurist Frontiers 1, 23-24. This thesis follows suit.
[123] Mattei, *Comparative Law and Economics* 77, 141.
[124] In this sense: Cafaggi, Nicita and Pagano, 'Law, Economics, and Institutional Complexity. An Introduction' 6.
[125] Mattei and Cafaggi, 'Comparative Law and Economics' 348; Mattei, *Comparative Law and Economics* 74.

authority, the legal system evolution may not necessarily entail cuts in transaction costs.[126] All these are matters which must be investigated on a case-by-case basis. However, what needs to be emphasised at this stage is that methodologically comparative law has a great deal of experience in the deconstruction of the declared legal rules as well as in the deep-level examination of the context-dependent conceptual framework.[127] Both are vital for making a sound economic analysis.

One important methodological question, on which comparative law has made a major difference and which needs to be clarified before engaging in the empirical research, is the divergent source-of-law structure in the compared common law and civil law jurisdictions. As already mentioned, in order to go beyond black-letter law and capture law in action, much of the empirical data in this research will come from careful examination of case-law in each jurisdiction.[128] Case-law, however, is not a source of law in civil law jurisdictions and in principle Bulgaria does not make an exception in this regard. Only the interpretative decisions and ordinances of the general assemblies of the supreme courts, which are binding on the courts and the executives,[129] are viewed as sources of law; yet, ones that should not be confused with the usual lawmaking acts because of their secondary and interpretative nature.[130] On the face, the selected legal systems neatly fit into the common perception of the

---

[126] Mattei, *Comparative Law and Economics* 120-121.
[127] On the formants approach in comparative law, which emphasises the clash between stated and operational rules as well as the importance of the legal discourse, see Monateri 22-24.
[128] See *supra* Section B. of Chapter I.
[129] Art. 130 (2) in connection with Art. 124 of the Judiciary Act, promulgated State Gazette №64 of 07.08.2007, last ammended State Gazette №93 of 25.11.2011.
[130] Tadjer 77-83. For a similar position, see Mariya Pavlova, 'On the Role of Case-law' [1998] 2 Contemporary Law 79, 83. Stalev, on the other hand, takes a broader stance, arguing that the interpretative decisions and ordinances of the supreme courts are secondary sources of law, which also clearly have a lawmaking function. Jivko Stalev, 'Case-law as a Source of Law' 6 Contemporary Law 7, 13-16. Rendered upon contradictory or incorrect case-law and not upon a particular court dispute, the interpretative decisions and ordinances resolve a legal problem in a general and abstract way; they have unindividualised circle of addressees, which includes not only courts and executives but also indirectly all natural and legal persons, and they are published in the supreme courts' bulletins. Despite all of these arguments, however, the source-of-law nature of these acts is not undisputed. Other legal scholars deny that they have such character, insisting that although binding, these acts stipulate interpretative rules that have only organisational and subsidiary nature; they solely explain and tell us how to understand the law, which is already provided in the legislation. Ivan Ruschev, 'Classification of the Internal Normative Sources of Private Law' in Malina Novkirishka-Stoyanova and Tencho Kolev (eds), *Roman Law and Contemporary Codifications* (First edn, Sofia: "St. Kliment Ohridski" University Press 2008) 161-166. Indeed, the starting point of the Bulgarian legal doctrine is that law is set out in the legislative acts, enacted by the State. Venelin Ganev, *Course in General Theory of Law* (Sofia: "Prof. Marin Drinov" Academic Publishing House 1995) 30-37. See also Law on Normative Acts, promulgated State Gazette №27 of 03.04.1973, last ammended State Gazette №46 of 12.06.2007. Once a court decision becomes effective, courts, institutions and municipalities must regard it with respect in the name of legal stability (see Art. 298 (1) and (2) in connection with Art. 297 of the Bulgarian Code of Civil Procedure, promulgated State Gazette №59 of 20.07.2007, in force since 01.03.2008, last ammended State Gazette №5 of 14.11.2011); yet, no rule of precedent exists and other

common law/civil law divide – the US and English legal systems are mostly based on judge-made law, applied according to the rule of precedent, while the Bulgarian legal system is grounded on statutory law, interpreted by courts. For these reasons, the predominant focus of the analysis on case-law can be *a priori* attacked as unconvincing both by mainstream law-and-economics scholars and by conventional domestic lawyers.

The argument of mainstream supporters of economic analysis is usually framed in terms of legal process. Concerned mainly with courts' efficient decision-making, they consider a civil law system such as the Bulgarian one inefficient from the start. In their view, in such a system the legislative process, subject to capture by interest groups, has the lead while judges, deprived of any lawmaking functions, are merely bureaucrats, enforcing the legislators' will. Domestic civil lawyers, on the other hand, are often preoccupied with research ignoring the differences in national structures of sources of law. They view economic analysis as placing disproportionate weight on case-law, which even if having some influence in legal reality, is not setting out binding legal rules. The absence of a rule of precedent gives rise to concerns over whether the economic approach is at all fit to be applied to civil law. Clearly both views are the legacy of the positivist conceptions of law, ignoring the latest achievements of comparative law methodology.[131]

Inherently anti-positivist in nature, comparative law has long passed the point of juxtaposing only the legislative texts of European continental legal systems, struggling with the phenomenon of uncodified common law. The focus on law in action has opened new lines of

---

judges faced with similar disputes are not bound by the earlier decision even if it was rendered by a higher court. A court decision can at best be a "point of reference" in similar disputes, but not a source of law. Vitali Tadjer, 'Case-law and General Acts of the Supreme Court of the National Republic of Bulgaria' in *Yearbook of Sofia University*, vol 69 (First edn, Law Department of Sofia University 1977) 186-187. As a rule this view is justified with the doctrine of separation of powers according to which the legislative and the judicial functions must be strictly separated: with legislators, therefore, making the law and judges - only interpreting and applying it. The dominating view in the legal doctrine also refuses to recognise the established, stable case-law (*i.e.* the accumulation of many court decisions containing the same interpretation of a legal rule) as a source of law. Tadjer, *Civil Law of National Republic of Bulgaria. General Part* 77-78; Pavlova, *Civil Law. General Part*; Pavlova, 'On the Role of Case-law' 84. Only Stalev is of the opinion that court decisions on particular court cases as well as the established, stable case-law constitute sources of law. Even though courts are not especially empowered to make law and a court decision binds courts only with regard to the particular case, an individual court decision is a source of law (including civil law), he argues, because the interpreted legislative act is applied in the sense, which case-law gives to it. From this perspective, the judge finishes what the legislator has already started and has his own lawmaking contribution. As for the established, stable case-law, it acquires binding force on the basis of its customary character, Stalev reasons, and thus, perpetuating the meaning with which the legislative act is applied, functions as a source of law. Stalev. Despite these scholarly arguments, the common perception spread among Bulgarian lawyers continues to be that case-law, except for the interpretative decisions and ordinances of the general assemblies of the supreme courts, is not a source of law.

[131] In this sense Mattei, *Comparative Law and Economics* 69-99.

enquiry revealing that the similarities between the two legal traditions are more than previously presumed. On the other hand, being faithful to historical analysis, comparative law has maintained that the national differences in the source-of-law doctrine can be understood only in view of the historical development of the particular legal system. Relying on these methodological premises, the amassed comparative experience shows that the differences between civil law and common law pointed out above are exaggerated and do not preclude economic analysis.

To be precise, the relationship between the legislative process and the judicial process has also raised concerns in common law jurisdictions. The declaratory theory of law, insisting that judges were not making but only digging out and declaring the ever existing common law, was a reaction to openly expressed uneasiness that judicial lawmaking was not in line with the doctrine of separation of power and with the fundamental principles of democratic legitimacy. It was the exercised self-restraint on the side of English judges and the strengthening of the rule of precedent in the course of the 19th century that assuaged fears of judicial creativity. Yet, after the rule of precedent had been relaxed in the second half of the 20th century, English judges have been increasingly criticised for their activism.[132] The issue of whether judges make or find the law is also a matter of dispute in the American legal doctrine. The debate usually receives a new impetus around the time of appointment of federal judges with some circles still supporting the myth that judges only interpret the law.[133]

As Bulgarian contract law developed largely within the Romanic legal tradition,[134] judges are denied any lawmaking role. This also explains the laconic judicial justifications in Bulgarian court decisions essentially written in the French style, without discussing the diverse scholarly opinions, as is typical for German case-law, or public policy reasons, as is increasingly done by English judges. Yet, the role of Bulgarian judges is not exhausted with being the "mouthpiece of statutory law", as appealed by Montesquieu. Bulgarian courts have developed important issues of the regime of damages for breach of contract, of the contract for the benefit of third parties, the contract for transfer of property in exchange of care and

[132] In this sense: Stefan Vogenauer, 'Judge-Made Law' in Dougas Baird and others (eds), *The Max Planck Encyclopedia of European Private Law*, vol II (First edn, Oxford: Oxford University Press 2012); Stefan Vogenauer, 'Precedent, Rule of' in Dougas Baird and others (eds), *The Max Planck Encyclopedia of European Private Law*, vol II (First edn, Oxford: Oxford University Press 2012).
[133] Mercuro and Medema 53, 57-58.
[134] See *supra* Section B.2. of Chapter I.

maintenance. Actually, the broad standards, used abundantly in the legislative acts in civil law systems, increase the importance of case-law, as judges are charged with the task of giving these broad concepts a concrete meaning.[135] The case-law in the area of preliminary contracts has even prompted amendments to the relevant statutory provisions.[136] What is more, the new legislation, adopted after the start of the democratic changes in Bulgaria, has supplied the basis for increasing the importance of case-law in the Bulgarian source-of-law system.

Thus, the currently effective Code of Civil Procedure provides the Supreme Cassation Court with an additional mechanism for standardising contradictory case-law besides the abstract and binding interpretative decisions and ordinances.[137] Now the individual decisions of the Court related to particular disputes also work to this end since where the appealed decision is rendered in the context of conflicting case-law, in its judgment the Supreme Cassation Court is obliged to point and reason which of the case-law is correct, which is not correct, and which is inapplicable to the case at hand.[138] Also, where the appellate court has pronounced on "an issue which is relevant for the accurate application of the law as well as for development of law", this constitutes a ground for cassation appeal.[139] Such a formula, recognising that courts resolve questions which matter "for development of law" already suggests tacit acknowledgement by the legislator that courts, too, contribute to lawmaking. Interesting enough, the Supreme Cassation Court chose to be more explicit and while interpreting these legislative provisions bindingly, to assert further the role of its case-law as a source of law.[140]

Recall that under the text of the Judiciary Act it is only the Supreme Cassation Court's interpretative decisions and ordinances that are binding, but not its individual decisions.[141] However, the Court defined its own case-law, the conflict with which represents a ground for

---

[135] Thus, Stalev argues, the judiciary participates in lawmaking according to the will of the legislator, which uses broad standards by reason of legislative policy. Stalev 12-13.
[136] Krassen Stoychev, 'Contracts. Bulgaria' in Roger Blanpain, Michele Colucci and Jacques Herbots (eds), *International Encyclopaedia of Laws*, vol I (First edn, The Hague: Kluwer Law International 1999) 12.
[137] See *supra* the text accompanying footnotes 129 and 130 of this Chapter.
[138] Art. 291 Code of Civil Procedure.
[139] Art. 280 (1) p. 3 ibid.
[140] *Interpretative Ordinance №1 of 19.02.2010*, comm c №1/2009, General Assembly of the Civil and Commercial Chambers of the Supreme Cassation Court.
[141] See *supra* the text accompanying footnotes 129 of this Chapter.

cassation appeal, by including both kinds of acts.[142] As a result, since it is possible for each appellate judgment to be challenged for conflicting with the Supreme Cassation Court's acts, be they abstract or individual, the lower instance courts, as well as indirectly the addressees of the interpreted legislation, are actually motivated to ensure their judgments, and respectively their behaviour, are in conformity with these acts. In this sense, by putting its interpretative acts and its individual decisions on the same footing, the Supreme Cassation Court in fact made the latter also binding on the lower instance courts, though binding only on the facts of the particular case.[143] This bindingness entails more than the courts' obligation to pay respect to effective court decisions, following from *res judicata*, and, functionally, is not different from the common law rule of precedent.[144]

The Supreme Cassation Court takes a further step in building the appreciation of its individual decisions as sources of law when elaborating on the meaning of the phrases "accurate application of the law" and "development of law" (part of another ground for cassation appeal).[145] The Court sees its contribution in the "development of law" not only in overturning the case-law which applies the law incorrectly, but also in changing the case-law (including the binding one) which has become outdated because of changed social conditions as well as in expanding the scope of existing legal rules in the course of interpreting by analogy.[146] How does this expanding of scope fits with the "accurate application of the law" and how far the Court can go in adjusting case-law to social changes are, indeed, vexing questions.[147] Clearly, such interpretative activity is akin to lawmaking and the Court uses the discussed interpretative ordinance to affirm its own influence in shaping and modernising

---

[142] See point 2 *Interpretative Ordinance №1 of 19.02.2010*. To be correct, the Court included the causal decisions, rendered under the new Code of Civil Procedure with the aims of standardising contradictory case-law or ensuring the accurate application of the law as well as development of law.

[143] The Supreme Cassation Court does not shun the categorising of its causal decisions as "binding" on the lower instance courts. See point 4 of *Interpretative Ordinance №1 of 19.02.2010*; point 2 of *Interpretative Ordinance №2 of 29.09.2011*, comm c №2/2010, General Assembly of the Civil and Commercial Chambers of the Supreme Cassation Court. See also Decision of 10.06.2013, comm. c. №1114/2013 of Regional Court – Ruse.

[144] The causal decisions rendered by panels of the Supreme Cassation Court, however, are not binding on other panels of the Court. See point 2 of *Interpretative Ordinance №2 of 29.09.2011*. In other words, the precedent applies only vertically, but not horizontally.

[145] Art. 280 (1) p. 3 Code of Civil Procedure.

[146] See point 4 of *Interpretative Ordinance №1 of 19.02.2010*. In fact, in this part of its interpretative ordinance the Court adopted and restated the arguments of Stalev, who, in the 1990s was the only Bulgarian legal scholar, holding the view that case-law is a source of law. Stalev. See also *supra* footnote 130 of this Chapter. This actually is no surprise when considering that before devoting himself entirely to scholarly work, Stalev used to be a judge.

[147] In fact, in her dissenting opinion Judge Darya Prodanova took the view that such interpretation by analogy was in direct conflict with the accurate application of the law. See also Pavlova, 'On the Role of Case-law' 82.

Bulgarian law.

In other words, emphasising its creative function and endowing its individual decisions with binding force even without an express statutory provision to this effect, the Supreme Cassation Court claims a source-of-law status for all of its judicial acts. Nevertheless, the traditional view which denies binding force to court decisions perpetuates, reflecting a common anxiety about possible legal uncertainty. In fact, the Bulgarian legal doctrine does not ignore the piling court decisions developing areas of civil law – discussing them, explaining them, criticising them, and today, most Bulgarian lawyers admit the utmost importance of case-law in the legal system. But even if legal scholars acquiesce to the creative role of judges, they are often not prepared to recognise case-law as a source of law.[148] Still, the reality is that Bulgarian judges do not have the position of dead letters in the Bulgarian legal system as imagined by mainstream law-and-economics authors.

Any judicial system needs to act in a coordinated way, resolving similar cases in a similar fashion. Despite the absence of a formal rule of precedent, usually, courts in Bulgaria follow their own previous decisions, the decisions of the higher courts, and especially those of the Supreme Cassation Court.[149] The centralised Bulgarian court system has its own means of requiring judges to honour previously rendered adjudicative acts when faced with a court dispute having the same facts. These means are different from the means used in the highly decentralised American and English court systems, but they do exist. The low number of reversed decisions by the higher court is one of the criteria in the attestation procedure, determining the future prospects of promotion for judges. The strong emphasis on case-law in the educational programme of the National Institute of Justice, organising the initial as well as the continuing training of magistrates,[150] as well as the existing formal and informal channels of publicising the existing case-law[151] also play a role for the acceptance and perpetuation of the legal arguments made in earlier court decisions. In other words, despite

---

[148] The general attitude toward judicial lawmaking is most probably best described by a short statement of a former assistant-professor of mine Krasimir Mitev: "Every lawyer knows that that he cannot get by without knowing the case-law…From a pragmatic point of view, we should never tell our judges that they can make law; otherwise, they will completely turn up their noses." Krassimir Mitev is a doctor of law, assistant-professor in law of obligations at "Paisiy Hilendarski" University of Plovdiv in Bulgaria. For the development of the Bulgarian judiciary, see also Tokushev, *The Judiciary in Bulgaria: from Antiquity to the Present*.
[149] Stoychev, 'Contracts. Bulgaria' General Introduction 12.
[150] See www.nij.bg, last accessed 01.12.2012.
[151] The formal channels include the published bulletins and yearbooks of the Supreme Courts. The informal ones include the privately developed legal databases – Ciela, Apis, Digesta, the existing legal journals, *etc*.

the refusal of conventional legal thinking to grant case-law the status of a source of law, *de facto* Bulgarian court decisions have a binding force. Indeed, this is not the juridical binding force, typical in common law, but it has enormous significance in the operation of the court system and the legal system as a whole.[152] In this sense, the existing difference between the selected common law and civil law jurisdictions is not unbridgeable and does not foreclose application of the economic approach, as maintained by positivist-minded domestic lawyers.

In my opinion, the argument of regulatory capture, which is supposed to downplay the legislative process as opposed to the presumptively neutral and uncorrupted judicial process, also does not stand with respect to the two codifying acts in Bulgarian contract and commercial law. Both the Contracts Act and the Commercial Act were drafted by a group of renowned Bulgarian legal scholars, largely following classic foreign models in the respective field.[153] Indeed, the Contracts Act, adopted in 1951, integrated the principles of socialist law and planned economy, but in a way they were additionally stitched to the legal tradition, already established by the 1892 Contracts Act, from which the new Contracts Act did not break.[154] This is confirmed by the ease with which in 1993 the socialist elements were cut out of the Contracts Act as well as by its vitality to this day.[155] The drafters were not in a hurry to insert all the solutions proclaimed by the Soviet legal doctrine and adopted by the Soviet legislation. With respect to compensation of non-pecuniary damages in case of breach of contract, they remained faithful to the conservative position of the Western legal doctrine.[156] Conversely, in tort, they retained the provision allowing equitable compensation

---

[152] For a similar argument, see Rosen Tashev, *Jurisprudence* (Fourth edn, Sofia: Sibi 2010) 125-126, 115-117; Vogenauer, 'Precedent, Rule of'.

[153] The Contracts Act was drafted by Prof. Ivan Apostolov, Prof. Alexander Kojuharov, Acad. Lyuben Vasilev, Prof. Jivko Stalev, all leading Bulgarian scholars in the field of contract law at the time. As for the Commercial Code, Prof. Vitali Tadjer and Prof. Ognyan Gerdjikov had a decisive role. See also *supra* Section B.2. of Chapter I.

[154] See *supra* Section B.2. of Chapter I.

[155] In Stoichev's view the Contracts Act establishes sufficiently full and well-composed models of particular contracts, which are naturally taken as templates in the process of contract drafting. Stoychev, 'Contracts. Bulgaria'.

[156] Although the Soviet legal doctrine does not support compensation of non-pecuniary damages, the fact that the Contracts Act is silent on the question when it comes to breach of contract and that until recently Bulgarian courts used this silence as an argument not to award this type of damages should not be attributed to the socialist past. In 1944 when Bulgaria started its course on the path of socialist development, the issue had already been much discussed in the Bulgarian legal doctrine. In a seminal article published in 1937/1938 Apostolov substantiates his view in favour of compensation of non-pecuniary damages in contract. See Ivan Apostolov, 'On the Theory of the Creditor's Pecuniary Interest in Contract' (1937/1938) 33 Yearbook of "St Kliment Ohridski" University - Sofia, Law Department 3, 3-4. His position remained unchanged in 1947 when he published his *Law of Obligations*. See Ivan Apostolov, *Law of Obligations. First part. General Theory of Obligation* (Second edn, Sofia: Bulgarian Academy of Sciences Publishing House 1990) 7-8, 98-99. In fact, the Bulgarian socialist legal

for pain and suffering, despite the prescription of the Soviet model to the contrary.[157]

In reality, at the time the economic development of the different regions and of the country

---

doctrine almost unanimously agreed that non-pecuniary damages should be compensated in case of contractual breach. See *e.g.* Alexander Kojuharov, *Law of Obligations. General Theory of Obligations*, vol I (Ognyan Gerdjikov ed, 2nd edn, Sofia: Sofi-R 1996) 265-267; Vasil Gotsev, *Contractual and Delictual Liability: Comparison and Competition* (First edn, Sofia: Science and Art 1979) 35-37. Only two Bulgarian legal scholars, Krassen Stoichev and Lyubomir Popov, opposed the idea. See Krasen Stoychev, 'Review of the Case-Law Regarding Non-Pecuniary Damages' (1982) 5 Legal Thought 79, 82-83; Lyubomir Popov, 'Non-Pecuniary Damages in Contract' (1987) 6 Socialist Law 26, 33. For a full review of the positions defended by Bulgarian legal scholars during the socialist period, see Vladimir Petrov, *Compensation for Non-Pecuniary Damages in Contract* (First edn, Sofia: "St. Kliment Ohridski" University Press 1991) 10-19. It is also worth recalling that Apostolov, Kojuharov and Stalev (the latter also championed compensation of non-pecuniary damages in case of contractual breach) were among the drafters of the 1951 Contracts Act. What is more, Stalev was actively involved in the preparation of the 1979 draft of Civil Code which explicitly provided for compensation of such damages within the frames of contractual liability. Thus, to explain the lack of an express legal provision in the Contracts Act with experienced pressure from the Soviet legal doctrine, especially considering that the act provides for compensation of non-pecuniary damages in *delict*, does not seem very convincing. On the contrary, the silence of the Contracts Act when it comes to contract is explained by Apostolov and Stalev with the way the institute developed in the European civil law doctrine and the specific Bulgarian context at the time of drafting the 1951 Contracts Act. Compensation of non-pecuniary damages was not overtly sanctioned in the Contracts Act just like it was not in its predecessor – the 1892 Contracts Act, the latter itself following the pattern of the Italian and the French civil codes. At the time they were drafted (1804, respectively 1864) the legal doctrine in France and Italy (as well as Germany) thought of compensation solely in terms of pecuniary damages. Since this was considered evident, both the French and the Italian civil codes did not contain a specific provision on the matter. It was not until the end of the 19th century that French civil scholars took on the new trends coming from Germany which supported compensation of the non-pecuniary interest of the creditor. Yet, the Code Civil was not amended and the rules on compensation of non-pecuniary damages were shaped by French courts. In contrast, the dominant opinion of the Italian legal doctrine remained hostile to the modern tendencies, swaying also Italian case-law. Thus, Bulgaria met the beginning of the 20th century with the 1892 Contracts Acts copying the French and Italian civil codes which, drafted under the influence of the old French civil doctrine, were silent on the issue. Nevertheless, Apostolov held the view that free from any specific instruction in the 1892 Contracts Act, Bulgarian courts were not facing any obstacle in developing case-law on non-pecuniary damages in contractual liability. This was probably one of the reasons for which a legal provision to this effect was not included in the 1951 Contracts Act. Such a rule was, however, considered necessary in the field of *delict* in order to repeal a provision of the 1935 Criminal Procedure Act which allowed compensation of non-pecuniary damages only when incurred by certain crimes. See Apostolov, 'On the Theory of the Creditor's Pecuniary Interest in Contract'; Jivko Stalev, 'Contractual Liability for Non-Pecuniary Damages' (1990) 1 State and Law 3, 6-7. The resulting asymmetry in the text of the Contracts Act regarding non-pecuniary damages in contract and *delict* was unfortunately used by the Supreme Court as an argument to refuse awarding such damages in case of contractual breach. See Decision №1786 of 02.07.1970, c. c. 1148/1979, I c. d. of the Supreme Court. The fact that non-pecuniary damages were claimed for discomfort caused by an unfinished heating system and a faulty elevator in a newly constructed residential building at a time when the State had serious troubles meeting the housing needs of the population probably also played a role. In this sense Petrov, *Compensation for Non-Pecuniary Damages in Contract* 25-26. Thus, in the aftermath, the negative attitude of Bulgarian courts towards non-pecuniary damages in contract is rather related to the conservative stance of the old European, and not of the Soviet, legal doctrine.

For the sake of good order, it must be pointed out, however, that by Interpretative Decision №4 of 2012 of the General Assembly of the Civil and Commercial Chambers, the Supreme Cassation Court overturned the Bulgarian case-law in this regard, proclaiming that awarding non-pecuniary damages is admissible in case of contractual breach. Note that under Art. 130 (2) of the Judiciary Act the interpretative decisions of the general assemblies of the Supreme Cassation Court are binding on the courts, the executive and local authorities as well as on all authorities, issuing administrative acts, thus, predetermining the future case-law and administrative practice on the issue. See *supra* the text accompanying footnote 129 of this Chapter.

157 Petrov, 'Development of the Idea on Civil Law Codification in the Republic of Bulgaria' 138-140; Apostolov, *Law of Obligations. First part. General Theory of Obligation* 95-98; Kojuharov 265-266.

as a whole was determined with the plan as well as with the numerous secondary legislative acts, adopted by the Council of Ministers and often bypassing the Parliament.[158] In addition, the judiciary was not shielded from the political process and even formal provisions prescribing its immunity were lacking.[159] So even if there were special interest groups, capturing the regulatory process, they were directing their efforts to influencing the plan, the secondary legislation or directly the outcomes of court disputes. The Contracts Act was too oblique a channel for achieving the goals of any economic ambitions.

The same can be said for the Commercial Act, adopted in 1991. In Bulgaria this was the time of the initial accumulation of capital in the process of transition to market economy. The major interests of the emerging shady economic groups lay in the process of restitution and privatisation of state property, not in sophisticated drafting exercises of commercial contracts, which at that time were in any case difficult to enforce through the court system. Further, since 1991 the development of Bulgarian contract law takes place largely through case-law as well as through separate legislative acts touching only very specific issues. The Act on Protection of Consumers, which is also of some interest to this research, has always literally reproduced the European solutions on consumer protection; so, it cannot be described as "captured", too. From this perspective, the Contracts Act and the Commercial Act remain mainly products of legal scholars, not of interest groups. This is also the moment to recall that both the US and the UK have adopted quasi-continental contract acts: the

---

[158] See also *supra* footnote 125 of Chapter I.

[159] See Act on the Organization of the People's Courts, promulgated State Gazette №70 of 26.03.1948; revoked as of 07.11.1952 according to which the court system was subject to constant social-political control. Judges were elected by the people's councils and had to report to them in writing about their work. They could also be recalled, including on the ground of impairing the social interest. In practice, this stripped of any meaning the judiciary's independence, formally proclaimed by the Constitution of 1947. At the time of the adoption of the Act on the Organization of the Court System, promulgated State Gazette №92 of 07.11.1952, revoked as of 19.03.1976 the judiciary was viewed as part of the unitary state power and was expected to pursue the communist policy for protection of the established political order and of the social interest. During the whole period of totalitarian government in Bulgaria (1944-1989) judges were subject to party and administrative pressure. It was not uncommon for them to receive instructions from local communist leaders with respect to the outcome of one or another court case. The pressure was softened to some extent only after the adoption of the new Act on the Organization of the Court System in 1976 (Act on the Organization of the Court System, promulgated State Gazette №23 of 19.03.1976, revoked as of 22.07.1994), which introduced the principle of judicial immunity and provided for the election of judges at all court instances by the National Assembly. This made the judiciary relatively independent from party leaders at the same level. In addition, non-party lawyers began to be elected as judges during the 70's. The currently effective Bulgarian Constitution proclaims the judiciary's independence and immunity. See Art. 117(2) and Art. 132 of Constitution of the Republic of Bulgaria, promulgated State Gazette №56 of 13.07.1991, in force as of 13.07.1991, last ammended State Gazette №12 of 06.02.2007. In 2007 Bulgaria was considered to have fulfilled the Copenhagen criteria, implying an independent and functioning judiciary, and became member of the EU. See also Tokushev, *The Judiciary in Bulgaria: from Antiquity to the Present* 303-304, 308, 312, 350.

Uniform Commercial Code, the Sale of Goods Act and the Supply of Goods and Services Act. In principle, as legislative enactments, they are also subject to risk of regulatory capture; yet, scholars do not start from the position that the process of their preparation must have been flawed and corrupted.

Certainly, legal process differences between the selected common law and civil law jurisdictions exist but with respect to contract law they should not be searched for in the availability of codifying laws and rule of precedent or by mechanically applying regulatory capture theories. The important differences rather relate to the existing incentives to litigate, the procedure of collecting relevant information in the judicial and legislative process, *etc.*[160] As it was shown, in the area of contracts, the courts in the US and England live in "the age of statutes",[161] while legislators in Bulgaria have to face the reality of increasing case-law influence on the legal system. For this reason, comparativists continuously emphasise that throughout the 20th century the common law/civil law differences in the source-of-law structure have been softened with the two legal traditions experiencing a process of convergence; as between England and Bulgaria this process of convergence is also to some extent supported by the membership in the European Union.[162] Acknowledging the changing social reality and in an effort to capture law in action, the most recent comparative theory maintains that a specific legal rule cannot be ascertained by solely consulting the source of law (legislation or case-law), endorsed by the national definition of the term. A legal rule is rather a product of the interaction of different "legal formants" (court decisions, legislative acts, scholarly works), each of which contributes to shaping the rule.[163] Thus, finding the rule requires consultation of many different texts, written by different suppliers of law, which may very well contradict and challenge each other. The role of the comparative lawyer then is, by analysing all these texts, to discover not the rule in force, but the true operational rule in the legal system as well as the various factors and influences that led to it. Resolving in

---

[160] Mattei, *Comparative Law and Economics* 77.
[161] Guido Calabresi, *A Common Law for the Age of Statutes* (First edn, Cambridge, Massachusetts: Harvard University Press 1982); Patrick Atiyah, 'Common Law and Statute Law' (1985) 48 Modern Law Review 1.
[162] Vogenauer, 'Common Law' 266-267.
[163] Rodolfo Sacco, 'Legal Formants: A Dynamic Approach to Comparative Law' (1991) 39 American Journal of Comparative Law 343. Legal formants may also be referred to in terms of professional communities who are engaged in shaping the law (judges, legislators, professors). John Dawson, *The Oracles of the Law* (Second edn, Westport, Connecticut: Greenwood Press 1978); Raoul van Caenegem, *Judges, Legislators, and Professors: Chapters in European Legal History* (First edn, Cambridge (Cambridgeshire); New York: Cambridge University Press 1987); Monateri. For the competition between the Bulgarian professional communities, see *supra* the text accompanying footnotes 137-147 of this Chapter.

this way the puzzle with the different source-of-law structure, comparative law not only manages to overcome the gap between common law and civil law systems and to establish itself as one of the most promising legal disciplines. It also makes it possible to perform an economic analysis which accounts for the dissimilarities between the different legal traditions and simultaneously bridges them in order to examine them from a common perspective.[164]

In fact, the conjugation of the comparative and the economic approach is especially productive with respect to sources of law. Embracing the theory of legal formants, comparative law and economics refutes the positivist model of cooperation by means of hierarchy and posits the different legal formants as competing, battling, trying continuously to enlarge their influence on the development of the legal system and thus offering different legal rules on the market of legal solutions.[165] Yet, this is not the time to go into details. The important argument from this section of the current work is that nothing in the economic approach to law makes it necessary to confine the analysis to the American (or to another common law) legal system. American law does not constitute an obligatory background for economic research, just like neoclassical economics is not the mandatory branch of economics to be used. Indeed, refuting the natural law and positive law assumptions that still underlie economic theory, comparative law sharply enhances its potential. Bringing with it ample empirical material and accrued knowledge of different institutional environments, it broadens the economic perspective of different types of transaction costs. Last but not least, as shown by the source-of-law example, it solves concrete problems which economic theory applied to different legal systems can hardly disentangle by itself.

---

[164] Mattei, *Comparative Law and Economics* 70-71.

[165] Ibid 101-121 Of course, it is possible that with respect to a particular legal solution (some of) the different legal formants cooperate and complement each other's role, but again this is not cooperation imposed by the harmonious hierarchical model of positivist legal theory. It must be also emphasised that this model leaves out legal doctrine which is not an official source of law in any legal system. Mattei and Cafaggi, 'Comparative Law and Economics' 349-350. Being closer to reality, the theory of legal formants also accounts for the role of legal scholars. As it was already shown, in Bulgaria legal scholars played a crucial role in drafting the Contracts Act and the Commercial Act. They are often consulted as experts in the legislative process. The law departments in Bulgarian universities may also be asked to give written opinions in the procedure of rendering interpretative decisions and ordinances by the Supreme Courts. Indeed, Bulgarian judges rarely refer to legal doctrine; yet, this does not mean that they do not consult scholarly works when drafting their court decisions. Just like every other participant in the legal process, in their legal thinking they have been at least to some extent influenced by the teachings of their former law professors. Sacco. Still, the process of decline of legal scholarship's influence, observed by comparativists in civil law systems, is also valid for Bulgaria. In contrast, the opposite trend has been detected in the English legal system. Vogenauer, 'Common Law' 267. As for the US, American law schools have always been viewed as having a special position in the legal process. Monateri 19.

Conclusion

To conclude this methodological chapter, it is worth emphasising once again that the approach was chosen for its fitness with the objective of the thesis as well as for its powerful potential. Considering the normative ambition of the project to contribute to the engineering of contract law on the European level, the method was naturally preferred to other more traditional approaches which *a priori* dismiss an instrumental view of law and consequential legal thinking. To any critic who suspects that the choice of methodology was determined solely by the fashionable common obsession with efficiency, the answer is that the author of this research went through her own intellectual crisis and disillusionment with economic analysis.[166] Nevertheless, the conscious decision was taken to remain on the chosen path and not to adopt a different perspective. This is not to say that I consider the economic approach as providing the "ultimate answer".[167] On the contrary, I am deeply convinced that if legal scholarship wants to be the driving force behind the development of European private law, it needs to commit itself to approaching law from many different viewpoints, experimenting with different ideas and methodologies. In this sense, efficiency is just one possible line of argument among many, an argument which bears no exclusive and absolutist connotation.

Still, I am also deeply convinced that the future of legal scholarship lies in breaking out of the self-woven doctrinal cocoon and turning to other social sciences. Interdisciplinarity opens new horizons to legal research and infuses it with new analytical energy. It is also clear that each method comes with shortcomings of its own and that a profound research calls for a combination of approaches. On this account, comparative law and economics seems a remarkably promising marriage between two methodologies of two different disciplines. Both inherently comparative and historical, New Institutional Economics and comparative law naturally complement each other, curing each other's weaknesses. In the resulting rich framework, efficiency ceases to be a universal benchmark to which all legal systems are measured against and acquires meaning only within the institutional environment of a particular jurisdiction. It is only regrettable that until now this new interdisciplinary field has not been fully explored. This thesis delves into it, engaging with

[166] See *supra* the elaboration on the premises of the Chicago school and New Comparative Economics in Section C. of this Chapter as well as on the role of comparative law in Section D. of this Chapter.
[167] Borrowed from Douglas Adams, *The Hitchhiker's Guide to the Galaxy* (25th Anniversary edn, Crown 2004). When finding that the ultimate answer to life, the universe and everything was "forty-two", Adams's characters realised that it was actually more important to search for the question.

the subject of remedies.

Having described the chosen methodology in detail, I move on to Chapter III in which I define the concept of damages and the different damage measures that are at the basis of the various incentive models developed by law-and-economics scholars.

Chapter III Damages

Any legal system, whether a common law or a civil law one, attaches certain legal consequences to the non-performance of a contractual obligation. Out of the remedies, generally available to the aggrieved party in case of breach of contract,[1] damages are probably the most important. Indeed, with regard to remedies, it is habitual to view the common law and the civil law tradition as characteristically different: while being the principal remedy in Anglo-American law, damages are considered somewhat limitedly available in continental legal systems, which appear more favourable to specific performance.[2] Yet, it has been suggested that although there is such a divergence, in practice it is less acute than expected, because the differently formulated rules may, allegedly, lead to similar results.[3] In addition, evidence has been put forward that specific performance is in fact rarely used in civil law countries and in disputes under CISG.[4] These arguments taken together imply that in all legal systems the aggrieved party can receive compensation in money with any restrictions on its availability being of rather theoretical nature.[5] Such indications on the commonness of damages in both legal traditions signal their innate significance in the national systems of contract law despite the remaining inter-jurisdictional differences.

Nevertheless, since 1976 – when Treitel published his seminal study on remedies of breach of contract (including a substantial part on substitutionary relief), comparative scholars seem to be more interested in the different national approaches to specific performance[6] or in the law of damages in the field of tort.[7] Even the recent academic projects that dealt with contractual liability (the PECL, the DCFR) were more or less aimed at unification and thus contain very

---

[1] Treitel's rough classification includes three kinds of remedies: specific relief, substitutionary relief and termination. Treitel 3. As opposed to specific and substitutionary relief, termination, involves putting an end to the contract. It is referred to as "rescission" in the common law tradition or "razvalyane" in Bulgaria. Ibid 110-111. In Treitel's classification the remedy also includes early termination of the contract, referred to as "repudiation" (the US), "anticipatory breach" (England) or "otkaz" (Bulgaria).

[2] Ibid 24; Zweigert and Kötz 470-485.

[3] *Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd* [1998] AC 1 (House of Lords) 11-12; Treitel 22; Arthur Taylor von Mehren and James Gordley, *The Civil Law System. An Introduction to the Comparative Study of Law* (Second edn, Boston/Toronto: Little, Brown and Company 1977) 1122-1123; .

[4] Investigating the use of specific performance, Lando and Rose find that it has been virtually abandoned in Denmark and is rarely used in France, Germany as well as in international disputes, in which CISG is the applicable law. Henrik Lando and Caspar Rose, 'On the Enforcement of Specific Performance in Civil Law Countries' (2004) 24 International Review of Law and Economics 473.

[5] In this sense see Treitel 24.

[6] Mak.

[7] Christian von Bar, *The Common European Law of Torts*, vol II (First edn, Oxford/New York: Oxford University Press 2000); Ulrich Magnus (ed) *Unification of Tort Law: Damages* (First edn, The Hague; Boston: Kluwer Law International 2001).

concise comparative notes which are meant to serve only as a starting point in examining the national laws. To some extent such a focus on other remedial issues is understandable. As the *prima facie* difference between common law and civil law, the dissimilar role of specific performance attracted a great deal of attention in relation to the European efforts in the area of consumer protection. In its turn, liability in tort became naturally topical due to the new and increased risks brought by the remarkable speed of technical progress in the last decades. On the other hand, until now the European Union law has only marginally affected the laws of contractual damages of the Member States with the ECJ largely accepting the national differences in this respect. In addition, determining the types of recoverable loss, the forms of compensation (in money or in kind), the way of calculating the amount of damages (when monetary), *etc*., the law of damages is fairly technical and complicated, thus making a detailed comparison a rather challenging task.

In contrast, damages *ex contractu* are at the focus of this research. What is more, by implication of the adopted interdisciplinary methodology, damages are analysed in terms of the incentive effects they generate. The latter notion marks a very important characteristic of the undertaken economic approach. Looking at damages as incentives is by no means customary for lawyers. Naturally, their view has also evolved and nowadays they agree that the principal aim of damages is compensatory and not penal[8] as was the dominant understanding in Roman law.[9] But it is common that lawyers perceive remedies as civil sanctions, *i.e.* as consequences of contractual breach.[10] Economists, on the other hand, seek to

---

[8] This is also the understanding of the US legal doctrine despite the fact that an award of punitive (also called "exemplary") damages may be allowed when breach of contract mingles with tortious elements. See UCC § 1-305. Remedies to be Liberally Administered. (a); Restatement (Second) of Contracts (1981) § 355 Punitive Damages; *Hibschman Pontiac, Inc. v. Batchelor* 362 NE2d 845 (Ind 1977) followed in *F. D. Borkholder Co., Inc. v. Sandock* 413 NE2d 567 (Ind 1980). In English law the general principle that exemplary damages are not awarded in contract has been systematically applied. It is derived from *Addis v Gramophone Co. Ltd* AC 488 (House of Lords). In line with the civil law tradition, punitive damages are awarded in Bulgaria neither in tort, nor in contract. Anguel Kalaydjiev, *Law of Obligations. General Part* (Third edn, Sofia: Sibi 2005) 378.

[9] This understanding was pushed into the background by the compensatory principle and the prohibition of unjust enrichment under the influence of the restitution theory developed by the Spanish Late Scholasticism. Thus, the basic principles that are at the root of the modern perception of damages were strongly inspired by natural law conceptions to which Spanish authors adhered and which, through their bearing on secular natural law ideas, still affect today's legal thinking. This natural law influence, however, casts little light on the types of loss recoverable and the amounts of damages granted in different legal systems as these are largely determined by value judgments changing between systems as well as over time. Wolfgang Wurmnest, 'Damages' in Basedow Jürgen and others (eds), *The Max Planck Encyclopedia of European Private Law*, vol I (First edn, Oxford: Oxford University Press 2012) 444-445.

[10] The problem with such positivist terminology is that it completely blurs the difference between punishment and compensation. See Kelsen. Legal scholars use the term "civil sanction" despite the express recognition of compensation as the primary aim of damages. See Trayan Konov, *Selected Works. Grounds of Civil Liability*

predict the consequences that are likely to follow from a particular remedy. This change of perspective shifts the focus from contractual obligations whose non-performance brings a certain remedy as an end result to remedies as sources of incentives which, if explored, will elucidate the consequences to be expected.

To be sure, at the core of such an understanding of remedies lies microeconomic theory in the framework of which legal rules constitute prices of illegal conduct and as such produce incentives to which rational individuals respond. In this sense, the art becomes to set the price (in this case *the remedy*) at a level which would incentivise market players to reduce their illegal conduct (in this case *breach of contract*) to the point at which the marginal benefits (*i.e.* the release from damage payments due upon non-performance of the contract) exceed the marginal costs of not engaging in breach where these costs are weighted by the probability of detection and successful verification of the illegal conduct in a court of law.[11] Thus, the economic perspective is "legal-centralist": having the capacity to induce and to alter individual incentives, legal rules are central to affecting individual behaviour in a way which would produce the desired economic results.[12] For this reason, the economic analysis of contract remedies is no longer confined solely to recognising their effect on the promisor's decision to fulfill or break his contractual promise. Rather, it evolved to identify a number of incentives that are induced by an adopted legal remedy and currently strives to evaluate contract enforcement from the point of view of all these incentives. As it will be seen, the fundamental concern of economics is to determine the optimal remedy which balances the whole set of induced incentives.[13] Much of this concern relates to adjusting the measure of damages, so economic analysis is particularly congenial to approach the measurement problems the law of damages needs to resolve.

(Third edn, Sofia: Reguli 2002) 26-32. In his account Konov clearly differentiates the compensatory from the penal goal and excludes the latter with respect to contractual damages, but such clarity is not valid for all Bulgarian legal scholars. Pointing at the sanctioning character of civil liability, Kojuharov emphasises the principle of attributing liability to the party who is at fault. Kojuharov 19, 23, 207-209, 256. This brings to mind associations with retribution and creates confusion about his understanding of the rationale of damages. The same can be said about Goleva, who confines herself to declaring that besides compensating, damages also "sanction in some way" since the debtor is obliged to pay them against his will. Goleva 132. Nevertheless, the majority of Bulgarian legal doctrine is straightforward. Apostolov expressly states that unlike criminal liability, civil liability is not a sanction for guilty conduct, the problem being economic rather than moral. Apostolov, *Law of Obligations. First part. General Theory of Obligation* 4, 229-230. On the concept and aims of civil liability Kalaydjiev sides with Konov. Kalaydjiev 378.

[11] Mercuro and Medema 104.

[12] Ibid 104, 33.

[13] Richard Craswell, 'Against Fuller and Perdue' (2000) 67 The University of Chicago Law Review 99; Craswell, 'Two Economic Theories of Enforcing Promises' 28, 30-32.

The chapter unfolds as follows. Section A. points at the waning vigour of the specific performance principle in Bulgarian contract law and argues that in some cases Bulgarian promisees *de facto* recover damages even if *de jure* they pursue a course of action classified as specific performance. Section B. defines the concept of damages. Section C. delineates the different damage measures and claims that, although grounded in a taxonomy originating in the US, the classification of damages, adopted by economists, is just as valid in civil law jurisdictions. The Chapter then concludes.

A. The principle of specific performance

In contrast to the US and England, in Bulgaria specific performance is erected into a basic principle, underlying the system of contract law.[14] For civil lawyers, it may be even strange that the remedy of damages is chosen to be compared in relation to defective performance, a legal doctrine which has traditionally been considered as built on the basis of the specific performance principle.[15] Indeed, two of the four enforcement options the Buyer has available to him in case of defective goods or construction works are in fact forms of specific performance: the right to repair as well as the right to replacement (if in the sale contract goods are specified only generically).[16] Nevertheless, although Bulgarian contract law erects specific performance into a general principle,[17] there are good reasons to insist on comparing the damage remedy and even on comparing it exactly in the case of defective performance.

First, in the last two decades or so Bulgarian contract law shows a clear trend toward weakening the position of specific performance in its relation to expectation damages. Generally, the principle manifests itself in the resolution of two basic issues: whether the promisee can seek expectation damages instead of performance when the latter is still possible and whether she can rescind the contract when performance is still possible. As the principle found its way in Bulgarian contract law with the adoption of the very first 1892

[14] Kalaydjiev 229.
[15] Krasen Stoychev, 'The Content of the Specific Performance Principle in the Contractual Obligations Between Socialist Organizations' [1986] Legal Thought 79; Chudomir Goleminov, *Civil Liability for Defective Goods* (First edn, Sofia: Romina 2001) 20-21.
[16] Art. 195 and Art. 265 Contracts Act. See Mak 120-123 who defines specific performance in a broad sense, including repair and replacement.
[17] In this respect, Bulgarian contract law is similar to German law whose starting point is also the right of the promisee to performance. Within the civil legal tradition French law chooses a different approach: specific performance is possible in relation to some obligations and is not possible in relation to others. Treitel 10-17; Kalaydjiev 306, footnote 18.

Contracts Act under the influence of the Romanic legal tradition, any comment that characterises it as a tenet normally following from the socialist system of economic governance is frankly exaggerated.[18] Yet, the principle was considerably strengthened during the socialist period. Thus, rescission was made an extreme remedy which could be resorted to only when all possibilities for performance of the contract had been exhausted.[19] Unlike the 1892 Contracts Act which gave courts discretion to grant the breacher with a new term for performance, the Contracts Act turned the provision of such a final chance to the promisor into a mandatory prerequisite for contract rescission.[20] In addition, while under the 1892 Act courts had the discretion to refuse rescission when requested for minor breaches and when the promisee did not have a serious interest in it, the Contracts Act straightforwardly disallowed the promisee's right to rescind if non-performance was immaterial with a view to her interest.[21] This interrelation between the rescission remedy and specific performance remains effective until today. The one between specific performance and expectation damages, however, appears changed.

As explained in this chapter, under Bulgarian contract law if the promisor breaches, the promisee is entitled to claim performance together with damages for delay (moratory damages), or damages for non-performance (compensatory or, as defined in this thesis, expectation damages).[22] When the promisee claims damages for non-performance, the

---

[18] For such characterisation of the specific performance principle, see Alexander Kojuharov, *Law of Obligations. General Theory of Obligations*, vol I (Sofia: Science and Art 1958) 206-207.
[19] Kojuharov, *Law of Obligations. General Theory of Obligations* 298-299.
[20] *Cf.* Art. 70 (3) Act on Obligations and Contracts, promulgated State Gazette №268 of 01.01.1892, repealed State Gazette №275 of 22.11.1950 and Art 87(1) Contracts Act; Decision №31 of 20.01.1930, c. c. №529/1935, I c. d. of the Supreme Cassation Court.
[21] *Cf.* Apostolov, *Law of Obligations. First part. General Theory of Obligation* 304-305, 310; Decision №31 of 1936, I c. d. of the Supreme Cassation Court and Art. 87(4) Contracts Act; Decision №1106 of 20.04.1957, c. c. № 2125/1957, IV c. d. of the Supreme Court; Ordinance №3 of 29.03.1973 c. c. № 2/1973, Plenum of the Supreme Court. To determine whether the non-performance is immaterial with a view to the promisee's interest in the context of construction contracts, courts normally enquire about the proportion of the work already done out of the whole construction work agreed upon. See Decision №1279 of 28.10.1999, c. c. № 553/1999 of the Supreme Cassation Court (where the court says that Art. 87(4) requires evaluation of the ratio between the uncompleted and the completed part of the construction work). See also Decision № 999 of 24.10.1995, c. c. № 737/1995, II c. d. of the Supreme Court (where the constructor performed between 93% and 97% of the work, the client had no right to terminate the contract since the non-performance amounted to maximum 7% of all the construction work agreed, which was immaterial with a view to the client's interest); Decision № 641 of 06.04.1999, c. c. № 54/1999, V c. d. of the Supreme Cassation Court (where the constructor did not complete 40% of the construction work, he was considered not to have fulfilled the condition precedent for acquiring the right *in rem* to construct on another plot, so the seller was entitled to rescind the contract for the sale of the right *in rem*); Decision № 1003 of 30.12.2001, c. c. № 420/2001, II c. d. of the Supreme Cassation Court (where the court decided that 62.27% of the construction work not being done, this amounts to non-performance that is material with a view to the client's interest).
[22] See *infra* the text accompanying footnotes 80-81 and 106 of this Chapter.

promisor can offer to perform and pay damages for the delay in case the promisee still has interest in performance.[23] This provision of the Contracts Act does not change in substance the legal rule effective under the preceding 1892 Contracts Act.[24] Both at the time of the latter Act and today the Bulgarian legal doctrine and courts have been maintaining that the non-breacher can freely choose between the two claims: the one for specific performance (possibly combined with moratory damages) and the one for expectation damages.[25] Such a right to choose can be deduced from the very wording of the relevant legal provisions and is completely in line with the French and Italian legal traditions which inspired them.[26] Only if the breacher offers to perform and pay moratory damages and proves that the promisor has interest in such delayed performance, will the promisor have to accept it.[27]

The specific performance principle was, however, implemented much more perseveringly during the socialist period in the contractual relations between socialist enterprises. At that time contracts between socialist enterprises were perceived as legal means ensuring the fulfilment of production and financial plans. For this reason the remedial regime was supposed to guarantee that socialist enterprises actually performed their contractual obligations and did not buy themselves out of the signed contracts.[28] Where commodities were distributed centrally and there was no free market, on which substitutes could be purchased, the then effective Act on Contracts between Socialist Organizations consistently

---

[23] Art. 79 Contracts Act.

[24] The new Art. 79(2) ibid, stipulating the breacher's right to offer performance together with damages for delay even if the non-breacher has already claimed damages for non-performance, in fact provided for what was already accepted in the Bulgarian legal doctrine. Apostolov, *Law of Obligations. First part. General Theory of Obligation* 288; Ivan Apostolov, 'Grounds of Contractual Liability' (1940/1941) 34 Yearbook of "St Kliment Ohridski" University - Sofia, Law Department 3, 39-40.

[25] Apostolov, *Law of Obligations. First part. General Theory of Obligation* 287-288; Apostolov, 'Grounds of Contractual Liability' 38; Decision №713 of 1928, III c. d. of the Supreme Cassation Court; Decision №207 of 22.03.1937, c. c. №129/1935, III c. d. of the Supreme Cassation Court; Kalaydjiev 333, 437-438; Ivan Ruschev, *Liability for Eviction* (First edn, Sofia: Reguli 1995) 190; Decision №16 of 13.03.2006, c. c. №706/2005, II c. d. of the Supreme Cassation Court.

[26] In this sense Apostolov, *Law of Obligations. First part. General Theory of Obligation* 288. For more detail on the importance of the French and Italian legal traditions for the relation between specific performance and expectation damages under Bulgarian contract law, see 32-40.

[27] Kalaydjiev 333. Note that if the breacher offers delayed performance but without moratory damages, the promisee does not have to accept even if she still has interest in performance. It has been held that the standard for deciding whether the promisee has interest in delayed performance is objective. She does not have such interest if performance has already become impossible or futile and, if under the particular contract, time was of the essence. When the breacher is in delay to pay money, the promisee always has interest in performance coupled with moratory damages. In this sense, see Decision №934 of 06.07.2010, c. c. №553/2009 of 12 c. panel of District Court – Varna, confirmed by Decision №8 of 13.01.2011, c. c. №615/2010 of Appellate Court – Varna. See also Decision №1640 of 14.08.1968, c.c. №981/1968 of I c. d. of the Supreme Court.

[28] Stoychev, 'The Content of the Specific Performance Principle in the Contractual Obligations Between Socialist Organizations' 80-81. On contract law during the socialist period, see *supra* footnote 130 of Chapter I.

obliged them to seek specific performance.[29] According to the steady case-law of the State Arbitration Court, which resolved disputes between socialist enterprises, the non-breacher was not entitled to choose between specific performance (together with damages for delay) and damages for non-performance and could not elect to claim directly monetary compensation.[30] The principle was expressed in a number of ways: the payment of damages did not release the breacher from his obligation to render performance,[31] the performance that was not rendered within the respective plan period (month or trimester) had to be rendered during the following one,[32] socialist enterprises had the right to amend a contract only to the extent allowed by the plan and to terminate it only to the extent it was not in the interest of the national economy,[33] and a socialist enterprise that was delivered a good with incurable defects was obliged to refuse it and require a new conforming one.[34] In other words, the application of the principle led to specific performance literally excluding the payment of expectation damages. It also affected the damage remedy indirectly. The amounts of the liquidated damages in the different legislative acts governing contracts between socialist enterprises had to be set so that they incentivise performance. Also, any contracts in which socialist enterprises released their contractual partners from the prescribed liquidated damages or agreed not to claim them in case of a legal dispute were forbidden.[35]

In this sense, the returning of Bulgarian courts and legal doctrine to the pre-socialist view of the relation between the specific performance and expectation damages represents a significant change in Bulgarian contract law. As Bulgaria set on the road of transition from planned to market economy, the legislative acts governing the contractual relations between socialist enterprises were revoked. Indeed, their steadfast commitment to the principle of

---

[29] Art. 8(2) in relation to (1); Art. 32(5) Act on Contracts between Socialist Organizations.
[30] Decision of 14.12.1982, sup. c. №705/1982 of the State Arbitration Court; Decision under sup. c. №243/1977 of the State Arbitration Court; Decision under sup. c. №128/1965 of the General Assembly of the State Arbitration Court.
[31] Art. 39(4) Act on Contracts between Socialist Organizations. The seller was also obliged to deliver goods that were his own produce. He could not perform his obligation by procuring goods from another manufacturer as all such goods had already been distributed under the plan and the plan did not indicate him as a buyer. Jivko Stalev, 'Characteristic Features of the New Legal Regime of the Sale Contract' (1951) 3-4 Bulletin of the Economic and Legal Institute 161, 178-179.
[32] Art. 11(2) Ordinance on the Specific Rules for Governing the Business Organizations and Units in the Transportation Branch, promulgated State Gazette №101 of 21.12.1979, revoked State Gazette №1 of 04.01.1991; Decision of 05.11.1981 under sup. c. №823/1981 of the State Arbitration Court.
[33] Art. 16 and 17 Act on Contracts between Socialist Organizations; Decision of 13.10.1973, c. №585/1973 of the State Arbitration Court.
[34] Art. 44(1) ibid.
[35] Stoychev, 'The Content of the Specific Performance Principle in the Contractual Obligations Between Socialist Organizations' 84.

specific performance was not facilitating the creation and development of a national market, in which actors had to be able to contract of their own free will and not because the plan required them to do so. If exchange was to be fostered, promisees had to be able to choose not only whether to enter into agreement at all but also how to enforce it and promisors had to have the possibility to be released from their contractual obligation also by payment of monetary compensation. Following closely classic western models, the Contracts Act (with only minor amendments) was able to provide the basis for expansion of the damages remedy. Today legal scholars and courts agree that it is not mandatory that a claim for expectation damages be preceded by a claim for specific performance. Even more bold opinions already find their way in the scholarly writing and arbitration practice. Kalaydjiev has taken the stance that specific performance cannot be imposed on the promisee against her will and that her interest must be preferred to that of the breacher.[36] In one decision the Arbitration Court at the Bulgarian Chamber of Commerce adds that the very choice of the promisee to seek expectation damages already means that she has lost interest in delayed performance and that it is not for a court to establish her lack of interest by resorting to any objective criteria.[37] That is why, considering that there is a visible trend in Bulgarian contract law toward narrowing the scope of specific performance and putting it on a par with expectation damages, a research on the – until recently – neglected damages remedy is undoubtedly necessary.

Secondly, one of the forms of specific performance under Bulgarian law is, in fact, tantamount to monetary compensation of the aggrieved party. Thus, in case of defective performance of a sale-of-goods or construction contract, the Buyer has the right to request that the court authorise her to have the defect repaired at the expense of the Seller.[38] To succeed in this course of action, classified as specific relief, the promisee is not required to have already made the expenditure necessary for repair; she can ask to be authorised and awarded the money in advance.[39] Also, if authorised, she does not have to personally effectuate the repair; she can contract and have the defect remedied by a third party. The

---

[36] Kalaydjiev 437-438. *Cf.* with the position taken by Kojuharov during the communist regime in Bulgaria. Kojuharov, *Law of Obligations. General Theory of Obligations* 289.

[37] Decision of 27.06.2000 internal arb. c. №3/2000 of the Arbitration Court at the Bulgarian Chamber of Commerce.

[38] Art. 80(1) in connection with Art. 195(1) and Art. 265(1) Contracts Act.

[39] Decision №55 of 22.04.2010, comm. c. №817/2009, Commercial Chambers, I comm. division of the Supreme Cassation Court; Decision №174 of 31.01.2011, c. c. №2627/2008, Civil Chambers, 7th panel of Sofia Appellate Court; Decision №20 of 04.02.2011, app. c. c. №537/2010 of Lovech District Court; Decision №12 of 22.02.2010, app. c. c. №645/2009 of Burgas District Court; Kalaydjiev 175, 306.

expenditure needed for this rectification, however, will have to be borne by the Seller. In other words, even though the Buyer's course of action is one for specific performance, in its end result it does not differ from the outcome under US and English law where in case of defective construction promisees are granted damages that often amount to the cost of remedying the defective work.

Nevertheless, the Bulgarian legal doctrine is firm that the monetary payment obtained by Buyers if authorised to have the defect remedied at the Seller's expense, is not an award of damages. The uniformly supported position is that the promisee's recovery is not aimed at compensating her for the losses suffered but at realising the result, implied in the promisor's obligation, a goal that is practically equivalent to the one of specific relief. That is why, the reasoning goes, this is a claim for specific performance and it is only the method of execution that is different: execution not by coercing the Seller to perform himself but by permitting the Buyer to attain the pursued result elsewhere and charge the Seller for the expenses. In this sense, it is only because the modern execution procedure has found new ways to ensure the promisee receives what she bargained for that the Buyer obtains a sum of money from the Seller; however, this sum of money does not constitute damages but specific performance in monetary form.[40] The fact that the statutory provisions provide for the promisee's opportunity to claim damages in addition to rectification of defects at the promisor's expense is pointed as a further argument that under Bulgarian law the recovery of expenditures is not intended as compensation.[41]

While tracing the above doctrinal distinctions, it becomes obvious that Bulgarian contract law draws the line between damages and specific performance differently from the selected common law jurisdictions. In fact, the Bulgarian concept of specific performance turns out to be more expansive both with regard to the parties who can deliver performance and with regard to the financial consequences for the promisor.

In the US and England a decree for specific performance is issued *in personam*, directing the promisor to perform under the threat of punishment for contempt of court.[42] In contrast in Bulgaria, when the contractual obligation is not *intuitu personae*, the promisee may be

---

[40] Apostolov, *Law of Obligations. First part. General Theory of Obligation* 231, 281; Konov 36-37; Kalaydjiev 305-306.
[41] Art. 195(2); Art. 79(1) Contracts Act; Konov 37-38.
[42] In this sense, see Treitel 7.

authorised to obtain substitute performance from a third party. Indeed, this will not be the exact performance she bargained for, but significantly delayed performance by the promisor himself would also not be precisely what the contract required.[43] In other words, unlike in the US and England, the Bulgarian civil law notion of specific performance also includes substitute performance by an outsider. In common law jurisdictions, on the other hand, Buyer's procurement of a substitute does not take place in relation to an action of specific performance and commonly gives rise to a claim for damages.[44] To be correct, in English law if a decree of specific performance is not complied with, the court may also direct that the act be done by another person at the cost of the defendant. This, however, is without prejudice to the court's power to punish the disobedient party for contempt.[45] In this sense, even if substitute performance may, in some cases, be available as a method of executing a specific performance decree already issued,[46] the coercive financial element of the Anglo-American concept, to which I turn now, remains present.

In the US and England, disobedience to a decree of specific performance leads to fines (*i.e.* sums of money) levied in the context of contempt proceedings. These fines go to the state and their size is not directly related to the creditor's loss, so it is undoubted that they constitute compulsion in monetary form rather than some kind of compensation. By contrast, the Buyer's claim to have the defect repaired, though classified as specific performance under Bulgarian law, does not entail the imposition of fines. On the contrary, it entails a monetary amount covering the cost of repair, which the promisee may be awarded as estimated by an expert in advance, without having to incur the expenses first. In addition, having received the sum, the Buyer does not have to use it to actually repair the defect; she may spend the money in some other way. So, unlike fines, the money payment going to the promisee, clearly invokes the idea of compensation, typical for the damages remedy.

---

[43] In this sense, see ibid 3, 7.

[44] Ibid 7. See UCC § 2-712. "Cover"; Buyer's Procurement of Substitute Goods. In England under the duty to mitigate the promisee is expected to buy substitute goods as long as there is a market in which he can obtain them. He can then claim damages amounting to the price difference. See Hugh Beale, 'Chapter 26. Damages' in Hugh Beale (ed), *Chitty on Contracts General Principles*, vol I (Thirty-first edn, London: Sweet&Maxwell; Thomson Reuters 2012) 1807; *Halsbury's Law of England. Damages*, vol 12(1) (Fourth. Reissue edn, London: Butterworths 1998) 459; Sale of Goods Act 1979, in force from 01.01.1980, c. 54, Pt VI, Section 51(3) Damages for non-delivery.

[45] See RSC Order 45 Enforcement of Judgments and orders: General, Rule 8, available at: http://www.justice.gov.uk/courts/procedure-rules/civil/sched_rsc/rscorder45#IDALKYS.

[46] Treitel Guenther Treitel, 'Chapter 27. Specific Performance and Injunction' in Hugh Beale (ed), *Chitty on Contracts General Principles*, vol I (Thirty-first edn, London: Sweet&Maxwell, Thomson Reuters 2012) 7.

Indeed, the concise comparison above leads to the conclusion that the Bulgarian concept of specific performance extends to embrace legal process (substitute performance, money payment collected by the promisee) which in common law jurisdictions is akin to the remedy of damages. Can we then consider the monetary amount, recovered by the Buyer if authorised to have the defect remedied, as equivalent to an award of damages despite the Bulgarian legal doctrine, which insists that the course of action is specific performance? It is appropriate here to remind that for the purposes of this thesis the categorisation of a remedy as damages should be determined by its fitness to the adopted functional definition[47] and not by its doctrinal classification in the respective legal system. From this viewpoint, the formal cataloguing of the described legal process as specific performance should not obscure the fact that a monetary payment, measuring the loss of the promisee and awarded to her, does compensate her for the harm suffered from breach. As already mentioned, the ultimate result of having the remedy granted is indistinguishable from the Anglo-American expectation damages calculated on the basis of cost of completion. In this sense, any sophisticated doctrinal arguments pointing out that the money payment does not represent damages but a monetary "surrogate" of the initial performance, due by the promisor,[48] originate in the strong tradition of the specific performance principle. At the same time they reflect awareness of the execution difficulties related to this principle and of the need to find practical devices to overcome them. The clash between tradition and modern dynamics results in preservation of the specific performance rhetoric which, however, disguises a conversion of the specific performance remedy into compensatory payment of damages.[49] After all, do not damages represent exactly a monetary surrogate of the promisor's initial performance? It is difficult not to notice that even the wording used by Bulgarian legal scholars in essence restates the definition of the concept, discussed in this chapter. For this reason, in the rest of the thesis the monetary amount received by the Buyer, if authorised to have the defect remedied at the expense of the Seller, will be put on the same footing with common law damages.

Thirdly, even when promisees in Bulgaria have requested and been granted by the court specific performance, at the execution stage the remedy is often reduced to monetary compensation. Under the Contracts Act, in case of defective performance, the Buyer has two remedies, which constitute classic forms of specific relief in the civil law tradition: the right to

---

[47] See *infra* Section B. of this Chapter.
[48] Konov 36-37.
[49] On the conversion of specific performance into damages, see also Lando and Rose, 475.

have the defective work or good repaired within a reasonable period of time without any additional payment[50] and the right to replacement of defective goods (provided that the goods have been specified in the sale contract only generically).[51] However, if the Seller does not comply with the judgment directing him to repair his own defective work/good, the only choice the Buyer has in the execution proceedings is to request the bailiff to authorise her to have the defect remedied at the expense of the Seller.[52] When the promisor's obligation is to do something (*facere*), but the promisor is not the only one who can do it, Bulgarian law does not provide for levying fines as a method of execution.[53] The promisee is allowed to have the defect rectified by a third party with the necessary expenses borne by the promisor. However, if she wants to collect the expenditure in advance, she must institute new court proceedings and request the court award her the money before the defect is actually repaired.[54] In other words, unless the Seller conforms to the court decision, the Buyer ultimately achieves what she would attain by asking the court directly to authorise her to have the defect remedied at the expense of the Seller. She receives a monetary amount equal to the cost of repair, but only after waiting in vain for the Seller to perform and going through two (instead of one) court proceedings. Since it is very likely that the right to repair is reduced to receiving a compensatory money payment in the execution proceedings, it is no wonder that Buyers generally prefer to request immediately the court for authorisation and award of the expenditure, necessary for repair.

The execution proceedings are likely to unfold in a similar way when the buyer has been granted replacement of defective generic goods. If the seller does not make a fresh conforming delivery, the bailiff must simply seize the goods from him and deliver them to the buyer.[55] Yet, if the bailiff does not find such goods in possession of the seller or he finds goods that have deteriorated, the buyer collects only the monetary equivalent.[56] Thus, instead of having the goods replaced, the buyer may very well receive a money payment equal to their

---

[50] Art. 265(1) Contracts Act. The right of the promisee in a sale contract to have the defective good repaired within reasonable time and without additional payment is not expressly stipulated in the Contracts Act, but the Bulgarian legal doctrine is unanimous that despite this omission the buyer has such a right. Alexander Kojuharov, *Law of Obligations. Specific Contracts*, vol III (Ognyan Gerdjikov ed, 2nd edn, Sofia: Sofi-R 1996) 95-96; Goleminov 32, 36.

[51] Art. 195(3) Contracts Act.

[52] Art. 526(1) Code of Civil Procedure.

[53] Art. 527 ibid.

[54] Art. 526(2) ibid. See *e.g.* Ruling № 2814 of 27.09.2013, pr. c. c. № 2543/2013 of District Court - Plovdiv.

[55] Art. 521(1) ibid.

[56] Art. 521(2) ibid.

market value.[57] In the face of such prospects, however, a commercial buyer, who measures time in terms of money, would prefer to terminate the contract (which she can do simply by sending a written notice without giving the seller an additional period to perform),[58] buy the generic goods elsewhere and then sue the seller for damages. It is not surprising then that in 1996 the Commercial Act set out that in case the buyer terminates and buys substitute goods within appropriate time, she can claim the difference between the contract price and the price of the substitute transaction together with other damages.[59] Recognising the need to speed money flows in the process of building a market economy, the legislator naturally provided for the possibility that the buyer makes a cover purchase and claims compensation measured by the contract-market differential.[60] Thus, without formally repealing the buyer's right to replacement, the new solution, provided by the Commercial Act, in practice works toward restricting the importance of specific performance in Bulgarian contract law.

In short, in Bulgaria the remedy of contractual damages is implemented in a specific institutional context, characterised by the possibility to claim specific performance irrespective of the kind of promisor's obligation (*dare*, *facere* or *non facere*). At the same time, when it comes to the practical application of the specific performance principle, it is more moderate than it appears at first glance. Even if granted at the court level, at the execution stage the remedy of specific performance is often relegated to a monetary award. What is more, despite the refusal of the mainstream legal doctrine to acknowledge it, contract law provides for the possibility that the right to repair is converted into damages as early as the court proceedings. To this one must add the trend toward narrowing specific performance relative to expectation damages as a result of of the political and economic changes taking place in Bulgaria since the end of the 1980's. Keeping an eye on the importance of these Bulgarian institutional peculiarities, I proceed to compare contractual damages in the three selected jurisdictions.

---

[57] Decision № 1566 of 06.12.1994, c. c. № 214/1994, V c. d. of the Supreme Court; Ruling № 460 of 19.12.2008, pr. comm. c. № 428/2008, II comm. d. of the Supreme Cassation Court.

[58] This solution regarding sale-of-goods contracts is an exception to the rule of general contract law according to which the promisee may terminate the contract only after giving the promisor an appropriate additional period of time for performance. See Art. 87(1) Contracts Act and *supra* the text accompanying footnote 20 of this Chapter See also Kojuharov, *Law of Obligations. Specific Contracts* 93 and Decision № 595 of 11.06.2004, c. c. №2700/2008, V comm. d. of the Supreme Cassation Court.

[59] Art. 323 Commerce Act.

[60] *Cf.* UCC § 2-712. “Cover”; Buyer's Procurement of Substitute Goods.; Sale of Goods Act 1979 Section 51 Damages for non-delivery.

B. The concept of damages

The development of an economic model of damages requires me first to spend some time on definitions. To some, the account in this Section B may appear somewhat boring. Yet, in my opinion, having a clear understanding of the concepts on which the model is based is highly necessary. As it will become evident further on in the thesis, comparing remedies of legal systems that belong to different legal traditions inevitably raises questions of delimitation that may easily cause misunderstandings. In this sense, any effort directed towards sparing terminological confusion is effort well spent. In addition, investigating the incentives generated by damages, the economic analysis centres mainly on the effects produced by three damage measures: expectation, reliance and restitution. This traditional law-and-economics classification follows the seminal article of Fuller and Perdue,[61] and is thus based on typical common law distinctions. As the comparative exercise also covers a civil law jurisdiction, it is important to question to what extent this taxonomy can be applied to study damages in Bulgarian contract law and whether it needs to be adjusted to the Bulgarian legal system.[62] Consequently, first, I define the concept of damages as used in this thesis, and, second, I argue that the differentiation of damage measures employed by economic analysis is compatible with the Bulgarian legal regime on damages.

If this research focuses on comparison of damages, what is it exactly that this concept stands for in the thesis? The answer is fairly short and straightforward. By damages I mean the compensation the aggrieved party receives as a substitute of the promised but unexecuted contractual performance. The term "damages", adopted in the thesis, is the common law term for substitutionary relief in money.[63] In some legal systems, another form of compensation, reparation in kind, is also available, making it difficult to distinguish, on one hand, between substitutionary and specific relief,[64] and on the other hand, between primary obligations (obligation to perform) and secondary obligations (obligations arising in case of non-

[61] Lon Fuller and William Perdue, 'The Reliance Interest in Contract Damages: 1' (1936) 46 Yale Law Journal 52; Lon Fuller and William Perdue, 'The Reliance Interest in Contract Damages: 2' (1937) 46 Yale Law Journal 373.

[62] In Ugo Mattei's view, the mechanic imposition of untweaked American models on a substantially different institutional context is perhaps one of the main reasons for the cold acceptance of law and economics in Europe. Mattei, *Comparative Law and Economics* 77.

[63] The term used in Bulgaria is "parichno obezshtetenie za vredi".

[64] Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' 3.

performance).[65] In line with the Romanic legal tradition,[66] the Bulgarian Contracts Act remains silent on the question of whether compensation should be in money or in kind. Nevertheless, in the field of contractual liability, the issue of reparation in kind can be raised only with respect to obligations not to do something (*non facere*). [67] Then substitutionary relief can take place *in natura*: by eliminating the consequences of breaching the undertaken obligation, *e.g.* by demolishing the structure the party promised not to build, by transferring title to the thing the party promised not to transfer to anybody else.[68] Most of the time, however, contractual obligations are obligations to do (*facere*) or to give (*dare*) something. This is also the nature of the Seller's obligations in the construction contract and the contract for sale of goods, with which this research is concerned (*i.e.* the obligations to perform the work and to deliver the good are such of *facere* and the obligation to transfer title to the good is such of *dare*).[69] In these cases, the reasoning goes, the remedy should bring about a new state of affairs, not restore the old one and, therefore, when the contract is enforced *in natura*, the consequences of breach are done away with by specific performance, not reparation in kind.[70] In other words, in Bulgaria, substitutionary relief is generally in money just as in most European legal systems. As already said, in Anglo-American law, damages in principle constitute a sum of money. For this reason, in the thesis the term "damages" refers to monetary compensation.

It must be admitted that such a functional definition of damages is very broad and cuts across the distinctions between remedies drawn in different places in the different legal systems. Indeed, since the thesis focuses on breach of non-monetary obligations, the question of whether the claim available to the promisee in case of non-payment is one for damages or one

---

[65] German law with its §249 (1) of *Bürgerliches Gesetzbuch* is the classic example of a legal system that provides explicitly for reparation in kind and even, at least as written in the civil code, gives preference to this form of compensation. See Hannes Unberath, 'Reparation in Kind' in Basedow Jürgen and others (eds), *The Max Planck Encyclopedia of European Private Law*, vol II (First edn, Oxford: Oxford University Press 2012) 1453.

[66] As to the legal solution adopted in the Romanic legal tradition, see Apostolov, *Law of Obligations. First part. General Theory of Obligation* 120; Unberath 1454.

[67] In contrast, when it comes to delictual liability, the aggrieved party in principle has the right to choose between monetary compensation and reparation in kind. Decision №631 of 13.05.1996, p. c. №511/1995, I p. d. of the Supreme Cassation Court; Decision of 23.06.2008, p. c. №1114/2007, c. d. of Sofia District Court.

[68] Kalaydjiev 437.

[69] Ibid 174, 176-177. For a Bulgarian non-lawyer, it may seem confusing that the obligation to deliver is an obligation to do (*facere*) while the obligation to transfer title is an obligation to give (*dare*). It will be helpful probably to remind once again that generally in Bulgaria the moment of transfer of title is different from the moment of delivery. See *supra* footnote 127 of Chapter I. That is why, in the contract for sale of goods the principal obligation of the seller to transfer ownership is an obligation of *dare*. His additional obligation to hand the good to the buyer is, taken alone, an obligation of *facere*.

[70] Kojuharov, *Law of Obligations. General Theory of Obligations* 288; Kalaydjiev 437.

for specific performance does not arise. But as it will be seen further, if defined from a functional viewpoint, damages, when explored within a particular legal system, encroach on other remedies: the remedy of restitution[71] as well as on the civil law concept of specific performance.[72] Still, such a functional definition is completely in line with the adopted methodological approach and thus has a number of advantages. First, anchored in the compensatory role of damages, it focuses on a principal trait of the remedy that is in fact common for all Western legal systems.[73] Secondly, the definition facilitates the comparative exercise as it allows me to go beyond the doctrinal rhetoric of each of the selected legal systems that tends to obscure monetary compensation with numerous technical details and demarcation lines. Thirdly, the definition also permits me to illuminate the important remedial differences across jurisdictions and at a later stage factor them in the comparison as sources of transaction costs.

If damages constitute monetary compensation of the harm suffered, the inevitable question is how exactly to measure the harm resulting from non-performance of the undertaken contractual obligation in order to offset it by the money award? For this reason, having defined damages as a concept, I now turn to the different measures used to calculate damages awards.

C. Measures of damages

As already mentioned, economic analysis has adopted Fuller and Perdue's differentiation of three measures of damages (expectation, reliance and restitution) and is thus rooted in US doctrinal notions[74] that have also permeated into English legal doctrine and case law.[75] At the same time a perfunctory look at the laws of damages of the compared legal systems gives the impression of a profoundly different structure across legal traditions. For example, due to the importation of French legal solutions, Bulgarian contract law textbooks commonly discuss

[71] See *infra* Section C.3. of this Chapter.
[72] See *supra* Section A. of this Chapter.
[73] Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' 24.
[74] Fuller and Perdue, 'The Reliance Interest in Contract Damages: 1'; Fuller and Perdue, 'The Reliance Interest in Contract Damages: 2'. The classification of Fuller and Perdue has pervaded the American legal doctrine and court practice. See *e.g.*: Restatement (Second) of Contracts (1981) § 344 Purposes of Remedies; *Sullivan v. O'Connor* 296 NE2d 183 (Mass 1973); Allan Farnsworth, *Farnsworth on Contracts*, vol III (Third edn, Aspen Publishers 2004).
[75] Beale 1769.

"compensatory" and "moratory" damages,[76] which do not readily seem to match the conventional common law categories of "expectation" and "reliance" damages.

If the inherent aim of damages is compensation, granting compensatory money awards requires comparison between the injured and uninjured state of the aggrieved party. Thus, the issue that arises is which uninjured state to take as the baseline of compensation: the state that the creditor planned to reach as a result of the contract performance or the state that preceded the conclusion of the contract. In fact, one of the contributions of Fuller and Perdue is that they conceptualised each of these uninjured states as "interests" of the promisee and then matched each interest with a different measure of damages.[77] In this section I argue that since the three interests of the promisee are recognised in each of the selected legal systems, whether common law or civil law, the damage measures, adopted in law and economics, can also be applied in a comparative research of damages that includes a civil law jurisdiction. The common ground is identified by means of a comparative exercise that seeks the contact points between legal traditions while simultaneously paying attention to the doctrinal differences and assessing their importance. Only if the mentioned classification of damage measures can be rooted in such common ground, can it be part of an economic model on incentives that is pertinent to all legal systems subject to comparison.

1. Expectation damages

The expectation interest has the purpose of placing the aggrieved party in the position she would have been in had the contract been fully performed. The protection of this interest in case of contractual default is characteristic for all common law jurisdictions, including the US and England.[78] As in all civil law systems, in Bulgarian law, the expectation interest is referred to as the "positive" interest, *i.e.* the promisee's interest that requires change in the

---

[76] Kalaydjiev 332. As it will be seen below, here the term "compensatory" is used with a sense that is narrower than the sense imputed in the above discussion of the "compensatory", as opposed to "penal", aim of damages.
[77] Fuller and Perdue, 'The Reliance Interest in Contract Damages: 1' 53-54. US and English court awards of "nominal damages" are an exception to the damage measure catalogue based on the protected interest. The trivial sum of damages is awarded when despite breach of contract the plaintiff suffered no loss or she failed to prove the loss with sufficient certainty. In this sense, nominal damages do not infringe the compensatory principle that underlies the remedy of damages. The reasons for such awards should be searched for in the old common law rule which barred courts from making purely declaratory awards. In this sense, see Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' 26, Farnsworth 189, Beale 1763. Bulgarian courts do not award nominal damages. Kalaydjiev 389.
[78] In this sense Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' 28.

status quo.[79] It is fully recognised in the Bulgarian Contracts Act which provides for the non-breacher's right to claim "damages instead of performance".[80] These damages are denoted in the legal doctrine as "compensatory".[81]

2. Reliance damages

In contrast, the reliance interest has the purpose of placing the aggrieved party in the position she would have been in had she not signed any contract at all. In the Bulgarian legal doctrine, this interest is referred to as the "negative" interest, *i.e.* the non-breacher's interest that requires preservation of the *status quo*. Under Bulgarian law the damages awarded to the promisee upon termination of the contract due to the promisor's non-performance protect precisely the negative contractual interest.[82] It must also be mentioned, however, that an argument about protection of the negative interest being a goal of liability in *delict* and not in contract[83] spurred a debate in the Bulgarian legal doctrine about whether the award of damages in this case represents contractual[84] or delictual[85] liability. The disagreement between Bulgarian scholars stems from the fact that in principle contract termination has retroactive effect.[86] Upon termination, the argument goes, the liability for damages arises from the retroactive rescission of the contractual obligation, not from its non-performance. If the contractual obligation falls away *ex tunc*, the liability cannot be contractual, but only non-contractual, delictual liability. Therefore, the damages awarded to protect the negative contractual interest are a special case of delictual liability.[87] Under Bulgarian law, the classification of the liability arising upon termination of the contract has concrete implications with regard to the applicability of the foreseeability requirement, the possibility to release the defendant from liability in case of contributory negligence, *etc.* Yet, this damage award will not be discussed here in further detail. At this point it is only necessary to stress that no matter whether the basis of liability is in contract or in *delict*, under Bulgarian law the negative interest is protected in case of contractual breach.

---

[79] Konov 45; Kalaydjiev 379; Goleva 118-119.
[80] Art. 79(2) and (1) Contracts Act.
[81] Kalaydjiev 332.
[82] Konov 45-46; Kalaydjiev 379-380.
[83] Konov 45-46; Kalaydjiev 379-380.
[84] Apostolov, *Law of Obligations. First part. General Theory of Obligation* 298; Gotsev 13; Ruschev, *Liability for Eviction* 186-188.
[85] Konov 54; Kalaydjiev 365-368
[86] Art. 88(1) Contracts Act.
[87] Konov 54; Kalaydjiev 365-368.

For the sake of consistency, in this thesis the measures of damages protecting respectively the expectation (positive) and the reliance (negative) interest are referred to as expectation and reliance damages. The terms "positive" and "negative damages" are deliberately avoided since in the Bulgarian legal doctrine they are used somewhat incoherently. While they usually denote the damages incurred upon infringing, respectively, the positive and negative interest,[88] sometimes they are employed to designate the structural elements of pecuniary harm.[89] Thus, one can encounter scholarly writing associating negative damages with *damnum emergens* (loss suffered) and positive damages with *lucrum cessans* (gains lost).[90] Consider, however, that the coverage of expectation damages is defined in the Bulgarian Contracts Act precisely by the notions of loss suffered (*damnum emergens*) and gains lost (*lucrum cessans*).[91] It is confusing then to use the label "positive damages" in order to refer both to the broader category of expectation damages and to one of its components: the prevented profit.[92]

The problem with the inconsistent positive/negative terminology is exacerbated when considering that the gains lost (*lucrum cessans*) may also be a part of the damages protecting the negative (reliance) interest. Indeed, this is not the usual rhetoric when it comes to shedding light on the kind of harm that reliance damages compensate. On the contrary, it is common to say that reliance damages include the expenses incurred in reliance on the contract: expenses made in preparation for or in performance of the contract (in the language of Fuller and Perdue "essential reliance") and expenses made in relation to collateral agreements that increase the benefit from the contract in question (in the language of Fuller and Perdue "incidental reliance").[93] In the case of a construction contract, an example of the former type of expenses would be the money spent by the constructor for the architect's drawings and for materials, while an example of the latter – the money spent by the client to

---

[88] Kojuharov, *Law of Obligations. General Theory of Obligations* 57-59.
[89] In this sense Trayan Konov and Anguel Kalaydjiev, 'Liability in Case of Infringed Negative Interest' (1988) 11 State and Law 24, footnote 4.
[90] In this sense: ibid, citing Lyuben Vasilev, *Civil Law of National Republic of Bulgaria. General Part* (First edn, Sofia: Science and Art 1956) 505.
[91] Art. 82 Contracts Act. See also Kojuharov, *Law of Obligations. General Theory of Obligations* 267-271; Apostolov, *Law of Obligations. First part. General Theory of Obligation* 99-100.
[92] The confusion becomes even greater when taking into account that in the German legal doctrine it is *damnum emergens* (*i.e.* the loss suffered) that is referred to as "positive damages" and *lucrum cessans* (*i.e.* the lost profits) that is named "negative damages". See Ludwig Enneccerus and Heinrich Lehman, *Recht der Schuldverhältnisse* (Fifteenth edn, Tübingen: Mohr 1958).
[93] Fuller and Perdue, 'The Reliance Interest in Contract Damages: 1'77.

purchase a stock of goods for the shop to be built.[94] Expenses made, however, may not be the only thing the promisee renounced in reliance on the contract. She may have also foregone the opportunity to enter into another contract, which might as well have been performed, and thus lost the gains this alternative contract could have yielded.[95] In this sense, referring to missed profit as the "positive" constituent of the negative (reliance) damages does not add to clarity, so throughout the thesis I will stick to the categories of "expectation" and "reliance".[96]

Having opened the subject of foregone opportunity I have to mention that economists denote the best opportunity passed up by the promisee in reliance on the contract as "opportunity-cost". Thus, striving for perfect measurement of the reliance interest, they define opportunity-cost damages as a form of reliance damages that place the aggrieved party in the position she would have been in, had she signed the contract that was the best alternative to the breached one.[97] Reliance damages calculated on the basis of opportunity costs are typically more generous than reliance damages calculated on the basis of expenses made (out-of-pocket damages).[98] If the three measures of damages are ranked, expectation damages will usually yield the highest and reliance-based out-of-pocket damages – the smallest amount. After all, the promisee normally chooses the best deal on the market and her lost expected value (measured by expectation damages) is higher than the expected gain from the second best contract (measured by opportunity-cost damages). Also, the promisee signs a contract in the first place because she expects that it will bring her a gain higher than her costs ($v > p + c$). So unless the contract turns out to be a losing one for the promisee, expectation damages exceed out-of-pocket damages. Last but not least, if the promisee signs the second best contract and it is performed, she will normally be better-off than if she refrains from contracting at all, which explains why opportunity-cost damages are higher than reliance damages based on out-of-pocket expenses.[99]

---

[94] This is a popular example used in the literature. See Farnsworth 154; Cooter and Ulen, *Law and Economics* 331-334; Robert Cooter, 'Unity in Tort, Contract, and Property: The Model of Precaution' (1985) 73 California Law Review 1, 11.
[95] Enneccerus and Lehman 62.
[96] For a critique of the usage of "positive" and "negative damages", see also Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' 29.
[97] Cooter and Ulen, *Law and Economics* 250-251.
[98] On the different formulae for calculation of reliance damages, see *infra* Table 1 accompanying footnote 134 of Chapter IV.
[99] Cooter and Ulen, *Law and Economics* 316.

Since the opportunity cost of the broken promise has been increasingly discussed in both legal and economic scholarly writing, opportunity-cost damages will also be considered in the economic model developed in the thesis. However, whether or not courts, when awarding reliance damages, actually account for the opportunities lost by the promisee is a different question that is left for the following chapters. Still, since a lot of parallels and distinctions have been made up to this point, it might be useful to express the introduced measures of damages in formal terms.

The expectation measure relates to the value v the promisee would have realised from the performance of the concluded contract. For example, a buyer agrees to purchase a good for a price p. So that she is able to use the good and enjoy the full value v this good has to her, she incurs costs c. If the seller does not deliver the good, in order to leave the buyer in a position as good as when the contract has been performed, the seller must pay expectation damages equal to $v - p - c$ in case the buyer has not yet spent p and c, or to v in case the buyer has already spent both. The out-of-pocket measure relates to the lost value of the investment made in reliance on the promised performance. Thus, in the example above if at the time of breach the buyer has already paid the price p and incurred the costs c, reliance damages will equal

$p + c$.[100] The opportunity-cost measure relates to the value of the opportunity which the buyer has foregone in reliance on the promised performance. Therefore, in the above example unless the buyer had contracted for the good at price p, she would have bought the good from another seller at price p_1. When the seller, with whom the buyer signed a contract, breached, the buyer had already lost her second best option, the good at p_1, and had to purchase the good at the spot price p_2. The opportunity cost damages then equal $p_2 - p_1$.[101]

Having distinguished the expectation and reliance measures of damages, it is important to see whether Bulgarian "moratory" damages fit in this distinction or whether they protect some other promisee's interest that is disregarded in the common law tradition. As already mentioned above, Bulgarian contract law opposes "moratory" to "compensatory" damages,[102] the latter relating to the promisee's expectation interest.[103] Unlike "compensatory" damages, "moratory" damages, however, do not represent damages for non-performance but damages

---

[100] The example follows an example given by Hermalin, Katz and Craswell 100.
[101] The example follows an example given by Cooter and Ulen, *Law and Economics* 312.
[102] See *supra* the text accompanying footnote 76 of this Chapter.
[103] See *supra* the text accompanying footnotes 78-81 of this Chapter.

for delay. In other words, they are distinguished on the basis of the form of contractual breach, a common criterion for differentiating damages in civil law systems.[104] Upon the promisor's delay, the promisee can claim either specific performance together with moratory damages, or compensatory damages.[105] It makes sense, however, to speak of promisor's delay when his performance is still possible.[106] If it has become impossible through the promisor's fault, if delayed performance is no longer of any use to the promisee or if the time fixed for performance must have been exactly complied with,[107] the delay amounts to total breach.[108] Then the promisee has no interest in claiming specific performance and moratory damages, so she can claim only compensatory damages. Note, however, that whichever the scenario, the promisor is in delay or his delay is equivalent to total breach, the promisee has the above remedies if she has not terminated the contract and stands ready to perform. In case she has terminated, she can resort neither to specific performance coupled with moratory damages, nor to compensatory damages, but only to reliance damages (together with restitution if she has already rendered performance).[109]

In other words, under Bulgarian contract law, moratory damages are not reliance damages. Rather, like compensatory damages, they seek to protect the non-breacher's expectation interest and the fact that we do not come across this category of damages in common law should not make us doubt this. The reason for which Anglo-American law does not make such a sharp differentiation between damages for delay and damages for non-performance is because it deals with contractual breach in a simple, integrated way. Whatever form the breach takes, be it delay or some other, it gives rise to a claim for damages. Whether time is of the essence or it is not of decisive significance may matter to the promisee's right to

---

[104] On the Roman roots of this approach, see Reinhard Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (First edn, Oxford: Oxford University Press 1996) 783-833. Besides delayed performance, the Bulgarian Contracts Act also distinguishes "impossibility of performance". Thus, impossibility of performance through the promisor's fault constitutes another form of contractual breach. See Art. 81(1). As for liability for defective performance, rules are scattered under several titles of the Contracts Act concerning specific contracts. On its side, the Bulgarian legal doctrine differentiates between: total breach, inexact performance, partial breach, delayed performance, performance ahead of the term, bad performance, defective performance. Kalaydjiev 303-304.

[105] Art. 79(1) Contracts Act.

[106] Thus, when the contractual obligation is specified only generically, performance cannot become impossible because gender does not perish. See *e.g.* Art. 81(2) ibid.

[107] Art. 87(2) ibid.

[108] Kalaydjiev 327-328.

[109] Ibid 332-333. For the restitution interest see *infra* the text accompanying footnote 117 of this Chapter.

terminate the contract but it does not lead to distinction between kinds of damages.[110] It is the incurring of loss that determines whether the non-breacher is entitled to damages, not the type of contractual default.[111] That is why, damages for delayed performance are in fact recoverable in Anglo-American law,[112] even if they are not sanctioned in the statutory texts.[113]

In this sense, Bulgarian moratory damages, do not upset the common law distinction of damage measures that has become the basis of the economic model. Naturally, since moratory damages complement performance and cover only the expenses made or gains lost resulting from the delay,[114] the magnitude of the compensated harm is smaller than the one in the event of no performance whatsoever. Yet, moratory damages are calculated on the basis of the same principles as compensatory damages[115] and like them are directed at putting the promisee in as good a position as if the contract had been performed.

3. Restitution

Fuller and Perdue also recognised a third interest in case of breach of contract – the restitutionary interest. Protection of the latter requires the party in default to give back whatever was conferred to him by the aggrieved party under the contract. In today's market exchange the time of payment often differs from the time of delivery, so the Buyer frequently makes a down payment and receives the promised counter-performance only later. If

---

[110] Neither the American UCC, nor the English Sale of Goods Act 1979 comprises provisions regarding damages for delay in performance.

[111] In this sense Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' 54-55.

[112] Farnsworth 278-279; Beale 1853-1854.

[113] Neither the American UCC, nor the English Sale of Goods Act 1979 comprises provisions regarding damages for delay in performance. They contain different rules on damages for non-delivery and damages for delivery of defective goods, but the differentiation is made on the basis of the consequences from breach and not the form of breach. See UCC § 2-708. Seller's Damages for Non-Acceptance and Repudiation., § 2-713 Buyer's Damages for Non-Delivery and Repudiation., § 2-714 Buyer's Damages for Breach in Regard to Accepted Goods.; Sale of Goods Act 1979 Section 50 Damages for Non-Acceptance, Section 51 Damages for Non-Delivery, Section 53 Remedy for Breach of Warranty.

[114] Goleva 123-124.

[115] In this respect the reader should not be confused by the special legal rule on calculation of moratory damages when the promisor delays a money payment since moratory damages are also awarded when the promisor delays the delivery of a commodity. In this sense, see also Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' 54. When the delay concerns an obligation to pay money, moratory damages amount to the legal interest as of the day of delay. For the losses exceeding the legal interest, the promisee can also claim damages but must prove their amount. Art. 86 Contracts Act. The legal interest is set by the Council of Ministers at the basic interest rate of the Bulgarian National Bank increased by 10 percentage points. See Decree №100 of 29.05.2012 for determining the basic interest rate in relation to lapsed obligations in Bulgarian leva and other currencies, promulgated in State Gazette №42 of 05.06.2012, in force as of 01.07.2012

eventually the Seller fails to perform, the court may order him to return the amount given to him in advance. In the above formalised example this will be the price *p*.[116]

Strictly speaking, restitution is not the remedy of "damages" as its principal aim is not to compensate the aggrieved party but to prevent unjust enrichment of the party in default.[117] Consequently, the award is measured by the benefit received by the breacher, not by the loss of the plaintiff. This difference in objective between "damages" and "restitution" is recognised in all legal systems under comparison. In case of contract termination the Bulgarian legal doctrine firmly distinguishes between the claim for returning what was already given and the claim for compensation.[118] Recovery of the benefit conferred under the contract is considered conceptually different from the notion of civil liability. Also, in case of defective performance, a distinction is made between the aggrieved party's claim for damages and the cumulatively available claim for price reduction. The latter has the purpose of restoring the balance between the parties' performances as initially agreed[119] and thus seems based on the principle of unjustified enrichment (restitution).[120] In US law restitution and expectation damages were commonly perceived as alternative remedies since damages pursued enforcement of the contract while restitution followed its termination.[121] The analogue of this reasoning in the Bulgarian legal doctrine is the view that the aggrieved party cannot simultaneously rescind the contract (*i.e.* cancel it retroactively) and claim compensatory damages for its non-performance, thus justifying the delictual ground of the breaching party's liability in case of contractual termination.[122] Of the three compared jurisdictions, England seems to take the most lenient approach allowing the plaintiff to recover the money paid by way of restitution or by way of a claim for damages for wasted expenditure (where there has been a total failure of consideration).[123] In addition, combining the different types of claim,[124]

---

[116] See *supra* the text accompanying footnote 101 of this Chapter.
[117] Farnsworth 154, 324; Dan Dobbs, *Law of Remedies: Damages, Equity, Restitution* (Second. An Abridgement edn, St. Paul, Minnesota: West Publishing 1993) 210, 793-794; Guenther Treitel, *The Law of Contract* (Eleventh edn, London: Sweet&Maxwell 2003) 941; Goleva 288-289.
[118] While the restitution claim is based on Art. 55(1) Contracts Act, the claim for damages is based on Art. 88(1) ibid. Konov, *Selected Works. Grounds of Civil Liability* 35; Kalaydjiev 363, 365-368; Kojuharov, *Law of Obligations. General Theory of Obligations* 316, 318-319.
[119] Art. 195(1)(2) and Art. 265(1) Contracts Act; Konov, *Selected Works. Grounds of Civil Liability* 36-37; Kalaydjiev 337; Kojuharov, *Law of Obligations. Specific Contracts* 94-95.
[120] Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' 43.
[121] Dobbs 794; Farnsworth 154, 324-325.
[122] Konov, *Selected Works. Grounds of Civil Liability* 54; Kalaydjiev 365-368.
[123] Beale 1772.
[124] *Millar's Machinery Co Ltd v David Way & Son* (1935) 40 Com Cas 204 (a buyer of a machine who receives it and pays the price but then discovers that the machine is not in accordance with the contract, recovers the price

English judges appear to be the least concerned with conceptual problems and guided solely by the principle against double recovery.[125]

Though Fuller and Perdue were aware of the theoretical difficulties regarding damages and restitution experienced by the American legal doctrine, they considered the classification of the action immaterial and related to the legal superstructure, not to policy questions.[126] Indeed, even if the restitutionary interest is termed to have the goal of placing the party in breach (not the aggrieved party) in the position he would have been in had the contract not been concluded, the ultimate effect of restitution is to put both the breacher and the non-breacher in this position.[127] In other words, the principle of unjustified enrichment and the compensatory principle do not generally contradict each other. Restitution also presupposes loss on the part of the aggrieved party with this loss resulting from a benefit that has flowed to the party in default who is then required to disgorge it.[128] It is this compensatory effect of restitution that is recognised in the Bulgarian legal doctrine when it is argued that even if restitution and liability are distinct, in reality compensatory (*i.e.* expectation) damages comprise two elements: the money equivalent to the unexecuted performance plus damages for the losses suffered from non-performance. This structure of compensatory damages, the reasoning goes, is easily recognised when they are juxtaposed to the alternative options available to the creditor: specific performance plus moratory damages or termination followed by restitution of the benefit conferred plus damages. The composition of compensatory damages, the reasoning goes, cannot be drastically different from the structure of their alternatives: it must comprise a damages element but also an element representing the value of the initial performance.[129] Allowing damages in addition to recovery of the price, the UCC

---

the machine would have had if it had been in accordance with the contract, thus recovering the price paid (restitution); the wasted expenditure such as installation expenses (reliance loss) and the net profit he would have been able to make by using the machine (the loss of the bargain)).

[125] Treitel, *The Law of Contract* 942; Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' 38.

[126] Fuller and Perdue, 'The Reliance Interest in Contract Damages: 1' 53.

[127] Treitel, *The Law of Contract* 941.

[128] Farnsworth 329.

[129] Konov, *Selected Works. Grounds of Civil Liability* 38-40. Konov argues that in pursuit of compensation of the expectation interest, Bulgarian law, just like other legal systems, seems to discard the difference between these two elements of compensatory damages. Yet, he points out, some legislative texts still take the distinction into account. One of them is Art. 126(1) Contracts Act stating that if performance becomes impossible and only one of the promisors is responsible, the promisee can seek from him the full amount of damages due while from the other promisors he can only seek the money equivalent to the initial performance. Both amounts constitute compensatory damages but the fact that they are different proves, in Konov's view, that compensatory damages consist of two components: the equivalent to performance and damages for the losses incurred, where only the second component represents contractual liability. Konov, *Selected Works. Grounds of Civil Liability* 40.

also changed the American perception of restitution and damages as mutually exclusive remedies.[130] Under its influence the combination of such claims has spread beyond the contract for sale of goods to other types of contracts.[131]

In other words, compensation and restitution are not *a priori* incompatible. Indeed, to put it in the words of Corbin, "full damages and complete restitution… [may] not be both given for the same breach of contract",[132] but this is a question of degree, not of contradiction. That is why, untroubled by doctrinal distinctions, law-and-economics scholars readily use the phrase "restitution damages" in their writing.[133] Even if this may be shocking to some mainstream lawyers, it is difficult not to admit that in case of breach of contract, restitution in fact reimburses the aggrieved party for her loss. For this reason, the model developed in this thesis will also encompass the restitution interest and consider recovery of the value given under the contract as one of the measures for compensatory damages.

Bringing the restitution interest into the model raises the question of whether it differs from the reliance interest. After all, the plaintiff's down payment is also a form of reliance on the contract since it is made in performance of the promisee's contractual obligations. It is precisely the fact of enrichment of the promisor that constitutes the difference between the two interests. Besides the down payment the promisee may make a number of other expenses which in no way benefit the counter-party: *e.g.* the buyer may order special equipment for the car that the seller is supposed to deliver. If the seller breaches, these expenses would constitute reliance damages as they are not received by the promisor. In contrast, the down payment goes directly to him and is thus subject to restitution. What is crucial is that the expenditure is not only a loss to the promisee but also a benefit to the promisor.[134]

It does not come as a surprise that in the above ranking of damages, restitution is typically the smallest remedy. It does not compensate the aggrieved party for the lost value of the broken contract (as expectation damages), for her foregone second-best bargain (as opportunity-cost damages) or for the part of wasted expenses that do not enrich the promisor (as out-of-pocket

---

[130] UCC § 2-711. Buyer's Remedies in General; Buyer's Security Interest in Rejected Goods. § 2-720. Effect of "Cancellation" of "Rescission" on Claims for Antecedent Breach.

[131] In this sense, see Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' 37-38.

[132] Arthur Corbin, *Contracts* (St. Paul, Minnesota: West Publishing 1963) § 1221.

[133] See *e.g.* Hermalin, Katz and Craswell 100.

[134] Dobbs 795; Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' 28.

damages).[135] As repeatedly asserted, it merely requires return of what was given under the contract. Restitution, just like reliance-based out-of-pocket damages, may turn out to be a bigger sum than expectation damages when the promisee struck a bad deal, *e.g.* the buyer did not predict the future development of the market and the price of the good, purchased under a futures contract, fell instead of rising. Naturally then, in case of default, the buyer will rather claim restitution than expectation damages. Yet, in reality in such situations the seller rarely breaches since the contract will be profitable for him. Another reason why the promisee may prefer restitution is because such a claim is easier to prove than the claim for lost expectation.[136]

4. Other categories of damages

The above account does not mean to say that the differentiation of expectation, reliance and restitution measures represents a full inventory of the kinds of damages a promisee can recover upon breach. Some categories of damages protect neither of the three described interests. This is the case with the damages which, though not labelled by a common term in the civil law tradition, are referred to as "incidental" in Anglo-American law. Incidental damages should not be confused with "incidental reliance", mentioned above,[137] as they are expenses made not "in reliance on the contract, but rather in consequence of its breach."[138] These include costs incurred in a reasonable effort to mitigate loss. For instance, where a party attempted, successfully or not, to effect cover, incidental damages would be the very expenses made to find and conclude the cover contract, not the price difference, compensable by recovering expectation damages. Incidental damages would also be the expenses made in relation to taking care of rightfully rejected goods.[139] Certainly, the examples given are typical but not exhaustive. To put it as generally as possible, the concept encompasses the

[135] Farnsworth 155; Cooter and Ulen, *Law and Economics* 318-319.
[136] Dobbs 794-795.
[137] See *supra* the text accompanying footnote 94 of this Chapter.
[138] Treitel, ‘Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)’ 30.
[139] Under Art. 198(1) Contracts Act and Art. 325(1) Commercial Act the buyer promisee has the obligation to take care of the rejected goods. Though neither act provides for this expressly or even uses the term "incidental damages", the promisee has the right to recover the expenses incurred, in case he rejected the goods rightfully. Kojuharov, *Law of Obligations. Specific Contracts* 91.

costs incurred by the aggrieved party to deal in some manner with the practical results from breach.[140]

The damages, called in the common law tradition "consequential", also frequently do not appear rooted in any of the three described interests. The term commonly refers to physical injury or damage to property (other than the subject-matter of the contract) suffered by the aggrieved party as a result of the breach. These are losses different from the loss in value of the other party's contractual performance.[141] Typical examples are the losses suffered by a buyer because she purchased cattle that proved to be infected and spread the disease to the rest of the herd or because she had to compensate a sub-buyer for the defective goods supplied to her where it was within the seller's contemplation that the goods would be resold. Though the Bulgarian legal doctrine qualifies the losses in these examples as "direct" and, hence, encompassed by contractual liability,[142] physical injury or damages to other promisee's belongings are in principle considered consequential damages that lead to delictual and not contractual liability.[143] Yet, the issue discussed here is whether the damages recovered for these losses are interest-based and not the label *per se*. The mentioned examples clearly illustrate that, used in this sense, consequential damages are not really lost expectation (unless we stretch the interest to comprise also expectation not to suffer additional losses) or reliance loss (unless we stretch the reliance interest to comprise also the buyer's assumption that the goods would not be defective).[144]

Still, as the term is employed with a number of meanings, attention should be paid to the sense which it bears on the concrete occasion. Thus, the term also frequently denotes "lost profits".[145] In this sense, consequential damages measure not the loss in value of the asset

---

[140] UCC § 2-715. Buyer's Incidental and Consequential Damages. (1); Restatement (Second) of Contracts (1981) § 347 Measure of Damages in General; Farnsworth 207-208; Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' 30; Beale 1777-1778. For the promisee's right to recover such expenses under Bulgarian law, see *e.g.* Decision №630 of 4.11.2010 г., с. с. №461/2009 of IV с. d. of the Supreme Cassation Court (where the promisee is authorised by the court under Art. 80(1) Contracts Act to perform at the promisor's expense, the promisee can also recover the expenses incurred to receive the court authorisation)).
[141] Restatement (Second) of Contracts (1981) § 347 Measure of Damages in General; UCC § 2-715. Buyer's Incidental and Consequential Damages. (2)(b).
[142] Apostolov, *Law of Obligations. First part. General Theory of Obligation* 103, 112; Kojuharov, *Law of Obligations. General Theory of Obligations* 280-282.
[143] Sukareva 184-186.
[144] Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' 30; Beale 1778.
[145] Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' 30; Beale 1779, footnote 183; Dobbs 226-229. See *e.g.*: *Duyck v. Northwest Chem Corp.* 764 P2d 943 (Or App

which is the subject-matter of the contract but the loss of income which the asset could generate.[146] For example, if a company is supplied with defective materials which cannot be used to manufacture the projected final goods, it loses the profit it could make from this produce.[147] Therefore, in this particular meaning, consequential damages are encompassed by what is called in Bulgarian law *lucrum cessans* (gains lost), the latter being, as already explained, a structural component of expectation damages.[148] "Gains lost", however, remains a more general term that comprises both the prevented gains, measured by the increased market price of the contractual subject-matter, and the lost income, measured by consequential damages.

In the third place, to complicate matters, the term also refers to lost profits that were not in the contemplation of the parties and were, therefore, too remote. Thus, just like in their second meaning, consequential damages again stand for a head of damages that in principle falls within the promisee's expectation; yet, here, they designate lost profits that cannot be recovered under the rule of *Hadley v. Baxendale*.[149] As the requirement of foreseeability[150] is the civil law counterpart of the *Hadley* limitation, the Bulgarian legal term that corresponds best to "consequential damages", used in this sense, is "unforeseeable" damages.

Other kinds of damages also stray away from the three-interest differentiation. Thus, the Anglo-American disgorgement damages are intended to wipe out not only the benefit that the promisee conferred to the promisor (as the restitution measure), but the profit of the promisor from his own breach.[151] Similarly to the US punitive damages, disgorgement damages exceed

---

1988) (farmer's claim for lost yields due to insecticide was barred as one for consequential damages). UCC does not define the term "consequential damages", insisting that it bears the sense with which it is used outside UCC. UCC § 1-305. Remedies to be Liberally Administered. comment.3. Thus, it has been suggested that the vague language of UCC § 2-715. Buyer's Incidental and Consequential Damages. (2)(a) implies precisely the loss of profit. In this sense: Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' 30, footnote 250.

[146] Dobbs 227-228.

[147] Kojuharov, *Law of Obligations. General Theory of Obligations* 268-269. See *supra* the text accompanying footnote 92 of this Chapter.

[148] In this sense Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' 30.

[149] *Hadley v Baxendale* (1854) 9 Ex 341; In this sense Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' 30; Beale 1779, footnote 183.

[150] Art. 82 Contracts Act.

[151] Disgorgement damages are granted by US courts in some rare cases of breach of sales contracts where the promisor has already sold the subject-matter of the contract to a third party. Unable to resort to the classic specific performance, courts compel the breacher to transfer his proceeds from the sale to the first buyer. See *Gassner v. Lockett* 101 So2d 33 (Fla 1958); *Bander v Grossman* 161 Misc2d 119 (NY 1994). As a result, in case of a fluctuating price, the promisee may recover an amount much higher than the estimate of damages from the

the promisee's expectation interest.[152] However, the goal of this section is not to give an exhaustive overview of the existing categories of damages in the compared legal systems. As it will be seen further in the thesis, courts often award monetary amounts that do not fit perfectly the interest-based classification of damage measures. The goal is rather to show that this classification, adopted by law and economics, does represent a common ground of the selected legal systems and can serve as a basis for their comparison. In this sense, the economic model elaborated below will not force Bulgarian remedial concepts into a strange extrinsic taxonomy.

Common among the selected legal systems is also the possibility for the parties to contract out of the default contractual remedies and stipulate in their agreement a fixed amount of money that the promisor has to pay in the event of breach. In other words, the law in all three jurisdictions recognises the right of the parties to choose their own measure of damages, though the freedom of their choice is not unlimited. Since generally in Bulgarian contract law such provisions are valid, even if the stipulated sum may be reduced when too excessive,[153] further in the thesis I will refer to them as "liquidated damages", the label used in Anglo-American law with respect to valid stipulated damages.[154] The term "penalty" will be employed only with respect to clauses that are voided in the common law tradition because the agreed amount is unreasonably high compared to the sustained or anticipated harm from breach.[155] In any case, the point made again is that there is a universal starting point to which the economic analysis of damages can be anchored even if it spans across legal traditions.

Conclusion

Having settled on a functional definition of damages, the short comparative exercise in this section allowed me to conclude that the traditional measures of damages used by law and economics, expectation, reliance damages and restitution, were not alien to the civil law

---

breach. In this sense and for more details, see Scott and Kraus, *Contract Law and Theory* 884. In England, after *Att-Gen v Blake* [2001] 1 AC 268, courts may award partial disgorgement or total disgorgement by an account of profits in breach of contract cases if there are special circumstances to justify it. In *Experience Hendrix LLC v PPX Entrerprises Inc and Edward Chaplin* [2003] EWCA Civ 323, [2003] 1 All ER (Comm) 830 it was recognised that an account of profits was also possible in a commercial case.

[152] See *supra* footnote 8 of this Chapter.

[153] Art. 92(2) Contracts Act; Art. 309 Commercial Act.

[154] The term used in Bulgarian contract law is "neustoika".

[155] For the US, see UCC § 2-718. Liquidation or Limitation of Damages, Deposits. (1); Restatement (Second) of Contracts § 356 Liquidated Damages and Penalties. For England, see *Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd* [1915] AC 79, 86-88.

system included in the research. Convinced that the framework underlying the economic model is not constrained to a single legal tradition, in the following chapter I connect the damage remedy to the two types of contract, explored in the thesis, the sale-of-goods and the construction contract.

Chapter IV Types of Contracts

The thesis compares damages not only across jurisdictions but also across specific types of contract, the sale-of-goods and the construction contract.

Perhaps the most important achievement of contract theory of the second half of the 20th century is the recognition that many contractual arrangements in the real world do not fit the classical concept of contract as a discrete event but are better described as ongoing dynamic "relations".[1] Having occurred in the field of socio-legal studies, the breakthrough was subsequently taken up by the founding father of New Institutional Economics, Williamson, who rationalised relational contracts in economic terms and elucidated them as intermediate solutions in the old Coasean dichotomy between contract and firm.[2] Yet, despite the voices claiming that the substantial differences between the one-shot exchange and the long-term contractual relationship require separate treatment,[3] so far neither the sociological, nor the economic literature has been able to develop different legal rules with regard to relational (as opposed to non-relational) contracts.

Clarifying the features that distinguish long-term from spot contracts (A.1 and A.2), Section A hypothesises that contract remedies have gradually been assuming a regulatory function in response to the market failures associated with the former type of contracts. The section also asserts that the complex problems arising in the case of breach of long-term contracts (A.4) make the choice of the optimal remedy particularly difficult. Section B employs the spot/long-term contract distinction to investigate the borderline between sale-of-goods and construction contracts in each of the three legal systems and to show that US and English contract law no longer conceptualise sale of goods as a simple spot contract. The Chapter then concludes.

---

[1] Macaulay; Ian Macneil, 'The Many Futures of Contracts' (1974) 47 Southern California Law Review 691. The core findings of Macaulay's preliminary study gave the direction of much of the scholarly research in the field of contracts in the following decades. Macneil, on the other hand, coined the term relational contract and clearly distinguished it from spot contracts.

[2] Oliver Williamson, 'Transaction-Cost Economics: The Governance of Contractual Relations' (1979) 22 The Journal of Law and Economics 233; Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*.

[3] Macneil, 'The Many Futures of Contracts' 813-816; Charles Goetz and Robert Scott, 'Principles of Relational Contracting' (1981) 67 Virginia Law Review 1089, 1090.

A. Spot v. long-term contracts

Before going deeper into the subject, some explanations with regard to the terminological choices made appear necessary. Why is this section entitled "Spot v. long-term" and not "Spot v relational contracts"?

1. A terminological note

Although both Macneil and Williamson differentiated between relational and long-term contracts,[4] the terminology seems to be fairly fuzzy. The conceptual vagueness partly comes from the fact that the literature has not generated a clear and concise definition of relational agreements. They are commonly described against the classical discrete contract[5] and even Macneil himself preferred "a rich classificatory apparatus" to a definitive approach.[6] As both relational and long-term contracts typically extend over a protracted period of time, the two concepts are often used interchangeably even by authors who have previously asserted that they are not necessarily equivalent.[7] Yet, even if relational contracts commonly govern continuing relations,[8] this is not always the case.[9] From this point of view, the two categories of agreements should not be confounded on the basis of time coverage. Goetz and Scott adopt a different construction: "[a] contract is relational to the extent that the parties are incapable of reducing important terms of the arrangement to well-defined obligations".[10] Though overcoming the focus on duration, this definition also does not seem satisfactory.[11] It points at the inherent incompleteness of relational contracts, but as developed below, incompleteness alone cannot mark out long-term contracts, considering that they are incomplete only to a

---

[4] Macneil, 'Contracts: Adjustment of Long-Term Economic Relations under Classical, Neoclassical and Relational Contract Law'; Williamson, 'Transaction-Cost Economics: The Governance of Contractual Relations'

[5] Macneil, 'The Many Futures of Contracts'; Goetz and Scott, 'Principles of Relational Contracting'.

[6] For a criticism of this method, see: Williamson, 'Transaction-Cost Economics: The Governance of Contractual Relations' 236. For Macneil's answer to this criticism, see: Ian Macneil, 'Economic Analysis of Contractual Relations: Its Shortfalls and the Need for a "Rich Classificatory Apparatus"' (1981) 75 Northwestern University Law Review 1018.

[7] See *e.g.* Scott, 'Conflict and Cooperation in Long-Term Contracts' 2053 but earlier: Goetz and Scott, 'Principles of Relational Contracting' 1091. Eisenberg also points at to the existing tendency to use the terms "relational contracts" and "long-term contracts" as synonyms. See: Melvin Eisenberg, 'Relational Contracts' in Beatson Jack and Daniel Friedmann (eds), *Good Faith and Fault in Contract Law* (First edn, Oxford: Clanderon Press 1995) 291.

[8] Alan Schwartz, 'Relational Contracts in the Courts: Analysis of Incomplete Agreements and Judicial Strategies' (1992) 21 The Journal of Legal Studies 271, footnote 1.

[9] Goetz and Scott, 'Principles of Relational Contracting' 1091; Eisenberg, 'Relational Contracts' 293-294.

[10] Goetz and Scott, 'Principles of Relational Contracting' 1091.

[11] In this sense also: Eisenberg, 'Relational Contracts' 294.

higher degree. Let me remind that even simple, one-shot contracts are most often not complete, especially when it comes to remedies.[12] In reality, the pure complete contingent contract, the one that is the basis of classical law and of Posnerian law and economics, does not exist.[13]

Despite this terminological ambiguity, a solid ground for having a preference toward the term "long-term contracts" was identified. As emphasised by Hviid, the literatures on long-term and relational contracts discuss different issues. While the former addresses the effects of renegotiation and the added value of long-term with respect to short-term contracts, the latter focuses on the role of social norms and non-legal sanctions in ensuring that parties fulfil their contractual obligations.[14] Since this work is concerned with courts' reactions to problems arising from renegotiation and self-enforceability is touched on only in passing, the better choice appears to be to stick to the terminology used in the corresponding literature.

Another important consideration also tipped the balance in favour of this terminological choice. Macneil sees contractual phenomena as occurring along a spectrum having with an extreme discrete and an extreme relational pole.[15] The extreme discrete pole is epitomised by the spot sale transaction[16] and the extreme relational pole – by the internal relations within a firm,[17] with particular contracts falling at different points along the spectrum. Thus, Macneil characterises the construction contract between firms (one of the contracts under comparison in the thesis) as long-term, *i.e.* a contract that is not entirely relational but clearly closer to the

---

[12] Ibid 295; Richard Craswell and Alan Schwartz, *Foundations of Contract Law* (First edn, New York/Oxford: Oxford University Press 1994) 199-200.

[13] As it is clearly pointed out, complete contracts are only "hypothetical". Paul Milgrom and John Roberts, *Economics, Organizations and Management* (First edn, London: Prentice-Hall International 1992) 597. See also *supra* footnote 45 of Chapter I.

[14] Morten Hviid, 'Long-Term Contracts and Relational contracts' in Boudewijn Bouckaert and Gerrit de Geest (eds), *The Encyclopaedia of Law and Economics*, vol III (First edn, Edward Elgar/University of Ghent 2000) 47, 54.

[15] Macneil, 'The Many Futures of Contracts' 736-741.

[16] Macneil gives as an example the purchase of gasoline at a service station along a superhighway (with the reservation that any prior or subsequent relations between the parties stemming from advertising, branding or crediting are ignored). Ibid 720. Another example he uses is the sale of a horse taking place at noon between a walker and a rider who are complete strangers. Ian Macneil, *Contracts: Exchange Transactions and Relations* (1977) 13. Williamson refers to a purchase of local spirits from a shopkeeper in a remote area of a foreign country which one will never visit again. Williamson, 'Transaction-Cost Economics: The Governance of Contractual Relations' 247-248. In any case, what is crucial is that neither are parties entangled in any noteworthy past relations, nor are they likely to get entangled in any such relations in the future.

[17] Macneil, 'Contracts: Adjustment of Long-Term Economic Relations under Classical, Neoclassical and Relational Contract Law' 865, 886-887.

relational rather than to the perfectly discrete pole.[18] Williamson also classifies the commercial construction transaction as highly idiosyncratic and thus akin to transactions which require relational contracting. However, as construction transactions are usually occasional (and not recurrent), he takes the view that a specialised governance structure, such as the one devised within the frames of relational contracting, would be too costly and that long-term contracting is a better fit. Nevertheless, in his classification, commercial construction transactions are also situated closer to the relational than to the discrete end of the spectrum.[19] With these taxonomies in mind, it appears more appropriate for this work to use the term "long-term" and not "relational contracts".

A short clarification is also needed with respect to the term "spot contracts". In the below account this term also does not denote the pure, discrete, complete-contingent contract that can be executed solely on the perfectly competitive market, itself a theoretical concept. Few contracts in the real world have the "totally isolated character" required for pure discreteness.[20] As expressly pointed by Macneil, many of us often shop at the same place or get attached to a particular brand or make purchases by credit cards, all of these being details that inject some past and future in the everyday one-shot contracts we conclude.[21] In this sense, real-world discrete contracts are frequently coloured by such relational elements while nevertheless preserving a substantial level of separateness from the accompanying past and future context. For this reason, guided by the aim to make a relatively realistic but still conceptual comparison, I use the term "spot contract" to denote not the perfect discrete contract, but real-world *quasi*-discrete contractual events which, for the purpose of clarity, are stripped from their secondary relational facets.

One last, yet not unimportant note of clarification should be made with regard to the "spot contracts" label. In economic terms, spot transactions by definition do not occur in the futures or forward market. They are settled either immediately or within a specified period of time

[18] Ibid 866, 877-878; Macneil, 'The Many Futures of Contracts' 731, footnote 120, 760.
[19] Williamson, 'Transaction-Cost Economics: The Governance of Contractual Relations' 237, 247 Figure I, 248, 253 Figure II.
[20] This is readily conceded by both Williamson and Macneil. See ibid 247; Macneil, 'The Many Futures of Contracts' 720, footnote 86. For examples of very discrete transactions, given by both scholars, see *supra* footnote 143.
[21] Macneil, 'The Many Futures of Contracts' 720, footnotes 86 and 87.

(usually a few days).[22] Yet, such instantaneous or very short-term contracts are no longer dominant in today's advanced economies in which exchange is routinely projected in the future through the vehicle of promise.[23] Clearly, the longer duration of a contract, such as a contract for future delivery of a commodity at a fixed price, undermines its discreteness as compared with that of an immediate exchange. But where promise as a presentation tool conserves a substantial level of discreteness of such contracts and where this discreteness is not outweighed by some relational elements of considerable importance, it makes sense to include such one-shot, forward contracts within the scope of "spot contracts."[24] Thus the term used may appear somewhat overstretched to some more economic-minded scholars, but I believe the below account will explain convincingly enough the reasons for the choice made.

In fact, to some extent this terminological note may also seem confusing to some legal scholars. It refers to two large groups of contracts but does not draw a clear-cut dividing line between them. Long-term contracts are positioned as the exact opposite of discrete ones, but spot contracts encompass contractual events that are not entirely discrete, either. Long-term contracts, as the term suggests, have a long time span, but under certain conditions some forward contracts are allocated to the spot contracts cluster. The presence or absence of completeness is also denied to be the factor which separates the two categories of contracts. What then are the distinguishing features between them, and where do these features place the sale and construction contracts, subject to this research, in the spot/long-term distinction?

2. Distinguishing features

From a law and economics perspective two important features distinguish spot and long-term contracts: specific investments and the degree of incompleteness. Some authors also point at the complexity of the problems related to contract breach as an additional, third feature,[25] but in my opinion the intricacy of some legal issue is rather a result of particular traits of a concrete real-world phenomenon. For this reason, in the thesis the complexity of breach

---

[22] For a definition of spot transactions, see http://financial-dictionary.thefreedictionary.com/Spot+Transaction; http://www.wisegeek.com/what-is-a-spot-transaction.htm; http://www.investopedia.com/terms/s/spottrade.asp, last accessed on 01.06.2013.

[23] On relations ousting discrete transactions in the modern world, see Macneil, 'The Many Futures of Contracts'

[24] Ibid 745, 749; Macneil, 'Contracts: Adjustment of Long-Term Economic Relations under Classical, Neoclassical and Relational Contract Law' 857 – 859.

[25] Mireia Artigot i Golobardes and Fernando Gomez Pomar, 'Long-Term Contracts in the Law and Economics Literature' in Gerrit De Geest (ed), *Contract Law and Economics Encyclopedia of Law and Economics*, vol VI (Second edn, Cheltenham, UK/ Northhampton, MA, USA: Edward Elgar 2011) 314.

problems (including the problem of remedies) is considered a logical consequence of the two features mentioned and not a distinguishing characteristic of itself.

Below is a comparison between spot and long-term contracts with respect to each of the attributes postulated as distinguishing. While progressing in the text, the reader is once again requested to bear in mind that both categories of contracts depart from the complete contingent model and do occur in the world of positive transaction costs. The comparison also allows to contrast the facilitative and regulatory function of contract law and to emphasise the importance of the latter with respect to long-term contracts.

Specific investments

This is not a term familiar to lawyers; yet, it has an exact equivalent in legal terminology: "reliance".[26] In this sense, such investments are nothing other than expenses that allow a contractual party to increase the gain, his own or that of his counterparty, from the particular contract.[27] As opposed to general investments which are beneficial if used in alternative contractual arrangements, specific investments have value only within the particular contract.[28] For example, when a Seller invests in specialised equipment to provide a customised commodity, for which there are few alternative Buyers, this is specific investment in specialised physical capital.[29] Specific investments are the efforts, time and other inputs that a contractual party devotes to any customised performance. They entail a considerable amount of risk since if the contract is prematurely terminated, they lose value and become

[26] In this sense, see also Robert Scott and George Triantis, 'Incomplete Contracts and the Theory of Contract Design' (2005) 56 Case Western Reserve Law Review 187, 189; .

[27] For the types of specific investment and for the effect of damages on the incentive to make them, see *infra* Section C. and Section D. of Chapter V. See also Robert Cooter and Melvin Eisenberg, 'Damages for Breach of Contract' (1985) 73 California Law Review 1432, 1465.

[28] Golobardes and Pomar 314, 326.

[29] Williamson, 'Transaction-Cost Economics: The Governance of Contractual Relations' 242; Williamson distinguishes three more types of asset specificity: human asset specificity (*e.g.* specialised training and learning-by-doing economies in production operations); site specificity (*e.g.* plant proximity to realise inventory and transportation cost economies) and dedicated assets (*i.e.* discrete investments made in general-purpose plant at the prospect of selling to a specific customer). Oliver Williamson, 'Credible Commitments: Using Hostages to Support Exchange' (1983) 73 The American Economic Review 519, 526. Later two further asset-specificity distinctions were added: brand name capital and temporal specificity (where timely response is crucial). Oliver Williamson, 'Comparative Economic Organization: The Analysis of Discrete Structural Alternatives' (1991) 36 Administrative Science Quarterly 269, 281-282.

sunk costs. For this reason specific investments tend to correlate with longer contractual terms during which they can be recouped.[30]

Since the duration of spot contracts is usually short, they generally do not involve transaction specific investments. Goods and services are standardised and as there are many alternative offers, the identity of the parties is of little importance. It is precisely the absence of specific investments resulting in sales of standardised goods, for which there is an active market, together with the short contact between the parties during contracting and performance that determine my view of some forward agreements as closer to the discrete end of the spectrum. The existing ready market for exchange of standardised goods and services is characterised by substantial competition which restrains the opportunistic behaviour of contractual parties. Policing takes place by reference to one's own experience (if the transaction is recurrent), to rating services or to the experience of other players on the market (if the transaction is occasional).[31] To put it briefly, spot contracting is feasible for standardised products and commonly takes place on an active market that constitutes the closest approximation to a perfectly competitive market.

In contrast, specific investments, often needed to fully realise the gains from trade, are typical for long-term contracts which ensure a much higher level of commitment.[32] The product of specific investments is specialised goods and services. As neither the Seller, nor the Buyer can find an alternative contractual partner without difficulty, the identity of the parties becomes important and they are practically locked into the contract. For example, a Seller invests in specialised equipment because he relies on selling the customised commodity to a

[30] Compared to a series of short-term contracts, a long-term contract implies commitment which is a way to solve the inter-temporal trade-offs between investment and return when parties do not have access to credit markets. If the Seller invests in physical capital but is compensated by instalments of the same amount over the whole life of the agreement, during the initial period the Buyer is effectively borrowing against the Seller. On his own turn, the Seller is better-off with a long-term contract (rather than with a series of short-term contracts) as the Buyer commits himself to purchase commodities for a period that is sufficiently long to allow the Seller to recoup his investment. Golobardes and Pomar 320-321.
[31] Williamson, 'Transaction-Cost Economics: The Governance of Contractual Relations' 248-249.
[32] That the element of commitment is important in long-term contracts is shown by Malcomson and Spinnewyn. They demonstrate that in principal-agent models, absent renegotiation, under asymmetric information a long-term contract can improve on a series of short-term contracts when one of the parties commits to a payoff lower than the one that could be obtained under the series of short-term contracts. James Malcomson and Frans Spinnewyn, 'The Multiperiod Principal-Agent Problem' (1988) 55 The Review of Economic Studies 391. In addition, Rey and Salanie argue that under asymmetric information long-term contracts are likely to perform better than a sequence of short-term contracts since the problems with investment incentives, resulting from incomplete information, are generally better overcome through *ex ante* commitment than through *ex post* conflict solving that leads to inefficiencies. Patrick Rey and Bernard Salanie, 'Long-term, Short-term and Renegotiation: On the Value of Commitment in Contracting' (1990) 58 Econometrica 597.

specific Buyer. The Buyer, on the other hand, will also find it more costly to obtain the commodity from other Sellers who do not dispose of such specialised capital.[33] Thus, the parties are not in a (perfectly) competitive setting and it is to the best interest of both of them that the transaction goes through.

Though in the above example the identity of the parties matters from the very beginning, often it becomes important only during the long period of time over which the contract stretches. Thus, for example, a constructor may initially bid with a client in a competitive environment. However, in the course of the construction process he gets to know the specific terrain, the project designs, identifies the defects of the structure that emerge during the work and solely or together with the client takes decisions on remedying them. Yet, this special knowledge of the constructor is worth nothing outside the particular construction contract. The client can also fully benefit from it only if he stays with his partner until the end of the work as from all the constructors on the market, this particular one is best acquainted with the problems and challenges presented by the specific construction project. The constructor, for example, is in the best position to remedy the defects of the structure at the least cost.[34] In addition, the intensive communication between the parties in the course of the construction process produces substantial communication economies. The parties develop a sense about each other's preferences, character, approach to problems, capability to adapt to new contingencies. To put it simply, they get to know each other which raises the costs of switching to another partner.[35] From this perspective, even if at the time of signing the agreement parties operate on a competitive market, after the contract has been awarded to the constructor, the relationship between him and the client gradually transforms into one of monopoly/monopsony bond, known as bilateral monopoly.[36] Thus, whether specific investments take place at the outset of the contractual relationship or are related to a progressive specialisation of the parties *vis-a-vis* each other, long-term contracts are associated with an imperfectly competitive environment.

---

[33] As pointed by Williamson, the cost of supply from specialised capital is presumably lower than from unspecialised capital. Williamson, 'Transaction-Cost Economics: The Governance of Contractual Relations' 239-240.

[34] For a similar example in the context of distribution contracts, see Goetz and Scott, 'Principles of Relational Contracting' 1100-1101, footnote 25.

[35] Ronald Gilson, Charles Sabel and Robert Scott, 'Contracting for Innovation: Vertical Disintegration and Interfirm Collaboration' (2009) 109 Columbia Law Review 431.

[36] Goetz and Scott, 'Principles of Relational Contracting' 1100-1101, footnote 25.

In the idiosyncrasy of such a relationship each party is dependent on the other and consequently more susceptible to opportunistic behaviour.[37] The more nonmarketable the expenses incurred, the greater the gap between their value in the particular contract and the second best contractual substitute.[38] In this sense, the party who makes the (higher) specific investment is especially vulnerable to strategic behaviour by the other party in the contract, *i.e.* to what economists refer as hold-up. The risk of hold-up becomes apparent upon breaking the commitment by a unilateral deviation (breach of contract) or multilateral deviation (renegotiation).[39] As the specific investments have increased the contractual surplus, the non-(less) investing party has the incentive to use his strategic advantage and try to capture a bigger share of the joint benefits[40] or as is also termed "to appropriate the quasi-rents".[41] Once the seller has installed the specialised equipment, the buyer may start bargaining to cut down the previously agreed price. Or the client may insist that the constructed structure does not satisfy his quality criteria and the constructor must rebuild it. Thus, the investing party is threatened to lose a part of the return on his investment. For this reason, the risk of hold-up strongly influences the parties' incentives to enter into the contract as well as to cooperate throughout its term.

---

[37] Williamson defines opportunism as "self-interest seeking with guile. This includes but is scarcely limited to more blatant forms, such as lying, stealing and cheating. Opportunism more often involves subtle forms of deceit… More generally, opportunism refers to the incomplete or distorted disclosure of information, especially to calculated efforts to mislead, distort, obfuscate or otherwise confuse". Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* 47. Scott and Goetz add that opportunism involves "bluffs, threats and games of 'chicken' designed to exploit another party's presumed bargaining disadvantage." Goetz and Scott, 'Principles of Relational Contracting' 1101, footnote 26. Klein, on the other hand, considers deceit as "a highly unsatisfactory, usually untestable way to explain" hold ups. He associates hold up with violating "the intent of the contract by taking advantage of the imperfect terms of the agreement" when the latter leaves the self-enforcing range of the relationship (*i.e.* the range in which the gains from non-performance exceed the losses from future trade). Klein 66-67. Whether and under what circumstances courts sanction opportunism as breach of contract is a subject for Chapters VI and VII. Here I only model long-term contracts to point that such behaviour increases transaction costs.

[38] Goetz and Scott, 'Principles of Relational Contracting' 1101, footnote 25.

[39] Golobardes and Pomar 327-328. The risk of hold-ups upon making specific investments is considered a foremost consideration in the decision of the parties to integrate vertically. Oliver Williamson, 'The Vertical Integration of Production: Market Failure Considerations' (1971) 61 The American Economic Review 112. Vertical integration is a solution to the deadlock situation in which parties want to make investments that are mutually dependent but each party fears that if he is the first to invest, the other one will seize the chance to extract more favourable terms. Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* 85-102. To the extent the gains from a hierarchical (instead of contractual) form of organisation are offset by the cost of monitoring management and labour within the firm, parties will prefer long-term contracting as the way to organise their relationship. Coase, 'The Nature of the Firm', 394-395; Armen Alchian and Harold Demsetz, 'Production Information Costs and Economic Organization' (1972) 62 American Economic Review 777, 777-783. This text discusses the contractual solutions directed toward reducing the risk of opportunism (and thus toward reducing transaction costs) in the specific investment context.

[40] Goetz and Scott, 'Principles of Relational Contracting' 1101, footnote 25.

[41] Benjamin Klein, Robert Crawford and Armen Alchian, 'Vertical Integration, Appropriable Rents and the Competitive Contracting Process' (1978) 21 Journal of Law and Economics 297.

Certainly enough, none of the parties would want to invest in the relationship unless he is sure that the other party would not take advantage of his vulnerable situation. *Ex ante* parties may resort to different ways to cope with this problem. They may write a contract setting out in detail the terms and conditions of cooperation[42] or take precautions by purchasing insurance. To the extent contract law enforces the parties' contract and thus, ensuring performance, encourages them to make specific investments, its function is not different from the facilitative role it plays in spot contracts.[43] Yet, long-term contracts are much more complex.[44] Spanning over a protracted period of time, they are inescapably accompanied by change in conditions (economic, technological, climatic, *etc*.) and thus place different strains on the existing contract law system. This leads me to the second important feature of long-term contracts.

Increased incompleteness

In theory, in discrete, one-shot exchanges parties could write a complete contingent contract, *i.e.* a contract that specifies *ex ante* all possible contingencies that might affect performance and the consequences that follow if these contingencies materialise. Such a contract could presumably allocate risks in all future states of the world and ensure that performance takes place when and only when it is efficient. There would be no need for the parties to renegotiate as they can anticipate in advance and integrate into their agreement any amendment or supplement needed. As for the role of the court in case of dispute, it would consist of more or less mechanical enforcement of the parties' promises to the letter.[45] However, in the real world of positive transaction costs, parties do not write such perfect, complete contracts.

Before indulging in contractual incompleteness, however, a short terminological clarification may prove helpful considering the diverse meaning which economists and lawyers impute

---

[42] Recent empirical research indicates that when the relationship between the parties involves specific investments, they tend to write more complete formal contracts. Especially when players have prior experience with similar exchanges, their familiarity with the possible obstacles results in more complete contracts. Golobardes and Pomar 329, 332. However, as it is shown below: on one hand, writing a perfectly complete contract is virtually impossible; on the other hand, parties need to find the balance between the dangers of over- and under-completeness. Ibid 333.

[43] For more details on this manifestation of contract law's facilitative function, see *supra* Section A.1. Encouraging specific investment of Chapter I.

[44] See also Baird, 585 who emphasises the complexity of long-term contracts by modeling them (not in formal terms) on the basis of repeated games.

[45] Oliver Hart, *Firms, Contracts and Financial Structure* (First edn, Oxford: Clanderon Press 1995) 22, footnote 10.

into the term. In this account I refer to incompleteness in the economic sense, *i.e.* informational incompleteness where the contract fails to differentiate all possible conditions on which performance could depend and, consequently, fails to pair each of these conditions with the optimal obligations. Lawyers, in contrast, usually understand contractual incompleteness as literal or, also called, obligational incompleteness, *i.e.* the contract fails to define a complete set of obligations not only explicitly, but also implicitly and thus has gaps.[46] To make it clear, a contract stating that a widget shall be delivered on a particular date for a specified price is implicitly obligationally complete as it provides for the parties' obligations under all possible conditions.[47] An obligationally incomplete contract then would be a contract stating, for example, that the seller shall deliver the widget on the agreed date if the weather is sunny, but shall not deliver it if it snows. Such a contract omits to define the seller's obligation on days that are neither sunny, nor snowy. What then is the seller required to do on days that are cloudy or rainy or foggy?[48]

Though more intuitive to lawyers, the latter conception of contractual incompleteness is potentially problematic. After all, parties can easily complete their contract by simply inserting a clause that provides for the outcome in the event of materialisation of all other contingencies that are not expressly listed in the agreement. In this sense, literal/obligational incompleteness presupposes extremely naïve parties, who do not simply fail to foresee some relevant condition but are not even aware they may fail to foresee a condition, which does not seem to be a good assumption when trying to explain why parties draft contracts that have gaps.[49] Indeed, Triantis argues that real-world contracts are seldom obligationally incomplete as envisaged obligations are usually framed to apply across an array of different states of the world, so these states are in fact foreseen, though it may have been more efficient to include them as specific conditions.[50] Note then that an obligationally complete contract, *i.e.* a

---

[46] For this distinction between informationally incomplete and obligationally (or literally) incomplete contracts, see Scott and Triantis, 'Incomplete Contracts and the Theory of Contract Design', 190-191; Robert Scott and George Triantis, 'Anticipating Litigation in Contract Design' (2006) 115 The Yale Law Journal 814, 816, footnote 2; Hermalin, Katz and Craswell 70-71, 72-73; See also in this sense, though not using the mentioned terms: Shavell, *Foundations of Economic Analysis of Law* 292-293.

[47] The example follows the example given by Scott and Triantis, 'Incomplete Contracts and the Theory of Contract Design' 190.

[48] The example is somewhat modifying a similar example, given by Shavell, *Foundations of Economic Analysis of Law* 292.

[49] Hermalin, Katz and Craswell 70-71; Scott and Triantis, 'Incomplete Contracts and the Theory of Contract Design' 190.

[50] George Triantis, 'Contractual Allocations of Unknown Risks: A Critique of the Doctrine of Commercial Impracticability' (1992) 42 Toronto Law Journal 450, 464-468.

contract which is complete in legal terms, may still be informationally incomplete, *i.e.* incomplete within the meaning of the economic literature, since it does not specify the *optimal* obligations of the parties under all possible circumstances.[51] From this perspective, when I refer to parties' inability to write a complete contract, I mean their inability to write an efficient complete contract as they can always draft an inefficient complete contract.

As it was already asserted,[52] incompleteness is by no means an exclusive attribute of long-term contracts. As a rule contracts are incomplete. Even when it comes to sale of standardised products, parties take care to plan mainly their primary obligations concerning the subject-matter and the price of the contract, often failing to reach an enforceable agreement on the other terms and conditions of exchange.[53] Planning takes place to the extent the gains outweigh the costs, so contingencies that are remote and unlikely are left out of the contract.[54] Note that these are deliberate, rational gaps which are justified by the costs that would otherwise be expended to achieve completeness.[55] The function of contract law, then, is to facilitate saving of contracting costs by supplying default terms for typical bargainers to fill the gaps as well as to enforce the express stipulations of the parties, enabling them to make credible commitments and engage in beneficial exchange.[56]

Turning to long-term contracts, the problem of incompleteness magnifies and becomes especially insurmountable.[57] Where the contract is of such extended duration, parties' bounded rationality makes them unable to predict at a reasonable cost, if at all, the infinite number of external contingencies following the signing of the agreement or the optimal reaction to these contingencies. Under conditions of uncertainty it becomes too costly for parties to foresee all the future changes in technology or in government regulation or the countless other possible states of the world that may affect the cost-profit calculus.[58] And even where they are capable of such foresight,[59] they may find it too complex to work out

---

[51] Scott and Triantis, 'Incomplete Contracts and the Theory of Contract Design' 190; Scott and Triantis, 'Anticipating Litigation in Contract Design' 816, footnote 2.
[52] See *supra* footnotes 12-13 in Section A.1. of this Chapter and the text accompanying them.
[53] Macaulay 57-60, 62.
[54] Ibid 64-65; Macneil, 'The Many Futures of Contracts' 761.
[55] Cooter and Ulen, *Law and Economics* 292-293.
[56] Scott and Kraus, *Contract Law and Theory* 279.
[57] Golobardes and Pomar 315.
[58] Scott and Kraus, *Contract Law and Theory* 333; Goetz and Scott, 'Principles of Relational Contracting' 1090, footnote 4.
[59] Bear in mind that sophisticated commercial parties, especially if they have prior experience in similar exchanges, are usually aware what contingencies can arise during the life of the contract. Schwartz, 'Relational

(between themselves) and then specify in a comprehensible, unambiguous (for a third party) way the efficient responses to each and every event together with the respective remedies for non-performance.[60] Thus, it may be difficult to determine at the outset all variables that are relevant with respect to a construction project: the "appropriateness" of materials, the "quality" of equipment, the "adequacy" of design or the "reasonableness" of precautions.[61] In addition, the very fact that the level of specialisation of the parties evolves in the course of the relationship depending on the circumstances makes it practically impossible to set out *ex ante* the desirable amount of specific investments.[62] In such situations of high uncertainty and complexity, the result can be no other but a contract that suffers from increased, added incompleteness.

Another source of the increased incompleteness of long-term contracts is information asymmetry.[63] A lot of variables that matter in long-term contexts are unobservable or unverifiable and thus, in economic terms, "non-contractible".[64] For example, the client often knows that his constructor shirked, but the costs of proving this to a third party enforcer can be fairly high. For this reason, in economic contract theory such intangible investments as the quality of effort, exerted by the constructor, are considered unverifiable. If parties condition their contract on such information, economic scholars reason, the contract will not be legally

---

Contracts in the Courts: Analysis of Incomplete Agreements and Judicial Strategies' 278-279. See also *supra* footnote 42 of this Chapter.

[60] Scott and Kraus, *Contract Law and Theory* 333; Goetz and Scott, 'Principles of Relational Contracting' 1090, footnote 4; Hart 23-24.

[61] These are only some of the variables formulated in such vague terms in construction contracts. They are extracted by way of review of construction contracts from all three jurisdictions under comparison. The collection (on file with the author) was made especially for the purposes of this research and includes all standard forms of agreement and general conditions in the A Series (Owner/Contractor agreements) of the latest 2007 edition published by the American Institute of Architects (AIA) in the US and 5 standard form construction contracts of the 2005 edition published by the Joint Contracts Tribunal (JCT) in England and Wales. For more information on AIA Contract Documents, see: http://www.aia.org/contractdocs/about/ and on JCT construction contracts, see: http://www.jctltd.co.uk/. The Bulgarian part of the collection includes 30 construction contracts, assembled by requests sent out to lawyers practicing in Bulgaria, and 7 template construction contracts, used in the jurisdiction. For the sake of good order, it must be emphasised that the collected templates are *not* standardised forms but only contracts which are sometimes used by legal counsel as starting samples that are redrafted and adapted according to the needs of the clients. Unlike the US and England, standard forms of construction contract are not published in Bulgaria. Two of the template contracts were found by internet search and five are published in: Zahari Tormanov, *The Contract in Construction and Real Estate* (Sofia: Sibi 2008) 123-157. The Bulgarian collection includes business-to-business as well as business-to-consumer construction contracts. Some of the contracts were drafted for different projects of the same company.

[62] Fernando Gomez, 'Breach of Contract Issues in Long-Term Distribution Contracts' (Presentation, EUI, Florence, 22 January 2010).

[63] For a definition of information asymmetry, observability and verifiability, see *supra* footnote 46 of Chapter I

[64] Schwartz, 'Relational Contracts in the Courts: Analysis of Incomplete Agreements and Judicial Strategies' 280; Schwartz, 'The Enforcement of Contracts and the Role of the State' 111-113.

enforceable. Hence, parties would never contract on such an unverifiable factor as the agreement would entail moral hazard and incentivise parties to misrepresent information.[65] Other important variables are not even observable. Since the long-term relationship has no adequate substitute, neither of the parties can turn to the market to monitor the relevant economic data of the other party. Thus, the promisee does not know the production cost of the promisor. She knows the probability distribution from which costs are drawn but not the production cost itself.[66] The promisor, on his turn, does not know the value of his performance to the promisee. Hence, the reasoning goes, parties cannot condition the contract on such unobservable information, as their promises will simply not be credible.[67] The difficulty to prove cost and value to the standard necessary for legal enforcement must also be added to this observability problem.[68] Thus, asymmetric information constitutes one of the main causes for the high incompleteness of long-term contracts.

It must be also emphasised that the very awareness of the parties that change in conditions and, consequently, renegotiation are unavoidable slows down revelation of information between them.[69] The promisor does not have incentives to disclose his costs as he fears that at renegotiation the promisee will bargain for a lower price. The promisee, in her own turn, is afraid the price will soar if the promisor becomes aware of her value.[70] It is also shown that a moral hazard problem arises since a principal who does not observe the agent's effort cannot induce him to undertake high effort at all if the agent anticipates renegotiation taking place after he has chosen the level of effort but before the outcome of his choice becomes known.[71] To the extent that the risk of hold up at renegotiation[72] also involves making choices in one's own and not in the joint interest, it is a part of the broader moral hazard problem which arises from the fact that the party making the specific investments must share the accrued gains with

---

[65] See Hart 37, footnote 15. The assumption about non-contractibility of investments is in the tradition of Oliver Hart and John Moore, 'Incomplete Contracts and Renegotiation' (1988) 56 Econometrica 755. However, as it will be shown below, the relationship between verifiability and the degree of contract incompleteness is more subtle. See also Scott and Triantis, 'Anticipating Litigation in Contract Design'.
[66] Hart, *Firms, Contracts and Financial Structure* 25.
[67] Schwartz, 'Relational Contracts in the Courts: Analysis of Incomplete Agreements and Judicial Strategies' 280; Schwartz, 'The Enforcement of Contracts and the Role of the State' 112.
[68] Note that calculation of payments on the basis of cost or profit varies depending on the accounting principles used. Scott and Triantis, 'Anticipating Litigation in Contract Design' 825, footnote 22.
[69] Hviid 49; Golobardes and Pomar 337.
[70] See *supra* footnote 46 of Chapter I. See also Shavell, *Foundations of Economic Analysis of Law* 354.
[71] Drew Fudenberg and Jean Tirole, 'Moral Hazard and Renegotiation in Agency Contracts' (1990) 58 Econometrica 1279. In this case the revelation of information is slowed down by the agent randomising over his choice of effort level. Hviid 49.
[72] See *supra* Section A.2. Specific investments of this Chapter.

his counterparty.[73] In other words, the increased incompleteness of long-term contracts necessitates their subsequent revision but at the stage of this revision the problem of information asymmetry manifests once again, opening the door to opportunism. Absent information and fearing expropriation, a party may suspect his contractual partner of strategic games and thus refuse to adjust even though in reality readjustment will enhance the joint surplus. Or the party may agree to adjustment but inadvertently fall in the hold-up trap set by the self-interested counterparty. In this sense, asymmetric information not only prevents parties from writing a complete contract *ex ante* but may also deter them from efficiently filling the gaps *ex post*.[74]

If the above-mentioned barriers (mostly of information character) to complete contracting are expressed in terms of transaction costs, two large groups of costs have to be distinguished: *ex ante* contracting costs and *ex post* enforcement costs. To avoid any confusion that may stem from the literature, it will be useful to itemise explicitly the types of transaction costs falling within the scope of these two large groups.[75] Contracting costs include search costs to locate a contractual partner, costs stemming from investments in acquiring information of the possible future contingencies and of the necessary adjustments to them, negotiating costs, drafting costs, costs arising from the information asymmetry between the parties. Enforcement costs include verification costs (costs of observing and proving to court relevant private information) as well as uncertainty and error costs.

Note that the same types of transaction costs exist in spot contracting; yet, their magnitude is considerably smaller. Finding a contractual partner on the spot market is not that costly due to the presence of many players offering similar goods and services. As generally conditions are not likely to change over the life of the contract, parties do not need to invest much in trying to foresee the future, do not need to worry about costly renegotiations and, consequently, do not need to spend that much time and resources in haggling over the contractual terms. There is, of course, information asymmetry even in spot exchange, but overcoming it to a substantial degree is much less costly on established thick markets.[76] All these problems being less

[73] Scott and Kraus, *Contract Law and Theory* 280.

[74] Hart, *Firms, Contracts and Financial Structure* 25-26.

[75] On contract theorists commonly focusing on costs at the one end and ignoring the costs at the other end of the contracting process, see Scott and Triantis, 'Anticipating Litigation in Contract Design' 817, 835.

[76] To assume complete transparency of the market would be quite unrealistic. Information asymmetries arise both with respect to consumers and businesses. As asserted by Stigler, market players cannot obtain full information even on markets for completely homogeneous commodities. Yet, the smaller dispersion of prices in

intense, drafting costs are also lower. In addition, asymmetric information does not produce significant *ex post* inefficiencies since, in the absence of specific investments, a contractual partner can be easily substituted with a new identical one.[77] The high number of market participants and alternative offers precludes opportunism – or, if it still occurs, minimises the costs arising from it. Enforcement costs, too, go down as the market readily provides a benchmark for calculating the damages suffered in case of breach.[78] In other words, put simply, one-shot exchange transaction costs are positive but they are still sufficiently low for bargaining to achieve (more often than not) efficient allocation of resources.[79] All contract law needs to do, then, is to push transaction costs even lower through supply of efficient default rules and enforce the efficient outcome of parties' contracting.

As the duration of the contract extends and the market thins due to the specific investments made, *ex ante* and *ex post* transaction costs rise impeding the efficient coordination of the parties. The degree of incompleteness of the contract no longer turns only on parties' unwillingness to plan for remote contingencies for which planning costs exceed the gains. Contractual gaps widen also because parties prefer to withhold some private information (such as costs and value) or because some facts (such as effort) are not verifiable in court. With contracts growing to be more imperfect as a result of information asymmetries, parties may be incentivised to avail themselves of the increased, added contractual incompleteness. Thus, when transaction costs become prohibitively high, the market starts to fail.[80] Ironically, fostering exchange by resorting solely to the same old means of reducing negotiating and drafting costs through supply of default rules will not do the job. Since the incentives for opportunistic behaviour are not eradicated, limiting the role of contract law to facilitation will

---

thick markets is explained by the lower search costs on such markets. George Stigler, 'The Economics of Information' (1961) 69 The Journal of Political Economy 213. Certainly, overcoming information asymmetries on the spot market may still prove to be prohibitively costly for consumers, but here the comparison is between thick and thin markets, not between consumers and businesses on the same market.
For those readers who are less familiar with economics terminology, a short terminological explanation may be useful. A thick market is a market with a high number of Buyers and Sellers and consequently a high number of bids and asks. They are characterised by a great number of transactions, low price volatility and high asset liquidity. Although the concepts of market thickness and market competitiveness are not equivalent, market thickness essentially indicates the level of competition on the market. Generally, the thicker the market, the more competitive it is. See: Daniel Leiter and Thiery Warin, 'An Empirical Study of Price Dispersion in Homogenous Goods Markets' Middlebury College Economics Discussion Paper No 07-10 <http://cat2.middlebury.edu/econ/repec/mdl/ancoec/0710.pdf> accessed 22.03.2013.
[77] Hart, *Firms, Contracts and Financial Structure* 25-26.
[78] For more details, see *infra* Section A.4. Spot contracts of this Chapter.
[79] For the Coase theorem, see *supra* Section C. of Chapter II. See also Cooter and Ulen, *Law and Economics* 85
[80] Ibid 85.

only trigger more and longer haggling, making an optimal agreement even less likely.[81] This, of course, is contrary to the postulate of the Coase theorem. But let me remind that in the context of long-term contracting parties are so far from the Coasean zero-transaction-cost world that we cannot simply rely on the Coase theorem to solve the problem. With strategic considerations raising transaction costs beyond a certain threshold, contract law needs to minimise not only the initial obstacles to cooperation but also the inefficiencies arising from failures to cooperate.[82] To be more straightforward, it needs not only to facilitate but also to regulate.

The dimensions of this necessity become clearer when considering that the failing market produces a social cost which may dwarf the efficiency losses experienced by the parties.[83] Information asymmetry leads to adverse selection where Buyers, being unaware of the quality of the purchased commodities, offer blended prices that do not warrant investment in production of high quality commodities, thus driving high-quality Sellers out of the market. The result is a market of "lemons" – and, in the extreme, - a complete collapse of the market.[84] Indeed, consider the reaction of the held up party when concluding the next contract. Taking into account the threat of opportunism, he may overinvest in precautions, thus limiting the amount of *ex ante* contractual surplus to be divided (private cost). He may decide to make investments that are only general, thus forgoing some efficiency gains (private cost but also a social cost as there is a decrease in the overall welfare). Or he may even choose to close down, reducing the amount of trade on the market altogether (again private as well as a social cost).[85] Multiply the latter result by the number of held up players and here is how an entire market may disappear. This implies a huge social cost which, according to Akerlof, explains the differences in social welfare between developed and underdeveloped countries.[86] The private and social inefficiency costs make a strong case for contract law performing a

[81] Cooter, 'The Cost of Coase', 23.
[82] This idea is developed in detail in ibid 17-20. Cooter takes as a starting point the Coase theorem as well as Hobbes' belief that people will never reach agreement unless there is a third party to coerce them, expressed in his 17th century work *Leviathan*. Revealing the falsehoods of the extremely optimistic Coase theorem and the extremely pessimistic Hobbesian approach (which Cooter calls the "Hobbes Theorem"), Cooter argues that to be efficient, law should be structured to balance between these two normative principles. See also Cooter and Ulen, *Law and Economics* 85, 91-94 as well as *supra* Section C. of Chapter II on the methodological differences between Chicagoans and New Institutionalists stemming from their different attitude toward the Coase theorem.
[83] Hart, *Firms, Contracts and Financial Structure* 26.
[84] George Akerlof, 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism' (1970) 84 The Quarterly Journal of Economics 488.
[85] Baird 587; Hart, *Firms, Contracts and Financial Structure* 26.
[86] Akerlof 488.

regulatory function in the context of long-term contracts. By regulating, contract law can correct market failures and minimise strategic conduct that exploits contractual incompleteness and erodes parties' readiness to engage in beneficial trade.[87]

Clearly, whether and to what extent contract law needs to perform a regulatory function depends on where a particular real-world contract lies along the contractual continuum. In the above account I have already identified several factors that determine the position of a contract as closer to the spot or to the long-term end of the continuum: the duration of the contract, the involvement of specific investments, the standardised or customised character of the contract subject matter, the importance of the parties' identity, the thickness/competitiveness of the market. Note that the commercial or consumer character of an agreement does not define its classification as spot or long-term as both consumer shopping and purchases on the commercial spot market readily fall within the scope of discrete exchange. It would also be wrong to automatically assign any sale contract to the spot range and any construction contract – to the long-term range of the spectrum. Nowadays many sales of goods occur not as one-shot, discrete contracts but as long-term supply agreements. As for construction contracts, as defined in the thesis,[88] they cover a very broad subject matter which does not always imply development of a mutual relation between the parties. Imagine, for example, an agreement for the execution of some simple plumbing work such as repair of the tap or trap of one's kitchen sink to eliminate a leakage: it does not exhibit the distinguishing features of a long-term contract.

Nevertheless, although every real-world agreement needs to be positioned on the continuum depending on its particular characteristics, contracts for services generally tend to be more prone to long-term contracting than contracts for sale of goods. In this sense, all other things equal, a construction contract would always lean more to the long-term range of the spectrum than a contract for sale of goods. Indeed, services are intrinsically less susceptible to standardisation and detailed advance planning and naturally presuppose the growth of some relation between the parties as the Seller is much more constrained by the idiosyncratic peculiarities and preferences of the Buyer.[89] Considering the lion's share of services in the

---

[87] In this sense, see: Cooter and Ulen, *Law and Economics* 244; Chirico 410.
[88] See *supra* Section B.1. of Chapter I.
[89] Macneil, 'The Many Futures of Contracts' 694, 717, footnote 78, 763, footnote 209, 767, footnote 217, 768-770.

GDP of EU Member States and the US,[90] it can be expected that enforcement of contract remedies has responded to the organisational changes in the economy and the increased use of long-term contracting. The question, then, is whether national contractual regimes regarding remedies draw a line between spot and long-term contracts and if they do, where and on what grounds.[91] Also, if existing, does this borderline entail the remedies of specific performance and damages gradually assuming a regulatory function? While these questions will be explored in the chapters that follow,[92] I turn now to some typical governance mechanisms by which parties regulate their long-term contracts.

3. Governance mechanisms

Before investigating the way courts in the compared jurisdictions resolve contractual disputes, it will be useful to get some idea of how parties themselves regulate the enhanced incompleteness of their long-term contracts. This section casts a light on the contracting dilemma confronting parties to long-term agreements and focuses on two important governance mechanisms used by them to organise their coordination: industry experts and vague contractual terms.

Parties, engaging in long-term contracting, have to balance between the need to bind their hands in order to stimulate efficient specific investment and the need to adapt as the future unfolds in order to ensure their exchange continues to generate joint benefits. Fixing obligations too rigidly may turn out to be counterproductive and prevent parties from adjusting when conditions change. Their agreement needs to be revisable in case of becoming suboptimal *ex post* but, ironically, such flexibility also increases the risk of hold up and weakens parties' *ex ante* commitment.[93] Trying to resolve this puzzle, incomplete contract theorists have expended a great deal of efforts developing economic models that seek to overcome the moral hazard and hold-up problems by means of the correct contractual design.

---

[90] For some statistics with regard to EU Member States, see *supra* Section B.1. of Chapter I. As for the US, in 2011 services activities accounted for nearly 80 per cent of private sector GDP and 82 per cent of all private sector employment. See http://blog.trade.gov/2012/05/21/expanding-trade-through-services/, last accessed on 01.06.2013.
[91] Fabrizio Cafaggi, 'From a Status to a Transaction-Based Approach? Institutional Design In European Contract Law' (2013) 50 Common Market Law Review 311, 320-321.
[92] For the empirical research, see *infra* Chapters VI and VII.
[93] On this *ex ante*/*ex post* tension in long-term contracts, see also: Scott and Kraus, *Contract Law and Theory* 334; Baird 586; Hviid 48; Golobardes and Pomar 330. In particular, on rent dissipation and the risk of hold-up resulting from increased contractual specification, see Klein, 'The Role of Incomplete Contracts in Self-Enforcing Relationships'.

The devised ingenious contractual schemes that disincentivise exploitation of the vulnerable partner or invest the latter with bargaining power in renegotiation are, however, based on very strong assumptions. They imply that parties are able to invent first-best contractual solutions which courts would specifically and mechanically enforce.[94] Yet, this is not what happens in practice. Neither parties are perfectly rational, nor are courts immune from making mistakes when enforcing (or not) the contracts that come before them.

With the information barriers discussed above (uncertainty, complexity, information asymmetry), parties are incapable of drafting ideal long-term contracts that resolve *ex ante* all conflicts between their joint interest and the individual interest of each of them. As a result, the vitality of their relationship depends to a great extent on their ability to incorporate in the agreement a sensible governance structure that permits them to adjust as they go along. Such governance structures may include measurement systems allowing for indexation of the price depending on the market conditions (sale contracts) or for valuation of the work depending on the costs incurred (cost-plus construction contracts). They may combine direct monitoring arrangements (such as the client's right to supervise the constructor's performance) with indirect monitoring systems that integrate incentive mechanisms stimulating higher performance efforts (such as termination rights or liquidated damages clauses).[95] Governance structures may also encompass extra-legal means of adjustment such as trust, reputation, norms of commercial ethics,[96] or enforceable contractual clauses assigning decision rights to one of the parties or providing for their mutual agreement. Written contract terms may also complement (instead of substitute) the mentioned self-enforcing mechanisms by making non-performance more costly.[97] Generally, governance is extremely varied and sensitive to the particular contractual context.

---

[94] Scott and Kraus, *Contract Law and Theory* 337; Posner, 'Economic Analysis of Contract Law after Three Decades: Success or Failure', 855.

[95] Scott and Kraus, *Contract Law and Theory* 348-352; Goetz and Scott, 'Principles of Relational Contracting' 1093-1094, 1115-1116.

[96] Macaulay 58-59, 61, 63.

[97] Klein, 'The Role of Incomplete Contracts in Self-Enforcing Relationships' 63-66. For example, construction contracts often require the constructor to use only subcontractors that are approved by the client or his agent beforehand. This increases the constructor's costs of substandard performance. For a similar point with respect to distribution contracts, see Fernando Gomez, 'Cooperation, Long-Term Relationships and Open-Endedness in Contractual Networks' in Fabrizio Cafaggi (ed), *Contractual Networks, Inter-Firm Cooperation and Economic Growth* (First edn, Cheltenham: Edward Elgar 2011) 35.

The role of industry experts

Even if a particular governance scheme dominates certain types of contracts, it may be implemented in very different ways across jurisdictions. For example, construction agreements typically provide for the rights of a third party, an industry expert, to make decisions affecting the obligations of the contracting parties. The reasons for this solution are apparent: on one hand, the constructor's performance is fairly multidimensional and dependent on the materialised state of the world; on the other hand, clients, unlike constructors, often have no experience in construction matters which usually require highly sophisticated technical skills. In such a situation, parties commonly charge a qualified specialist with the responsibility to specify *ex post* many aspects of the constructor's performance. In the US and England, this role is routinely delegated to the architect; in Bulgaria, - to several professionals in the industry. In all jurisdictions, depending on his contract, the expert controls the choice of construction materials, equipment and subcontractors, instructs rectification of defects and variations and generally ensures that the work complies with the contract requirements. Though these powers are ambiguously referred to as "contract administration", their exercise in fact completes the parties' imperfect construction contract.

Yet, looking more in depth, the role of such industry experts varies in the different jurisdictions under comparison. In the US and England, the architect's judgment regarding the valuation of the work and its completion according to the contract is embodied in certificates which are made conditions precedent to the right of the constructor to be paid.[98] In both jurisdictions the design professional is the initial decision-maker who resolves claims for payment of money, extension of time or other relief under the contract as well as any other disputes between the contractual parties. His decision is binding on the parties unless challenged following the procedure envisaged by the contract – mediation, adjudication or binding dispute resolution (arbitration or court proceedings).[99] Commonly, the ultimate

[98] Such is the role of the architect under AIA Document A201 – 2007 General Conditions of the Contract for Construction and the JCT Standard Building Contract (2005 edition). See also Justin Sweet, *Legal Aspects of Architecture, Engineering and the Construction Process* (Sixth edn, Brooks/ Cole Publishing Company 2000) 574-583; John Uff, *Costruction Law* (Tenth edn, London: Thomson Reuters; Sweet & Maxwell 2009) 236, 289-294, 410-411.

[99] See Article 15 of AIA Document A201 – 2007; Clause 2.26-2.29, Section 4 and 9 of the JCT Standard Building Contract (2005 edition). See also J. Uff and V. Moran, 'Chapter 37. Construction Contracts' in H.G. Beale (ed), *Chitty on Contracts Specific Contracts*, vol II (Thirty-first edn, London: Sweet&Maxwell/Thomson

certificate issued at the end of the construction process enjoys a certain degree of finality and is binding unless there was fraud or gross mistake.[100] In other words, the architect serves both as an agent of the client, ensuring that he is not taken advantage of by the constructor, and as an impartial arbitrator who gives his professional opinion having regard to the interest of both parties.[101] The architect presumably has to show objectivity also when making decisions on matters relating to aesthetic effect and when evaluating the standard of workmanship as such to his "reasonable satisfaction".[102] And although in England the architect is said to resolve controversial points between the parties only incidentally, by issuing certificates and giving instructions,[103] while in the US his authority to resolve claims and disputes is particularly emphasised,[104] in both jurisdictions he is given the role of a "judge".

However, the agency relationship with the client naturally implies hazards to the impartiality of the design professional. These hazards are additionally increased by another potential conflict of interest: the architect may bypass defective work to incentivise the constructor not to file a claim for additional time or cost that may point at the architect's professional negligence or conversely he may give instruction for rectification of a defect trying to conceal his own mistake in the design.[105] Prioritising the goal to avoid costly delays of construction projects as well as enforcement costs, Anglo-American law relies on the architect's reputational stake as a guarantee against all the perils inherent in his dual role. After all, in demonstrating objectivity, the design professional increases his chances to be selected in subsequent contracts. In contrast, Bulgarian law sacrifices some of the speed of adjustment in return for higher chances for unbiased decision.

In Bulgaria, the function of the Anglo-American architect is divided between several industry experts. The law obliges the client to contract with the design professional who supervises the

---

Reuters 2012) 805 To avoid confusion, here the term "adjudication" is not used in its usual sense of legal process by which an arbiter or judge comes to a decision that determines rights and obligations between the parties. The term here refers to another procedure of settlement of disputes (also different from mediation) that is set out in the Scheme for Construction Contracts (England and Wales) Regulations 1998 (SI 1998/649) and envisaged by the JCT Standard Building Contract (2005 edition).

[100] See §9.10.1 AIA Document A201 – 2007; Clause 1.10 of the JCT Standard Building Contract (2005 edition). See also Restatement (Second) of Contracts (1981) § 227 Standards of Preference with Regard to Conditions, comment c, illustrations 7 and 8; Sweet 580-581; Uff, *Costruction Law* 291.

[101] Sweet 26, 574-575; Uff and Moran, 'Chapter 37. Construction Contracts' 804.

[102] §4.2.13 AIA Document A201 – 2007; Clause 1.10 of the JCT Standard Building Contract (2005 edition); Uff and Moran, 'Chapter 37. Construction Contracts'.

[103] See *Kaye v Hosier & Dickinson* [1972] 1 WLR 146.

[104] §15.2.1 AIA Document A201 – 2007; Sweet 576.

[105] Sweet 576.

project for its adherence to the drawn up designs[106] as well as with a licensed consultant who ensures its compliance with the mandatory legislative construction requirements and with the designs.[107] If licensed, the design professional may also serve as consultant but very often this function is entrusted to another specialist – the one who has previously reviewed the designs and opined on their conformity with the mandatory norms as a precondition for obtaining the approval of the public administration.[108] Whether they be same or different persons, both of these participants in the construction process instruct correction of defects and minor variations in the work and thus, securing a certain minimum quality of effort on the side of the constructor, make binding decisions on some matters of contention between the parties. They also sign the acts and protocols that are drawn up in the course of the project and have evidentiary force as to the facts related to the execution of the construction work.[109] To the extent that they evaluate the constructor's performance, both the design professional and the consultant function as arbitrators between the parties. The consultant is also responsible for resolving disputes between all participants in the construction (including disputes between the parties, between the design professional and the constructor and between the client's agent and the constructor or the design professional) and his decisions are binding, though subject to appeal before the competent public construction administration.[110] In this sense, his function comes closest to the judging role of the architect in the US and England.

Note, however, that although the mentioned acts and protocols certify the quality and quantity of the work carried out, they do not have any bearing on the valuation of the work and the payment due to the constructor. Neither the design professional, nor the consultant are authorised to grant additional time or additional cost to the constructor. Generally, they stay out of the economics of the relationship between the parties. They take care that the structure complies with the mandatory requirements of the construction legislation and the designs but not with any higher requirements of the client that may be prescribed by the construction agreement. To ensure that the work meets his own particular demands as to quality of materials, standard of workmanship, aesthetics, *etc.* that go beyond the specifications of the

[106] Art. 162 of the Spatial Development Act, promulgated State Gazette №1 of 02.01.2001, in force as of 31.03.2001, last ammended State Gazette №80 of 14.11.2011 (hereafter "Spatial Development Act").
[107] Art. 166 ibid.
[108] Art. 166 (3) in connection with Art. 166 (1) 1. Ibid.
[109] Art. 4 (1) in connection with Art. 1 (4) of Ordinance №3 of 31.07.2003 on Drawing Up Acts and Protocols in the Course of Construction, promulgated State Gazette №72 of 15.082003, last ammended State Gazette №29 of 07.04.2006.
[110] Art. 5 (7) ibid.

mandatory law and the designs, the client needs to contract with an additional expert as his agent on the site.[111] The latter can also control the quantity of materials used, the choice of subcontractors as well as manage the valuation of the executed work. Yet, his accounting does not create a debt due for the client as do the certificates issued by American and English architects. Nor he is commonly empowered to grant time extensions to the constructor. Thus, as the responsibilities of the client's agent usually concern the proper performance of the day-to-day construction work, matters such as payment and time remain for the agreement of the parties.

In short, Bulgarian law relies much less on the stature and integrity of design professionals. It imposes control on the observance of a certain mandatory minimum of quality prescribed by the legislation and the administratively approved designs and then leaves it to the client to ensure that the project meets his own particular requirements. For this reason, the figures of the objective supervisor and of the client's agent are commonly separated in Bulgaria with the legal system providing a mechanism (the consultant) for quick initial resolution of disputes between all participants in the construction process. This is a more cumbersome system requiring better coordination between the different players but it generally reduces the risks to *ex post* decision-making stemming from the assignment of a protective (for the client) and a judging role to the same person. Yet, if the constructor is provided with a specific proxy for his effort (the minimum requirements) and clients regularly save costs by cutting out the supervision of an agent, this may lead to an overall lower level of quality of construction and more disputes between the parties as to the efforts expended by the constructor. In addition, adjustments on time and payment are generally left out of the domain of the experts that are part of the project. Their judgment on such issues is purely advisory, so differences between the parties on these matters may lead to costly delays and high enforcement expenses incurred in court or arbitration procedures. Thus, the less powerful monitoring role of construction experts in Bulgaria impedes parties' subsequent adjustment.

[111] There is no legal obstacle for the client to charge the consultant with this function. In practice, however, licensed consultants are not inclined to take such responsibilities as they imply closer involvement in the relationship between the client and the constructor. An expert who takes on this job must also enjoy the full confidence of the client. For these reasons, clients usually employ an additional expert as their agent on the site. Tormanov 109.

Rules and standards

Yet, let us leave the *ex post* operation of governance devices and go back to the time of contracting when parties need to decide on the ratio between commitment and flexibility in their agreement. To strike this balance, parties draft their contracts by alternating precise rules[112] and vague standards.[113] Rules ensure the credibility of commitment[114] while standards accommodate the inevitable need for cooperation over the life of the relationship. That parties commonly use vague terms in their agreements including with regard to the effort owed by the Seller is an undeniable fact confirmed by the review of the construction contracts collected for this research.[115] Thus, the US AIA form contracts regularly provide for the constructor's "best skill and attention".[116] The English JCT forms often require the constructor to perform "in a proper/good and workmanlike manner"[117] while Bulgarian construction contracts call for the "due care of a prudent merchant".[118] And although for reasons of time constraints no similar collection of sale contracts could be made for the purposes of this thesis, that goods sold are also often described fairly imprecisely was pointed out as early as Macaulay's seminal study and remains undisputed to this day.[119] Contracts specifying the quality of the gadget as "high", "premium", "merchantable" or by another ambiguous term are

---

[112] For the definition of a rule, see *supra* footnote 69 in Section A.2. Default rules and mandatory rules of Chapter I. In this context they are sometimes referred to as '"hard" terms'. See Gilson, Sabel and Scott 453; Scott and Kraus, *Contract Law and Theory* 336.

[113] Such vague clauses in parties' contracts are also sometimes referred to as '"soft" terms'. See Gilson, Sabel and Scott 453; Scott and Kraus, *Contract Law and Theory* 336-337.

[114] All three legal systems under research require contracts to meet a certain level of definiteness to be legally enforceable. In the US the common law indefiniteness doctrine infers the intention of the parties to be legally bound from the extent to which material terms were left unspecified by the parties. *Varney v. Ditmars* 111 NE 822 (NY 1916); Scott and Kraus, *Contract Law and Theory* 33. In England an agreement which is so vague that it requires adding new terms to acquire a definite meaning or which is obviously incomplete in some important respect is not a binding contract. *G Scammell&Nephew Ltd v. Ouston* [1941] AC 251; *Bols Distilleries BV v. Superior Yacht Services Ltd* [2006] UKPC 45; Edwin Peel, *Treitel. The Law of Contract* (Thirteenth edn, London: Sweet&Maxwell/Thomson Reuters 2011) 50, 52. In Bulgaria the failure to reach an agreement on a material term makes the contract not legally binding. Kalaydjiev 86, footnote 85.

[115] See *supra* footnote 61 of this Chapter and the accompanying text.

[116] All AIA documents of the 2007 edition contain a vague standard with respect to the effort owed by the constructor: he must use his "best skill and attention" (8 contracts), "best efforts" (2 contracts) or simply has the obligation to "cooperate" (9 contracts).

[117] Three construction contracts of the English collection require the constructor to act "in a proper/good and workmanlike manner" and one: to act "carefully and competently".

[118] Bulgarian contracts require constructors to act with "due care of a prudent merchant" (8 contracts), "regularly and diligently" (1 contract) or "to carry out work with quality and in a timely manner" (10 contracts). Phrases such as "to make maximum effort" (2 contracts) and "to provide services of the best quality" (1 contract) also appear.

[119] "Although most businessmen think that a clear description of both the seller's and buyer's performances is obvious common sense, they do not always live up to this ideal. The house counsel and the purchasing agent of a medium size manufacturer of automobile parts reported that several times their engineers had committed the company to buy expensive machines without adequate specifications." Macaulay 58.

not rare at all. That is why, the premise of economic theorists that parties would not contract on unverifiable factors such as effort and quality and would stay away from vague clauses which are prohibitively costly to verify is simply wrong.[120] The question is rather how courts interpret and enforce such broad terms, not whether parties would contract for them or not. From this perspective, an assumption that verifiable (precise) terms are costless while unverifiable (vague) terms are costly to enforce, does not seem to be a good starting point for exploring the effect of legal institutions on parties' contracting.[121]

Indeed, verification costs are one of the primary causes for contractual incompleteness but just like any other type of transaction costs they do not simply define two discrete antagonistic alternatives (verifiable/unverifiable) but lie on a spectrum reflecting differing degrees of verifiability.[122] In this sense, economists' proposition on the undesirability of standards, embraced by some legal scholars,[123] also suggests a very stylised and unrealistic conception of contractual incompleteness, which, ironically, seems closer to the previously described legal view,[124] since it envisages incompleteness merely as the absence of contractual provisions on information that entails fairly high verification costs. This conception implies that contracts do not contain terms conditioning prices on such relevant variables as quality and effort but solely terms that make price dependent on verifiable consequences of these variables, *e.g.* the volume of trade.[125] However, the review of real-world contracts reveals that with regard to quality and effort obligations, incompleteness presents itself not as missing terms that result in a literal contractual gap which can be filled by the court only at a very high cost. Rather, incompleteness manifests as a vague standard which applies across many different states of the world (as is typical for informational incompleteness) and appears in combination with precise rules that stipulate some of the relevant aspects of performance and mitigate verification costs.

---

[120] See Scott and Triantis, 'Anticipating Litigation in Contract Design' 824-825, footnote 22 who make this argument with respect to incomplete contracts in general. In this sense, my observations resulting from the review of the collected construction contracts entirely confirm Scott and Triantis' argument.

[121] Alan Schwartz and Joel Watson, 'The Law and Economics of Costly Contracting' (2004) 20 Journal of Law, Economics and Organization 2, 14, footnote 18.

[122] Gillian Hadfield, 'Judicial Competence and the Interpretation of Incomplete Contracts' (1994) 23 Journal of Legal Studies 159, 162.

[123] See, for example, Schwartz, 'Relational Contracts in the Courts: Analysis of Incomplete Agreements and Judicial Strategies' 280.

[124] See *supra* Section A.2. Increased incompleteness of this Chapter.

[125] Hart, *Firms, Contracts and Financial Structure* 37-38, footnote 15; Schwartz, 'The Enforcement of Contracts and the Role of the State' 111-112.

Thus, the above-mentioned ambiguous clauses requiring constructor's "best skill and attention", "good and workmanlike manner" or "due care" come together with fairly exact terms that introduce imperfect, but specific proxies of the desired performance.[126] In fact, the obligation of the constructor to follow strictly the project designs constitutes such a proxy for the skill and care that is expected from him during the construction process. Indeed, this proxy establishes only a certain minimum level of investment that does not correlate ideally with the relevant effort that the Seller has agreed to exert but, still, it alleviates the verifiability problem confronting the parties. Another proxy requiring a certain level of investment on the side of the constructor is his obligation to use materials having particular technical characteristics, or materials of a particular brand, or such satisfying particular standards. Concrete technical specifications and standards with regard to equipment, construction systems and workmanship which the constructor must apply in the course of the construction work also serve as performance proxies. As a result, precise rules provide courts with some measures of the relevant variable (effort) and constrain the discretion of the court, thus limiting verification costs. Yet, as precise rules cannot exhaust all facets of the desired performance, parties also include the vague standard that is supposed to capture the remaining unspecified aspects of desirable conduct which do not fall within the scope of precise terms.[127]

To put it briefly, by alternating rules and standards in their incomplete long-term contracts, parties balance between the advantages and disadvantages of commitment and flexibility. Rules make the contract definite and legally binding, but also increase the likelihood of *ex post* efficiency losses as parties hinge on predictions about the probability of future contingencies. Standards allow parties to subsequently adapt and thus decrease the danger of an overly rigid agreement. At the same time they create moral hazard by giving to the party with the stronger bargaining power a chance to transfer some of its costs to his contractual partner and dissipate some of the *ex ante* joint surplus. But while enabling parties to enhance incentives for both *ex ante* efficient investment and *ex post* efficient performance, such

[126] As emphasised by Scott and Triantis, courts do not observe facts directly but instead rely on evidentiary proxies to make factual determinations. The term "proxy" refers to the "operative facts" that establish compliance or non-compliance with the contract terms. Scott and Triantis, 'Anticipating Litigation in Contract Design' 818, footnote 8, 826, 837.
[127] Ibid 852. For more details with respect to other rule-standard combinations, see ibid 851-856.

interweaving of precise and vague terms also has another important implication: it allows parties to pursue these conflicting objectives at the optimum level of transaction costs.[128]

Rules increase the contracting costs parties incur *ex ante* to create efficient incentives. The more concrete the specification of the performance requirements in the contracts, the less work the court has to do to decide whether the Seller has fulfilled his contractual obligations. Consequently, the *ex post* enforcement costs decrease. And conversely: by including in the contract vague standards inviting cooperation, parties delegate courts with discretion to choose the relevant proxy that determines which one of them was responsible for the breaking down of the relationship. In this way, parties save on *ex ante* contracting costs and rely on the court which, having the benefit of hindsight, can potentially select a more efficient measure to evaluate performance. Yet, they have to swallow the higher *ex post* enforcement costs. Thus, by drafting their contracts as a mixture of rules and standards, parties can shift transaction costs between the time of contracting and the enforcement stage trying to maximise the improvement in incentives at minimum total expenditure of *ex ante* and *ex post* costs.[129] Considering the generally high level of transaction costs typical for long-term contracts,[130] such cost optimisation is especially important.

Where parties manage to reorganise their cooperation in the joint interest, the governance mechanisms integrated in their agreements have proved adequate to reduce sufficiently the incentives to cheat, generated by the increased contractual incompleteness. However, where renegotiation does not go as smoothly or does not take place at all (*e.g.* because immediate action is needed or because contacting the other party is difficult), parties often turn to courts and entrust them with the task to sort out whose (in)actions amounted to breach of contract.

4. The complexity of the problems related to breach of long-term contracts

This section also compares spot and long-term contracts but this time with respect to the problems arising in case of contractual breach. The specific investments and increased incompleteness typical for long-term contracts logically result in greater complexity of the issues encountered by courts upon breach. At the core of this complexity stand the problems

---

[128] Gilson, Sabel and Scott 454-455; Scott and Triantis, 'Anticipating Litigation in Contract Design' 817, 822-823.
[129] Scott and Triantis, 'Anticipating Litigation in Contract Design' 823, 836-838; Gilson, Sabel and Scott 454-455.
[130] See *supra* Section A.2. Increased incompleteness of this Chapter.

of moral hazard and asymmetric information that are so inherent to the long-term contractual setting. Long introductions are not necessary here since these problems were already clarified above,[131] but as the discussion that follows also touches on issues related to calculation of damages, a short disclaimer needs to be made before proceeding to the essence. The subsequent account refers solely to the logical method of computation of damages and not to the actual way they are calculated by courts in the researched legal systems. The latter is a task for the following chapters.

Spot contracts

In the context of spot contracts breach of contract issues are relatively unproblematic. The (usually) short-term duration of the contract and the general stability of conditions during its life *a priori* endow parties with fewer occasions for shirking and chiselling. In addition, the large-numbers competition on the market protects each party against the opportunistic behaviour of the other. As the contract is more complete, with the rights and obligations – better defined, and the standardised goods and services – simpler to specify and measure, breach is not that costly to observe and prove. The choice of the most efficient remedy is also less complicated since in the absence of specific investments it does not have to account for the effect of the remedy on parties' investment decisions. Courts also encounter much less trouble in verifying contractual breach and estimating compensation as the value the market accords to the standardised goods and services provides a good proxy for assessment of damages.

From this point of view, recall that the market has many similar Sellers and Buyers and upon breach, each party can find an alternative contractual partner. In such a strongly competitive environment, expectation damages equal the difference between the contract price and the price of the substitute contract concluded on the spot market (the so-called substitute-price formula).[132] But for the breached contract, each party could have contracted with an

[131] See *supra* Section A.2. of this Chapter.
[132] See *infra* Table 1. If the breached contract is for the sale of a differentiated (and not homogeneous) commodity so that the Buyer cannot purchase a perfect substitute, then the substitute spot price can be arrived at by means of extrapolating the prices of the closest comparable commodities available on the market. Cooter and Eisenberg, 'Damages for Breach of Contract', 1439, 1448. For example, the substitute spot price of a 1985 Brunello di Montalcino bottle of wine can be calculated by extrapolating the prices of a 1985 Brunello di Montepulciano as well as a 1975 and a 1983 Brunello di Montalcino bottles. Such extrapolation, however, already implies some computation error and departure from perfect compensation.

alternative counterparty on approximately equal terms. Hence, reliance damages equal the difference between the price of the alternative, second-best contract that could have been concluded at the time of contracting and the price of the substitute contract concluded on the spot market after the breach (the so-called opportunity-cost formula).[133]

Table 1[134]

Damages	Formula	Breaching party	Computation
expectation	substitute-price	Buyer	contract price - spot price
		Seller	spot price - contract price
reliance	opportunity-cost	Buyer	forgone price - spot price
		Seller	spot price - forgone price
expectation	lost-surplus	Buyer	contract price - cost
		Seller	subjective value - contract price
reliance	out-of-pocket-cost	Buyer	cost - realisable value
		Seller	cost - realisable value
expectation	diminished-value	Buyer	contract price - price received
		Seller	contract price - market price of performance received

[133] See *infra* Table 1. Ibid 1440-1441, 1448.
[134] Table 1 follows closely the table on damage formulas in ibid 1443.

Note that the closer the market approximates the perfectly competitive market, the smaller the difference between the contract price and the forgone price of the alternative contract; hence, the more expectation damages approach reliance damages.[135] Of course, this model has some implicit assumptions,[136] but it demonstrates very well two things in the case of discrete, one-shot contracts, taking place on a strongly competitive market. First, the market itself promptly provides an apt benchmark for computing damages. Second, for determining the amount of compensation, market price constitutes the most suitable benchmark. Basing the calculation of expectation damages on the lost profits from the breached contract (as in the lost-surplus formula)[137] would not account for the profit made from the substitute contract.[138] And computation of reliance damages taking as yardstick the out-of-pocket costs incurred in reliance on the agreement (as in the out-of-pocket-cost formula)[139] would not account for the opportunity lost as a result of the breached contract.[140] In this sense, any other proxy besides market price would yield damage awards that deviate to a greater extent from perfect compensation.

An exception from the latter general principle emerges, however, when the Seller's business conduct is described not by the traditional but by the statistical-planning model. The model implies that the Seller accounts for the high, but predictable on a statistical basis, rate of breach and enters into more contracts than the number of units he offers on the market. It is relevant, for example, with regard to airlines' sales of plane tickets. The received wisdom is that when the statistical-planning model applies to the Seller's business behaviour and the actual rate of breach is higher than the one predicted, the promisor is left with excess inventory; he incurs lost volume and consequently lost profits. Expectation damages then need to be determined by way of accounting for the surplus that the aggrieved Seller would have enjoyed in case of due performance. This surplus can be captured by some adjustment of the lost-surplus formula.[141]

---

[135] Ibid 1445, 1448.

[136] The model assumes that the non-breacher's costs are unaffected by breach, that the parties' business conduct is described by the traditional model (Sellers provide until the marginal cost equals the contract price and Buyers purchase the whole production) and that breach occurs at a low rate. Ibid 1445-1449.

[137] See *supra* Table 1 as well as ibid 1439-1440.

[138] Ibid 1448-1449, 1478-1480.

[139] See *supra* Table 1 as well as ibid 1442.

[140] Ibid 1449.

[141] Ibid 1449-1451.

Long-term contracts

As already emphasised,[142] the extended time-horizon and the inherent incompleteness of long-term contracts predestine the necessity of *ex post* renegotiation at the stage of which there is an ample room for opportunism on the side of the party having greater bargaining power. However, non-cooperative behaviour may be manifested not only at the moment of renegotiation. Since specific investments constrain the choice of trading partners, policing eventual evasive tactics through simply switching to a new partner becomes costly. Thus, shirking may covertly permeate the whole relationship and represent a continuous test for its successful development.

The problem of moral hazard is additionally aggravated by information asymmetries that are difficult to surmount at a reasonable cost. If the client is unable to monitor the constructor's efforts in the execution of the construction project, it is highly likely that the constructor will not resist the temptation to underperform. Indeed, governance mechanisms attenuate the moral hazard and asymmetric information concerns, but they cannot completely annihilate all opportunistic incentives. Despite the important role of industry experts in the construction process, for example, the amount of construction disputes heard by courts in the three jurisdictions under comparison is not insignificant at all. In addition, let me also remind that the problems caused by private information concern not only observability but also verifiability of the characteristics of performance. Even if the Buyer can observe (or only infer) that the quality of the good or the Seller's efforts are not as required, he needs to prove this to a court in order to be able enforce the contract. Yet, in the construction process, for example, defects are easy to cover while the quality of the construction practices being part of the process, the communication between the parties and the exercised care by the constructor are difficult to establish. The awareness that one's own breaching behaviour is hard to verify only augments parties' common propensity to act in their own self-interest and to misrepresent facts in court. Thus, where the policing effect of market competition is absent and the party-designed governance mechanisms have failed, courts are called upon to resolve breach of contract disputes in a context of conspicuous information asymmetry between them and the parties.

---

[142] See *supra* Section A.2. Increased incompleteness of this Chapter.

The problems of moral hazard and information asymmetry manifest themselves when courts have to give precise meaning to vague standards. In fact, this is a difficult task from the outset since courts need to appraise conduct such as "effort", "reasonableness", "care" that may acquire multiple dimensions, that is difficult to quantify and whose conformity with the contract heavily depends on the circumstances developing over the life of the agreement.[143] In addition, to the extent vague standards describe desirable behaviour that is not encompassed by the imperfect proxies specified by the parties,[144] courts are compelled to determine the relevant proxy themselves. Note that in doing this job, they do not receive much guidance from lawmakers who, constrained by drafting costs (that should not exceed the social gain), generally devise statutory norms applicable to a large set of heterogeneous parties and to great many possible contingencies.[145] Thus, broadly framed defaults providing for *e.g.* "good faith", "reasonableness", "care of a prudent merchant", *etc*. are not an exception in the contract and commercial legislative acts of any of the three jurisdictions under comparison.[146] In this sense, the combined drafting practices of lawmakers and parties result in greater burden for courts which not only have to establish the true state of the world (also necessary when it comes to applying precise rules), but also have to choose the proxy that is optimal with respect to the realised state.[147] From this perspective the regulatory activity of courts finds expression not only in setting aside or modifying explicit contractual terms,[148] but also in assigning particular import to parties' ambiguous clauses.

The latent moral hazard that is so intrinsic to vague standards additionally complicates the work of courts which are anyhow charged with more responsibility. As already emphasised, standards integrate the need for cooperation[149] and reduce the promisee's incentives to extract a premium for his readjustment. But at the same time they encourage promisors to claim change of circumstances even when such has not ensued and force the other party in renegotiation appropriating some of the quasi-rents.[150] Standards' ambiguity may also incentivise an opportunistic party to evade a portion of his responsibility and then suggest to

---

[143] Gomez, 'Breach of Contract Issues in Long-Term Distribution Contracts'.
[144] See *supra* Section A.3. Rules and standards of this Chapter.
[145] Schwartz and Scott, 'Contract Theory and the Limits of Contract Law', 598-601.
[146] See UCC § 2-311. Options and Cooperation Respecting Performance. (1); the Supply of Goods and Services Act 1982, Part II, Section 13; Art. 302 of the Bulgarian Commercial Act.
[147] Scott and Triantis, 'Anticipating Litigation in Contract Design' 842.
[148] Cooter and Ulen, *Law and Economics* 224.
[149] See *supra* Section A.3. Rules and standards of this Chapter.
[150] Baird 587.

the court a proxy that is more favourable to him.[151] Certainly, specifying obligations after events have already taken place, courts have an informational advantage compared to parties who at the time of contracting can only presuppose the likelihood of occurrence of various contingencies.[152] Having superior information *ex post*, courts can be expected to select a more efficient proxy for the required performance.[153] Yet, the resolution of uncertainty does not alleviate the information asymmetry between the parties and the enforcer and the fact that the enforcer needs a sufficiently convincing evidence to take a decision. Thus, where the choice of optimal proxy depends not so much on the way the unknowable future evolved but on hidden information about quality of performance, the problem of verifiability remains and increases the possibility of court error.[154]

Another peculiarity that attaches an additional level of complexity to the issues encountered by courts upon breach of long-term contracts is the fact that the awarded remedy has an effect on parties' investment decisions. As already asserted,[155] long-term contracts are characterised by an implicit tension between *ex ante* and *ex post*, making the achievement of both *ex post* efficient trade and *ex ante* efficient investment a significant problem. To recall once again: as the future unfolds the *ex ante* contractual arrangements, ensuring specific investment that maximises the gains from trade, become suboptimal with respect to performance; yet, renegotiating them to guarantee efficient *ex post* trade disincentivises *ex ante* investment because of the possibility for hold-up. In fact, with change of conditions routinely affecting the cost and/or value of performance and with efficient levels of specific investment being impossible to fix at the time of contracting,[156] the problem of motivating concurrently efficient *ex post* trade and efficient *ex ante* specific investment has been identified as the central issue of economic contract theory today.[157] Note that this issue does not arise in the case of spot contracts where investments are normally generic and, thus, not subject to expropriation.

---

[151] Scott and Triantis, 'Anticipating Litigation in Contract Design' 844-845.
[152] Gilson, Sabel and Scott 454.
[153] Scott and Triantis, 'Anticipating Litigation in Contract Design' 842, 845.
[154] Ibid 842-843.
[155] See *supra* Section A.3. of this Chapter.
[156] For the difficulties to contract *ex ante* on specific investments, see *supra* Section A.2. Increased incompleteness of this Chapter.
[157] Schwartz and Scott, 'Contract Theory and the Limits of Contract Law' 545; Fernando Gomez, 'Termination and Compensation in Long-Term Distribution Contracts: An Economic Perspective of EU Law' in Pierre Larouche and Filomena Chirico (eds), *Economic Analysis of the DCFR The Work of the Economic Impact Group within CoPECL* (München: Sellier European Law Publishers 2010) 186.

Indeed, as already emphasised,[158] various governance devices implemented in parties' contracts are directed toward resolving, or at least attenuating, the above conundrum. However, such governance mechanisms may often turn out to be inadequate in counteracting the insufficient incentives to invest that result from the moral hazard problem (which is additionally exacerbated by vague standards) and the difficult verification of contractual breach. Therefore, harnessing all possible tools that have the capacity to contribute against dissipation of incentives to make specific investment is essential. In fact, legal remedies can have an important role in this respect. As it will be shown below,[159] they have a major impact on parties' investment decisions with the particular effect depending on the type of investment and the type of remedy. Yet, for the moment my point is a more limited one. Assuming courts are concerned with efficiency, their decision on the remedy in a dispute for breach of a long-term contract is more complex. One of the reasons for this is that they need to consider an additional effect of the legal remedy they will award: the effect on the incentive to make specific investment of parties who in the future may turn out to be in a situation similar to the facts of the case.

Last but not least, the problem of asymmetric information causes further difficulties when it comes to calculating damages with respect to contract breaches in specialised markets that differ substantially from perfect competition. As the market for substitute performance becomes thinner, the value of the second best alternative contract, compared to the value of the one concluded, decreases. As a result, expectation and reliance damages diverge considerably (the former exceeding the latter) making damage computation in case of breach of long-term contracts trickier.[160]

Irrespectively of whether Sellers adopt business conduct described by the traditional or by the fishing model, they often respond to breach by holding prices constant and reducing sales volume. Breached commodities are not resold on the spot market either because the latter is not sufficiently competitive and the resale would in fact lead to lower profits (traditional model) or because the very essence of the adopted strategy entails inventory adjustment as a

---

[158] See *supra* Section A.3. of this Chapter.

[159] For all the effects of remedies, see *infra* Chapter V. In particular, for the effect of remedies on parties' investment choices, see *infra* Section B., Section C., Section D and Section E. of Chapter V.

[160] This is true even where the business conduct of market participants is described by the traditional model. Cooter and Eisenberg, 'Damages for Breach of Contract' 1451. For long-term contracts being typical for specialised markets that differ substantially from perfect competition, see Section A.2. Specific investments of this Chapter.

response to demand fluctuations (fishing model).[161] Since there is no replacing of the breached contract with a substitute one (as required by the substitute-price formula), expectation damages equal the lost profits from the breached contract (the lost-surplus formula).[162] Yet, damages that account for the lost surplus from performances that have not in fact taken place are hard to establish.[163] Calculating the Buyer's expectation damages is also challenging. Since by definition idiosyncratic performances have few, if any, adequate substitutes, the market itself provides price information which implies computation error that is not insignificant. If the commodity is unique and not readily traded on the market, the estimated compensation is particularly imperfect as benchmarks for comparison are difficult to find. This issue arises in the case of partial or defective performance where expectation damages equal the difference between the contract price and the market price of the received performance (the so-called diminished-value formula).[164] Using market price to infer the Buyer's expectation damages also yields very inaccurate assessments when the Buyer values performance more than the market. If courts really face an atypical party (as opposed to an opportunistic party), an objective proxy such as market price may deviate so substantially from the plaintiff's subjective value that this results in reliance damages exceeding the expectation damages calculated by court.[165]

Turning to reliance damages, verifiability becomes even more problematic. If the non-breacher would have contracted with an alternative party, reliance damages need to reflect the opportunity cost of the breached contract captured by the opportunity-cost formula.[166] Yet,

---

[161] In imperfectly competitive markets in which the Seller's business conduct is described by the traditional model, the Seller may choose to lower prices and resell the breached commodities on the spot market. Yet, if the spot market is not sufficiently competitive, the Seller would be better off if, instead of prices, he adjusts inventory, *i.e.* retains the breached commodities and sells fewer of them without lowering the price. Ibid 1452-1454. The fishing model implies business conduct similar to the behaviour of a fisherman who casts his bait and waits for a catch to jump at it. Thus, if a Buyer defaults, the Seller simply waits for another one, willing to buy at the same price. In other words, under the fishing model a breach on the futures market does not result in an additional sale on the spot market. Ibid 1455-1457.

[162] See *supra* Table 1 in Section A.4. Spot contracts of this Chapter.

[163] Hermalin, Katz and Craswell 101.

[164] Cooter and Eisenberg, 'Damages for Breach of Contract' 1442; Cooter and Ulen, *Law and Economics* 310, footnote 3. See also *supra* Table 1 in Section A.4. Spot contracts of this Chapter.

[165] Cooter and Ulen, *Law and Economics* 316; Goetz and Scott, 'The Mitigation Principle: Toward a General Theory of Contractual Obligation', 1004, footnote 97.

[166] See *supra* Table 1 in Section A.4. Spot contracts of this Chapter. It must be emphasised that the Seller forgoes an opportunity only if his business conduct is described by the traditional model. Under the fishing model, the Seller contracts with anyone who is willing to pay the quoted price; hence, he does not forgo opportunities and does not incur opportunity-cost damages. The Seller is also not likely to incur significant out-of-pocket-cost damages since by not lowering the price he receives the expected return from the costs made every time he

determining the value of lost opportunities is easier said than done since it requires, first, proving the negative fact of not pursuing alternative offers and, second, verifying the forgone price, which is a largely speculative exercise where there is not an active market for the commodity, providing information about the second-best price.[167] Reliance damages seem easier to calculate if the non-breacher would not have contracted with an alternative contractual partner in which case they need to account for the difference between the costs of the investment made in reliance on the contract before breach and the realisable value of the investment after breach (the out-of-pocket-cost formula).[168] Still, computation is complicated by the fact that reliance expenditures often include overhead expenses and joint costs not readily assignable to a specific contract. This only increases the investor's incentive to mischarge costs and shift them between investments.[169] Measuring the promisee's gains from the investment made might also be problematic. If such problems lead to an award close to mere reimbursement of the out-of-pocket expenses, the reliance damages suffered by the promisee may be significantly overestimated.[170] In addition, when it comes to quantifying non-monetary investment representing the time and effort devoted by an executive manager to the particular contract, proving reliance damages in court is extraordinarily hard.[171]

In short, breach of long-term contracts raises more complex issues compared to spot contracts. While the opportunities and temptations for breach increase, so do the costs of observing and proving a non-cooperative behaviour. For courts, on the other hand, distinguishing breach from non-breach and choosing the most efficient remedy also becomes more difficult. This last subsection outlines three concrete aspects that make the task of courts with respect of breach of long-term contracts a more complicated one: interpretation of vague standards, awarding a remedy that offsets the insufficient incentives for specific investment

---

concludes a contract. Therefore, where the Seller's business conduct is described by the fishing model, he does not incur reliance damages. Cooter and Eisenberg, 'Damages for Breach of Contract' 1457-1458.

167 Ibid 1455, 1461, 1470; Hermalin, Katz and Craswell 101.

168 See *supra* Table 1 in Section A.4. Spot contracts of this Chapter. Cooter and Eisenberg, 'Damages for Breach of Contract' 1442, 1455; Cooter and Ulen, *Law and Economics* 311, footnote 5.

169 Charles Goetz and Robert Scott, 'Enforcing Promises: An Examination of the Basis of Contract' (1980) 89 The Yale Law Journal 1261, footnote 54; Yeon-Koo Che and Donald Hausch, 'Cooperative Investments and the Value of Contracting' (1999) 89 American Economic Review 125 125, footnote 1; Alexander Stremitzer, 'Standard Breach Remedies, Quality Thresholds and Cooperative Investments' 28 The Journal of Law, Economics, and Organization 337, 354.

170 Goetz and Scott, 'Enforcing Promises: An Examination of the Basis of Contract' 1289, 1290, footnote 57 and 58.

171 Cooter and Eisenberg, 'Damages for Breach of Contract' 1470; Che and Hausch, footnote 1.

and calculating damages. The first two lines of enquiry will be deepened in the following chapters.

This section B, on the other hand, strives for a different and more general point. The dominant distinction in national legal systems as well as in European Contract Law continues to be between business and consumer contracts. The view that consumers are systematically disadvantaged with respect to collecting valuable information has given rise to European and national consumer contract law intended to remedy information asymmetries that consumers can overcome only at prohibitively high costs. The section, however, leaves aside this ubiquitous division and instead pursues the distinction between spot and long-term contracts, with each of these categories including both business and consumer agreements. Thus, it is shown that information asymmetries are particularly grave in long-term contracting where they arise not only with regard to consumers but also with regard to business people. In the long-term range of the contractual continuum, asymmetric information (among other factors related to information costliness) causes increased contractual incompleteness which coupled with specific investment creates the setting for opportunistic behaviour that undermines *ex ante* efficiency and generates a huge social cost. From this perspective, long-term contracts call for contract law performing a regulatory function in order to correct the market failure as well as for researching whether national remedial contract rules exhibit trends in assuming such a regulatory function. The plausibility of that hypothesis is also confirmed by the predominance of long-term contracting and the persistently growing share of services (inherently gravitating towards the long-term contractual range) in the modern economies of developed countries.

This, however, should not be read as an argument in favour of introducing new mandatory rules in business contracts. As already explained in Chapter I,[172] default rules can also exercise a regulatory function and should be preferred as a regulatory method in the field of contract law. An eventual performance of such a regulatory function by national remedial contract rules does not preclude the possibility that they still differentiate between business and consumer contracts. The point, however, is that the prevailing business/consumer distinction may simply be blinding contemporary lawyers and diverting them from the possibility to see that national contract law has also been accommodating differences based

[172] See *supra* Section A.2. Default rules and mandatory rules of Chapter I.

on the degree of contractual incompleteness and investment specificity and not only on the status of the contracting parties. Such (in)sightlessness may be particularly counterproductive when discussing the structural design of new European legal instruments intended to boost trade in the internal market as well as the future of the entire European contract law.

B. Contract for sale of goods v. contract for services

The distinction between spot and long-term contracts in Section A. of this chapter ended with the conclusion that in the real world sale-of-goods and construction agreements may happen to fall in either range of the continuum; yet contracts for services (construction agreements included)[173] naturally lean more to the long-term end. This, however, is only a theoretical reflection that assumes pure sale-of-goods and service contracts which are delimited from each other by a clear and doubtless boundary. As usual, however, reality is much more complex and disorderly. Many of the contracts concluded on the market place today constitute neither pure transfer of property in existing goods, nor contracts for erection of a building and thus cannot be described as, respectively, sale-of-goods and construction contracts without any shadow of uncertainty. On the contrary, they contain both sale and service elements and, thus, present any national contract law with classification difficulties. Such mixed contracts then raise interesting questions. How does each of the three legal systems distinguish between contracts for sale of goods and contracts for services? Do they qualify contracts, containing strong service elements, as contracts for sale of goods? Or do they limit the contract of sale solely to title transfer?

The answers to such questions are important for at least for three reasons. First, the classification of mixed contracts within a legal system ultimately determines the applicable rules on remedies. In this sense, awareness of differences in legal taxonomy across jurisdictions (*e.g.* the same contract is classified as a sale of goods in one of the compared legal systems and as a contract for service/construction contract in another) is vital for performing comparative fact-based analysis. Second, how each national law resolves delimitation difficulties has a bearing on the way it accommodates long-term transactions within its own legal categories of sale-of-goods and service contracts. In this sense, the presence of service elements in a contract, classified as sale of goods, may push the contract

[173] Recall that in this thesis contracts for work and labour are termed "contracts for services". See *supra* the text accompanying footnotes 114-116 in Section B.1. of Chapter I.

away from the spot range. Third, the way in which national contract law accommodates the economic distinction between spot and long-term contracts in its legal taxonomy invariably affects the level of transaction costs in the national legal environment. For this reason, this section explores how each of the compared legal systems classifies mixed, borderline contracts that stray away from the ideal legal categories of a sale-of-goods and service contract.

The comparative investigation that follows is organised along two typical scenarios that spur problems of delimiting a contract for services from a contract for sale of goods: the first, – where the Seller produces a new thing using his own materials; and the second, – where the Seller affixes a moveable supplied by him to the land or premises of the Buyer. In both factual scenarios the passing of title to a thing, having the characteristics of a good, is accompanied by rendering a service. Yet, the first scenario emphasises the work that goes into the creation of the good, while the second one accentuates the work of erection or installation.

One last note before proceeding to the actual comparison. Investigating the second scenario, I inevitably discuss agreements that in the national context are usually entitled "contracts to supply and install machinery/equipment". Even when the national law classifies such agreements as contracts for services, some authors prefer to label them "contracts in the construction process"[174] rather than "construction contracts", in order to differentiate them from the classic contract for erection of a building. Nevertheless, to the extent that the following comparison shows that national judges deem the installation of machinery/equipment as no different from the erection of a building and apply the same remedial default terms, I will not hesitate to refer to such agreements as "construction contracts" further on in the thesis.

1. Producing a new thing with one's own materials

The vexing question of distinguishing between contract for sale of future goods and contract for services, where the Seller's work results in the creation of *nova species* to be delivered in performance of the contract, can be traced back to Roman law.[175] To this day the scenario in

---

[174] Miroslav Dimitrov, *The Construction Contract* (First edn, Sofia: Sibi 2012) 56-62, 66-67.

[175] As the law was settled by Justinian, the distinction between *emptio venditio* (the sales contract) and *locatio conductio operis* (lit. a hiring contract for services) depended on whether the material was supplied by the Seller,

which it is the Buyer who provides the materials necessary for the production of the new movable(s) does not raise doubts. All of the selected legal systems categorise such a relationship between the parties as contract for services.[176] However, the classification of a particular agreement which obliges the Seller not simply to repair or improve a thing of the Buyer, but to deliver an entirely new movable, manufactured by him, with his own materials, is by no means self-evident. The way in which each of the selected legal systems resolves this difficulty actually determines whether specialised goods, the latter, recall, being typical of long-term contracts,[177] can be subject to sale agreements at all.

Under Bulgarian law sale contracts do not entail specialised goods. Since the fact that the Seller carries out work with his own materials by no means precludes qualification of an agreement as one for services,[178] courts seek the differentiation of service from sale-of-goods contracts in the degree of individualisation and specification of the new thing which the promisor creates in order to perform his contractual obligations. If the agreement defines the new chattel that is to be manufactured only generically, this is a contract for sale. Conversely, if the agreement defines the chattel pointing at specific characteristics it needs to have or at specific parameters (*e.g.* productivity) it needs to satisfy, this is a contract for services. The explanation for relying on individualisation as a distinguishing feature is simple: to a buyer the process of producing the new thing is irrelevant; she is not interested in who and how will manufacture it; what she cares about is to become the owner of a chattel of a certain gender, so she defines it only by generic traits. By contrast, when it comes to a service contract, the client is in no way indifferent to the production process; she has particular requirements, even

---

in which case it was a contract for sale of goods, or by the Buyer, in which case it was a contract for services. Gaius, *Institutes of Roman Law*, vol III 24, 4, § 147.

[176] For the US, see *Wells v. 10-X Mfg. Co.* 609 F2d 248 (6th Cir 1979); *North Am. Leisure Corp. v. A&B Duplicators* 468 F2d 695 (2d Cir 1972). For England, see *Accurate Bailiffs & Collection Agency Ltd v. ITM Industries Ltd.* (1993) 78 BCLR (2d) 1; Philip Rawlings, 'Chapter 1. The Contract of Sale of Goods' in Michael Bridge (ed), *Benjamin's Sale of Goods* (Eighth edn, London: Sweet&Maxwell/Thomson Reuters 2010) 39-40. For Bulgaria, see Decision №1243 of 07.07.1997, c. c. №1288/1996, V c. d. of the Supreme Cassation Court; Decision №310 of 03.04.2008, comm. c. №994/2007, II comm. d. of the Supreme Cassation Court; Decision №205 of 17.03.2006, comm. c. №491/2005, I comm. d. of the Supreme Cassation Court; Kojuharov, *Law of Obligations. Specific Contracts* 166. Where each party supplies some of the materials, the characterisation of the contract depends on who supplies the principal (England, Bulgaria) or most (the US) of the materials. Again if this is the Buyer, the contract is one for services. For the US, see *Jackson Hole Traders v. Joseph* 931 P2d 244 (Wyo 1997); for England, see *Clay v. Yates* (1856) 1 H & N 73 and the subsequent explanation of the argument in *Lee v. Griffin* (1861) 1 Best and Smith 272, 121 ER 716, 716; for Bulgaria, see Kojuharov, *Law of Obligations. Specific Contracts* 166-167.

[177] See *supra* Section A.2. Specific investment of this Chapter.

[178] Art. 261(2) Contracts Act; Decision of 26.06.1964, c. №340 of 1964 of the State Arbitration Court. Thus, the distinguishing factor used by the Roman jurists is not adopted in Bulgarian law.

pretensions, to the article produced; consequently, the latter is individualised in detail by her specifications or design.[179] To be precise, following closely the German legal tradition, Kojuharov poses the (non-)fungibility of the new thing, and not its generic or specific identification, as the distinctive criterion between a sale-of-goods and a service contract. Yet, the reasoning remains the same: where the Seller creates a fungible chattel, the production process does not become part of the agreement, which is an outright sale; conversely, where the Seller creates a non-fungible chattel, the production process has substantial importance to the Buyer, which makes the contract one for services even though it is the Seller who supplies the materials.[180] Thus, although from a theoretical point of view individualisation and fungibility are different concepts,[181] the uniformity of the underlying rationale makes it of little significance which one is used as a criterion to distinguish between the two categories of contracts.[182] The described core rationale also reveals that Bulgarian contract law reserves custom-made goods to service contracts. This is not to say that sale-of-goods contracts can never fall into the long-term range. If nothing else, both the Contracts Act and the Commercial Act provide for sale contracts with periodic deliveries.[183] Yet, normally the goods involved in a sale are standardised, meaning that under Bulgarian law sale-of-goods contracts are typically attached to the spot range of the continuum.

This is not the case under US contract law where UCC flatly allows long-term sale arrangements having specialised goods as their subject-matter. In this respect, the Code differs from the previous Uniform Sales Act under which, similarly to today's Bulgarian law, a transaction, entailing goods manufactured by the seller especially for the buyer and not

---

[179] Asen Nikolov, *Liability of the Contractor in the Manufacture Contract* (Sofia: Science and Art 1970) 11-13. For a court case, applying the individualisation criterion to distinguish between a contract for sale of goods and a contract for services, see Decision №318 of 27.06.1994, c. c. № 177/1994 of the Supreme Court (a contract for the manufacturing of spare parts according to the drawings and technical specifications of the Buyer is categorised as contract for services).

[180] Kojuharov, *Law of Obligations. Specific Contracts* 167-168. For a court case, applying the (non-)fungibility criterion, see Decision №1574 of 7.01.2004, c. c. № 361/2003 of the Supreme Cassation Court. In German law a transaction in which the Seller supplies all the materials is equalised to a sale contract, except where a non-fungible thing is produced, in which case, it is classified as "*Werklieferungsvertrag*", a "mixed contract", requiring also application of legal provisions concerning contracts for services. Lorenz 7.

[181] Kalaydjiev 180.

[182] The label of the distinctive criterion makes a difference when analysing the time of passing of property rather than when deciding the category of the specific contract. *Cf.* Nikolov 11-13 with Kojuharov, *Law of Obligations. Specific Contracts* 167-168 and see Decision №1574 of 7.01.2004, c. c. № 361/2003 of the Supreme Cassation Court. But see also Decision №318 of 27.06.1994, c. c. № 177/1994 of the Supreme Court where while classifying the contract for manufacturing and delivery of spare parts as a contract for services, the court denied that the fungibility of the spare parts is of any relevance at all.

[183] Art. 208 Contracts Act; Art. 332 Commercial Act.

suitable for sale to others in the ordinary course of the seller's business, was not a sale, at all.[184]

In the UCC-era, when encountering a "mixed" agreement, US courts follow the so-called "predominant factor" test to determine whether the contract is a transaction in goods, and therefore covered by UCC, or a transaction in services, and therefore governed by common law. To decide whether the "predominant factor" "…, reasonably stated, is the rendition of service, with goods incidentally involved… or is a transaction of sale, with labour incidentally involved…"[185] courts examine several aspects of the contract: its language, the manner in which the transaction was billed, the intrinsic worth of the materials involved, the nature of the Seller's business, the moveability of the subject-matter.[186] Neither of these factors alone is determinative for the classification of the agreement. In any case, in order for UCC to apply, the transaction must be "in goods" and the very definition of "goods" under the Code includes "specially manufactured goods".[187] In this sense, the mere fact that the thing produced is adapted to the needs of a particular buyer does not take the contract out of the scope of the UCC. On the contrary, US courts consistently evaluate the services of engineering, design and manufacturing the good as incidental to the primary purpose of the contract and, hence, by no means precluding its characterisation in its entirety as a sale.[188] Thus, unlike Bulgarian law, US law does not exclude customised goods from sale contracts.

Struggling to distinguish between a contract for sale of goods and a contract for services where the promisor's work results in the creation of a new thing that is to be delivered in performance of the contract, English courts have developed two different rules that cannot be

---

[184] *Aced v. Hobbs-Sesack Plumbing Co.* 360 P2d 897 (Cal 1961). Surprisingly, there is one US court, relying on this pre-UCC decision to justify the applicability of UCC to a particular contract. See *Varco-Pruden, Inc. v. Hapmshire Construction Co.* 50 Cal App 3d 654 (Cal 1975). No other UCC case, however, follows this approach.

[185] *Bonebrake v. Cox* 499 F2d 951 (8th Cir 1974) at 960. The test is also sometimes called "predominant thrust" or "predominant purpose".

[186] For the "predominant factor" sub-tests, used by courts, see *Coakley and Williams, Inc. v Shatterproof Glass Corp.* 778 F2d 196 (4th Cir 1985); *BMC Industries v. Barth Industries* 160 F3d 1322 (11th Cir 1998); *Hensley v. Ray Motor's Co.* 580 SE2d 721 (NC App 2003).

[187] UCC § 2-105. Definitions: Transferability; "Goods"; "Future" Goods; "Lot"; "Commercial Unit". (1) as well as § 2-201. Formal Requirements; Statute of Frauds. (3)(a).

[188] *Belmont Industries v. Bechtel Corp.* 425 FSupp 524 (ED Pa 1976) (a contract to design, fabricate and deliver structural steel for construction of a container handling system); *Aluminum Co. of America v. Electro Flo Corp.* 451 F2d 1115 (10th Cir 1971) (a contract to design and produce flooring material according to the panel floor requirements of the client); *BMC Industries v. Barth Industries* (a contract to design and manufacture automated eyeglass lens equipment).

reconciled.[189] Judges consider neither the ownership of the materials, on which the work is bestowed,[190] nor the comparative value of the work and the materials conclusive of the matter.[191] Under the first test established in *Lee v. Griffin*, a contract is one for sale if "… when carried out, it would result in the sale of a chattel". Only "if the result of the contract is that the party has done work and labour which ends in nothing that can become the subject of a sale", is this a contract for service.[192] Following this famous dictum of Blackburn, J., courts have often held or simply assumed the contracts in dispute to be sale-of-goods, among them agreements, involving specially manufactured goods,[193] that would have also been characterised as sale contracts under US law, but would have been classified as service ones under Bulgarian law.[194] It cannot be overlooked, however, that under such an approach sale of goods can subsume any contract that can be described as transferring a chattel for a price,[195] even a contract with a sculptor, commissioned to execute a work of art.[196] Still, another, more restrictive test was introduced in *Robinson v. Graves* where a contract to paint a portrait of a lady was held to be a contract for services.[197] The court doubted the dictum of Blackburn J. in *Lee v. Griffin* and insisted that what was decisive was the "substance" of the contract: "If … the substance of the contract was the production of something to be sold …, then that is a sale of goods. But if the substance of the contract … is that skill and labour have to be exercised for the production of the article and that it is only ancillary to that that there will pass … to

---

189 In this sense, see also Rawlings 43.

190 This was suggested as a distinguishing criterion in *Atkinson v. Bell*, 1048, but the dictum was repudiated in *Grafton v. Armitage* (1845) 2 CB 336, 339.

191 *Lee v. Griffin*, 718.

192 In ibid a contract to make a set of artificial teeth was held to be a contract for the sale of goods. See the influential dictum of Blackburn J. in ibid 718.

193 See *e.g. Newman v. Lipman* [1951] 1 KB 333 (where a photographer took a photograph on the street and offered to supply a copy of it later), *Marcel Furriers Ltd v. Tapper* [1953] 1 WLR 49 (where a fur coat was made with materials and according to a style selected by the client, this was a contract for sale on a special order), , *Ashington Piggeries Ltd. v. Christopher Hill Ltd.* [1972] AC 441 (where animal food was compounded in accordance with a formula of the client), *Deta Nominees Pty Ltd. v. Viscount Plastic Products Pty Ltd.* [1979] VR 167 (an Australian case where the defendant produced a tool for the production of plastic drawers according to plaintiff's specifications).

194 *Cf. Deta Nominees Pty Ltd. v. Viscount Plastic Products Pty Ltd.* (see *supra* footnote 193 of this Chapter) with the Bulgarian Ruling №61 of 4.02.2009, comm. c. №812/2009, II comm. d. of the Supreme Cassation Court (a contract for the manufacturing and delivery of a drying machine produced according to specifications of the client, classified as a contract for services) and Decision №36 of 16.03.2004, c. c. №358/2003, IV c. d. of the Supreme Cassation Court (a contract for the manufacturing of a plum-mousse flow production line according to specifications of the client, classified as a contract for services) as well as with the US *BMC Industries v. Barth Industries* (see *supra* footnote 188 of this Chapter).

195 In this sense, see also Rawlings 41-42.

196 See the dictum of Blackburn J. in *Lee v. Griffin* 718.

197 *Robinson v. Graves* [1935] 1 KB 579. According to *Bonebrake v. Cox* at 960, under the US predominant factor test, a contract with artist for painting would also be a contract for services.

[the] client … some materials in addition to the skill involved … the substance of the contract is the skill and experience … in producing …".[198] Thus, in view of these lines one concludes that the "substance" of the contract depends on the relative importance of work and materials, both components of the final product that is to be delivered.

In essence determining the "substance" of the contract very much resembles determining its "predominant factor" – though in the US, the comparison between the importance of the different components involves, more correctly I think, the work element and the element of transfer of a finished good (which in the case of *Robinson v. Graves* would be the portrait) rather than the work element and the transfer of materials used in manufacturing the good.[199] Yet, by limiting the expansive test of *Lee v. Griffin*, the rule of *Robinson v. Graves* also brings the state of English law closer to the Bulgarian *ratio decidendi*. Note that in deciding *Robinson*, the court did not overrule *Isaacs v. Hardy*[200] where a picture dealer engaged an artist to paint and deliver him a picture of a given subject, so that he could sell the picture in the course of his business.[201] Note also that Slesser L.J. decided *Robinson* on the particular facts, pointing that the commission was to paint "the portrait of a *specific* lady" (emphasis added) who had to "give sittings" so that the work be executed.[202] All this suggests that the distinctive criterion, actually used by the English court, may be no other but the extent to which the Seller needs to tailor his performance in order to meet the requirements of the particular Buyer.[203] Indeed, it is only natural that as the need for tailoring increases, the importance of work also swells, becoming at one point the central component and, therefore, determining some of the contracts, involving customised goods, as contracts for services. This is also the implicit rationale of the standard applied in Bulgarian law where the contract is categorised as one for services based on the individualisation (or the non-fungibility) of the new thing produced, in which individualisation (non-fungibility) in fact serves as a proxy for the significant labour invested in the customisation of the good.[204] From this perspective, *Robinson v. Graves* could lead to the classification of an agreement for the supply of a good,

---

198 *Robinson v. Graves* 587. In fact the court returns to the criterion, suggested in *Clay v. Yates* 78, but discarded in *Lee v. Griffin*.
199 Note also that the intrinsic worth of the materials constitutes one of the sub-tests of the US predominant factor test while under English law the relative importance of the work and the materials is not determined by their relative value. See also *supra* the text accompanying footnote 191 of this Chapter.
200 *Isaacs v. Hardy* (1884) Cab & El 287.
201 *Robinson v. Graves* 594.
202 Ibid 591-592.
203 In a similar sense, see also Lorenz 6.
204 See *supra* the text accompanying footnotes 179-182 of this Chapter.

manufactured by the Seller with his own materials, as a contract for services, an outcome that would be the exact opposite to the one that would result under *Lee v. Griffin*. This would consequently engage common law remedies for breach of contract rather than the remedies under the Sale of Goods Act. Thus, the two different tests, pronounced in English law, could produce conflicting legal solutions and bring the application of different legal rules.

However, presented with a dispute regarding an agreement that mingles the service of transforming materials into a new good with the element of sale, English courts do not generally categorise the contract by applying *Robinson v. Graves*. Only when it comes to shipbuilding agreements, do judges, without referring expressly to the latter test, consider them to resemble construction contracts due to the significant work element involved.[205] Yet, these seem to be the only cases in which English courts do not reduce the parties' contractual relationships of the factual pattern discussed here to simple sale-of-goods contracts.[206] Normally, English courts prefer the clearer and more straightforward test of *Lee v Griffin*,[207] thus allowing sale contracts to have specialised goods as their subject matter. In other words, English law, just like US law, accommodates long-term sale-of-goods contracts much better than Bulgarian law.

2. Affixing supplied moveables

Conversely, Bulgarian law seems to confine the sale contract to the spot range of the continuum as far as possible. It generally conceives sale of goods as a transaction where delivery and payment take place simultaneously and at the same place.[208] Any sale contract which deviates from this ideal (sale by instalments or sale with advance payment) or which is conditional and, hence, can be expected to entail higher incompleteness (sale on try-out or inspection, sale with right of pre-emption, sale with additional specification of the subject-

---

205 *Hyundai Heavy Industries v. Papadopoulos* [1980] 1 WLR 1129; *Stocznia Gdanska v. Latvian Shipping* [1998] 1 WLR 574.

206 In *Foster Wheeler Group Engineering v. Chevron UK* Unreported February 29, 1996 the court viewed *Robinson v. Graves* as running along the lines of *Lee v. Griffin* and simply assumed the former to be the correct test. Yet, in this case the Seller was not obliged to manufacture a new thing; he only had engineering responsibilities – as well as responsibilities to correct the defects of the contractors that actually fabricated the equipment, so *Robinson v. Graves* was not really applied to a situation, in which the Seller created a new thing with his own materials. The same is true with respect to *Dodd and Dodd v. Wilson and McWilliam* [1946] 2 All ER 691 where veterinary surgeons supplied and applied a veterinary vaccine which, however, they purchased from a third party.

207 The Canadian Supreme Court of Victoria even considered the *Robinson v. Graves* test "unsatisfactory and illogical". See *Deta Nominees Pty Ltd. v. Viscount Plastic Products Pty Ltd.*

208 Art. 200(2) Contracts Act.

matter), has been considered to deserve a special rule.[209] In addition, the law strips the sale contract of any service element that may have a role in the transaction. This concerns not only the work of manufacturing the good, the importance of which, as shown above, removes the particular contract from the scope of sales law, but also the work of installing or affixing the good. Where installation and fitting services are offered independently of any title transfer, the agreement is an outright service contract.[210] The same is true where, as it is usual with specialised machinery, the contract entails work both in relation to the creation of the good and to its affixing.[211] With designing and manufacturing labour having determined the agreement as one for services, the presence of installation responsibilities is just one more fact that adds to such categorisation of the contract. Yet, in today's commerce installation services also commonly accompany the sale of standardised products, appliances or systems as Sellers offer them to Buyers in relation to the goods they deliver. On such occasions, Bulgarian courts "unmix" the different elements of the contract and apply sales law to the supply obligations and service law – to the installation and set-up responsibilities,[212] thus moving the latter under the same remedial regime that pertains to construction contracts. In other words, where the work does not go into the making of the good delivered, the contract is divided into a sale and a service portion, each governed by the relevant legal rules.[213]

By contrast, English courts do not engage in such separation of the different elements and classify the contract either as one for the sale of goods or as one for services.[214] Where they construe the parties' intention to be that property passes at the time of delivery of the chattel

---

[209] For sale by instalments, see Art. 205, 206 ibid and Art. 335 Commerce Act; for sale with advance payment, see Art. 201(1)(a) Contracts Act and Art. 334 Commerce Act; for conditional sales, see Art. 204 and 209 Contracts Act as well as Art. 331 and Art. 333 Commerce Act.

[210] Decision №250 of 11.01.2011, comm. c. №535/2010, II comm. dep. of the Supreme Cassation Court (a contract for the installation of equipment at a petrol station site where the equipment was furnished by the client).

[211] Decision №586 of 21.06.2007, comm. c. №227/2007 of the Supreme Cassation Court (a contract for the manufacturing and installation of an overhead crane). In addition, the agreements with respect to which Ruling №61 of 4.02.2009, comm. c. №812/2009, II comm. d. of the Supreme Cassation Court and Decision №36 of 16.03.2004, c. c. №358/2003, IV c. d. of the Supreme Cassation Court (see *supra* footnote 194 of this Chapter) were rendered also included installation responsibilities, which, however, were not decisive in categorising the contracts as such for services. Even if the Seller had not been charged with any affixation obligations, the agreements would have been classified as contracts for services based on the specific individualisation of the machines that were to be produced.

[212] Decision of 2003, comm. c. №2268/2002, I c. panel of the Sofia Appellate Court (a contract for sale, installation and set-up of a one-channel telephone radio communication system).

[213] See also Dimitrov 67.

[214] Thus, although in *H. Parsons (Livestock) Ltd. v. Uttley Ingham & Co Ltd* [1978] QB 791 Lord Denning thought the contract for the sale and erection of a hopper was divisible into two parts (at p. 800), the court held there was only one contract - a contract for sale (at p. 805 and 809).

and before its installation, the contract is a sale with a supplementary term to affix the good. Where courts find that parties intended property not to pass until affixation, *i.e.* until the time when the article had lost its character as a moveable, the contract is not for the sale of the article as a good, but a contract for services.[215] Sometimes, however, the intention of the parties may not be easy to determine, thus making the distinction between a sale-of-goods contract (with the installation agreement being only ancillary) and a service contract (with the supply of materials being only ancillary) very fine.[216] In this respect, the degree of individuality of performance matters. If the thing delivered is a standardised good, available on the market, which needs to be fixed because it cannot be used otherwise, English courts consider this a sale.[217] Indeed, installation entails some regard of the buyer's needs, but the seller offers to do this mainly to secure additional contracts, so it remains a comparatively small matter. If, however, the Seller undertakes to manufacture something under the contract for the particular Buyer and the thing comes into being through the very process of its incorporation in the Buyer's premises, then this is a contract for services, akin to construction contracts.

The approach of English courts is perhaps most apparent when comparing *Pritchett & Gold v. Currie*[218] and *Clark v. Bulmer*.[219] In both cases the contracts required the Seller to deliver a number of component parts at the Buyer's premises where he had to erect and put them together. Yet, in *Pritchett & Gold v. Currie* the contract was held to be a sale of the component parts of a battery, with an additional agreement for their erection,[220] while in *Clark v. Bulmer* it was held to be a contract for services.[221] The different interpretation adopted by courts in these two cases can be explained by the different degree of customisation that characterised the Seller's performance up until – and during – the time of affixation. Thus, in *Pritchett & Gold v. Currie* there was nothing particularly special either about the sixty-five component cells, making up the battery, or about the installation process. Though

[215] For a concise review of English case-law from which these principles can be distilled, see *Collins Trading Co. v. Maher* [1969] VR 20.
[216] In this sense, see also Rawlings 39.
[217] *Love v. Norman Wright (Builders) Ltd.* [1944] KB 484 (a contract for the supply and fixing of black-out curtains, rails and battens); *Philip Head & Sons v. Showfronts* [1970] 1 Lloyd's Rep 140 (a contract to deliver and lay a carpet at the defendant's showrooms); *H. Parsons (Livestock) Ltd. v. Uttley Ingham & Co Ltd* (see *supra* footnote 214 of this Chapter).
[218] *Pritchett & Gold v. Currie* [1916] 2 Ch 515.
[219] *Clark v. Bulmer*.
[220] *Pritchett & Gold v. Currie* 524-525.
[221] *Clark v. Bulmer* 796.

manufactured on the defendant's order, the cells themselves were identical and thus were hardly adapted to the specific conditions of Mrs. Currie's house. Their erection and connection was also a fairly ordinary process that required only standard fittings and did not have to be done exactly by the seller.[222] In fact, most probably the battery was delivered in component cells and not in a complete state mainly for logistical, if for any other, reasons. So, though the analysis of the parties' correspondence and material documents did not lead the court to construe the contract as a sale of a completed article,[223] it concluded the contract was for the sale of unascertained goods (the battery cells) the property of which passed at the time of delivery when they were appropriated to the contract. In other words, the agreement regarding installation was interpreted as a supplemental term to a contract that in substance was a sale.[224]

Although similar on the surface, in its essence the situation in *Clark v. Bulmer* was very different. The Seller was required to invest special skill and labour in order to build a steam engine that fit the particular purpose of pumping water out of the Buyer's mine. He was to exercise his expertise at all stages of performance – both at the stage of selecting materials and transforming them into tailor-made engine components and at the stage of fixing the components to the ground at the Buyer's colliery. The affixation process itself was essential to contract performance. The components produced at the Seller's manufactory were forwarded in parts and at different intervals to the mine where they were fixed one by one to the soil and, thus, converted into the engine that the Buyer sought to acquire.[225] Thus, unlike in *Pritchett & Gold v. Currie*, neither were the engine components a set of standard elements, nor was installation a mundane process of assembling and fixing the different components. The engine was not available, complete except for fixing, on the market. In fact, it became an engine only upon its erection, much like a building constructed on the owner's land, so erection was not merely some supplemental part of the contract. For these reasons, Parke, B. thought that the proper construction of the agreement was not as a contract for the sale of an engine which would afterwards be affixed but as a contract for erecting and constructing an engine. Following his earlier decision in *Tripp v. Armitage*, which concerned the treatment of

[222] Indeed it was the defendant company that ultimately erected the battery and not the seller, as agreed. *Pritchett & Gold v. Currie* 517.
[223] The correspondence and the material documents of the transaction all pointed at the delivery and erection of battery cells and not of a battery. *Clark v. Bulmer* 516-517.
[224] *Pritchett & Gold v. Currie* 524-525.
[225] *Clark v. Bulmer* 796.

materials used in the construction of a building,[226] Parke, B. refused to deem the engine components as goods sold and delivered, either. Where the contract was a service one, there was no sale of the engine components as moveables, at all.[227] The Buyer did not contract to acquire the parts of a steam engine; she contracted to have an engine, capable of fulfilling a certain task, constructed at her premises – and this was the substance of the contract that determined its classification. In this sense, it was the comparative importance of affixation and the overall extent of adaptation of the Seller's performance that shaped the outcome in *Clark v. Bulmer*. To put it differently, the same features that situate agreements for the making and installation of specialised machinery closer to the long-term end of the continuum, qualify such contracts in English law, in the same way as in Bulgarian law, as contracts for services.[228]

How does the involvement of installation services influence the categorisation of mixed contracts in the US? Similarly to Bulgarian courts, US courts sometimes sever the goods and the service aspect of the contract, using the so-called "gravamen of the action" test. Instead of centring on the nature of the transaction, the test focuses on whether the underlying action is brought because of a defect in the goods furnished, in which case UCC governs, or because of the quality of the services rendered, in which case common law applies.[229] Though the approach is rather an exception, it is often resorted to, just like in Bulgaria, where the goods involved can be purchased on the general market.[230] Thus, in a widely cited case, *Anthony Pools v. Sheehan*,[231] the court employed the gravamen test with respect to a contract that was predominately for consumer services (a contract to construct a swimming pool) to hold that the UCC warranty provisions applied to the incidental sale of an allegedly defective consumer good (a diving board), which was part of the pool-related equipment supplied by the constructor and which had retained its identity as consumer good. Yet, discussing the practice

---

[226] *Tripp v. Armitage* (1839) 4 M & W 687, 150 ER 1597 (a contract to build a hotel). See also *Young & Marten Ltd. v. McManus Childs Ltd.* [1969] 1 AC 454 (a sub-contract for roofing houses).
[227] *Clark v. Bulmer* 796.
[228] *Buxton v. Bedall* (1803) 3 East 303, 102 ER 613 (a contract for making two machines especially for the buyer and fixing them up at the buyer's premises); *Appleby v. Myers* (1866-1867) LR 2 CP 651 (a contract to erect certain machinery on the defendant's premises).
[229] *In re Trailer & Plumbing Supplies* 578 A2d 343 (NH 1990) at 345.
[230] In his concurring opinion in *Schenectady Steel Co. v. Bruno Trimpoli Gen. Constr. Co.* 350 NYS2d 920 (NYAD 1974) at 924, Greenblott, J. also advocates dividing the contract, with UCC controlling the Seller's obligation regarding the goods, "at least where the goods involved could have been purchased on the general market and used by the (customer)' ". *Cf.* with Lord Denning's dictum in *H. Parsons (Livestock) Ltd. v. Uttley Ingham & Co Ltd* at 800 (see *supra* footnote 214 of this Chapter).
[231] *Anthony Pools v. Sheehan* 455 A2d 434 (Md 1983).

of dividing mixed contracts, it must be emphasised that *Anthony Pools v. Sheehan* does not feature the same factual situation as the cases in which Bulgarian courts separate the transaction. Recall that what Bulgarian judges do is to divide the sale of standardised goods from the related installation responsibilities.[232] Conversely, in an identical factual situation, English courts consider the contract as a whole and apply sale-of-goods law.[233] That is, in a mixed contract with a clearly dominating sale component and only ancillary affixation responsibilities, Bulgarian courts relegate the sale and service portion of the contract to different bodies of law, while English courts apply the law of the dominating component to the entire contract. In contrast, in *Anthony Pools v. Sheehan* the court faces a predominately service contract and separates the incidental sale of related equipment from the leading work element to allow application of UCC warranties and afford better protection to the consumer-buyer. In other words, even though the case is a famous example of the divisibility approach applied by some courts in the US, it is not analogous to the factual situations in which Bulgarian courts sever the contract and in this sense does not represent material that is appropriate for comparison with the factual set distilled under Bulgarian law.

In fact, although there is some authority for treating mixed contracts, including those that entail affixation work, as divisible,[234] the majority of US courts still evaluate the entire contract along the sale-services continuum.[235] That is to say, similarly to English judges, when deciding whether to apply UCC or common law to a hybrid agreement, involving both sale of goods and provision of installation service, US judges normally engage in determining

---

[232] See *supra* footnotes 212 and 213 of this Chapter and the text accompanying them.

[233] See *supra* footnote 214 of this Chapter and the text accompanying it.

[234] In *Dixie Lime & Stone Co. v. Wiggins Scale Co.* 240 SE2d 323 (Ga App 1977) the court also divided the contract for sale and installation of a truck scale by using the gravamen test. Since the claimant was suing for defective construction of the pit and installation of the scale without claiming a defect of the scale itself, the court reasoned that the cause of action was based on the contractual provision for furnishing services, not on the separate provision for selling the scale and so refused to apply UCC. In *Insurance Co. of North America v. Radiant Electric Co.* 222 NW2d 323 (Mi 1974) in a dispute concerning a contract to install electrical wiring in an apartment building, the court held that UCC implied warranty applied with respect to the goods (clamps and cable) installed while common law implied warranty applied to the manner in which the goods were installed. In *Hooker & Sons v. Roberts Cabinet* 683 So2d 396 (Miss 1996) the court held that since the case did not concern the quality of the new cabinets manufactured, it was general contract law rather than UCC Article 2 that governed the dispute between a general contractor and subcontractor arising from the latter's refusal to dispose of cabinets that it tore out from a public housing redevelopment site for purposes of installation of new cabinets.

[235] Thus, in *Milau Assoc. v. North Ave. Dev. Corp.* 368 NE2d 1247 (NY 1977) at 1249-1250, the court sustained the practice of classifying the entire contract as either one for the sale of goods, or as one for services. See also *Pittsley v. Houser* 875 P2d 232 (Idaho App 1994) at 235 where the court was of the opinion that severing contracts into various parts and applying different law to each separate part contravenes the UCC's purpose ' "to simplify, clarify and modernize the law governing commercial transactions." '.

the overriding and the incidental component of the contract.[236] Using the predominant factor test,[237] they regard "mobility", being a key feature of goods,[238] as one of the significant factors, which though not decisive, may tip the balance in favour of classifying the contract as one for goods and not services.[239] In this respect, however, the fact that a moveable qualifying as a "good" is involved in the transaction is not sufficient. What is necessary is that the moveable constitutes the very subject-matter of the transaction and is still mobile at the time of identification to the contract. [240] Applying this so-called "moveability" sub-test to contracts for the supply and installation of equipment, US courts sometimes conclude that the subject of the transaction, the equipment system installed, comes into being only as an immoveable and consequently cannot be mobile when identified to the contract. For example, in *Osterholt v. St. Charles Drilling Company*[241] the court characterised the contract as primarily one for services because the defendant undertook to install a well and water system, specified only in terms of required capacity and not in terms of comprising goods.[242] Hence, the court reasoned, the component parts did not become identified to the contract until they were actually affixed to the plaintiff's property, so the transaction could not be qualified as essentially one "in goods".[243] In this sense, the court treated the contract as a classic contract for the construction of an immoveable fixture.

Still, very frequently, albeit not always, US courts hold that contracts for the supply and installation of equipment fall on the goods side of the *Bonebrake* test, thus differentiating them from classic construction contracts. In such contracts, the reasoning goes, the equipment is not just a material used in the erection of a fixture, but the primary subject of the transaction. It is completed and existing before its installation and, hence, is still moveable at

---

[236] To recall the test used by English judges, see *supra* the text accompanying footnotes 215 and 216 of this Chapter.
[237] See *supra* the text accompanying footnote 185 of this Chapter.
[238] See the definition of goods in UCC § 2-105. Definitions: Transferability; “Goods”; “Future” Goods; “Lot”; “Commercial Unit”. (1) as well as the Official Comment to Subsection (1).
[239] *BMC Industries v. Barth Industries* at 1330; *Space Leasing Associates v. Atantic Building Systems, Inc.* 241 SE2d 438 (Ga App 1977) at 441.
[240] On moveability as a sub-test of UCC applicability, see *BMC Industries v. Barth Industries* 1330-1331; Robert Marshall, ‘The Applicability of the Uniform Commercial Code to Construction Contracts’ (1979) 28 Emory Law Journal 335, 366-367.
[241] *Osterholt v. St. Charles Drilling Company* 500 FSupp 529 (Miss 1980).
[242] Recall that such specification of the system to be installed would also categorise the agreement as a contract for services under Bulgarian law. See *supra* the text accompanying footnotes 179 and 211 of this Chapter.
[243] *Osterholt v. St. Charles Drilling Company* at 533.

the time of identification. Therefore, the equipment falls within UCC's definition of goods.[244] Thus, where the moveability sub-test along with other determining factors, such as the language of the agreement and the manner in which the transaction was billed,[245] point at the dominance of the goods element, courts very often classify a contract for the supply and installation of equipment as a sale.

In this respect, if the equipment to be affixed is standardised, the moveability sub-test commonly directs a result identical to that in English law. Being pre-fabricated, the equipment is available complete, except for fixing, on the market and, in the absence of any special agreement, becomes identified upon delivery, *i.e.* while still being moveable. Under such circumstances, courts generally deem the installation service, provided under the contract, as only incidental and determine UCC as the governing law.[246] Even where the subject to be constructed is a steel building, the fact that it is pre-designed and pre-engineered makes the court view it as a kit of pre-made components which merely need to be assembled, rather than as a fixture which is constructed by taking a great variety of materials and assembling them into something new.[247] However, if applied to a contract, involving specially designed and manufactured equipment where installation plays an important role, the moveability sub-test again frequently leads US courts to the conclusion that the contract is predominately a sale of goods. On one hand, "specially manufactured" articles are not less "goods" within the meaning of UCC.[248] On the other hand, since the enquiry focuses on the nature of the equipment at the time of its identification to the contract, to the extent parties do not stipulate that identification occurs only upon affixation, the equipment, once fabricated, is

---

[244] *BMC Industries v. Barth Industries* at 1331 (see *supra* footnote 188 of this Chapter, the contract for design and manufacture of automated eyeglass lens equipment also included installation responsibilities, so besides discussing the importance of the service element of design and manufacturing, the court also applied the moveability sub-test); Marshall 366-367.

[245] See *supra* the text accompanying footnotes 185-186 of this Chapter.

[246] The most famous example, given at the very enunciation of the "predominant factor" test, is installation of a water heater in a bathroom. *Bonebrake v. Cox* at 960. The court in *Bonebrake* also classified the disputed contract, an agreement for delivery and installation of bowling equipment, as a contract for sale, emphasising that the equipment was identified before installation and that it did not come into existence on the site because it was pre-fabricated and already used. Ibid 959. See also *Meyers v. Henderson Construction* 370 A2d 547 (NJ Super 1977) where a contract for the supply and installation of pre-fabricated overhead doors was qualified as a contract for sale of goods although the installation of the disassembled doors required a mechanic and a helper to spend more than 15 days hinging the panels together, installing the tracks, setting the assembled doors in place and mounting the glass panels in them. But see *Glover School & Office Equipment Co. v. Dave Hall* 372 A2d 221 (Del Super 1977) where a contract for providing and installing school lockers, tackboards and chalkboards, all standard items, was held to be a contract for services.

[247] *Cober v. Corle* 610 A2d 1036 (Pa Super 1992), but see *Herman v. Bonanza Buildings* 390 NW2d 536 (Neb 1986).

[248] See *supra* footnote 187 of this Chapter and the text accompanying it.

still moveable at the relevant moment and, hence, a "good" in the sense of the Code.[249] Thus, the fact that the contract involves installation services, which ultimately render the article immobile, is of little consequence. The contract is considered heavily weighted toward goods and hence falling within the scope of UCC.[250]

To put it shortly, in contrast to their Bulgarian and English colleagues, US judges tend to view contracts for the supply and installation of specialised machinery/equipment as "transactions in goods". And though the contrast is the same in its end result, the reasons for it differ depending on the jurisdiction. While the difference with Bulgarian law is a logical outcome of the latter's consistent removal of any service element, including those related to affixation, from the sale contract, the divergence with English law is rooted in the different moment in time, pertinent to the evaluation of the contract's predominant purpose. Moving this moment to the earlier time of identification to the contract (as opposed to the time of passing property in England)[251] allows US courts to depreciate the importance of the installation services involved. Such depreciation takes place irrespectively of any counterarguments about the size of the equipment erected on the Buyer's premises[252] or the amount of labour and skill entailed

---

[249] For the time when identification to the contract occurs, see UCC § 2-501. Insurable Interest in Goods; Manner of Identification of Goods.

[250] *Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co.* 532 F2d 572 (7th Cir 1976) (a contract for the construction of a one-million-gallon water tank); *Cambridge Plating Co. v. Napco* 991 F2d 21 (Mass 1993) (a contract for design, delivery and installation of wastewater treatment system) - *cf.* with *Osterholt v. St. Charles Drilling Company* (see *supra* footnotes 241-243 of this Chapter and the text accompanying them); *BMC Industries v. Barth Industries* (see *supra* footnote 188 of this Chapter); *Ogden Martin Systems of Indianapolis v. Whiting Corp.* 179 F3d 523 (7th Cir 1999) (a contract to construct, deliver, and assemble two 13.5 ton solid waste refuse cranes and operating systems) - *cf.* with Decision №586 of 21.06.2007, comm. c. №227/2007 of the Supreme Cassation Court (see *supra* footnote 211 of this Chapter).

[251] Under US and English law the title to equipment and materials in construction contracts passes only upon their incorporation into the site despite the fact that they have been identified/appropriated to the contract at an earlier stage, *e.g.* upon delivery or approval. For England, see *Tripp v. Armitage* (1839) 4 M & W 687, 150 ER 1597; for the US, see Sweet 413. Still, in some US cases the issue of passing of title has also been considered by courts when determining the predominant purpose of the contract. For example, in *Nitrin, Inc. v. Bethlehem Steel Corp.* 342 NE2d 65 (Ill App 1976) at 78, the court took into consideration, among other things, that under the disputed contract for the construction of an anhydrous ammonia plant, the client acquired title to all machinery, equipment and supplies not from the constructor but directly from the individual dealers. This meant that the disputed contract did not contain any sale element that could mandate the application of UCC. Also, in *Entron, Inc. v. General Cablevision* 435 F2d 995 (5th Cir 1970) at 1000, the court interpreted the contractual provision stating that title remained with the Seller until completion, acceptance and payment of the entire television system as a clear indication that the contract was for sale of goods.

[252] *Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co.* at 580 ("…we are unaware of any authority that specially manufactured small dies should be goods and a very large tank not so classified."); *Ogden Martin Systems of Indianapolis v. Whiting Corp.* at 529 ("The suggestion that an object such as a crane is capable of being delivered and yet incapable of being moved approaches an oxymoron.").

in the process of affixation.[253] It also permits courts to focus not on the moment of conversion of the different pieces of equipment into a unified operational system, but on the moveability characteristic of the separate parts and, thus, regard them as goods sold and delivered. This is exactly the opposite stand to that taken by Parke, B. in *Clark v Bulmer* where, recall, he refused to treat the parts of the engine as moveable goods the property of which passed upon delivery at the plaintiff's premises.[254] In this sense, by liberally constructing the definition of "goods", US courts tend to broaden the scope of UCC and subsume under the Code mixed long-term contacts,[255] which in England and Bulgaria would be classified as contracts for services and handled as construction contracts.

In fact, the emphasis on mobility sometimes leads US courts to qualify even classic construction contracts, which do not involve any specialised machinery or equipment, as contracts for the sale of goods. Thus, in *Smith v. Union Supply*[256] a contract to install a new roof was held to be governed by UCC with the sole argument that the materials installed on the roof were moveable at the time of identification to the contract.[257] It is also not clear what distinguishes the contract to furnish and install pre-fabricated overhead doors, characterised in *Meyers v. Henderson Construction*[258] as sale of goods on the basis of the moveability criterion, from an ordinary construction subcontract, under which the subcontractor purchases doors specified by the client directly from the manufacturer and then installs them on the job

---

[253] Evidently, careful and skilful installation was crucial in order for the wastewater treatment system in *Cambridge Plating Co. v. Napco* to operate properly. Installation included eighty-eight different pieces of equipment and, along with debugging, took a whole year. Subsequently, only the second expert, and only after a lengthy and meticulous inspection, could identify that some parts of the equipment were not installed. Nevertheless, the court classified the contract as one for sale of goods.

[254] See *supra* the text accompanying footnotes 226 and 227 of this Chapter. *Cf. Clark v. Bulmer* at 796 with *Cambridge Plating Co. v. Napco* at 24. To make the juxtaposition even more explicit, imagine how *Clark v. Bulmer* could have been decided under US law. Indeed, unlike the contract in *Cambridge Plating Co. v. Napco*, the contract in *Clark v. Bulmer* did not identify the various components of the steam engine and in this sense the engine appeared less as a kit that only needed to be assembled and affixed to the plaintiff's land. Yet, Parke, B. could decide that the very delivery of the component parts at the colliery clearly indicated that the Seller had designated them as goods to which the contract referred and so the time of their identification undoubtedly occurred before installation.

[255] In this sense, see *Cambridge Plating Co. v. Napco* at 24; *Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co.* at 580; *Meyers v. Henderson Construction* at 80 citing approvingly *Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co.*; *BMC Industries v. Barth Industries* at 1330 citing *Cambridge Plating Co. v. Napco* as well as another case, in which the courts believed that the general trend is to view such mixed contracts as governed by the UCC.

[256] *Smith v. Union Supply* 675 P2d 333 (Colo App 1993).

[257] Ibid at 334. *Cf.* with *O.W. Grun Roofing & Construction v. Cope* 529 SW2d 258 (Tex 1975); *Frommert v. Bobson Construction* 558 NW2d 239 (Mich App 1996) as well as with *Young & Marten Ltd. v. McManus Childs Ltd.* [1969] 1 AC 454 (see *supra* footnote 226 of this Chapter).

[258] *Meyers v. Henderson Construction* (see *supra* footnote 246 of this Chapter).

site.[259] Add to this also the other aspects of the contract that courts deem important when evaluating its predominant nature – the contractual language, which they sometimes interpret fairly selectively;[260] the presence or absence of a separate charge for services; the portion of the overall contractual price that the cost of goods constitutes – and it becomes clear that, compared to English courts, US ones tend to focus on form and to downgrade the overall substance of the contract.[261]

In other words, when it comes to mixed agreements that involve affixation services, the decisions of US judges are less consistent than those of their Bulgarian and English colleagues. While Bulgarian and English courts are firm that contracts to supply and install specialised machinery/equipment are contracts for services, the position of US courts is not so foreseeable: they may characterise such agreements as service contracts but at the same time exhibit a clear tendency toward classifying them as contracts for sale of goods. While Bulgarian and English courts do not express any doubts as to the categorisation of construction subcontracts, US courts may sometimes render surprising decisions qualifying them as transactions in goods. From this perspective, compared to the default tests in Bulgaria and England, the predominant factor test with its intrinsic lack of predictability[262] unquestionably raises transaction costs. First, it raises drafting costs since parties either need to be very careful with the contractual language they use in order not to prompt the court to categorise the contract contrary to their intention, or need to include an explicit provision as to the governing law (UCC or common law).[263] Second, it raises uncertainty and error costs. Since the court has to analyse a number of proxies together with the evidence related to them as well as to choose what weight to place on the different proxies, the likelihood of judicial

---

[259] In this sense, see also Marshall 354. *Cf.* with *Ranger Construction v. Dixie Floor* 433 F Supp 442 (DSC 1977) (a contract for installation of resilient flooring where the court, relying on the language of the contract and on the nature of the subcontractor's primary business, found UCC inapplicable); *Milau Assoc. v. North Ave. Dev. Corp.* (a contract under which a subcontractor was obliged to furnish and install a wet pipe sprinkler system - also characterised as a contract for services); *Coakley and Williams, Inc. v Shatterproof Glass Corp.* (a contract with a subcontractor to furnish and install an aluminium and glass curtain wall and storefront work in a building - also deemed a contract for services).

[260] In *Entron, Inc. v. General Cablevision* at 1000 (see *supra* footnote 251 of this Chapter) the court, relying heavily on the contractual language, held that a contract for the construction of a community antenna television system was sufficiently a sale of goods as to bring it within UCC. The court considered it significant that the contract referred to the defendant as the "buyer", but at the same time ignored that the agreement spelled out the plaintiff's obligation as being to "*construct* and sell" (emphasis added) the television system.

[261] In this sense, see also *Anthony Pools v. Sheehan* at 440.

[262] For a strong criticism and rare explicit refutation of the test, see *Elkins Manor Assoc. v. Eleanor Concrete Works* 396 SE2d 463 (W Va 1990) at 469.

[263] On the possibility that parties may, by an explicit provision, subject a contract to UCC or exclude it from its scope, see Allan Farnsworth, *Farnsworth on Contracts*, vol I (Third edn, New York: Aspen Publishers 2004) 58

error increases. This invites parties to behave opportunistically. A defendant, for example, may strategically claim that the agreement is a sale-of-goods contract in order to justify the application of the shorter UCC limitation period and thus preclude the plaintiff from obtaining any remedy.[264] Or a plaintiff may claim that a service contract is in fact a sale-of-goods one to be able to assert breach of a UCC implied warranty and thus benefit from a smaller evidentiary burden.[265] Moreover, considering the different remedies under UCC and common law, opportunism may not be limited to parties' conduct in court. The possibility of having to pay UCC market damages rather than the higher cost-of-completion damages, typical for construction contracts, may incentivise a promisor, whose benefit from breach would be sufficiently great, to shirk his responsibilities and default in the first place.[266] All this taken into account, the increase in transaction costs may in fact offset the advantage of having such a multi-factored test which, in principle, is appropriate for heterogeneous contexts and allows for decisions that reflect the actual nature of the particular contractual relationship. In fact, neither the Bulgarian (focusing on the degree of individualisation in the contract and the presence of installation services), nor the English test (focusing on the time of passing of property), which differentiates sale-of-goods from construction contracts, is a default *rule* in the sense of a default term whose content is specified in advance.[267] Each of them gives courts some flexibility and opportunity to account for the concrete circumstances – the English test – more than the Bulgarian one. Yet, since the tests do not involve so many sub-aspects and relevant proxies, they are applied more uniformly and entail less uncertainty and prospect of judicial error. Thus, the more predictable Bulgarian and English tests appear to be more cost-saving than the US predominant factor test.

---

[264] Under UCC § 2-725. Statute of Limitations in Contracts for Sale. (1) the UCC limitation period is four years and parties may not agree to extend it. In contrast, in most states the limitation period applicable to contracts that fall outside UCC is five years or more.

[265] In contrast to UCC, common law does not imply any warranty of merchantability or of fitness for particular purpose. See UCC § 2-314. Implied Warranty: Merchantability; Usage of Trade. and § 2-315. Implied Warranty: Fitness for Particular Purpose. Thus, when common law applies, the plaintiff cannot simply show that the thing is not fit for its ordinary or particular purpose. She has to resort either to a negligence claim (requiring her to prove that the promisor has a duty to the aggrieved party and has violated the respective standard of care) or to a claim of breach of an express warranty (requiring her to prove violation of an explicit warranty term in the agreement). Marshall 337-339.

[266] See *e.g. Freeman v. Shannon Construction* 560 SW2d 732 (Tex 1977) (where a cement subcontractor who had abandoned work contended that the contract called for sale of goods and consequently the general contractor's damages should have been limited to the difference between the market and the contract price together with any incidental and consequential damages as provided by UCC § 2-713. Buyer's Damages for Non-Delivery or Repudiation).

[267] See *supra* footnote 69 of Chapter I.

Discussing transaction costs, a note on the approach of dividing mixed contracts *versus* that of treating them as entire, is also necessary. As shown by the comparative analysis above, while Bulgarian courts divide agreements mixing sale of standardised goods with installation services, English and US courts generally consider such contracts as entire and apply to them sale-of-goods law.[268] The latter practice has the advantage of lowering *ex post* transaction costs. First, it lowers verification costs as the aggrieved party does not have to verify whether non-conformity stems from a defect of the good or from defective installation; she simply needs to show lack of conformity without proving the reason for it. Second, it simplifies *ex post* administration for courts and thus reduces uncertainty and error costs. Still, the practice also has a downside because it may incentivise strategic behaviour on the side of the Buyer. Extending the more demanding warranties of sale-of-goods law to the service element of the contract, the approach may motivate her to claim breach of contract for any performance of the affixation obligations that is less than perfect. The Buyer may even terminate the entire contract, including its sale portion, for only a minor non-conformity resulting from installation.[269] Thus, whether ultimately the gains from treating the contract as entire will exceed the losses from opportunism depends on the particular circumstances.

In this respect, note that even though the contracts, of which the choice is between dividing the contract or considering it as entire, are all contracts involving the sale of standardised goods and affixation responsibilities, they still vary considerably from one another. Thus, a contract for the sale of curtains and rails which must also be fixed[270] is so predominantly a sale contract with installation being so incidental an obligation that the reduction in transaction costs may very well surpass any eventual losses from opportunism. On the other hand, in a contract for the construction of a steel building out of pre-made components[271] the service element is not as marginal and a qualification of the entire transaction as such "in goods" is fairly disputable. From this perspective, even in these standardised-good contracts,

---

[268] *Cf.* footnotes 212 and 213 of this Chapter and the text accompanying them (for Bulgaria), with footnote 214 of this Chapter and the accompanying text (for England), and with footnote 235 of this Chapter and the accompanying text (for the US).

[269] See *e.g. Hooker & Sons v. Roberts Cabinet* (see *supra* footnote 234 of this Chapter) where the Buyer asserted that since the contract was governed in its entirety by UCC, the Seller's substantial performance and breach of only an incidental service obligation did not preclude her from unilaterally terminating the agreement. For opportunistic behaviour on the part of the Seller, see *Dixie Lime & Stone Co. v. Wiggins Scale Co.* (see *supra* footnote 234 of this Chapter), where the Seller contended that the Buyer had no right to damages since, the contract being in its entirety a contract for sale of goods, she had not given notice of alleged defects which under UCC was a precondition for an action of damages.

[270] *Love v. Norman Wright (Builders) Ltd.* (see *supra* footnote 217 of this Chapter).

[271] *Cober v. Corle* (see *supra* footnote 247 of this Chapter).

which are characterised in their entirety as sale-of-goods in the US and England, the importance of the service element fluctuates. As the importance of its role increases, the risk of opportunism also augments, thus increasing the chance that the gains from cost-saving may be swallowed by the losses from strategic behaviour. Thus, where the service mingling with the sale of standardised goods does not play so trivial a role and the choice is between severing the contract and relegating it in its entirety to the single body of sale-of-goods law, the former approach may be the better option.

The comparison of the categorisation of mixed contracts in the two scenarios above: where the Seller delivers a new good, which he has manufactured with his own materials, and where the contract involves the sale of a moveable and installation responsibilities, reveal US and Bulgarian contract law as diametrical opposites. While Bulgarian contract law denies to any contract involving a service element, be it the service of manufacturing or of affixing, the character of sale of goods, US law tends to downplay the importance of the service component in order to fit the contract within the scope of UCC. Thus, while Bulgarian contract law reserves the sale-of-goods contract for the spot range, US law, allowing for the involvement of a substantial service component, rather envisages sale of goods as a contract gravitating to the long-term span. As for English contract law, it takes an intermediate position. Classifying as sales, contracts that involve significant work related to the creation of the delivered good, English courts accommodate long-term transactions within contracts for sale of goods. Where, however, the service element involves erection, affixation, or installation obligations, which play an important role, thus pointing at a long-term relationship, the contract is classified as one for services. In this sense, English contract law incorporates long-term transactions in contracts for sales of goods; yet, it does not exhibit the tendency of US law to subsume all mixed contracts with substantial service elements under sale-of-goods law.

Conclusion

Having distinguished the features which determine the spot or long-term character of a contract and having shown that in a legal system the differentiation between sale-of-goods and construction contracts does not necessarily go along the lines of the spot/long-term distinction, I can now make some basic decisions about the positive comparative analysis in Chapter VI.

First, while comparison of the availability of termination will take place not only across jurisdictions but also across the legal categories of sale-of-goods and construction contracts, the selection of similar court disputes concerning each of the specific contracts will always be made with an eye on the availability of a market for substitute performances. In this sense, the analysis will seek to compare not only whether national courts grant termination in a similar factual situation, involving a sale-of-goods, respectively, a construction contract, but also whether the type (spot or long-term) of the particular contract, being it sale-of-goods or construction, affects the remedial awards of courts belonging to the same jurisdiction. As it has been shown, where the presence of a market for substitute performance is a criterion for matching analogous contractual disputes, some issues of delimitation between sale-of-goods and service contracts arise and it is perfectly possible that a contract classified as a sale of goods in one of the chosen jurisdictions is actually qualified as a contract for services in another.[272] In this respect, once the national legal taxonomy has served to identify the applicable legal rules, the comparative analysis will not hesitate to go beyond it and juxtapose similar factual scenarios even if they happen to be classified under a different legal category in the different jurisdictions.

Second, the selection of similar contractual disputes will not cover cases in which courts apply the special contractual remedies, provided by national contract law in case of breach of consumer sale-of-goods and construction contracts. In practice, this would affect the selection of court cases with respect to Bulgaria and England, which having implemented the consumer *acquis*, adopted on the EU level, differentiate their contract rules according to the kind of parties involved – business or consumer.[273] It would not make a difference with respect to the choice of cases in the US, where contract law, whether common law or UCC, is not intended to deal with problems of consumer protection and, thus, remains integrated.[274] Some may

[272] See *supra* Section B. of this Chapter.

[273] In other words, the selection of similar contractual disputes will not cover cases, decided under the Act on Protection of Consumers in Bulgaria as well as under Part 5A Additional Rights of Buyer in Consumer Cases of the Sale of Goods Act 1979 and Part 1B Additional Rights of Transferee in Consumer Cases of the Supply of Goods and Services Act 1982 in England.

[274] In the US, UCC does not generally provide consumer buyers with specific contractual remedies. Continuing the common law tradition that contract law applies to merchants as well as others, the Code itself is not designed to protect consumers and leaves this role to the Uniform Consumer Credit Code and to other statutes adopted on state level. UCC legal provisions directed particularly to sale-of-goods contracts involving consumers can be counted on the fingers of one hand. See *e.g.* UCC § 2-502. Buyer's Right to Goods on Seller's Repudiation, Failure to Deliver or Insolvency. (1)(a); § 2-719. Contractual Modification or Limitation of Remedy. (3). A number of the amendments to UCC proposed in 2003 envisaged the modification of some legal provisions precisely with respect to consumer contracts; yet, since no state enacted the amendments and the prospects for

think that disregarding the consumer protection remedies available in Bulgaria and England skews the comparison; yet, this is a conscious and justified decision. The *raison d'être* for treating consumers as a special class of contracting parties is that they are inevitably the weaker actor, so in case of supply of defective goods[275] they need to be provided with additional, special remedies to correct the informational asymmetry that disadvantages them. As already emphasised, however, asymmetric information is a serious issue when it comes to long-term contracting generally, no matter whether the contracting parties are businesses or consumers. For this reason, the thesis engages in exploring the role of contractual remedies by investigating national contract law through a distinction based on the type of contract and not on the kind of party involved. This does not mean that the comparison will cover only disputes between businesses. On the contrary, court cases concerning business-to-consumer contracts are also included in the survey, but they have either been decided before the insertion of the special consumer remedies in English and Bulgarian law,[276] or they do not end with the award of consumer remedies, which once adopted are available simultaneously and in parallel to the general ones.[277] In this respect, the purpose is, first, to explore whether

---

enactment were fairly gloomy, the amendments were withdrawn from the Official Text in 2011. See Recommendation of the Permanent Editorial Board for the Uniform Commercial Code to Withdraw the 2003 Amendments to UCC Articles 2 and 2A from the Official Text of the Uniform Commercial Code, available at: http://www.theconglomerate.org/2011/05/withdrawing-the-2003-amendments-to-ucc-articles-2-and-2a.html, last accessed on 08.06.2014.

[275] The special remedies of consumer buyers, which were inserted in English and Bulgarian law to comply with the requirements of Consumer Sales Directive, apply only in case of supply of defective goods. They do not apply with respect to claims for lack of title and claims for pure non-delivery or late delivery.

[276] In England the additional consumer remedies were inserted in the Sale of Goods Act 1979 and the Supply of Goods and Services Act 1982 by the Sale and Supply of Goods to Consumers Regulations 2002 (SI 2002/3045) and became effective on March 31, 2003. In Bulgaria the special consumer remedies were introduced by the Act on Protection of Consumers, promulgated State Gazette №99 of 09.12.2005, in force since 10.06.2006, last amended State Gazette №18 of 01.03.2011.

[277] The special remedies made available to consumers excluded neither the existing common law remedies in England, nor the existing remedies under the Contracts Act in Bulgaria, which are considered to be "more stringent provisions", ensuring a higher level of consumer protection, in the sense of Art. 8.2 of the Consumer Sales Directive. Indeed, in England it has been maintained that since the special consumer remedies are heavily qualified by limitations of reasonableness and proportionality, which are determined by a court only *ex post*, the common law remedies are more advantageous to a consumer buyer. See in this sense F. M. B. Reynolds, 'Chapter 12. Remedies in Respect of Defects' in Michael Bridge (ed), *Benjamin's Sale of Goods* (Eighth edn, London: Sweet&Maxwell/Thomson Reuters 2010) 634-635, 658-659; A. G.; Reynolds Guest, F. M. B.; Beale, H. G., 'Chapter 43. Sale of Goods' in H.G. Beale (ed), *Chitty on Contracts*, vol II (Thirty-first edn, London: Sweet&Maxwell/Thomson reuters 2012) 1513-1514. In Bulgaria, too, it has been pointed out that the limitations as to the order, in which the special consumer remedies may be used, in practice make them inferior to the general remedies under the Contracts Act, the choice of which is left entirely to the buyer's own discretion. Kristian Takov, 'Rights of the Consumer Buyer in Case of Non-Conforming Goods' (2007) 2 Commercial Law 35, 56-57. In addition, §1 of the Bulgarian Act on Protection of Consumers, stating that in case of conflict between two statutory acts, the one that ensures a higher level of protection to consumers applies, also leads to the conclusion that the special consumer remedies do not simply derogate the existing general remedies for non-conforming goods. Anguel Shopov, 'Consumer Contracts in Bulgarian Law' (2010) 1 Legal World 141, 146-

aggravation of informational asymmetry causes national contract law to develop a regulatory function on its own, without EU law having to impose outside legal solutions. And second, the aim is also to explore whether national contract law accounts for the peculiarities of consumers (*i.e.* fewer resources available to collect information, limited cognitive abilities, smaller bargaining power, attaching idiosyncratic value to performance) but within the frames of the more general long-term contract type, which can appear either as commercial, or as consumer agreements.

Yet, before proceeding to the actual comparison, the reader still needs one more piece of the puzzle. After all, if remedies are going to be explored from a consequentialist viewpoint, one needs to know how they affect human behaviour, and what they encourage and discourage parties to do. Since economic analysis has advanced most with respect to incentives generated by damages, this is the remedy on which the model, reconstructed in the following chapter, is grounded. Yet, as it will be shown in Chapter VI below, the knowledge provided by this model can be adapted to analyze other remedies, including termination, which has so far remained outside the focus of law-and-economics scholars' attention.

In a way, the previous two chapters of the thesis can be viewed as such identifying the very basis of the economic model of incentives. Thus, Chapter III defined the three damage measures used in the model and showed that they are not restricted solely to the common law tradition. This chapter, on the other hand, isolated the variables of *ex ante* specific investment and *ex post* contractual performance and, thus, set the scene for illuminating the trade-offs among the different incentives, generated by damages. Departing from this foundation, I now turn to the economic model itself.

147, 154, 157. See Decision №4454 of 27.06.2011, app. c. c. №2069/2011 of Sofia City Court where on appeal the court rejected the buyer's complaint about the first instance court wrongly classifying the seller's liability under the Contracts Act instead of under the Act on Protection of Consumers, stating that the latter act did not exclude, limit or decrease the seller's obligations under the Contracts Act and the Commercial Act. Thus, the court recognised that the buyer had two alternative paths for seeking protection but pointed out that she should have raised the issue at the first instance. See also Decision №1614 of 31.07.2014, c. c. №2633/2014 of Regional Court – Bourgas where the court discussed the fact that the liability of the seller toward the consumer-buyer was provided in two acts – the Contracts Act and the Consumer Protection Act, and then resolved the conflict between the two statutes by applying, on the grounds of §1, the longer (and hence more favourable to the consumer) two-year term of the Act on Protection of Consumers. Justifying its decision as to the applicable law, the court also pointed out that the plaintiff herself based her claim on the Consumer Protection Act, thus implicitly acknowledging that the Contracts Act was not an unavailable course for demanding protection.

Chapter V Incentives

This chapter analyses how damages affect parties' incentives. Besides exploring which measures of damages induce efficient performance and efficient specific investment (categories already identified as crucial in Chapter IV), the current chapter distinguishes a number of other effects generated by damages.

Unlike the first generation of economic analysis, which focused solely on the ability of different damage measures to induce an efficient breach decision, today's economic scholarship recognises that damages produce a whole constellation of incentive effects. Somewhat paradoxically, in its early days contract law and economics downplayed the significance of remedies. As long as *ex post* negotiation costs were sufficiently low, the reasoning went, renegotiation would correct any inefficient incentives regarding performance and breach that might be produced by a suboptimal remedy. Thus, it was suggested, the measure of damages mattered only when renegotiation was prohibitively costly and, hence, failed or did not take place at all.[1] Acknowledging the many aspects of contractual behaviour influenced by damages, modern economic analysis, in fact, reveals the true role of remedies. Damages also allocate risks and affect the parties' incentives to take precautions against breach, to mitigate or to search for a contracting partner. But unlike the decision to perform or breach, all these decisions are made before uncertainty has been resolved, so the inefficiencies they entail cannot be rectified by renegotiation even if it was costless. In this sense, the measure of damages is relevant whether renegotiation is sufficiently cheap to carry out or not.[2] Damages, thus, are a truly powerful mechanism to achieve efficient results.

This does not mean to say that *ex post* renegotiations make no difference at all.[3] As it was shown in the previous chapter, renegotiation has an importance of its own. Besides performance or breach, it is another choice available to promisors in case of regret contingency. And, as already emphasised, it has a mixed effect on players' behaviour, an

---

[1] Richard Craswell, 'Contract Remedies, Renegotiation and the Theory of Efficient Breach' (1988) 61 Southern California Law Review 629, 632-636; Shavell, *Foundations of Economic Analysis of Law* 362-364.
[2] Craswell, 'Contract Remedies, Renegotiation and the Theory of Efficient Breach'.
[3] For the factors, among them asymmetric information, on which the likelihood of renegotiations depends, see Shavell, *Foundations of Economic Analysis of Law* 314-316; William Rogerson, 'Efficient Reliance and Damage Measures for Breach of Contract' (1984) 15 The Rand Journal of Economics 39, 41.

effect which should be taken into account when designing efficient legal rules,[4] especially considering that parties cannot consensually rule out subsequent contract modification.[5] For this reason, the complications brought by renegotiation are also considered in the economic analysis of incentives induced by damages.

Finally, I would like to point out that the model in this chapter relies on the assumptions commonly made in traditional microeconomic analysis: transaction costs are either zero, or prohibitively high; information is symmetric and parties are risk neutral (it is only Section J. below that admits that actors are often risk averse and discusses risk allocation). Enforcement costs are generally ignored, so the promisee is assumed to sue whenever damages are positive. The reader, however, should not hastily interpret this as a step back from the commitment to realism proclaimed in Chapter II. Let me remind that as early as the second chapter I noted that this thesis will not simply ignore traditional economic models that are necessary to identify the many incentive effects generated by damages as well as the trade-offs between incentives.[6] This is precisely the purpose of the current chapter, which justifies the above-mentioned assumptions. Having thrown light upon these issues, I will be able to open the window onto reality in a more informed way in the following chapters.

The different effects induced by damages are elaborated below one by one,[7] leading to the conclusion that no single damage measure is optimal in view of all of the isolated behavioural incentives.

---

[4] On the importance of renegotiation, see Ian Ayres, 'Valuing Modern Contract Scholarship' (2003) 112 Yale Law Journal 881, 892-894; Scott and Triantis, 'Incomplete Contracts and the Theory of Contract Design' 192-195.

[5] In all three jurisdictions under comparison, courts do not enforce contractual clauses that prohibit contract modifications. For the US, see Restatement (Second) of Contracts (1979) § 311 Variation of a Duty to a Beneficiary, comment a; *Beatty v. Guggenheim Exploration Co.* 122 NE 378, 381 (NY 1919); *Zum-winkel v. Legget* 345 SW2d 89, 93-94 (Mo 1961). UCC § 2-209. Modification, Rescission and Waiver. (2) permitted no-oral-modification clauses but simultaneously subjected them to certain procedural and substantive requirements. For England, see *Schebsman (Deceased) Ex p. Official Receiver, Re* [1944] Ch 83 at 104. For Bulgaria, see Art. 20a(2) Contracts Act. Even if such contractual clauses were enforceable, parties would always be able to circumvent them by dressing a modification of the initial contract as a new agreement.

[6] See *supra* the text accompanying footnote 57 in Section C. of Chapter II.

[7] The model of incentive effects created by damages largely follows Hermalin, Katz and Craswell 102-114. Still, the account herein identifies and discusses an additional effect of damages: the incentives they create with regard to making cooperative investment. See *infra* Section D. of this Chapter.

A. The decision to perform or breach the contract

Assuming the promisor would choose to default if paying damages leaves him better off than performance, it is fairly intuitive that the higher the amount of damages a promisor has to pay upon breach, the greater his incentive to perform would be.[8] Economic analysis, however, goes beyond this general intuition and identifies the remedy that incentivises a contracting party to perform when and only when it is efficient. If the promisor's costs are higher than the promisee's expected value from the transaction, it is more efficient to default. Calling off performance under these conditions is referred to in the literature as "efficient breach".[9] To put it less formally, breach is efficient not when an increase of the promisor's costs (or decrease of the promisee's value) make the contract unprofitable for him, but when performance creates no surplus for both parties *en masse*.[10] If costs and expected value had single, fixed valuations, parties would forgo contracting in the first place. But as they are stochastic variables whose valuations are realised after signing and shortly before performance of the contract, providing for a remedy which incentivises the promisor to perform or breach efficiently an already existing contract is particularly important.[11]

As it was mentioned before, the decision to perform or breach is taken only after the uncertainty as to costs and expected value has been resolved. Since this is also the time when *ex post* readjustment makes sense,[12] in the case when renegotiation is possible, whether the applicable remedy generates efficient incentives to perform or breach is not an issue at all. Renegotiation would lead to efficient performance irrespective of the remedy.[13] If the latter induces performance when it is inefficient, the promisor would pay to the promisee up to her loss to be excused from performance. If the remedy induces the promisor to breach

---

[8] Such an assumption implies that when making the decision to default, a promisor ignores the harm inflicted by breach on his reputation.
[9] Hermalin, Katz and Craswell 102.
[10] Gerrit De Geest, 'Specific Performance, Damages and Unforeseen Contingencies in the Draft Common Frame of Reference' in Filomena Chirico and Pierre Larouche (eds), *Economic analysis of the DCFR: the Work of the Economic Impact Group within CoPECL* (Sellier European Law Publishers 2010) 124.
[11] Hermalin, Katz and Craswell 102-103.
[12] Instead of assuming breach at the time of performance, the more recent economic models provide for a more refined timeline, which includes an anticipatory breach. See Yeon-Koo Che and Tai-Yeong Chung, 'Contract Damages and Cooperative Investments' (1999) 30 The Rand Journal of Economics 84, 89, 97-98, footnote 26; Stremitzer 342-343. Renegotiation can take place before or after breach, whether it is anticipatory or not, but always after realisation of the cost and value of performance. In any case, the timing of renegotiation (before or after breach) does not change the analysis. Che and Chung, 'Contract Damages and Cooperative Investments' 97, footnote 26.
[13] Craswell, 'Contract Remedies, Renegotiation and the Theory of Efficient Breach' 632-636; Shavell, *Foundations of Economic Analysis of Law* 362-364; Hermalin, Katz and Craswell 104.

inefficiently, the promisee would "bribe" the promisor to motivate him to perform. In this sense, functionally, renegotiation is an alternative means to ensure *ex post* efficient exchange.[14] In the absence of renegotiation, however, the remedial rule is crucial with regard to inducing performance if and only if its value exceeds its cost. The remedy that creates this very incentive, given a fixed level of reliance, is expectation damages.[15]

The explanation of this effect of expectation damages lies in the fact that they reflect the costs the breach inflicts on the promisee.[16] Assuming the promisor knows the magnitude of these costs, to decide whether to perform or not, he has to weigh his savings in case of breach against both his own and his partner's losses. Thus, expectation damages incentivise the promisor to breach when the cost of performance to him exceeds the value of performance not only to him but also to the promisee. In other words, the promisor chooses to breach precisely when it is efficient to do so.[17] Since neither reliance damages, nor restitution compensate fully the promisee for her lost benefit of the contract, both measures induce the promisor to breach more often than the efficient level.[18] Only if the market strongly resembles a perfectly competitive one can reliance damages create efficient incentives for the promisor's performance as then they are practically equal to expectation damages.[19] On the other hand, supracompensatory damages, such as disgorgement and punitive damages, motivate the promisor to perform more often than the efficient level.[20]

The result about the expectation measure holds regardless of the realised valuations of cost and expected value, irrespective of which party is the breacher (the Seller or the Buyer), and regardless of the time of payment of the price (up-front or at the time of performance).[21]

---

[14] Shavell, *Foundations of Economic Analysis of Law* 316-319. The given examples, in which one of the parties bribes the other, implicitly assume that renegotiation can take place only before breach. The conclusion about the role of costless renegotiation in ensuring efficient performance does not change if renegotiation can occur after breach. In this case, the promisor accounts for the expected return from negotiations when deciding whether to breach. Even if he breaches inefficiently, for strategic purposes, renegotiation again results in efficient trade. Che and Chung, 'Contract Damages and Cooperative Investments' 89, 97-98, footnote 27.
[15] Steven Shavell, 'Damage Measures for Breach of Contract' (1980) 11 Bell Journal of Economics 466, 478, 485.
[16] Recall that expectation damages put the promisee in the position he would have been in had the contract been performed. See *supra* the text accompanying footnotes 78-81 in Section C.1. of Chapter III.
[17] Hermalin, Katz and Craswell 103; Cooter and Eisenberg, 'Damages for Breach of Contract' 1463.
[18] Hermalin, Katz and Craswell 105.
[19] See *supra* the text accompanying footnote 135 in Section A.4. Spot contracts of Chapter IV; Cooter and Eisenberg, 'Damages for Breach of Contract' 1463.
[20] Hermalin, Katz and Craswell 105.
[21] Shavell, 'Damage Measures for Breach of Contract'; Shavell, *Foundations of Economic Analysis of Law* 349.

Under some conditions it is also valid where performance is not a binary yes/no decision.[22] Thus, in the case when actors sign a contract for some quantity of commodities,[23] expectation damages incentivise the party who has the decision rights over the actual quantity that is eventually traded to choose the quantity that is optimal and breach efficiently with respect to the commodities that turn to be in excess of the optimal amount of trade.[24] Compensating the other party for her expectation, the promisor receives whatever is left from the joint profit generated by the contract. He is the so-called "residual claimant of the joint surplus"; hence, he is motivated to choose only that part of the agreed quantity with respect to which the value of performance exceeds the cost.[25] Also, under certain conditions (a Cadillac contract, payment made to the breaching party up-front and a broad duty to mitigate) expectation damages motivate the selfishly or cooperatively investing Seller to make an efficient decision when he chooses to breach by performing non-conformingly.[26] However, having emphasised

---

[22] Aaron Edlin and Stefan Reichelstein, 'Holdups, Standard Breach Remedies and Optimal Investment' (1996) 86 The American Economic Review 478; Aaron Edlin, 'Cadillac contracts and Up-Front Payments: Efficient Investment under Expectation Damages' (1996) 12 Journal of Law, Economics and Organization 98, 111-114; Aaron Edlin, 'Breach Remedies' in Peter Newman (ed), *The New Palgrave Dictionary of Economics and the Law*, vol I (First edn, London: Macmillan Reference Limited 1998) 174. By contrast, in Shavell's model trade is discrete and the promisor either performs, or not. Shavell, 'Damage Measures for Breach of Contract' 470. Edlin, in fact, extends Shavell's result to situations in which performance is not a dichotomous decision.

[23] In the language of economists, where parties sign a contract for a quantity of commodities that is larger than 1 unit, trade is not discrete but is better denoted by a continuous variable. Edlin, 'Breach Remedies' 174.

[24] For the sake of clarity, a party can have unilateral decision rights with regard to the actual quantity that is eventually traded only if this quantity is smaller than the one agreed upon. With regard to a larger quantity, the parties will have to renegotiate, which is inconsistent with unilateral decision rights. Ibid. In order for the breacher to be able to unilaterally decide on the traded quantity, it is necessary that the contract be interpreted as divisible. For a definition of a divisible contract, see Restatement (Second) § 240 Part Performances as Agreed Equivalents. When the contract is divisible (*i.e.* comprising of corresponding pairs of part performances that can be properly regarded as agreed equivalents), the breacher's cancellation of some of the apportioned pairs does not affect the parties' obligations with respect to the remaining portion of the quantity due under the uncancelled pairs of part performances. Otherwise, if the contract is deemed entire, the non-breacher will be released of all her obligations and will be able to claim expectation damages not only with respect to the cancelled portion but with respect to the entire contracted quantity. In other words, the promisee will be able to hold up the breacher and insist on more than her expectation interest in order to perform only on the smaller optimal quantity. Ibid 174-175; Edlin and Reichelstein, 'Holdups, Standard Breach Remedies and Optimal Investment' 487. The issue of divisibility does not arise when the contract provides for periodic performances over time since when the breacher cancels a portion of the agreed quantity, the non-breacher cannot escape performance on the quantities of the previous periods. In such case, for the breacher to have decision rights on the traded quantity, it is sufficient that he has the right to terminate the contract prematurely. Edlin, 'Breach Remedies' 175; Edlin, 'Cadillac contracts and Up-Front Payments: Efficient Investment under Expectation Damages' 114, footnote 23. Note that this discussion of the termination right ignores the issue of the optimal timing of breach and focuses only on the issue of optimal quantity. Regarding the optimal timing of breach, see *infra* Section G. of this Chapter.

[25] Edlin, 'Breach Remedies'.

[26] This is another extension of Shavell's efficient breach result to cases of non-discrete trade. Edlin, 'Cadillac contracts and Up-Front Payments: Efficient Investment under Expectation Damages', 111-114; Edlin, 'Breach Remedies' 174; Stremitzer. In case the Seller invests cooperatively, an up-front payment is not necessary. Ibid 346, footnote 13.

the broad applicability of the optimal perform-or-breach result generated by the expectation measure, it is also necessary to note its limitations.

As they compel the breacher to internalise only his partner's losses, expectation damages incentivise the promisor to consider only the promisee's but not any third parties' change of position resulting from his breach. Arguing that it is antitrust, environmental or other fields of law that are concerned with such negative externalities, when analysing contract law, economics-minded scholars generally assume away costs that might be inflicted on third parties.[27] I also follow most of the literature in this respect. In addition, expectation damages will create an efficient incentive to perform as well as the other incentives discussed below to the extent the contract can actually be enforced. If the promisor believes that there is a good chance for him to get away without paying, he will have an incentive to breach that from the perspective of efficiency is excessive.[28] A promisor, in fact, may have a number of reasons to expect that he would not have to compensate the other party: courts sometimes make mistakes or they may be corrupt, bailiffs may be corrupt or incapable of enforcing courts' awards, the breacher may expect to go bankrupt or that the promisee would not sue. The distortion of incentives resulting from the uncertainty of enforcement may be corrected by increasing the size of damage awards in the cases actually resolved by courts. This has been used as an argument in favour of supracompensatory, in particular punitive, damages. Without elaborating on the problems with this rationale,[29] it serves to recall once again that punitive damages are awarded very rarely in contract, if at all.[30] Last but not least, to generate the said effect, expectation damages must be calculated perfectly. Potentially the expectation measure permits judges to hold liable all contract breachers and to save themselves the inquiry about the efficiency of any particular default. Yet, they need to be able to measure correctly the promisee's value from performance.[31] Courts, on the other hand, are widely believed to have the propensity to award lower than perfect expectation damages. Various reasons are pointed

[27] Schwartz and Scott, 'Contract Theory and the Limits of Contract Law' 546.
[28] Hermalin, Katz and Craswell 103.
[29] On one hand, the multiplier that optimises the perform-or-breach decision may not optimise the other decisions affected by damages. On the other hand, sometimes the optimal multiplier will lead to decreasing, not increasing the damage awards. See Craswell, 'Contract Remedies, Renegotiation and the Theory of Efficient Breach' 664-665.
[30] Hermalin, Katz and Craswell 121-122. As for punitive damages, see *supra* footnote 8 of Chapter III.
[31] Ibid 103; Craswell, 'Two Economic Theories of Enforcing Promises' 22-23.

at: the non-breacher's losses may be difficult to verify,[32] awards are limited to damages that are foreseeable at the time of signing the agreement,[33] damages often do not reflect adequately the costs that the delay causes to the non-breacher; the non-breacher, even if successful in court, bears his own litigation costs.[34] If courts, however, are likely to err downwards in awarding expectation damages, promisors will not have a strong enough incentive to perform.[35]

Besides affecting the very decision of whether to perform or breach a contract, damages also influence the parties' decisions that are directed at reducing the probability of harm-inflicting breach: the decision to take precautions and to select a contractual partner. In the following section I turn to the precaution decision of the party who commits breach.[36]

B. The breaching party's decision to take precautions

In the literature the term "precautions" is used to denote expenses incurred to reduce the likelihood of breach or the scale of damages that follow from it.[37] Being expenses, economists think of them as investments[38] while lawyers see them as a species of reliance. When made by the promisor, they fall into the category Fuller and Perdue refer to as "essential reliance".[39] In other words, these are expenditures incurred towards the performance of the promisor's own obligations, which entail concrete measures intended to prevent breach. In the case of a construction contract, the constructor, for example, could order materials early in the project to avoid price increases that would raise his costs and incentivise him to default. Or he could

---

[32] On verification difficulties, see *supra* the text accompanying footnote 162-171 in Section A.4. Long-term contracts of Chapter IV.
[33] On this point see *infra* Section E. of this Chapter.
[34] This is the general rule in the US where the party prevailing in litigation still bears his own attorney fees and major litigation expenses. The losing party is charged only with some small litigation cost items such as charges for service of papers. Dobbs 276. In contrast, in England and Bulgaria the party losing the lawsuit bears all litigation costs. Art. 78(1) Code of Civil Procedure. As to the reasons for courts' imperfect assessment of damages, see Steven Shavell, 'Why Breach of Contract May Not be Immoral Given the Incompleteness of Contracts' in Omri-Ben Shashar and Ariel Porat (eds), *Fault in American Contract Law* (First edn, New York: Cambridge Univesity Press 2010) 263.
[35] Hermalin, Katz and Craswell 103.
[36] For the precaution decisions of the non-breaching party, see *infra* Sections C. and E. of this Chapter. For the selection decision, see *infra* Section H.1. of this Chapter.
[37] Cooter, 'Unity in Tort, Contract, and Property: The Model of Precaution' 3.
[38] Hermalin, Katz and Craswell 104.
[39] Fuller and Perdue, 'The Reliance Interest in Contract Damages: 1' 78. See also *supra* the text accompanying footnote 94 in Section C.2. of Chapter III. Eisenberg and McDonnell refer to the same category of expenses as "necessary reliance". See Melvin Eisenberg and Brett McDonnell, 'Expectation Damages and the Theory of Overreliance' (2002) 54 Hastongs Law Journal 1335, 1342-1344.

hire additional workers to avoid any undesirable change in circumstances (such as many absentees because of illness) that would lead to a delay in the project and eventually cause him to breach. Precautions can also be taken by Buyers. A buyer who has purchased machinery that calls for concrete foundations must make the necessary expenses to lay the foundation in order to be able to take delivery.[40] In any case, the precautionary steps taken by the breaching party increase the chances that the surplus of the contract will materialise.[41]

The reasoning evolves similarly to that in relation to the perform-or-breach decision. The higher the breacher's liability, the greater his incentive to increase the probability of himself performing. The promisor, however, decides how much to spend on precautions before the uncertainty as to the stochastic variables of cost and value has resolved. In this sense it is important that the law prescribes a remedy that incentivises the breaching party to take an efficient decision with regard to precautions, a decision that accounts for the possibility that under some realised valuations of cost and value, it will be more efficient to breach. A given precautionary measure is optimal if the additional expenses the potential breacher would make by taking it are less than the increase in the non-breacher's expected revenue caused by the higher probability of performance.[42] Since expectation damages (if calculated accurately) make the breaching party compensate the promisee for all her losses resulting from breach, they compel the breacher to internalise the costs of his failure and to take efficient steps against possible obstacles to completion of the contract. Consequently, expectation damages incentivise the breacher to take efficient precautions.[43] Thus, it is expectation damages that can optimise both the promisor's decision to choose between performance and breach and his decision to make expenses on precautions.[44]

Unless equal to expectation damages, reliance damages, which in principle do not reflect the aggrieved party's benefit of the contract, enable the breacher to externalise some of the costs of his breach and respectively give him the incentive to take precautions that are insufficient relative to the efficient level. This is also valid for restitution as well as for any remedy that is

---

[40] The example is borrowed from Eisenberg and McDonnell, 'Expectation Damages and the Theory of Overreliance' 1342.
[41] Cooter, 'Unity in Tort, Contract, and Property: The Model of Precaution' 11, Cooter and Eisenberg, 'Damages for Breach of Contract' 1464.
[42] Cooter, 'Unity in Tort, Contract, and Property: The Model of Precaution'13, 34; Hermalin, Katz and Craswell 104.
[43] Hermalin, Katz and Craswell 104-105; Cooter and Eisenberg, 'Damages for Breach of Contract' 1464.
[44] Shavell, 'Damage Measures for Breach of Contract' 485-486; Hermalin, Katz and Craswell 105.

systematically less than expectation damages.[45] As explained above, under these remedies, the promisor tends to breach more often than it is efficient; consequently, he does not get the full return on his investment in performing, so his incentive is to spend less on costly precautions than what would be optimal.[46] Conversely, supracompensatory damages induce the promisor to make excessive efforts to prevent breach.[47]

To put it another way, expectation damages incentivise the breaching party to take efficient precautions because they reveal to him the costs his default imposes on the non-breacher.[48] This incentive-generating function of theirs, however, rests on the assumption of perfectly informed courts and promisors. It implies that courts are able to calculate the promisee's expected gain from performance and promisors are able to measure the damages they will be liable for. Under these conditions, expectation damages are crucial for the efficiency of the promisor's precaution decision. This is not the case, though, when it is not the promisor but the promisee that is perfectly informed. If before signing the contract promisees can observe the level of precautions taken by a promisor, the market could induce him to take optimal precautions since otherwise he would lose business to competitors that are more careful about reducing the chances for breach.[49] Even if promisors choose precautionary measures only after contracting, in a world of perfect promisee's information breachers will take efficient precaution decisions regardless of the damage measure. This assumption of perfect information, however, is very strong as it requires that promisees know not only the average distribution of risks in the market. It is not even sufficient that promisees know the risks created by any particular promisor; they must also be able to accurately assess the difference between the risk associated with the level of precautions taken by this same promisor and the risk associated with other promisors.[50] Obviously, these are very difficult-to-satisfy information requirements; yet, mechanisms that effectively make non-breachers more informed could optimise the precaution decision. For example, if promisees can observe promisors' reputation for taking precautions, a potential breacher could have efficient incentives to prevent default. After all, a good reputation would allow him to negotiate higher

---

[45] Cooter and Eisenberg, 'Damages for Breach of Contract' 1464; Hermalin, Katz and Craswell 105.
[46] Shavell, 'Damage Measures for Breach of Contract', 486-487.
[47] Hermalin, Katz and Craswell 105; Craswell, 'Contract Remedies, Renegotiation and the Theory of Efficient Breach' 647.
[48] Lewis Kornhauser, 'Reliance, Reputation, and Breach of Contract' (1983) 26 Journal of Law and Economics 691, 701.
[49] Ibid 694; Hermalin, Katz and Craswell 105.
[50] Craswell, 'Contract Remedies, Renegotiation and the Theory of Efficient Breach' 653-655.

prices on his goods/services.[51] Thus, where non-breaching parties are informed shoppers, whether due to a legal or non-legal institution, a remedy that is systematically less than expectation damages might do.[52]

Often, however, it is not only the promisor who can take precautions against breach. Promisees are also able to take steps directed at reducing the harm from the promisor's default. In Sections C., E. and F. below I consider the various forms of precaution that can be taken by the promisee. To understand better how damages affect the non-breacher's incentives to take precautions, it is worth starting from the promisee's decision to rely on the contract by investing selfishly in it.

C. The non-breaching party's decision to make selfish investment in reliance

The more precautions the promisor takes against breach, the more he relies on the contract. In contrast, for the promisee taking precautions means less (and not more) reliance.[53] The reason for this asymmetry lies in the fundamentally different nature of the non-breacher's reliance. The latter is not necessitated by the promisee's contractual commitment; rather it is discretionary and often occurs in relation to collateral contracts, thus constituting what Fuller and Perdue call "incidental reliance".[54] In addition, it does not simply enhance the likelihood that the promisee enjoys the benefit from the contract, it enhances this benefit. By relying on the contract, the non-breaching party increases the value of performance to himself; yet, in this way he also adds to the damages he would suffer in case of breach. From this perspective, less reliance on the promisee's side actually represents a precautionary measure that decreases the losses he would possibly bear.[55]

Most often, reliance on the contract has (at least) some relation specific element to it.[56] Economic scholars term the promisee's reliance expenditures with the above-mentioned

---

[51] Kornhauser; Hermalin, Katz and Craswell 105.
[52] Craswell, 'Against Fuller and Perdue' 16.
[53] Cooter, 'Unity in Tort, Contract, and Property: The Model of Precaution' 3, 11.
[54] See *supra* the text accompanying footnote 94 in Section C.2. of Chapter III. Note that the advance purchase of a stock of goods for a shop under construction, given as an example of selfish investment (see *infra* the text accompanying footnote 57 in Section C. of this Chapter) is also given as an example of "incidental reliance" (see *supra* the text accompanying footnote 95 in Section C.2. of Chapter III). See also *infra* the text accompanying footnote 68 in Section C. of this Chapter.
[55] Cooter, 'Unity in Tort, Contract, and Property: The Model of Precaution' 3, 11; Cooter and Eisenberg, 'Damages for Breach of Contract' 1465.
[56] Hermalin, Katz and Craswell 105. See also *supra* Section A.2. Specific investments of Chapter IV.

characteristics as a selfish specific investment, *i.e.* specific investment the benefit from which accrues to the investing party. An investment is selfish when it is made by a Buyer to increase the value he places on the delivered good or service (*e.g.* purchase of a stock of goods and hiring employees for a shop under construction so that it can open as soon as the works are over) or by a Seller to decrease his cost (*e.g.* purchase of a specialised machine).[57] Affecting these variables, selfish specific investment actually augments the contractual surplus, which is the reason to single it out from the other forms of non-breacher's reliance on the contract.[58] Considering that the promisee's investment is not contractible and is made under conditions of uncertainty,[59] the issue of interest is which legal remedy incentivises such desirable selfish reliance, yet only to the extent it is profitable given the probability of breach.

As it was shown in the previous chapter, in the presence of specific investment the possibility of renegotiation becomes extremely important. Though renegotiation is costly and does not necessarily result in an efficient outcome, economic models consider the effect of damages on the non-breaching party's reliance decision in the two extremes: when renegotiation is costless and when it is impossible due to prohibitively high costs. The costless renegotiation case has two repercussions on the analysis. First, since at zero transaction costs the parties can renegotiate to an *ex post* efficient trade irrespective of the legal remedy, economists can focus solely on the non-breacher's reliance decision. Thus, the comparison of the efficiency of the different remedies turns only on their effect on the promisee's incentive to rely *ex ante*.[60] Second, the non-breacher's decision on the optimal level of investment depends on the outcome he expects from the renegotiations where his anticipations are determined by an exogenously specified parameter, representing his bargaining power.[61] On the other hand, the

---

[57] Che and Chung, 'Contract Damages and Cooperative Investments' 85; Che and Hausch, 'Cooperative Investments and the Value of Contracting' 126.

[58] For another form of non-breacher's reliance on the contract, see *infra* Section E. of this Chapter.

[59] Let me remind that non-contractible specific investments and high uncertainty as to the efficiency of exchange are typical features of long-term contracts. See *supra* Section A.2. of Chapter IV. Sure enough, the clear separation between the *ex ante* reliance decision and the *ex post* resolution of uncertainty in economic models involves a considerable degree of simplification. In the real world, both reliance and resolution of uncertainty often occur continuously, so events are not so sharply separated from each other. Yet, such arrangement of the timeline allows investigation of the problem of generating incentives to invest in an environment dominated by uncertainty, which is fairly common. Shavell, 'Damage Measures for Breach of Contract' 470, footnote 16.

[60] Rogerson 41; Edlin, 'Breach Remedies' 175; Ayres, 'Valuing Modern Contract Scholarship' 893-894.

[61] Sometimes the parameter is also termed patience, confidence or negotiating/bargaining strength. In the case where renegotiations do not occur, this parameter is in fact set to zero. Rogerson 41. Economic models also assume that parties share the entire surplus from bargaining, *i.e.* they do not commit to make payments to a third party to avoid renegotiation. For more details on such a three party scheme intended to bar renegotiation, see Schwartz and Watson, 'The Law and Economics of Costly Contracting' 24-25. This assumption is realistic because being an alternative to no-modification clauses, such three party schemes are also unenforceable.

case where *ex post* negotiations do not take place requires that the effects of the damage rule on both the promisor's perform-or-breach decision and the promisee's reliance decision be taken into account. This case corresponds to a scenario in which the parties submit their contractual dispute to be resolved by court. The court decisions I analyse in the following chapters in fact constitute pieces of evidence of situations in which renegotiation failed or did not occur at all.

In case of breach the promisee will lose the expected return on her selfish investment. Therefore, to be efficient, the promisee's reliance should reflect the fact that in some states of the world it will be efficient for the promisor not to perform. Thus, a promisee should rely until the consequent marginal increase in revenue, discounted by the objective probability of the promisor performing as agreed, equals the marginal cost of reliance, discounted by the objective probability of breach. In other words, the more certain the other party's performance is, the higher the efficient amount of the non-breacher's reliance expenditures will be. And vice versa, the more likely the other party's is to breach, the lower the efficient level of the non-breacher's selfish investment in reliance will be.[62]

Expectation damages (again if perfectly calculated) incentivise the non-breacher to rely excessively on the contract. Giving the promisee her expectancy, they practically fully insure her investment against the contingencies in which it will not pay off because of the promisor's breach. Whether performance or breach, the promisee always receives the expected benefit of her reliance: in the first case -– through the increased value of the realised exchange, in the second case – through the damage compensation. Naturally then the promisee perceives the profit increase resulting from her reliance as certain and has an incentive to rely beyond the optimal level.[63] Under reliance damages the non-breacher's overreliance is even higher than under the expectation measure. Indeed, the promisee does not realise the expected gain from her selfish investment, but being compensated for her investment expenditures, she also does not realise a loss. As a result, she underestimates the risk of promisor's breach and again relies too heavily. This explains the excessive incentive to rely given to the non-breaching party but does not explain why reliance damages perform worse than the expectation measure.

---

[62] Shavell, 'Damage Measures for Breach of Contract' 471-472; Cooter, 'Unity in Tort, Contract, and Property: The Model of Precaution' 13-14, 16-17; Cooter and Eisenberg, 'Damages for Breach of Contract' 1465-1466.

[63] Shavell, 'Damage Measures for Breach of Contract' 472, 478; Cooter, 'Unity in Tort, Contract, and Property: The Model of Precaution' 18; Cooter and Eisenberg, 'Damages for Breach of Contract' 1466; Edlin, 'Breach Remedies' 175; Hermalin, Katz and Craswell 106.

Receiving in the event of breach only the expenses she made in reliance, the promisee is in fact worse off than under the full insurance provided by expectation damages. Hence, the promisee prefers performance and strives to make it more likely through more reliance as this automatically increases the amount of damages she will be entitled to in case of the promisor's default.[64] Thus, ensuring high protection to the non-breacher, the expectation measure of damages generates moral hazard; yet, ironically, the less protective reliance damages distort the promisee's reliance incentive to an even greater extent.

These gloomy results about expectation and reliance damages and their effect on the non-breacher's decision to invest selfishly in reliance hold regardless of whether the Seller and the Buyer are, respectively, the breacher and the relying party or vice versa[65] as well as regardless of whether the probability of performance is exogenous or endogenous.[66] The results also do not change depending on the lack or presence of renegotiations or on the bargaining power of the relying party.[67] Still, the overreliance problem is not as ubiquitous as it seems at first glance.

First, it does not concern promisee's reliance which is not in any way specific to the particular transaction. When the promisee's investment retains its (or almost all of its) value outside the parties' contract, expectation damages and even no damages (*i.e.* no enforceable contract) at all do not generate inefficient incentives to rely. Thus, in the construction contract example, given above,[68] if the client can resell all the stock purchased in advance at the acquisition price and with very few transaction costs, his choice to buy it before the end of the construction process has been efficient. The non-breacher's investment is also not wasted when upon default she can easily find equally good substitute performance on the market and, if time is of the essence, obtain it on time. In this sense, the promisee's decision to rely is not distorted significantly in the case of spot contracts[69] and is not distorted at all in the case of

[64] Shavell, 'Damage Measures for Breach of Contract' 479-480; Hermalin, Katz and Craswell 106.
[65] Shavell, 'Damage Measures for Breach of Contract' 475; Rogerson 51.
[66] Hermalin, Katz and Craswell 106.
[67] Rogerson 41, 47, 49.
[68] See *supra* the text accompanying footnote 57 in Section C. of this Chapter.
[69] For the definition of spot contracts, see *supra* the text accompanying footnotes 20-24 in Section A.1. of Chapter IV.

their most salient representative: the consumer contract for sale of goods where the relying party is the buyer.[70]

Second, the overreliance problem by no means concerns all types of promisee's specific reliance. Excessive incentives to rely are not induced in the cases of pure cooperative specific investment (*i.e.* investment which confers benefits on the investor's counterparty)[71] and hybrid specific investment, where the underlying cooperative elements are relatively more important. From this perspective, the choice of the efficient damage measure depends not only on the presence or absence of promisee's investment but also on the kind of specific investment made.[72]

Third, the overreliance problem is not especially prominent when it is the Seller who is the non-breaching promisee. Though Sellers' reliance can also be of the selfish-investment type (a Seller may spend time and money on R&D to lower his production cost), it usually represents expenditure incurred in preparing to perform or in rendering performance, thus constituting precaution in the sense of the previous Section B. Such expenditure cannot be decreased significantly since its reduction leads to the Seller's own breach and, consequently, it remains out of the ambit of overreliance. Even the Seller's decision about when to begin performance, which in some respects resembles the kind of selfish reliance discussed here, in fact associates more closely with the preventative actions considered before. While the start of performance is within the Seller's discretion and, if delayed, decreases the costs the Seller makes before Buyer's breach (features typical of the selfish-investment decision), a decision on timing also accounts for the obstacles to performance and normally entails its early beginning to increase the likelihood of timely completion (features typical of precautionary measures). Upon low probability of material breach,[73] an early, breach-preventative beginning is in fact efficient since in this way the Seller gains from less difficult and, hence, more likely performance:

---

[70] Rogerson 42, footnote 42; William Rogerson, *Efficient Reliance and Contract Remedies* (1980); Eisenberg and McDonnell, 'Expectation Damages and the Theory of Overreliance' 1353; Cooter and Eisenberg, 'Damages for Breach of Contract' 1466.

[71] For the incentives induced by damages with regard to cooperative specific investment, see *infra* Section D. of this Chapter.

[72] Hybrid specific investments are neither purely selfish, nor purely cooperative but confer benefits on both parties. An example is the investment made by a producer in consulting its major retail customers regarding the organisation of their dairy cases where the producer's recommendations led to a substantial rise in the retailers' sales as well as in the producer's sales to the retailers. Che and Hausch, 'Cooperative Investments and the Value of Contracting' 126-127.

[73] This is usually the case in advanced economies like the three jurisdictions under comparison. Eisenberg and McDonnell, 'Expectation Damages and the Theory of Overreliance' 1346.

gains which in general by far exceed the surplus increase generated by the saving of performance costs that will go to waste in the event of Buyer's breach. Since the Seller's timing decision has a stronger breach-reducing than cost-lowering marginal effect, its precautionary element dominates its selfish-investment nuance. From this perspective, the overreliance incentive does not relate to the Seller's choice of when to begin performance. In addition, the domain of overreliance ends where the Buyer's breach ceases to be a statistical probability. It makes no sense to speak of Seller's motivation to overinvest in lowering performance cost when the Seller is permitted to withhold performance altogether and initiate a suit for breach of contract. This is the case when the concrete circumstances reveal a risk of Buyer's default and the Seller is not provided with due assurance upon his request.[74] Having Bearing in mind all of the above, it would not be wrong to say that it is usually Buyers that are the promisees who rely too strongly.[75]

Despite these limitations, the overreliance problem remains a concern since there is not a single damage measure that simultaneously optimises the promisor's breach and precaution decisions and the promisee's decision to invest selfishly in reliance.[76] In the absence of renegotiation in which the promisee could be held up, her reliance can be optimised if the promisor is not liable for breach of contract at all.[77] In this case the non-breacher is incentivised to rely efficiently (given the probability of breach) because she bears all the costs of her selfish investment in the event of default. Presumably, if there is no enforceable contract, the parties will agree on payment of the price only at performance to make sure the promisor is not tempted to withhold both performance and repayment of the money given in advance. Yet, with no damages due upon breach, even this arrangement leaves the promisor's incentive to perform less than optimal. For this reason, restitution, under which in case of breach the promisor again loses only the contract price, achieves identical results with respect to the levels of breach and reliance.[78] Expectation damages, on the other hand, create an

[74] For the US, see UCC § 2-609. Right to Adequate Assurance of Performance. (1); Restatement (Second) of Contracts § 251 When a Failure to Give Assurance May Be Treated as a Repudiation and § 252 Effect of Insolvency. For Bulgaria, see Art. 90(2) Contracts Act.

[75] Eisenberg and McDonnell, 'Expectation Damages and the Theory of Overreliance' 1344-1346, 1348-1350; Cooter and Eisenberg, 'Damages for Breach of Contract' 1466.

[76] Shavell, 'Damage Measures for Breach of Contract' 483.

[77] Economic scholars translate the lack of promisor's liability as a no-damage measure which they consider employed in the cases in which the contract is not enforceable in the particular jurisdiction, or in which enforcement is impractical due to high enforcement costs or a judgment-proof defendant. See *e.g.* Ibid 471.

[78] Ibid 480-481. Under reliance damages, restitution and no damages the price has not only a distributive, but also a surplus-augmenting effect. A higher price incentivises the promisor to breach less often. For this reason,

optimal perform-or-breach incentive (given reliance)[79] but induce too much selfish investment by the promisee. In this sense, when one party decides about breach and the other party decides about selfish reliance, expectation damages and no damages/restitution generate symmetrically opposite incentives. This constitutes a manifestation of the so-called "paradox of compensation" in contract. The promisor's liability for damages that force him to fully internalise the promisee's losses from breach allows the promisee to externalise the costs of her reliance. No liability beyond return of the price paid up-front makes the promisee internalise the downside of her selfish investment but lets the promisor externalise the costs of his insufficient precautions against breach. Either possibilities prevent parties from internalising their own costs; hence, the opposite incentives regarding breach and selfish reliance. The same problem of not fully internalising one's own costs arises with compensation to some intermediate level, such as reliance damages, which optimise neither the promisor's breach-or-perform decision, nor the promisee's reliance decision.[80]

One way out of this paradox is to optimise the incentives of one of the parties by some means, other than damages, and then set the compensation at the damage measure which provides efficient incentives to the other party. Thus, if the breacher can be given efficient motivation by way of reputation effects, no damages, in the absence of renegotiation, could turn out to be the efficient choice.[81] Another solution, if renegotiation is ruled out, is to fix the amount of compensation so that it does not depend on the non-breacher's reliance. Unable to increase her damages, the promisee will bear the cost of her selfish investment over a certain level. As a result, the very compensation she receives in the event of default will not incentivise her to boost her expectancy beyond the fixed monetary amount; yet, she will still be induced to invest until her benefit from the contract becomes equal to the set lump sum. Such a constant damage measure, whose value is not affected by the non-breacher's reliance, is liquidated damages. Once they are adjusted to equal the value that performance has to the promisee if

---

the promisee may be willing to agree on a higher price, especially if the contract is fairly profitable for him. Yet, under these damage measures, the promisee will never be willing to pay a price that is high enough to induce the promisor to breach only if it is efficient. On this effect of the contract price, see ibid 479-480, footnote 37, 481, footnote 39.

[79] For expectation damages incentivising the promisor to make an efficient choice between performance and breach, see *supra* Section A. of this Chapter.

[80] Cooter, 'Unity in Tort, Contract, and Property: The Model of Precaution' 3-5, 11-14; Cooter and Ulen, *Law and Economics* 331-334.

[81] Hermalin, Katz and Craswell 107. Alternatively, previously acquired reputation for making efficient reliance choices could also motivate the non-breacher to invest efficiently, so in the particular context expectation damages, having the ability to ensure efficient breach, might be the optimal damage measure. Ibid 108.

she invested efficiently, both parties can be given optimal incentives. The promisor will take efficient precautions to avoid breach and breach only if it is efficient because he has to pay the agreed damages; the promisee will rely efficiently because she bears the actual harm beyond the stipulated damages.[82]

The paradoxical opposition of incentives generated by the full compensation/no compensation dichotomy, however, disappears if renegotiation is possible. Indeed, as already noted, in the presence of renegotiation, expectation (as well as reliance) damages induce overreliance; yet, the lack of liability when the promised exchange does not take place again distorts the promisee's incentives. Where there is no enforceable contract and renegotiation is not ruled out, the threat of holdup causes the party who makes the specific investment to underrely.[83] Nevertheless, if parties design their contract appropriately, economic scholars maintain, they can avoid both overreliance and underreliance as well as provide efficient incentives to both the promisor and the promisee. To the extent that contractual terms are strictly enforced by courts, two fixed-price contractual schemes are suggested to achieve first best even though the investment is non-contractible. Both do not specify the renegotiation process and are enforced with standard breach remedies.

The first contractual scheme seeks to balance the risk of moral hazard, generated by damages, and the risk of hold-up by means of the commodity quantity. As already explained, when the quantity that is efficient to trade is smaller than the one provided by the contract and the breacher can unilaterally, without any renegotiation, decide on the output that is eventually traded, expectation damages incentivise him to choose exactly the quantity that is optimal and breach on the remainder.[84] Expectation damages, however, subsidy the non-breacher as they insure her for all the benefit created by her selfish investment, even for the one with respect to the quantity that was not efficient to trade. This so-called "breach subsidy" incentivises

[82] Cooter, 'Unity in Tort, Contract, and Property: The Model of Precaution' 14-15, 18-19; Robert Cooter and Melvin Eisenberg, 'Damages for Breach of Contract' (1985) 73 California Law Review 1432 1467; Cooter and Ulen, *Law and Economics* 335-336; Hermalin, Katz and Craswell 107.

[83] To the extent the promisee does not have any renegotiation strength, he may not rely at all. With the rise of his belief that upon renegotiation he may extract a portion of the additional surplus, his level of reliance increases but becomes efficient only if he has all the bargaining power and thinks that his partner will not be able to appropriate any of the quasi-rents. Rogerson, 'Efficient Reliance and Damage Measures for Breach of Contract' 41, 46-47. For more detailed explanation of Williamsonian hold-up, see *supra* Section A.2. Specific investments.

[84] See *supra* the text accompanying footnotes 23-25 in Section A. of this Chapter. Edlin and Reichelstein, 'Holdups, Standard Breach Remedies and Optimal Investment', 487; Edlin, 'Breach Remedies' 176.

overinvestment.[85] On the other hand, when the efficient quantity is higher than the one provided by the contract, the parties have to renegotiate to increase trade. Adjusting the quantity, they also bargain to divide the extra surplus of which the breacher captures a certain share, thus expropriating a part of the value generated by the non-breacher's reliance. In other words, the breacher levies a "hold-up tax" on his counterparty's increased return, inducing the promisee to underrely. From this perspective, the overreliance outcome is not inherent to expectation damages (the legal remedy in both scenarios) but results from the constructed economic models in which the efficient quantity was never higher than the one agreed upon.[86] If parties contract for the efficient quantity, expectation damages will not induce overreliance. Rather the breach subsidy will offset the holdup tax and the non-breacher will be given incentives to make efficient selfish investment.[87] That is why, the argument goes, when the Buyer wants some quantity of commodities, the parties should create the possibility for holdup by agreeing on a smaller quantity that will motivate efficient reliance. If the Seller performs, the parties can strike a spot contract for the difference between the quantity desired by the Buyer and the initially agreed upon intermediate quantity. Of course, if the Buyer wants just one unit, a contract for a fraction of this unit will not be enforceable, but even then parties can agree that the unit should be delivered in some contingencies and not in others. Then the possibility for holdup exists in the contingencies, in which, though it is efficient for the exchange to occur, the Buyer has no obligation to accept delivery.[88]

However, where renegotiation is possible, expectation damages can incentivise the promisee to make efficient selfish investment (provided the contract requires the optimal quantity of trade) if the promisee is the only relying party. If both the breacher and the non-breacher invest selfishly, expectation damages create asymmetric reliance incentives for parties. While they give the promisee her full profit, even the part of it generated by her inefficient reliance,

---

[85] Edlin's breach-subsidy result in fact extends Shavell's and Rogerson's results about the effect of expectation damages on selfish reliance to situations where trade is not discrete but continuous. Edlin and Reichelstein, ‘Holdups, Standard Breach Remedies and Optimal Investment’ 488.

[86] Indeed, both Shavell's and Rogerson's models provide for discrete trade where the agreed quantity is one unit and it is never efficient to trade a higher quantity. See Shavell, ‘Damage Measures for Breach of Contract’; Rogerson, ‘Efficient Reliance and Damage Measures for Breach of Contract’.

[87] The result holds for a wide class of sharing rules, referred to as monotonic, *i.e.* a rule which ensures that each party's share of the renegotiation surplus is increasing in the size of the surplus. Where the sharing rule is a constant, the efficient quantity decreases as the investor's bargaining power increases. Edlin and Reichelstein, ‘Holdups, Standard Breach Remedies and Optimal Investment’. See also Edlin, ‘Breach Remedies’ 176.

[88] Whether the contingencies in which there is obligation to trade are really the contingencies in which trade is efficient is irrelevant. Rather it is important that the probability of their realisation equals that of trading the optimal quantity. Edlin and Reichelstein, ‘Holdups, Standard Breach Remedies and Optimal Investment’ 489-490, 494-495; Edlin, ‘Breach Remedies’ 176; Hermalin, Katz and Craswell 107.

the promisor is left with the residual from trade and thus with the optimal return from his selfish investment. Therefore, to optimise the reliance incentives of both parties, the contract should be designed to create a possibility for a holdup of the promisee (which, as explained before, requires agreement on an intermediate quantity) and for breach subsidy of the promisor (which requires very high quantity that can be adjusted downwards when this is efficient). Thus, there is simply not one single contractual quantity that equalises the breach subsidy and the holdup tax for each of the parties. For this reason, where investment is bilateral, expectation damages fail in inducing efficient reliance incentives to both the breacher and the non-breacher.[89] Still, as the breacher, unlike the promisee, invests efficiently, the second contractual design that eliminates overreliance as well as underreliance is based on the idea of having the same party make the decisions to invest selfishly and to breach.[90]

Three instruments are used to generate efficient selfish investment in this contractual scheme. First, the parties should agree on a price such that it induces the investing party to breach: if the party who makes selfish investment is the Seller, the price should be below marginal cost; if this is the Buyer, it should be over marginal value. Second, to motivate the investing party to agree to such an unfavourable price, the non-investing party should sink a big up-front payment to the investor.[91] These two mechanisms do away with the relying party's incentive to overinvest.[92] Third, to eradicate the possibility of hold-up in a potential renegotiation and thus the investor's propensity to underinvest, the parties should sign a 'Cadillac contract', *i.e.* a contract for a very high quality or quantity. Such contracts eliminate the contingencies in which it will be efficient to trade commodities of higher quantity or quality and, consequently,

---

[89] Edlin and Reichelstein, 'Holdups, Standard Breach Remedies and Optimal Investment' 491-492; Edlin, 'Breach Remedies' 176.

[90] Edlin, 'Cadillac contracts and Up-Front Payments: Efficient Investment under Expectation Damages'.

[91] An up-front payment may constitute not only a monetary transfer but also a waiver of a large amount which is due otherwise or the signing of another profitable contract. It is defined as anything valuable delivered at the time of contracting, other than the promise for payment of the contract price. Ibid 102. Note that unlike the up-front payment considered by Shavell (see Shavell, 'Damage Measures for Breach of Contract'), this is an up-front payment to the investing rather than the non-investing party. Also central to the model is the assumption that the non-investor who breaches cannot sue to receive back the up-front payment (whether on the ground that the investor will be unjustly enriched or on the ground that the up-front payment constitutes a disguised illegal penalty). Otherwise, the relying party may not get the surplus as the non-investor will himself try to net it by breaching earlier. Edlin, 'Cadillac contracts and Up-Front Payments: Efficient Investment under Expectation Damages' 105-106, footnote 11, 109; Edlin, 'Breach Remedies' 177.

[92] In other words, the claim is that an up-front payment is needed not only to protect the investing party from being held up where enforcement of the contract in court is not viable (because of prohibitively high costs or because of the defendant's insolvency) but also to eliminate the excessive investment incentive where enforcement is costless and the defendant will not be able to avoid payment. Edlin, 'Cadillac contracts and Up-Front Payments: Efficient Investment under Expectation Damages' 99, footnote 1.

the need for renegotiation that will entail a hold-up tax.[93] If this contractual design is implemented, expectation damages will induce efficient selfish investment provided that only one of the parties relies and that courts come up with "unbiased estimates of damages".[94] The latter qualification in fact lowers somewhat the informational requirements to expectation damages (in the case of discrete trade) and posits that it is more important not to bias damages (*e.g.* by *a priori* eliminating awards that are only tentative and approximate) than to calculate them absolutely accurately. Efficient selfish reliance is generated even where trade is not discrete and investment choices are multidimensional if the law requires the Buyer to accept partial or inferior performance (when the breacher-investor is the Seller) and gives the Buyer a right to terminate the contract prematurely (when the breacher-investor is the Buyer).[95] In other words, in case selfish investment is unilateral, parties can endogenously determine the investor as the party who is likely to breach and use expectation damages to optimise both his *ex ante* and *ex post* incentives. Indeed, expectation damages will not induce the same first-best result with respect to the non-breacher's incentives but if she does not make significant unverifiable investments, this is not of much importance.[96]

Besides parties stipulating a constant damage measure in their contract or adopting an appropriate contractual design, courts can also incentivise efficient reliance by restraining the promisee's recovery of expectation or reliance damages on the basis of selfish investment that was optimal. Courts can apply such restrained damage measures[97] by imputing the requirements of efficiency into the standards of reasonableness or foreseeability. If they

[93] Where trade is discrete, a contract to exchange one unit is a Cadillac contract. Ibid 99, 102, 105, 113-114.
[94] Ibid 99, 114-115, 117.
[95] Multidimensional investment choices entail a propensity to spend on overly specific assets rather than assets with higher levels of generality. For more details, see Aaron Edlin, 'Aspects of the Efficient Recovery of Fixed Costs: A Collection of Essays' (Stanford University 1993). Expectation damages eradicate this propensity, too, if combined with the suggested contractual design and particularities of the applicable law. In contrast, expectation damages, coupled with the contractual design that stakes on the choice of optimal quantity, fail to induce efficient reliance where investment is multidimensional. Edlin, 'Cadillac contracts and Up-Front Payments: Efficient Investment under Expectation Damages' 108-109, 111, footnote 20. The Buyer's broad duty to mitigate and his right to terminate prematurely, which the legal system should incorporate, are both intended to vest the investor with the unilateral decision to breach, thus eliminating the possibility for renegotiation, holdup and, consequently, under-reliance. Again, instead of law allocating the right to premature termination to the Buyer (when the breacher-investor is the Seller), courts could interpret the contract as divisible. Ibid 111-114, footnote 23. The need for a broad duty to mitigate and for a right to terminate prematurely, however, implies that where trade is not discrete and investment is multidimensional, it is relevant whether the Buyer or the Seller is the investing party. Ibid 104, footnote 8.
[96] Edlin, 'Cadillac contracts and Up-Front Payments: Efficient Investment under Expectation Damages' 116.
[97] The designation "restrained damage measure" is used by Craswell in Richard Craswell, 'Performance, Reliance and One-Sided Information' (1989) 18 The Journal of Legal Studies 365. Craswell attributes it to Cooter, 'Unity in Tort, Contract, and Property: The Model of Precaution' 16, footnote 36.

compensate only "reasonable"[98] or "foreseeable"[99] reliance, interpreting it as reliance up to the optimal level, they can render the awards of expectation or reliance damages independent from the promisee's actual level of selfish investment, much like parties can do so by agreeing on the constant liquidated damages. The non-breacher will then be forced to bear the costs of any selfish reliance going beyond the maximum measure set through the criteria of reasonability or foreseeability. This, of course, requires that courts be able to assess the efficiency of the promisee's reliance and to verify the factors that establish it as optimal or not.[100]

Having clarified the effect of damages on the non-breacher's selfish investment, I now turn to another kind of investment decision: the decision to make cooperative investment. It may seem inelegant that having once moved to the promisee's decisions, I embark on a choice that (as will be discussed below) can be either a promisor's, or promisee's. Yet, there is no better time to address this decision, I think. Chronologically, cooperative investment was differentiated later than its selfish counterpart, so research on selfish investment, which at the time had already advanced considerably, naturally influenced the development of the cooperative reliance literature. As a result, the latter can be understood best in connection with selfish investment models. This is the reason for which the following section deviates from the non-breaching party's incentives to discuss cooperative investment. Further in Section E. I proceed with the core of the promisee's precaution decision.

D. The decision to make cooperative investment

As mentioned above, in contrast to selfish investment, cooperative investment confers benefits on the investor's counterparty.[101] Thus, the Seller's cooperative investment increases the value the Buyer derives from trade and the Buyer's cooperative investment decreases the Seller's cost of performance. For example, the Seller's effort in providing high-quality goods

---

98 Goetz and Scott, ‘Enforcing Promises: An Examination of the Basis of Contract’ 1280; Cooter and Eisenberg, ‘Damages for Breach of Contract’ 1467.
99 Cooter, ‘Unity in Tort, Contract, and Property: The Model of Precaution’ 15-16.
100 Hermalin, Katz and Craswell 108.
101 See *supra* the text accompanying footnote 57 in Section C. of this Chapter. The term "cooperative investments" was first used in two articles published at approximately the same time: Che and Chung, ‘Contract Damages and Cooperative Investments’ and Che and Hausch, ‘Cooperative Investments and the Value of Contracting’. The same kind of investments are also referred to as "investments with externalities" or as "cross-investments". See, respectively Georg Nöldeke and Klaus Schmidt, ‘Option Contracts and Renegotiation - A Solution to the Hold-up Problem’ (1995) 26 Rand Journal of Economics 163 and Sergei Guriev, ‘Incomplete Contracts with Cross-Investments’ (2003) 3 Contributions to Theoretical Economics.

or services is cooperative, including his investment in customising output to accommodate the Buyer's demands, as well as the Buyer's investment in improving the efficiency of the Seller's production process or in supplying him with more legible blueprints.[102] The immediate gains in these cases, go to the investing party's contractual partner and the investor benefits only to the extent he can obtain a more favourable price. Note, however, that although either parties can invest cooperatively, most often it is the Seller who makes this type of investment, as it is he who provides the commodity and who can engage in quality enhancement. Buyers, on the other hand, have the obligation to pay the price. Usually, they know little of the Seller's production process and have little possibility to affect its cost. As it will be seen below, law has developed legal institutions (quality thresholds) that are specific to the case in which the Seller is the cooperative investor. Economic models, too, normally posit the Seller as the relying party.[103] All this indicates that the scenario where the Seller (and not the Buyer) invests cooperatively is the more typical one.

Like selfish investment, cooperative investment increases the contractual surplus; yet, unlike its selfish counterpart, it is not discretionary but is required under the contract. Indeed, as it will be discussed in more detail below, real world contracts do not simply remain silent on the matter and the investor has explicit or implicit contractual obligations as to making the investment. Thus, cooperative investment falls into Fuller and Perdue's broad category of "essential reliance".[104] However, it is a special case of essential reliance, which unlike the one, discussed in Section B. above, is not purely precautionary. Even if the investor incurs expenses in order to fulfil his own contractual obligations, the purpose of these expenses is not only to reduce the probability of breach but also to enable the other party to benefit more from the contract. Consequently, cooperative reliance expenditure results in specialised performance, which differentiates the relying party from the competition.

When exploring the incentive to invest cooperatively, economists also need to choose the party taking the perform-or-breach decision. As it will be seen below, in economic models the

---

[102] Che and Chung, 'Contract Damages and Cooperative Investments' 85; Che and Hausch, 'Cooperative Investments and the Value of Contracting' 126-127; Edlin, 'Breach Remedies' 177.

[103] Che and Chung, 'Contract Damages and Cooperative Investments' 89; Stremitzer 342; Richard Brooks and Alexander Stremitzer, 'Remedies On and Off Contract' 120 The Yale Law Journal 690. Only one model posits the Buyer as the cooperative investor while explicitly stating that the case in which the Seller relies cooperatively is completely symmetric. See Urs Schweizer, 'Cooperative Investments Induced by Contract Law' (2006) 37 The Rand Journal of Economics 134, 136.

[104] See *supra* the text accompanying footnote 94 in Section C.2. of Chapter III.

party making cooperative investment may be posited either as the promisor, or as the promisee. This is a choice economists make rather *ad hoc*.[105] As it will be shown, however, whichever the case, the issue is always the same: which damage measure overcomes the tendency to underinvest.[106] In this sense, by contrast to the decisions to invest selfishly and to take pure precautions, in the event of cooperative reliance, whether the choice to invest and the choice between performance and breach are allocated to the same or to different parties is of little relevance.

Cooperative investment is more difficult to stimulate than selfish investment. Being relation-specific, cooperative investment is subject to hold-up, which leads to the relying party's incentive to underinvest. While in the case of selfish investment the benefit accruing to the investor naturally generates an investment incentive, no such motivation, counteracting the suboptimal result, exists in the case of cooperative investment.[107] Raising his partner's value from the initial contract, the investor in fact improves the status quo position of his counterparty and worsens his own bargaining position in potential renegotiations. In this sense, by investing cooperatively, the party increases his own risk of hold-up. That is why, the reasoning goes, if parties want to incentivise efficient cooperative investment, they must commit not to renegotiate in order to exclude the possibility of opportunistic expropriation. If parties cannot do this (just as they cannot under the studied legal systems),[108] they may not be able to generate optimal reliance incentive even if the investment is only weakly cooperative. In fact, where renegotiation cannot be ruled out, the capacity of contracting and, hence, of damages to create efficient incentives to invest decreases as the investment becomes more and more cooperative. It is even argued that a contract, which does not incorporate an enforceable ban on renegotiation, not only does not bring a first-best result but is completely useless in

---

[105] Che and Chung model the non-investing Buyer as the one making the choice between performance or breach. Che and Chung, ‘Contract Damages and Cooperative Investments’ 89, 90. In Schweizer's model, too, it is the non-investor who makes the perform-or-breach decision. Schweizer. By contrast, in Stremitzer’s model this choice is made by the investing Seller. Stremitzer 344-345. Stremitzer, however, claims that his assumption as to the party charged with the perform-or-breach decision is not *ad hoc* since, having a broad duty to mitigate damages under the doctrine of substantial performance, the Buyer will be induced not to breach. See ibid 342, 354-356. Regarding the doctrine of substantial performance under US and English law as well as its rough equivalent under Bulgarian law, see *infra* Section A.2. of Chapter VI.

[106] Che and Chung as well as Stremitzer argue that their results will not change if the other party (in Che and Chung’s model - the Seller; in Stremitzer’s model – the Buyer) is also allowed to breach on her performance obligation. Che and Chung, ‘Contract Damages and Cooperative Investments’ 90, footnote 11. Stremitzer 354, footnote 28. In Schweizer's model, both parties may claim expectation damages and, hence, both parties are allowed to breach. Schweizer 135.

[107] Che and Chung, ‘Contract Damages and Cooperative Investments’ 103.

[108] See *supra* footnote 5 of this Chapter.

motivating purely cooperative investment. In such case whether parties contract *ex ante* (as in long-term contracts) or negotiate only *ex post* (as in spot contracts) makes absolutely no difference.[109]

With this general intuition about an implicit tension between the *ex ante* investment decision and the *ex post* performance decision,[110] the question is which damage measure, if any, induces efficient cooperative investment. Such investment will be optimal if the investor's additional reliance expenses are less than the increase in the non-investor's expected value from performance.[111] Investment is assumed to be observable but unverifiable.[112] As it will be shown below, the strictness with which this assumption is pursued varies among economic models and this is at the core of the contradictory results, obtained by economists regarding the effects of damages on the incentive to invest cooperatively. Thus, while the worthlessness-of-contracting result implies that damages cannot induce cooperative investment in the presence of renegotiation,[113] two other articles maintain that reliance damages and bilateral expectation damages can generate efficient incentives to invest cooperatively with costless renegotiation.[114]

---

[109] Che and Hausch, 'Cooperative Investments and the Value of Contracting'. Note that this result holds for the whole range of bargaining shares of the parties and with monotonic sharing rules (*i.e.* a more general class of sharing rules than constant ones) as long as the share remains sufficiently constant. Ibid 130, footnote 11. The capacity of contracting, and, hence, of remedies, to motivate hybrid investment depends on the investor's bargaining power. The higher his bargaining power is, the more he relies on renegotiation to increase his profit. From this perspective, he is more sensitive to deterioration of his bargaining position and less willing to make investment that has an underlying cooperative element. Consequently, the capacity of the simple fixed-price contract to incentivise him to make the hybrid investment decreases. Ibid 135-136.

[110] Recall that in case of change of conditions parties ensure efficiency of exchange by *ex post* renegotiation. See *supra* the text accompanying footnote 93 in Section A.3. of Chapter IV. For *ex post* renegotiation ensuring efficiency of the performance decision regardless of the applicable remedy, see *supra* the text accompanying footnotes 12-14 in Section A. of this Chapter.

[111] As in the selfish investment models, parties share the entire bargaining surplus according to their exogenously specified bargaining powers. Che and Hausch, 'Cooperative Investments and the Value of Contracting' 126; Che and Chung, 'Contract Damages and Cooperative Investments' 90; Stremitzer 343. For the sake of precision Schweizer's result about bilateral damages does not require that parties split the renegotiation surplus in fixed shares, but is based only on participation constraints. It is also not necessary that renegotiation always leads to *ex post* efficient perform-or-breach decisions. Schweizer 139.

[112] With observable but unverifiable investment, the hidden action problem is avoided but the profit-sharing contract typical for the principal-agent literature is unfeasible. Che and Hausch, 'Cooperative Investments and the Value of Contracting' 126, footnote 6; Che and Chung, 'Contract Damages and Cooperative Investments' 85, footnote 5.

[113] Indeed, where investment is strictly unverifiable, specific performance appears to be the only feasible remedy since to enforce it, the court needs to observe only delivery and payment. Stremitzer 341, footnote 6.

[114] Che and Chung, 'Contract Damages and Cooperative Investments'; Schweizer. Interestingly, Yeon-Koo Che who together with Chung favours reliance damages is also one of the authors claiming that with respect to cooperative investment contracting has no value in the presence of renegotiation. See Che and Hausch, 'Cooperative Investments and the Value of Contracting'.

The first article focuses on the trade-off between the incentive to invest cooperatively and the efficiency of the perform-or-breach decision.[115] It is argued that with renegotiation possible or not, expectation damages induce an efficient breach decision and zero cooperative investment. Compensated for her expectation interest, the relying Seller ends up with the same profit whether the Buyer performs or breaches; hence, she has no incentive to incur additional costs if she does not receive a part of the surplus increase. The result, in other words, is worse than the case in which *ex ante* parties sign no contract at all as then the Seller still invests – though less than efficiently (unless she holds the entire bargaining power).[116] As for the Buyer, having to pay expectation damages, she always breaches efficiently. And because the investment affects her payoff, her breach is in fact a signal that the Seller's reliance expenses fell short of what was promised. The zero-investment outcome does not change even in the event of a Cadillac contract which raises the cost of performance so high that it turns the investor into a breacher. Owing expectation damages, the Seller breaches efficiently but again has no incentive to make cooperative investment since in this way he only raises the amount of damages he is liable for.[117]

Liquidated damages perform better, stimulating positive, though suboptimal, cooperative investment since it becomes possible for the Seller to internalise a portion of the surplus increase, generated by his reliance expenditure. Stipulating damages, the parties can attune them to an amount that institutes a "net trade price" (the difference between the contract price and damages) that is higher than the Seller's cost of performance. Set at such level, the net trade price in fact provides the Seller with a "prize for trade". In other words, the Seller is better off when the Buyer accepts performance than when she breaches and pays damages, so the Seller has an incentive to invest cooperatively. On the other hand, in the absence of renegotiation in which the contract price can be lowered, the trade prize also motivates the Buyer to breach inefficiently whenever her value from performance remains below the net trade price. Then, it is simply cheaper for the Buyer to default and pay damages (even if this is inefficient) than to accept performance. The positive, though suboptimal, level of

[115] Che and Chung, ‘Contract Damages and Cooperative Investments’ A fixed-price non-contingent contract and a binary performance choice are assumed. Ibid 86.
[116] Ibid 87, 91-92, 99.
[117] Ibid 92, footnote 13. Recall that under certain conditions a Cadillac contract ensures efficient selfish investment. See *supra* the text accompanying footnotes 91-96 in Section C. of this Chapter.

cooperative investment[118] is, thus, achieved at the price of distortion of the perform-or-breach decision. This contract game is not unrealistic. It is in place, for example, in purchase-on-approval contracts where the Buyer has an option to accept performance at a predetermined price or refuse it without being liable for damages (or to put it differently, having to pay zero liquidated damages).[119] With renegotiation possible, however, the role of the trade prize is somewhat different. When the Buyer accrues benefit that is small relative to the incurred cost, the trade prize incentivises her to breach inefficiently in order to extract a price concession. The parties negotiate *ex post* to reverse the inefficient breach and the Seller's investment incentive is generated by this very renegotiation, in the process of which the Seller receives a share of the increased gains. In this sense, renegotiation is not the stage at which the hold-up threat materialises but the stage which allows parties to implement the optimal contract. Nevertheless, they do not achieve first-best since the Seller underrelies (unless he has the entire bargaining power). In other words, some cooperative investment is motivated, but it remains at a level that is not higher than the level achieved when parties have not signed any contract in the first place. From this perspective, renegotiation has some additional value only if the investor has the entire (or close) bargaining power. On the contrary, if the relying party has no (or almost no) bargaining power, the created incentive for cooperative investment is worse (as bad as under expectation damages). A smart move will then be for the parties to ban renegotiation, but as pointed out, under the studied three legal systems, this is not possible.[120]

The sceptical results, obtained with regard to expectation and liquidated damages in the presence of *ex post* readjustment, lead to the conclusion about the uselessness of fixed-price contracts in generating cooperative investment where renegotiation is not ruled out.[121] On the other hand, with renegotiation absent, a damage rule can, at best, balance the cooperative investment incentive with the distortion of the performance-or-breach decision. Hence, to achieve a first-best result, either the parties should implement a more complex contract, or the

---

[118] The effect is suboptimal but whether it is one of under- or overinvestment can be established only with more information about the way the price divides the surplus between the parties. Ibid 93, footnote 14.
[119] Ibid 87, 91-94.
[120] Ibid 87, 99-101.
[121] This result is in fact a special case of the worthlessness-of-contracting result, obtained by Che and Hausch, 'Cooperative Investments and the Value of Contracting'. Ibid 126, footnote 5; Che and Chung, 'Contract Damages and Cooperative Investments' 86, footnote 9, 101, footnote 29, 103. Recall that under certain conditions, fixed price contracts coupled with expectation damages generate efficient selfish investment in the presence of renegotiation. See *supra* Section C. of this Chapter.

investment should be contractible.[122] Since in reality parties often write fairly simple, fixed-price contracts or contracts that incorporate very few contingencies,[123] the authors choose to relax the unverifiability assumption.[124] Assuming that courts are able to verify the amount of reliance expenditures incurred by the Seller and to obtain an unbiased estimate of these expenditures, Che and Chung turn to reliance damages and maintain that with or without renegotiation, they perform the best.[125] In the absence of renegotiation, parties can again institute a net trade price higher than the Seller's cost of performance, thus giving the Seller a trade prize. In addition, reliance damages have a sort of subsidy effect since when the Buyer breaches (her value of performance being lower than the net trade price), the Seller receives back all his reliance expenses already made. This subsidy effect lowers the cost of investment and enhances the stimulating effect of the trade prize. As a result, reliance damages encourage more cooperative investment than liquidated damages, given the same net trade price, or generate as much cooperative investment with performance closer to the efficient level.[126] With renegotiation possible and a net trade price set above the cost of performance, the Seller internalises a part of the increased surplus whether the Buyer breaches efficiently or not.[127] If the Buyer breaches efficiently, no renegotiation takes place but reliance damages compensate the Seller for all investment expenditure. If the Buyer breaches inefficiently, the renegotiation that follows corrects the inefficiency of the perform-or-breach decision while the Seller still obtains the subsidy, though not by collecting damages but by receiving an increased share in the renegotiation surplus due to his better bargaining position than under the liquidated-damages regime.[128] In other words, in the presence of renegotiation, reliance damages incentivise more cooperative investment than liquidated damages and if the parties agree on an appropriate price, they can even achieve both efficient performance and efficient reliance.

---

[122] Che and Chung, 'Contract Damages and Cooperative Investments' 93, footnote 15.

[123] Ibid 86. See also Posner, 'Economic Analysis of Contract Law after Three Decades: Success or Failure' 859.

[124] In contrast, in the case of selfish investment both contractual designs that induced efficient investment incentives in the presence of renegotiation assume that the court can observe only breach of contract. Investment is strictly unverifiable. See *supra* Section C. of this Chapter. Stremitzer 340, footnote 5.

[125] Recall that when it comes to selfish investment, reliance damages, in the absence of renegotiation, incentivise inefficient breach and even more overinvestment than expectation damages. In the presence of renegotiation, breach is efficient but investment is still too much relative to the efficient level, again more than under expectation damages. See *supra* the text accompanying footnotes 64-67 in Section C. of this Chapter.

[126] Che and Chung, 'Contract Damages and Cooperative Investments' 87, 94-97.

[127] In contrast, under liquidated damages the Seller benefits from the surplus increase only if the Buyer breaches inefficiently as only then do the parties renegotiate. The higher net trade price increases the likelihood of Buyer's inefficient breach. Ibid 100.

[128] The subsidy effect of reliance damages ensures the Seller a better status quo position than under liquidated damages and, hence, a better bargaining position in the renegotiations.

Again, while renegotiation is usually associated with underinvestment, in this case it achieves a first-best result.[129] This ability of reliance damages to lead to the desirable outcome when cooperative investment is important, the article argues, explains some contractual arrangements typical to the construction industry contractual arrangements such as cost-plus contracts.[130]

Without denying the ability of reliance damages to produce the first-best outcome where trade is a binary yes/no decision and renegotiation is possible,[131] the second article that provides results incongruous with the worthlessness-of-contracting outcome seeks to re-establish expectation damages. The author Schweizer maintains that they can also induce efficient incentives to perform and to invest cooperatively; furthermore, they can produce such first-best outcomes with or without renegotiation and regardless of whether performance is a binary or continuous choice.[132] It is argued that the discouraging result generated by the expectation measure in Che and Chung's model emerges due to the adopted assumption of non-contractibility of investment which leads to positing the investing party as the only one who can claim expectation damages. This assumption, the reasoning goes, commonly used regarding selfish investment, is simply transferred to the cooperative investment model without taking into account that where reliance confers benefits on the contractual partner, the latter will also have a claim to the investor as parties must in some way note the investment down in their contract. Thus, in Schweizer's model, expectation damages feature not in their mundane version, but as 'bilateral', meaning that the relying party is not only able to claim compensation upon non-performance, but is also liable if she underinvests relative to the efficient level. In other words, the relying party is both promisee and promisor. Bilateral expectation damages induce the first best result under three conditions. First, parties must stipulate the efficient level of cooperative investment in their contract, a fairly strong assumption, which after Che and Chung's already relaxed informational assumptions

---

[129] Che and Chung, 'Contract Damages and Cooperative Investments' 87, 101-103.

[130] See AIA Document-2007 Standard Form of Agreement between Owner and Contractor; AIA Document A131CMc–2003 Standard Form of Agreement Between Owner and Construction Manager.

[131] Schweizer 135, 143-144.

[132] The investment decision is generally assumed to be continuous and one-dimensional. Ibid 136-137. See also *supra* footnote 112 for the other assumptions on which Schweizer's model is based. To contrast once again cooperative and selfish investment, recall that in the selfish investment case if trade is discrete, expectation damages induce overreliance whether renegotiation is ruled out or not. Where investment is selfish, only if trade is continuous and renegotiation corrects inefficient perform-or-breach decisions, can expectation damages generate a first best result under certain conditions. See *supra* Section C. of this Chapter.

regarding reliance damages,[133] represents a further departure from the standard unverifiability postulate. Second, the contract specifies a sufficiently high performance choice, so that expectation damages awarded to the investor always compensate her fully for her loss of value from breach. This second condition implies that the investor's value from performance is also verifiable. Third, the investor's compensation must be calculated to reflect the efficient level of cooperative investment stipulated in the contract and not the actual investment made. That is, the investor is not able to increase the damages she will receive by saving reliance expenditures that directly reduce her gain.[134] With this contractual design, the relying party has efficient incentive to invest cooperatively because she always receives her expected profit whether through performance or through damages; yet, by fulfilling her investment obligations, she avoids her own liability. The non-investor is also given an incentive to perform efficiently because any inefficient breach prevents him from realising the benefits of the other party's cooperative investment.

Schweizer also extends Che and Chung's model of unilateral expectation damages (*i.e.* damages that can be claimed only by the relying party) to continuous trade.[135] Unlike bilateral expectation damages, unilateral ones have only modest potential to induce cooperative investment in such context. If the contract specifies low quantity and parties anticipate that inefficient performance choices will be corrected in *ex post* renegotiation, some cooperative investment will be induced, but it will remain suboptimal.[136] Still, this outcome is superior to the one under a contract providing for high quantity, where unilateral compensation ensures efficient perform-or-breach decisions but gives the relying party absolutely no incentive to invest cooperatively. This result is in sharp contrast with the one achieved by bilateral expectation damages, which in the case of sufficiently high performance choice not only incentivise more cooperative investment than the low-performance-choice scenario but

---

[133] See *supra* the text accompanying footnote 126 in Section D. of this Chapter.
[134] Schweizer 135, 137, 139-140, 144-145. Some contrasts with the case of selfish investment need to be emphasised. Where investment is selfish, in the event of continuous trade and possible renegotiation, a very high performance choice may not be efficient as parties need to balance the breach subsidy with a hold-up tax. In addition, an assumption that the investing party's compensation depends on the efficient and not the actual level of investment would be implausible with respect to selfish investment. As the latter benefits the relying party, her compensation can reflect only the investment actually made. For this reason, to induce efficient investment incentives, contract designs require attuning of the performance choice. See *supra* Section C. of this Chapter. Ibid 140.
[135] Recall that Che and Chung's results concerned only discrete trade. See *supra* footnote 116 in Section D. of this Chapter.
[136] Unfortunately, Schweizer does not compare this suboptimal investment incentive with the underinvestment incentive in the absence of any contract, so it is not clear in which case there is less underinvestment.

generate both efficient performance and efficient cooperative reliance.[137] Bilateral expectation damages should also be preferred to reliance damages which can also induce first-best but only where trade is binary and renegotiation is not ruled out.[138]

As already mentioned, the reason for the inconsistent results produced by economic scholars with regard to cooperative investment lies in the dissimilar informational requirements of the different economic models. While the impotence of contracting and damages to incentivise cooperative reliance in the presence of renegotiation rests on the assumption that investment is non-contractible and courts are capable of verifying only delivery and transfer payments,[139] the first-best results generated by reliance and bilateral expectation damages rely on the supposition that the incurred investments are straightforwardly verifiable in court. Bilateral expectation damages also require that parties determine from the outset the efficient level of cooperative investment in their contract.[140] Indeed, first adopted with respect to homogeneous goods and selfish investment,[141] the assumption of non-contractibility of any investment-related information (including such information regarding quality) is too strong in the setting of cooperative investment, which inevitably results in customisation and heterogeneity.[142] Yet, by implicitly assuming that parties can forthwith contract and courts forthwith verify reliance expenditure, economists simply substitute one extreme case for another. Where specific investment takes an intangible form (such as effort), its specification in the contract, proving in court and quantifying in monetary damages remain a difficult problem. And even where out-of-pocket expenses are evidenced by accounting records, verification of indirect costs and their correct allocation is a vexing issue.[143] That is why, any relaxing of established assumptions should go hand in hand with the examination of real-life mechanisms that are used to overcome information barriers.[144]

When it comes to cooperative investment, the reality indicates an informational context that falls neither in the case of strict non-contractibility of investment, nor in the opposite polar

---

[137] Schweizer 141-142.
[138] Ibid 143-144.
[139] Che and Hausch, 'Cooperative Investments and the Value of Contracting' 130.
[140] Che and Chung, 'Contract Damages and Cooperative Investments' 90, 94-95; Schweizer 135, 139. In this sense, see also Stremitzer 341.
[141] Hart and Moore, 'Incomplete Contracts and Renegotiation' 757-758.
[142] In this sense, see also Schweizer 135; Stremitzer 340.
[143] See *supra* Section A.2. Increased incompleteness, especially the text accompanying footnotes 60-62; footnote 65 and Section A.4. Long-term contracts, especially the text accompanying footnotes 168-169 of Chapter IV.
[144] For a similar argument see Stremitzer 341.

case of direct verifiability. As the review of real-world construction contracts showed, in this intermediate informational context, parties contract on quality (a signal of investment) by combining vague standards with a number of precise rules that ensure a minimum level of investment.[145] In case parties refrain from stipulating express quality requirements in their contracts, default terms that provide for required quality levels implicitly become part of the agreement.[146] From this perspective, Stremitzer's argument attributing the poor performance of (unilateral) expectation damages to the overly strong unverifiability assumption of Che and Chung goes to the very root of the matter.[147] Strictly implemented, this assumption remains far from reality as it implies that neither can contracts include clauses about required quality, nor can courts imply such terms in the absence of an express agreement of the parties. In this sense, Stremitzer's application of quality requirements represents a completely justified departure from the standard non-contractibility assumption; departure that allows him to introduce into his cooperative investment model existing legal instruments used in practice to deal with the information asymmetries.[148]

In the presence of a binding quality requirement (agreed by the parties or set out in a default term) with which courts can compare the good delivered, expectation damages induce positive cooperative investment. In contrast to the case in which the Seller's performance does not have to meet a certain level of quality,[149] in the event of quality requirement set above variable cost, the Seller's gain is made dependent on his cooperative investment. Investing to ensure that his performance conforms to the contract, he reduces the damages he would owe to the Buyer if he does not fulfil his obligations as to quality. Thus, the Seller becomes able to internalise some of the benefit from his cooperative investment and, hence, more motivated to invest. The higher the required quality, the more the investment incentive improves; yet, generally, the Seller underinvests since he does not gain more than what the contract permits

---

[145] See *supra* Section A.3. Rules and standards of Chapter IV.
[146] Such default terms exist in all three legal systems under comparison, For the US, see: UCC § 2-314. Implied Warranty: Merchantability; Usage of Trade.; § 2-315. Implied Warranty: Fitness for Particular Purpose. No implied warranties are available under the Restatement (Second) of Contracts. For England, see Sale of Goods Act (1979) Section 14 Implied terms about quality or fitness, as well as Section 13 Sale by description. and Section 15 Sale by sample. For Bulgaria, see Art. 64; Art. 261(1) Contracts Act.
[147] Che and Chung, 'Contract Damages and Cooperative Investments'. See *supra* the text accompanying footnotes 142-143 in Section D. of this Chapter.
[148] Stremitzer.
[149] Che and Chung, 'Contract Damages and Cooperative Investments'. In the language of economists, Che and Chung's model sets the level of required quality to zero. Consequently, as long as performance takes place, it is always conforming to the contract and the Seller's gain remains the same irrespectively of whether he invests in quality or not. Thus, as the Seller receives no benefit from his cooperative investment, he has no incentive to invest. Stremitzer 338, 349.

him to, even if the quality of his performance exceeds the benchmark level. Expectation damages induce the first best only if the quality threshold is set as high as it can possibly be. In the case of such Cadillac contracts, performance of a quality higher than that required is simply not feasible; consequently, there does not exist a valuation of performance for which the Seller does not internalise all the benefit from his cooperative investment. Thus, with a Cadillac contract the Seller becomes the residual claimant of the surplus and has efficient incentives both to perform and to invest cooperatively.[150]

In essence, these results do not change in the presence of renegotiation. Still, renegotiation has a value of its own because when the required level of quality is not very high, the Seller's incentive to invest increases compared to the no-renegotiation case. Seeing that performance will meet and even exceed the quality requirement and anticipating that his renegotiation share will surpass the expectation damages he has to pay, the Seller has motivation to breach strategically in order to internalise, in the subsequent renegotiation, a bigger portion of the surplus created by his investment. These prospects of increasing the realised benefit in the renegotiation process naturally stimulate the reliance incentive. As the quality requirement surpasses a certain threshold, however, the potential of renegotiation to induce more cooperative investment is depleted and the investment incentive equalises with that created without renegotiation. Again expectation damages ensure an efficient decision to rely cooperatively (and of course an efficient perform-or-breach decision) only in combination with Cadillac contracts. Yet, such contracts cannot be seen in practice very often, so more research is needed on the real world mechanisms used to optimise parties' investment incentives.[151] Nevertheless, with or without renegotiation, expectation damages are shown,

---

[150] Stremitzer 346, footnote 14, 349. Where investment is selfish, for expectation damages to generate the first-best, the Cadillac contract has to be combined with up-front payment. See *supra* footnotes 91-93 and the text accompanying them in Section C. of this Chapter. In the context of cooperative investment, however, if parties sign a Cadillac contract, expectation damages induce the first-best without any up-front payment being necessary. In the selfish investment scenario the role of the up-front payment is to induce the Seller to accept a very low price, which on its own turn is needed to make the Seller the breaching party and avoid his overinvestment. Where investment is cooperative, the issue of overinvestment does not arise, so the Cadillac contract does not have to be coupled with up-front payment. However, an up-front payment may be necessary in the cooperative setting, if the contract is not a Cadillac one. Ibid 346, footnote 13, 345, footnote 11, 338.

[151] The example usually given for Cadillac contracts are contracts offered by moving companies which commit to deliver clients' possessions undamaged. This, in fact, is the maximum the companies can promise and they do it although not infrequently they fail to live up to this standard. For this example, see Edlin, 'Cadillac contracts and Up-Front Payments: Efficient Investment under Expectation Damages' 102. Yet, as Stremizer correctly points out, usually companies promise to deliver commodities that are feasible under the state of technological development at the moment. That is, the promised quality of performance is straightforwardly attainable and in this sense the contract is not really a Cadillac one. Stremitzer 349.

contrary to the result of Che and Chung, to be able to induce positive, even if suboptimal, cooperative investment.[152]

It is also important to emphasise that Stremitzer's optimistic results with regard to unilateral expectation damages imply only a slight departure of Che and Hausch's strict non-contractibility assumption. They still hold in an informational context in which courts are unable to verify the Seller's cooperative investment,[153] thus allowing the use of expectation damages where their bilateral counterpart or reliance damages would not work. In addition, while these results entail the relaxing of one informational precondition, in other aspects they are more demanding to the informational environment. In the one assumed by Che and Hausch, courts are not capable of verifying the promisee's value of the rendered performance, a requirement which is necessary for the enforcement of expectation damages. In this sense, Stremitzer's results do not invalidate Che and Hausch's argument about the uselessness of contracting and damages in motivating purely cooperative investment where renegotiation is not ruled out. For this reason, while recognising the potential of expectation damages to motivate cooperative investment, it is also necessary to acknowledge that they imply a significant informational onus on courts.[154]

In short, damages have different effect on the investment decision depending on whether the investment is selfish or cooperative. When it comes to cooperative reliance, expectation damages induce too little and not too much reliance as they do in the case of selfish investment. Thus, the choice of the optimal damage measure also hinges on the type of specific investment that is made in a particular contract. Having clarified the different incentive effects generated by damages with regard to making investment, I now turn to the promisee’s choice on the level of precautions.

E. The non-breaching party's decision to take precautions

Like promisors, promisees can also take precautions before breach has occurred.[155] But while the promisor’s precautions reduce the probability of him breaching, the preventative

[152] Stremitzer 347-350.
[153] Ibid 343.
[154] Ibid 339, 341-342.
[155] For the promisor’s decision to take precautions, see *supra* Section B. of this Chapter.

measures, taken by the promisee reduce her losses from breach.[156] For instance, in the already used example of a contract for the construction of a shop,[157] the client may delay the closing of the sale of his old outlet until the construction works have finished even if this is costly. Thus, in case the construction is not finished on time, the client will suffer less harm as he will be able to continue operating and even to sell in the old store some of the goods purchased for the opening of the new outlet. The precautionary decision of deferring the sale of the old shop is efficient if the additional cost associated with it is less than the resulting reduction in damages that the client will suffer in case of delay of the construction process. To put it differently, the promisee limits the magnitude of her losses from breach by accounting for the probability that her counterparty may not perform as promised and by consequently restraining her reliance. In this sense, the promisee's choice of insufficient precautions represents another species of her reliance on the contract.[158]

As already explained in Section C. above, expectation and reliance damages incentivise the promisee to overrely. Hence, given the reverse connection between the non-breacher's reliance and precautions, the expectation and reliance measure induce the promisee to take too few precautions. The problem cannot be corrected by renegotiation as the latter occurs at a time when the precautionary decision is already made. However, in both common law and civil law jurisdictions contract law includes doctrines that may be used to deny the promisee compensation for losses she could forestall by taking efficient precautions. For example, all of the three legal systems under comparison have a default term allowing non-breachers to recover only the damages that were foreseeable at the time of contracting.[159] Thus, if courts interpret as unforeseeable losses the promisee would not have incurred by taking precautions at the efficient level, non-breachers will be induced to take appropriate preventative measures. Similarly to liquidated damages, the default term sets an upper limit to the obtainable compensation. If the limit is calibrated to the efficient level of precautions (reliance), the

[156] Cooter, 'Unity in Tort, Contract, and Property: The Model of Precaution' 3, 14, footnote 32, 30, footnote 61,
[157] See *supra* the text accompanying footnote 82 in Section C. of this Chapter.
[158] Cooter, 'Unity in Tort, Contract, and Property: The Model of Precaution' 3, 11; Hermalin, Katz and Craswell 108. See also *supra* the text accompanying footnote 80 in Section C. of this Chapter.
[159] For the US and England, see *Hadley v Baxendale*. For the US, see also Restatement (Second) of Contracts (1979) § 351 Unforeseeability and Related Limitations on Damages (1). Such foreseeability rule is also typical for all civil law jurisdictions whose contract law follows the French legal tradition. Bulgarian contract law does not make an exception - see Art. 82 Contracts Act.

promisee will be forced to bear any losses resulting from her suboptimal precautionary steps (or stated otherwise – from her overreliance).[160]

In addition, other doctrines, such as impossibility, impracticability, frustration,[161] could also be employed to compel promisees to internalise the costs of their insufficient (relative to the efficient level) precautions and thus incentivise them to make an efficient precautionary decision.[162] If courts excuse promisors exactly when and only when non-breachers have not taken efficient measures to prevent losses and hold promisors fully liable when non-breachers have acted efficiently, this could induce both parties to behave optimally.[163]

Of course, the above mentioned doctrines will correct the distortion of the promisee's precautionary choice only if courts are actually able to distinguish the cases in which non-breachers did too little to minimise their losses.[164] Whether this is so and if yes, which national courts prove to be more proficient in this respect, is an issue for a comparative positive analysis. For now I turn to another manifestation of promisees' precautions: their decision to mitigate losses.

---

[160] Cooter, 'Unity in Tort, Contract, and Property: The Model of Precaution' 14-16; Cooter and Ulen, *Law and Economics* 336; Richard Posner, *Economic Analysis of Law* (Sixth edn, New York: Aspen Publishers 2003) 127. See also *supra* the text accompanying footnote 82 in Section C. of this Chapter.

[161] The three legal systems under comparison use various terms to denote the different doctrines that excuse the promisor for his non-performance as a result of a supervening event. In addition, the various terms are often not used uniformly within a legal system. Legal scholars in the US distinguish between impossibility of performance (when performance is not physically possible, see *Taylor v. Caldwell* 1863 WL 6052 Court of King's Bench), frustration of purpose (when performance is physically possible but it has become futile, see *Krell v. Henry* 1903 WL 12966 Court of Appeal) and impracticability (when performance has become much more costly than initially thought, see *People v. Howard* 451 P2d 401 (Cal 1969)). See Richard Posner and Andrew Rosenfield, 'Impossibility and Related Doctrines in Contract Law: An Economic Analysis' (1977) 6 The Journal of Legal Studies 83. On the other hand, both UCC and Restatement (Second) of Contracts use the term "impracticability" as one encompassing both the concepts of impossibility and impracticability in the sense just mentioned (see § 2-615. Excuse by Failure of Presupposed Conditions. and Restatement (Second) of Contracts (1981) § 261 Discharge by Supervening Impracticability). The Restatement also differentiates "frustration of purpose" (see Restatement (Second) of Contracts (1981) § 265 Discharge by Supervening Frustration). In England the doctrine of frustration of contract unites three lines of cases: cases in which performance is characterised as factually or legally impossible (*Taylor v. Caldwell*), cases in which the purpose of the contract is frustrated (*Krell v. Henry*) and cases in which the change of circumstances renders performance "radically different" from what was contemplated by the parties at the time of contracting (*Davis Contractors v Fareham Urban DC* 1956 WL 17734 House of Lords). See also Zweigert and Kötz 220-225. The Bulgarian legal doctrine distinguishes between "impossibility of performance" (see Art. 81(1) Contracts Act and Art. 306 Commercial Act, the latter using the term "*force majeure*") and "commercial intolerability" (see Art. 307 ibid encompassing cases where performance is possible but uneconomical). See Kalaydjiev 307-324.

[162] Posner and Rosenfield, 'Impossibility and Related Doctrines in Contract Law: An Economic Analysis'.

[163] Hermalin, Katz and Craswell 108-109.

[164] Ibid 109.

F. The non-breaching party's decision to mitigate losses

The decision to mitigate is also directed at reducing losses, but unlike the promisee's core precautionary decision, discussed in the previous Section E., it is made after breach has already taken place. From this perspective, the mitigation choice of the promisee constitutes a form of precaution but not a form of reliance, the latter occurring only before breach.[165] While the breacher's liability for expectation damages gives him efficient incentive to take precautions,[166] it undermines the non-breacher's motivation to act preventively whether before or after breach.[167] Once breach has occurred, it is again the promisee that is in the better position to minimise the undesirable consequences of the default. For example, imagine that the Buyer has purchased special equipment to be installed in the shop under construction, but the structure was eventually not finished. The Buyer, however, may be able to mitigate her losses by using the equipment in her old outlet, though its salvage value will be considerably lower than the value it would have had, had the construction been executed as planned. Certainly, such mitigative measures will be efficient only if they do not cost more than the saved loss, *i.e.* than the realised value of the equipment.[168] Yet, the point is that the promisor's full liability does not induce the promisee to take after-breach precautions and she omits the last clear chance to prevent damages, thus externalising some of her losses onto the promisor.[169]

In fact, no damage measure is efficient from the perspective of both promisor's precautions and promisee's mitigation.[170] In theory, when renegotiation is feasible, the damage measure can be chosen to optimise only the breacher's decision as the promisor can always induce the non-breacher to mitigate in a cost-effective manner by means of a side payment. Note,

---

[165] Ibid 109; Cooter, 'Unity in Tort, Contract, and Property: The Model of Precaution' 16, footnote 36, 32, footnote 70.
[166] See *supra* Section B. of this Chapter.
[167] Cooter, 'Unity in Tort, Contract, and Property: The Model of Precaution' 3-5, 11-14. See also *supra* Section E. of this Chapter.
[168] Hermalin, Katz and Craswell 109.
[169] While Cooter makes this argument with respect to promisor's and promisee's precautionary decisions taken before breach, the argument can easily be adapted to promisee's mitigation choice, which as already stated is also a form of precaution. The asymmetry between promisor's incentives to take precautions and promisee's incentives to mitigate is another manifestation of the paradox of compensation. Cooter, 'Unity in Tort, Contract, and Property: The Model of Precaution' 4, 11-14; Cooter and Ulen, *Law and Economics* 331-334; Donald Wittman, 'Optimal Pricing of Sequential Inputs: Last Clear Chance, Mitigation of Damages, and Related Doctrines in the Law' (1981) 10 The Journal of Legal Studies 65, 72-78. See also *supra* Section C. of this Chapter.
[170] Cooter, 'Unity in Tort, Contract, and Property: The Model of Precaution' 4; Wittman 74.

however, that if the promisee is not obliged to mitigate, she will be able to extort a payment that may considerably exceed the cost of the mitigation activity. In addition, the Seller, potential breacher, will factor the extra payment into his contract price, driving away risk-averse Buyers, who would not be willing to pay a higher price at the outset for the possibility to make more money later.[171] Yet, it is not the right time to go into redistribution and risk preferences.[172] Rather, the point is that even when renegotiation costs are low, a legal rule requiring the promisee to mitigate efficiently appears to be a fairly good idea. And it is necessary when costs are prohibitively high and renegotiation, in which the promisee can be motivated to mitigate, is impossible.

The duty to mitigate, provided for by the contract law of all three legal systems under comparison, could, in principle, incentivise the promisee to take efficient measures to reduce her losses. Charged with the mitigation duty, the non-breacher cannot recover for the losses she could have avoided by taking "reasonable" steps (the US, England) or "with the care of a good proprietor" (Bulgaria); yet, she is compensated for the costs incurred while actively mitigating.[173] Again, the underlying idea is to prevent the non-breacher from passively or actively inflating her damages and simultaneously encourage her to attempt to limit them. Whether the promisee is actually provided with efficient incentives to mitigate depends on courts' interpretation of the standards of "reasonable" and "good proprietor". But if the application of these formulae is attuned to the requirements of efficiency and courts are able to verify the costs and gains of mitigation actions,[174] a promisee's duty to mitigate coupled with promisor's expectancy liability could, in principle, optimise both the breacher's precaution and the non-breacher's mitigation decisions. It is also argued that under some conditions a broad duty to mitigate together with liability for expectation damages is crucial for creating efficient incentives to make selfish specific investment.[175]

---

171 Craswell, 'Contract Remedies, Renegotiation and the Theory of Efficient Breach' 657.

172 For the risk allocation effect of damages, see *infra* Section J. of this Chapter.

173 For the US, see § 2-704. Seller's Right to Identify Goods to the Contract Notwithstanding Breach or to Salvage Unfinished Goods. (2) comment 2; Restatement (Second) of Contracts (1981) § 350 Avoidability as a Limitation on Damages; *Rockingham County v. Luten Bridge Co.* 35 F2d 301 (4th Cir 1929) at 307-308; Goetz and Scott, 'The Mitigation Principle: Toward a General Theory of Contractual Obligation' 973-974, footnote 18. For England, see *British Westinghouse Electric Co Ltd v. Underground Electric Rys* [1912] AC 673; Beale 1805-1806. For Bulgaria, see Art. 83(2) Contracts Act; Art. 323 Commercial Act; Kalaydjiev 432-433.

174 Hermalin, Katz and Craswell 109.

175 Edlin, 'Cadillac contracts and Up-Front Payments: Efficient Investment under Expectation Damages' 111-114. See also *supra* footnote 95 and the accompanying text in Section C. of this Chapter.

Having clarified the non-breacher's decision to mitigate losses, I now turn to the decision to terminate a contract prematurely which is also employed to reduce the compensation due by the breacher. The choice to terminate can be made either by the promisor or the promisee.

G. The decision to terminate a contract

The performance of many contracts involves many moves and choices over their lives. Thus, for example, the construction of a building entails many stages, the early ones of which may take place when costs are still uncertain and it is still unclear whether finishing the building will be economic. From this perspective, each stage can be perceived as entailing a choice whether to continue performing or to abandon the contract.

Each of the three legal systems under comparison recognises the possibility for a party (in the above example, the Seller) to terminate a contract early by means of repudiation or renunciation.[176] And each of the three legal systems treats such early termination as anticipatory breach that renders the promisor liable for damages suffered by the other party. Terminating the contract, the promisor surrenders this opportunity for profitable exchange; yet, on the other hand, breaching before the time due for performance enables him to trigger early the promisee's duty to mitigate and thus to reduce his liability. From this perspective, the termination decision implies a trade-off between the losses saved by early mitigation and the potential benefit from performing the contract.[177] This trade-off can be given an options interpretation under which the value of the contract to the promisor consists of (a) the present value of the exchange in the absence of breach and (b) the value of the option to breach anticipatorily and pay expectation damages at any time between the date of contracting and

---

[176] For the US, see UCC § 2-610. Anticipatory Repudiation.; Restatement (Second) of Contracts § 250 When a Statement or an Act is Repudiation. On renunciation in England, see Ewan McKendrik, 'Chapter 24. Discharge by Breach' in Hugh Beale (ed), *Chitty on Contracts General Principles*, vol I (Thirty-First edn, London: Sweet&Maxwell/Thomson Reuters 2012) 1711-1712. See also *Forslind v. Becheley-Crundall* (1922) SC 173 HL (where the conduct of the seller warranted the purchaser in believing that the seller did not intend to fulfil his part of the contract timeously, although he might, if it suited him, proceed to deliver timber, such conduct amounted to repudiation of the contract). Under Bulgarian general contract law, the promisor, normally, cannot repudiate anticipatorily. In principle, performance becomes due only upon expiry of the contract period, so before that the promisor cannot commit breach, at all. See Art. 70(1) and Art. 84(1) Contracts Act; Kalaydjiev 256-257; Goleva 82; Kojuharov, *Law of Obligations. General Theory of Obligations* 165. The possibility for the promisor's early termination is set out only with respect to specific service contracts, *e.g.* the construction contract (Art. 268 Contracts Act), the mandate contract (Art. 289 ibid).

[177] Richard Craswell, 'Insecurity, Repudiation and Cure' (1990) 19 Journal of Legal Studies 399, 405.

the due date of performance.[178] Thus, even if at a particular moment the contract appears unprofitable (for example because the cost of performance exceeds the price), when deciding whether to terminate the Seller should take into account that relinquishing the agreement, he will also relinquish a valuable option. The option is valuable because the cost of performance may subsequently decrease, turning the contract eventually into a profitable one. Therefore, the decision to terminate will be optimal only when the damages avoided by taking it outweigh the option value of the contract.[179] Such optimal termination choice can also be considered as breach that is efficient from the viewpoint of timing.[180]

Surrendering the contract at the optimal time is particularly important in long-term contracts where the cost and value of performance are highly uncertain as well as diverging because of the thin market of substitute performance.[181] Since, as explained above, perfectly calculated expectation damages induce efficient breach,[182] it is intuitive to suppose that they also induce efficient choice between terminating and persisting with performance. Expectation damages, however, are meant to give the promisee the benefit from performance, so they do not cover the loss of the time value of any breach option the promisee may have. As a result, expectation damages, not compensating for this loss, will incentivise the promisor to terminate too early.[183] If there is a possibility of promisee's insolvency, this propensity of the promisor will be aggravated even further.[184] On the other hand, if when deciding whether to terminate, the promisor knows that at the time of enforcement he himself will not be fully

---

[178] Alexander Triantis and George Triantis, 'Timing Problems in Contract Breach Decisions' (1998) 41 Journal of Law and Economics 163. It is assumed that the exercise price of the option to breach is only the damage payment, calculated on the basis of expected values at the time of repudiation. Any enforcement costs and reputational sanctions are assumed away. Renegotiation is also excluded. Ibid 168-169, 173-174.

[179] Ibid. The factors that affect the Seller's decision to terminate are: the remaining time until the date when performance is due, the volatility of his cost of performance, the magnitude of the damage reduction that can be achieved by mitigation, the interest rate, how many times the Seller expects to consider termination in the future. Ibid 166, 176-184.

[180] See also Hermalin, Katz and Craswell 110.

[181] In a thick market in which close substitute is easy to procure, the Seller's cost and the Buyer's value of performance tend to converge. Thus, in the example above, the rise of the Seller's cost of performance leads to a rise of the Buyer's value and consequently to an increase of the damages due by the Seller. For this reason, the Seller is unable to keep down the exercise price of the option (the damages due upon breach) by means of termination and in this way increase the value of the option (the difference between the Seller's cost and Buyer's value of performance). Therefore, the contract does not entail a valuable option to breach anticipatorily. Triantis and Triantis, 'Timing Problems in Contract Breach Decisions'.

[182] See *supra* Section A. of this Chapter.

[183] Triantis and Triantis, 'Timing Problems in Contract Breach Decisions'.

[184] Ibid 199-200.

solvent and, hence, will be unable to pay the full amount of compensation, he will repudiate the contract too late.[185]

Legal systems (including those under comparison) also permit the non-breaching party to treat herself as discharged by the other's breach before the due time for performance.[186] In this way, the promisee activates the breacher's liability for any damages suffered; yet, making such an early choice may allow her to reduce her losses and, consequently, the magnitude of the promisor's compensation. In this sense, this step of the promisee can be considered a kind of precaution.[187] And vice versa, a promisee who refrains from terminating early can be considered to be relying on the contract.[188] However, as emphasised above, full insurance of the non-breacher for all her losses distorts her reliance and precaution decisions[189] and, hence, it would not induce her to take an optimal decision for early termination, either.[190]

All three legal systems under comparison require courts to police the promisee's decision to terminate early. Thus, in the US, the non-breacher must show that she has a "reasonable" ground for insecurity and that upon demand the other party has failed to provide "adequate" assurance for performance.[191] The plaintiff in England has to prove that the anticipatory

---

[185] Craswell, 'Insecurity, Repudiation and Cure' 408-409. This result is based on the assumptions that the promisee does not have an anticipatory breach option, there is no possibility of the promisee's insolvency and the promisor incurs the cost of performance only at the performance date. If the cost of performance is not incurred all at once at the time of performance, but periodically, starting from the time of contracting, the insolvent (or soon-to-be insolvent) promisor will have less incentive to delay the moment of termination since debt overhang will be preventing him from financing the investments he needs to make. In addition, it is argued that an anticipatory breach option available also to the promisee, especially if coupled with a chance of a promisee's insolvency, speeds up termination by promisors despite the chance that they also become insolvent. Triantis and Triantis, 'Timing Problems in Contract Breach Decisions' 165, 198-200.

[186] Hermalin, Katz and Craswell 110. For this right of the promisee, see in the US: UCC § 2-609. Right to Adequate Assurance of Performance., Restatement (Second) of Contracts § 251 When a Failure to Give Assurance May Be Treated as a Repudiation and § 252 Effect of Insolvency; in England: see McKendrik 1693-1694 as well as *Universal Cargo Carriers Corp. v. Citati* [1957] 2 QB 401 (where the court decided that the owners were not entitled to rescind the contract as none of the charterer's were breaches of condition). In Bulgaria the promisee has such right in the context of some specific contracts, as she does in the context of the construction contract (Art. 262(2) Contracts Act). General contract law, however, does not permit early termination since before the due date the promisee's right is not yet exigible. Kalaydjiev 256-257; Goleva 82; Kojuharov, *Law of Obligations. General Theory of Obligations* 165. See also Art. 70(1) and Art. 84(1) Contracts Act as well as *supra* footnote 177 in Section G. of this Chapter.

[187] For the meaning of the term "precaution", see *supra* the text accompanying footnote 37 in Section B. of this Chapter.

[188] See *supra* the text accompanying footnote 53 in Section C. of this Chapter.

[189] For the non-breacher's decisions to rely and to take precautions, see *supra* respectively Section C. and E. of this Chapter.

[190] Hermalin, Katz and Craswell 110-111.

[191] UCC § 2-609. Right to Adequate Assurance of Performance. (1); Restatement (Second) of Contracts § 251 When a Failure to Give Assurance May Be Treated as a Repudiation and § 252 Effect of Insolvency; Art. 90(2) Contracts Act.

breach will "frustrate the object of the venture"[192] while in Bulgaria – that the defendant will obviously "not perform on time or in due manner".[193] The non-breacher must show that the promisor's breach was "total", "material" (the US),[194] "fundamental", "substantial", goes "to the root of the contract" (England).[195] Certainly, these tests would lead courts to permit early termination only when it is optimal provided that judges are able to observe all the variables that determine the efficiency of the termination decision and that they apply the mentioned terms in accordance with the standard of efficiency. And if such conditions, in view of neoclassical economists, are already fairly demanding, the fact that judicial control over the promisee's right to terminate is only *ex post* brings, they point, further difficulties. At the time the non-breacher exercises her right, the reasoning goes, she is not completely certain whether the court will interpret the breach as "total" or "substantial" or will consider the given assurances "inadequate" or will find it, indeed, "obvious" that the promisor will not perform on time or in due manner. And since a subsequent decision of the court holding that there were no grounds for the promisee's early termination would in fact incur her liability, a risk-averse promisee may choose not to take chances while a less risk-averse promisor may use the uncertainty to negotiate a contractual modification in his favour.[196] Thus, the vagueness of legal standards coupled with the *ex post* governance technique are viewed as hurdles toward optimising parties' incentives.

The reasoning until now ruled out renegotiation. With costless renegotiation possible, parties would correct *ex post* the inefficiency of any termination decision as, after all, the latter is a kind of breach-or-perform decision.[197] The problem is that while optimising the termination choice, renegotiation will distort other decisions. Thus, if the promisee has to bribe the promisor not to repudiate too early, the promisor's expected liability upon default as well as his incentive to take sufficient precautions against breach will be reduced.[198] In addition, the promisee's choice to enter into the particular contract will also be altered as the prospect of a side payment relieving the breacher from some of his responsibility will induce him not to

---

[192] *Universal Cargo Carriers Corp. v. Citati* at 422, 450.
[193] Art. 262(2) Contracts Act.
[194] See Restatement (Second) of Contracts § 251 When a Failure to Give Assurance May Be Treated as a Repudiation in relation to § 243 Effect of a Breach by Non-Performance as Giving Rise to a Claim for Damages for Total Breach and § 241 Circumstances Significant in Determining Whether a Failure is Material.
[195] For England, see McKendrik 1725-1726.
[196] Hermalin, Katz and Craswell 111.
[197] See *supra* the text accompanying footnotes 13 and 14 in Section A. of this Chapter.
[198] Triantis and Triantis, 'Timing Problems in Contract Breach Decisions' 202; Craswell, 'Insecurity, Repudiation and Cure' 410. For the promisor's decision to take precautions, see *supra* Section B. of this Chapter.

factor all the cost of his failure to perform into his price. As a result, the non-breacher's ability to select the less risky contractual partners on the basis of price information will deteriorate.[199] Conversely, the promisor bribing the promisee so that she does not force inefficiently early termination will affect the promisee's reliance decision. Receiving a side payment, the promisee will be incentivised to rely on the contract even more than she overrelies with perfect expectation damages.[200]

Having clarified parties' decision to terminate the contract prematurely, I now turn to their choices regarding collecting and disclosing information.

H. The decisions to collect and disclose information

As already emphasised several times, in their analysis of contract remedies economists generally assume symmetric information in which each party knows the other's cost or value of performance. However, as in the real world parties are not perfectly informed, if they are interested in certain information, they must invest to collect it. Or if it is information their contractual partner already has, he can provide it to them. Despite the fact that law and economics seems to have focused mainly on the breach and reliance choices, remedies for breach also influence the decisions to collect and disclose information. Below I discuss some information-related incentives and the way they are affected by damages.

1. The decision to search for contractual partners

Besides legal rules on contract formation, damages also have an effect on parties' motivation to collect information about potential contractual partners and look for better ones who can increase their profits. A party's search is efficient until it reaches the point where the marginal cost of any additional hunting effort exceeds its marginal value.[201] Generally, the higher the damages, the more they discourage a party to search for a new partner as the compensation the party has to pay to his old one automatically reduces his increased surplus from the new contract.[202] In addition, the incentives that damages induce also depend on whether a market

[199] Craswell, 'Insecurity, Repudiation and Cure' 411-412. For the decision to enter into a particular contract, see *infra* Section H.2 of this Chapter.
[200] For the promisee's decision to rely, see *supra* Section C. of this Chapter.
[201] Hermalin, Katz and Craswell 58.
[202] Lewis Kornhauser, 'An Introduction to the Economic Analysis of Contract Remedies' (1986) 57 University of Colorado Law Review 683, 693; Hermalin, Katz and Craswell 112. For a very technical, though very

actor's search decision has an external effect on the other market participants.[203] In markets with many traders where an increase in search does not affect other parties' meeting probabilities, expectation damages optimise a market actor's search motivation. In this context, too, however, actors, who continue to seek out a better match though they already have a contract, may grow to have excessive search incentives if they still value the possibility to complete their existing agreement. The reason is that though such parties are willing to breach, they will do so only if they find a good partner who is himself partnerless as the latter will bring a higher gain than some other potentially good but already poorly matched partner.[204] On the other hand, in markets with low density of potential partners where any additional search increases the chances for finding a potential trader not only of the searcher but also of other market participants, expectation damages create too weak search incentives. Since the searcher cannot internalise all the benefits of his investment in hunting for a better partner, he is inclined to search less than is efficient. In fact, if such positive externality occurs, no damage measure, even overcompensatory damages, results in an efficient search decision.[205]

---

enlightening analysis of parties' incentives to search for a better contractual partner, see Peter Diamond and Erik Maskin, 'An Equilibrium Analysis of Search and Breach of Contract, I: Steady States' (1979) 10 The Bell Journal of Economics 282; Peter Diamond and Erik Maskin, 'An Equilibrium Analysis of Search and Breach of Contract II. A Non-Steady Example' (1981) 25 Journal of Economic Theory 165.

[203] Risk neutrality is again assumed. Diamond and Maskin, 'An Equilibrium Analysis of Search and Breach of Contract, I: Steady States' 285; Diamond and Maskin, 'An Equilibrium Analysis of Search and Breach of Contract II. A Non-Steady Example' 167.

[204] Partnerless actors are generally more valuable partners than actors who already have a poor contract as they are willing to settle for a smaller share of the contract surplus (after all they do not have to pay damages to previous partners) while at the same time they bear the burden of the damages their good match needs to pay to his old poor partner. Diamond and Maskin, 'An Equilibrium Analysis of Search and Breach of Contract, I: Steady States' 286, footnote 15, 293-294. In such markets with high density of potential contractual partners overcompensatory damages also generally induce too much search as then the searcher needs to find a good partner from whom he can extract a sufficiently large share of the contract surplus which to enable him to pay the higher damages to his previous poor match. In this sense, under overcompensatory damages investment in finding a new good counterparty is expected to generate a higher return than that under expectation damages; hence, search goes beyond the efficient level. Ibid; Diamond and Maskin, 'An Equilibrium Analysis of Search and Breach of Contract II. A Non-Steady Example'.

[205] Overcompensatory damages can somewhat improve search incentives because a party who has to pay high damages to his previous poor partner is generally motivated to persist in finding a new good contract generating a higher gain; yet, overall, the induced search will remain below the efficient level. Note that damages can be increased only up to the point where they exhaust the extra surplus made with the new good contract. Damages set over this level will make breach unprofitable and, hence, very unlikely, stripping search activity of hardly any sense. To be correct, in Diamond and Maskin's analysis the argument is made with liquidated damages set by the parties above the compensatory level; yet, it carries on to the case where overcompensatory damages are awarded by courts. Diamond and Maskin, 'An Equilibrium Analysis of Search and Breach of Contract, I: Steady States' 294-295, 300.

The decision to gather information for the purpose of finding a better partner must be differentiated from another decision related to collecting information: the decision of whether to enter into a contract with an already located contractual partner.

2. The decision to enter into a particular contract

To make it clear from the outset, in the following discussion the incentive to collect information in order to decide whether to enter into a particular contract is not associated with collecting information about the likely market trends[206] but with an inquiry about the possible hazards that may render one of the parties unable to perform. The distinction is not unimportant since both kinds of information are related to the profitability of the contract; yet, unlike the first kind, the second one is not collected with the intention to make money on it and its value by no means depends on its confidentiality. The issue is also not which party, the potential promisor or promisee, is best positioned to collect information, but rather, assuming that the Seller is the would-be breacher and also the most apt to investigate, how much research it is optimal for him to conduct in order to decide whether to enter into a contract.[207]

Indeed, a Seller learns his true costs of performance only *ex post*, but he does not have to bind himself blindly, without having any clue about the obstacles he will face in fulfilling his promise. On the contrary, in deciding whether to contract at all, he can investigate possible risks that may render performance too expensive and force him to breach. From this perspective, collecting information about one's own potential costs of performance is a sort of precaution; yet, such that is taken prior to contracting.[208] It is intuitive that higher liability will induce more investment in collecting information; yet, the important question is not which damage measure increases a party's investigation activity, but which damage measure induces him to collect as much information as it is efficient. A party has reached the optimal level of risk research when further increase in information-gathering will entail a marginal cost that

---

[206] For analysis of the incentive to collect information about the state of the market, see Antony Kronman, 'Mistake, Disclosure, Information, and the Law of Contracts' (1978) 7 The Journal of Legal Studies 1.

[207] Certainly in some cases, it may be the Buyer, *i.e.* the promisee, who is better positioned to collect information. The damage measure that will then induce her to research optimally depends on the same factors as the ones indicated in the discussion that follows above. Richard Craswell, 'Precontractual Investigation as an Optimal Precaution Problem' (1988) 17 The Journal of Legal Studies 401, 404, 406. For some of the issues related to the decision which party is better positioned to collect information, see Posner and Rosenfield, 'Impossibility and Related Doctrines in Contract Law: An Economic Analysis' 90-92.

[208] Contrast with the promisor's precautions in Section B. of this Chapter, which are also intended to prevent breach but are taken after the contract has already been signed.

surpasses the reduction in expected losses. In fact, insufficient precontractual research may lead to two kinds of losses: losses resulting from concluding a contract that will eventually not be performed and losses resulting from not concluding a contract that will potentially be profitable. In the first case, these are the reliance damages the promisee would not have incurred without the signed contract; in the second case, losses equal the surplus the potential contract could have but did not generate because it was not signed. In order to have an optimal incentive to collect information before contracting, the party should fully internalise both kinds of costs of inadequate investigation.[209]

In a perfectly monopolistic and perfectly competitive market, both reliance and expectation damages, if perfectly calculated, create optimal incentives to collect information.[210] Undoubtedly, reliance damages will force the Seller to bear the Buyer's reliance losses from entering into a contract that will not be completed. And expectation damages, which in these market structures converge with reliance damages, will have the same effect.[211] As for the costs from the Seller's imprudent decision not to contract, a monopolistic Seller may internalise them through the very loss of the contract price that he, engaging in first-degree price discrimination, could set equal to the Buyer's value, thus extracting the whole contractual surplus. In perfect competition, on the other hand, the Seller is not able to charge a price, higher than his costs. Consequently, his failure to conclude a contract does not lead to any loss of social surplus, and, hence, to any costs that he needs to internalise.[212]

However, in a market which (like most markets) is neither perfectly monopolistic, nor perfectly competitive, the choice of the optimal damage measure is not so clear-cut. In such a market, neither of the parties will be able to command the price and each will capture only a

---

[209] Craswell, 'Precontractual Investigation as an Optimal Precaution Problem' 413-414.

[210] A short note on the assumptions underlying the results regarding this decision will be useful. To focus on the effect of legal remedies, Craswell assumes away any nonlegal sanctions. He also makes some assumptions that allow him to concentrate on the effect of damages solely on the incentive to collect information: the Seller cannot do anything to increase the probability of performance and the Buyer cannot change his reliance expenditure, which is implied to be reasonable. The possibility that the Buyer does not enter into her first-best contract, which will cause her reliance damages to exceed her expectation damages, is also excluded. The usual assumption of risk-neutrality also applies. Ibid 403, footnote 5, 407, 410.

[211] On the convergence of expectation and reliance damages in perfectly competitive markets, see *supra* the text accompanying footnotes 132-135 in Section A.4. Spot contracts of Chapter IV. As already explained, expectation damages encompass the promisee's reliance losses as well as her lost profits. See *supra* the text accompanying footnote 92 in Section C.2. of Chapter III. In a perfectly monopolistic market, however, the Seller is able to set a contract price equal to the Buyer's value from performance, thus leaving the Buyer unable to make any profit on the contract. As a result, Buyer's expectation damages cover only her reliance losses and equal reliance damages. Ibid 416-417.

[212] Ibid 416-420.

share of the contractual surplus. Under these conditions, reliance damages motivate too little information-gathering as the Seller bears the costs of his ill-considered decision to contract, but does not bear the full costs of his poor choice not to contract (after all, if he does not collect the contract price, he loses only a part of the unrealised contractual surplus). The optimal damage measure, therefore, is one that results in compensation higher than reliance damages. Yet, it does not follow that it is exactly the expectation measure that optimises the incentive to collect information. Certainly, expectation damages increase the amount of damages the Seller has to pay in case he has struck an unprofitable contract and thus stimulate him to investigate more before binding himself. However, this may lead to an incentive that is too strong relative to the optimal level since expectation damages may exceed reliance damages by too much. Or the incentive may prove to be too weak to compensate for the fact that, dividing the contractual surplus, the price in fact understates the costs of an imprudent decision not to contract. In other words, if the expectation measure ever proves to be optimal, this will be only coincidentally. Most often it will turn out to be less or greater than the optimal damage measure.[213]

It is important to emphasise that all of the above outcomes hold in an imperfect informational environment in which the Buyer does not have concrete information of the probability of performance of the particular Seller but is aware only of the average risk associated with Sellers like the one she negotiates with. To put it differently, the Buyer is assumed to have rational expectations about the amount of investigation the Seller conducts prior to contracting.[214] Without such relaxing of the assumption of perfect information, damage measures either do not matter at all (perfect monopoly and perfect competition), or all provide the Seller with the same suboptimal incentive (a market falling between the two extremes). As long as the Buyer is perfectly informed, perfect competition will induce the Seller to collect information optimally regardless of the damage measure because otherwise he will be driven out of the market.[215] A perfectly price-discriminating monopolist will also decide on the optimal amount of research irrespectively of the applicable damage measure since he bears all the costs of any increase in investigation as well as internalises, through the higher contract price, all the gains brought by it.[216] On the other hand, in an intermediate market environment

---

[213] Ibid 402, 421-423.
[214] Ibid 418-419.
[215] Ibid 419-420.
[216] Ibid 417.

in which the Buyer knows the exact level of risk posed by the particular Seller, the Seller will always collect less information than efficient because whatever the damage measure he will always capture only a share of the surplus produced by his wise decision to contract. Indeed, as already explained, a higher damage measure will improve the Seller's incentive to investigate, but will also make the Buyer (who is better insured against non-performance) less eager to pay a higher price for more research. As these diametrically opposite incentive effects exactly offset each other, the Seller will have too weak an incentive to collect information under any damage measure, even if it is higher than the reliance one.[217]

Under the rational expectations assumption, however, the Seller is unable to increase the price claiming that he engages in more research of the potential risks since the Buyer simply does not observe any changes in the Seller's level of investigation. Thus, even though in each type of market the Seller is able to charge the same price as under perfect information, he is unable to extract a bigger share of the Buyer's surplus through raising it. As a result, the Seller's motivation starts changing depending on the damage measure. In perfectly monopolistic and perfectly competitive markets only reliance and the converging expectation damages induce the Seller to collect the optimal amount of information.[218] And in an intermediate market environment, the optimal damage measure exceeds the reliance one but may be below or above the expectation measure.[219] In this sense, when it comes to the Seller's decision to enter into a contract, in order for the choice between damage measures to make any sense at all, it is necessary to leave the comfortable perfect informational environment, typical for most Chicagoan economic models.[220]

Sometimes, the information a party needs to make an efficient decision is held by his contractual partner. Damages can also affect the informed actor's decision to disclose the collected information to the party who needs it in order to behave efficiently.

---

[217] Ibid 421-422.
[218] Ibid 419.
[219] Ibid 402, 422-423.
[220] In this sense also ibid 427.

3. The decision to disclose information

As it was already explained, the promisor's decision to take efficient precautions depends on his awareness of the promisee's expected value from performance.[221] Consequently, if the promisee has this information and discloses it to the promisor, the latter will be able to adjust his precautions to the optimal level. And conversely, to optimise her own selfish investment, the promisee needs to account for the probability of promisor's breach.[222] Hence, if the promisor knows the likelihood of breach and conveys it to the promisee, the latter will have an easier time deciding on the optimal amount of her reliance expenditure.[223] Thus, if communication costs are outweighed by the benefits resulting from taking efficient precautions, respectively from relying optimally, disclosing such private information to the other party is socially desirable.[224]

Generally, in contract law parties are induced to disclose information not through remedies for breach of contract but through rules on fraud, misrepresentation and nondisclosure. Thus, it is argued that constant and restrained damage measures, which are considered capable of optimising the promisee's selfish investment decision,[225] cannot incentivise the promisor to communicate truthfully the likelihood of his performance. The promisor is rather motivated to achieve a higher price, so he does not give information that is perfectly accurate but such that would make the promisee perceive the contract as more profitable. If the constant damage measure is set below the expectation one, the promisor has the incentive to make performance look more probable. If the constant damage measure exceeds the expectation measure, he has the incentive to make performance seem less likely as to the promisee breach appears the more valuable option. The promisor, in other words, has no stimulus to tell the truth. Consequently, if rules policing his statements for misrepresentation, fraud or nondisclosure are absent and he is only liable for breach of contract under a constant or restrained damage measure, the promisee will not have optimal reliance incentives since she will not receive credible information about the likelihood of performance. To put it differently, the mentioned

---

[221] For the promisor's decision to take precautions, see *supra* Section B. of this Chapter.
[222] For the promisee's decision to make selfish investment in reliance, see *supra* Section C. of this Chapter.
[223] In this sense, see also Hermalin, Katz and Craswell 113.
[224] Lucian Bebchuk and Steven Shavell, 'Information and the Scope of Liability for Breach of Contract: The Rule of Hadley v. Baxendale' (1991) 7 The Journal of Law, Economics and Organization 284, 286, 288.
[225] Recall that restitution and no liability can optimise the promisee's selfish investment in a second-best sense. In addition, liquidated damages and restrained damage measures can optimise both the promisor's perform-or-breach and promisee's selfish reliance decisions. See *supra* the text accompanying footnotes 77-78, 82, 97-99 in Section C. of this Chapter.

damage measures produce optimal effect if the promisee has perfect information but they themselves do not guarantee that she is perfectly informed.[226]

Nevertheless, all three legal systems under comparison contain a remedial default term incentivising the promisee to disclose accurate information about her value of performance. This is the effect generated by the Anglo-American rule of *Hadley v. Baxendale*[227] and the Bulgarian provision of Art. 82 of the Contracts Act,[228] both denying full compensation to non-breachers who at the time of contracting have not revealed the extraordinary harm they will suffer in the event of breach. By limiting promisors' liability to the foreseeable damages, this "penalty default"[229] induces promisees with unusually high losses to convey their special circumstances and thus alert promisors about the higher level of precautions that need to be taken to ensure performance. Assuming this type of promisees is a minority, in a competitive market such a legal rule is efficient as the potential breacher, in fact, gets to know the valuation of all promisees (those who do not identify themselves must value performance as usual) but the socially desirable information transfer occurs at minimum transaction costs. Conversely, in the absence of such limitation to liability, promisees may still disclose their value of performance; yet, the communication process will entail more transaction costs as it will be the majority of ordinary promisees, driven by a desire to achieve a lower price, who will be motivated to reveal information.[230]

In addition, there is yet another reason for which the present foreseeability rule is argued to be preferable in a competitive market.[231] Since in such a market price equals cost, Buyers with extraordinary losses capture all the gain in surplus resulting from their disclosure.

---

[226] This outcome results under several assumptions: that the information about the probability of performance is private and the only way for the promisee to obtain it is if the promisor discloses it; that the promisor cannot prove in any way the reliability of the information he discloses; that parties always contract when it is efficient. Craswell, 'Performance, Reliance and One-Sided Information', 373-382. Constant damage measures are also shown not to induce the promisor to disclose accurate information if renegotiation is possible. Ibid 388-393.
[227] *Hadley v Baxendale*, see *supra* footnote 160 in Section E. of this Chapter.
[228] Art. 82 Contracts Act, see *supra* footnote 160 in Section E. of this Chapter.
[229] Ayres and Gertner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules'.
[230] Bebchuk and Shavell 286-289; Cooter and Ulen, *Law and Economics* 337. The same reasoning pointing at the conservation of transaction costs justifies the superiority of the present limiting-liability rule, if information disclosure is not socially desirable, but nonetheless occurs. Conversely, if no communication occurs, the present rule will be inferior since unlike the unlimited liability rule, it will lead promisors to take low instead of average precautions, the latter being the optimal behaviour in case distinguishing between promisees is not possible. Bebchuk and Shavell 290-292.
[231] Bebchuk and Shavell 289, 297-298; Ayres and Gertner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules' 108. Parties are also assumed to be risk-neutral as risk-aversion may affect the promisee's incentive to disclose information. See Bebchuk and Shavell 306.

Consequently, as long as this gain is sufficiently large, they always reveal their type though this inevitably means they also have to pay a higher price. Conversely, under a rule requiring payment of full expectation damages, no disclosure may occur whatsoever. Indeed, in these circumstances low-value Buyers may have an incentive to identify themselves; yet, if, being the majority, their benefit is too little compared to the communication costs, they may simply find self-identification worthless.[232] High-value Buyers, on the other hand, will be unwilling to reveal their type as they would face a price increase despite the fact that the Seller's liability will not expand any further. In other words, although disclosure will result in efficient adjustment of precautions, promisees with large losses will prefer not to divulge information for strategic reasons.[233] The superiority of the present limitation on liability, then, lies in disallowing such strategic motivation to prevent efficient information disclosure. To reiterate, however, this result is contingent on the underlying assumption of a competitive market where high-value Buyers' self-interest perfectly corresponds to the social interest since they extract the entire surplus increase resulting from their disclosure.

While inducing promisees to convey important information at the time of contracting, the present penalty default does not encourage promisors to act likewise after the agreement is already signed. This is not an issue in spot contracts for which costly *ex post* readjustments are not typical even if the moment of performance may differ from the moment of contracting. Yet, in the case of long-term contracts where circumstances may change substantially before performance, a promisor may significantly reduce promisee's losses from breach by communicating to her relevant information that he obtained only subsequently. Such information may rescue the contractual partner, but may also make her regret she has entered into the contract at all. For this reason, having once struck the bargain, the promisor who cannot easily resell his customised performance, has no incentive to make *ex post* disclosures that may endanger the contract completion. This natural absence of motivation is additionally aggravated by the foreseeability rule which fixes the time of contracting as the relevant moment determining the scope of promisor's liability.[234] Such exclusion of the time

---

[232] Note that the gain of low-value Buyers from disclosing their type depends on the number of Buyers facing extraordinary losses. Thus, where the latter are too few, the price decrease achieved by low-value Buyers may be very little while the communication costs they bear are not insignificant. Ayres and Gertner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules' 110-111.
[233] Bebchuk and Shavell 297-301; Ayres and Gertner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules' 108-111.
[234] Goetz and Scott, 'The Mitigation Principle: Toward a General Theory of Contractual Obligation' 1012-1015.

period between contracting and performance, a period which in long-term contracts is fairly extensive and rich in information accumulation, does not induce cooperation between the parties and consequently does not alleviate the information asymmetry between them.

In any case, any consideration of the incentives to disclose information, be they *ex ante* or *ex post*, implies a non-homogeneous population of market players: promisors differing with regard to the likelihood of their performance, promisees differing with regard to how much they value a particular contract. Where parties are diverse, however, damages are important not only as a source of motivation to reveal one's type but also as a method of distinguishing contracting parties.

I. Damages and party heterogeneity

Where market players are heterogeneous and information is asymmetric, parties can use damage clauses to collect information about their contractual partners or to inform them of their own type. If a promisor deals with both high and low-value promisees, his expected cost of damages varies depending on the type of the promisee he contracts with. Not knowing to which category each Buyer belongs, an uninformed Seller cannot simply price discriminate among his contractual partners. However, if he has market power, he can engage in second-degree price discrimination and distort non-price contractual terms, including remedial terms, to distinguish his counterparties and boost his profits.[235] For example, by offering a whole menu of contracts, incorporating different liquidated damages clauses, the Seller can screen the common pool of Buyers and separate them into different types. Conversely, damage clauses can also be used by informed parties to convey information. For example, a Seller may promise to pay high liquidated damages in order to signal his trustworthiness to a hesitating Buyer and thus distinguish himself as a party whose performance is virtually certain.[236] In other words, contractual damage clauses can also be analysed as devices used to sort a heterogeneous population of market players.[237]

[235] For using the warranty term to distinguish among different classes of Buyers, see Steven Matthews and John Moore, 'Monopoly Provision of Quality and Warranties: An Exploration in the Theory of Multidimensional Screening' (1987) 55 Econometrica 441.
[236] Signalling games are first studied by Spence, see Michael Spence, 'Job Market Signaling' (1973) 87 Quarterly Journal of Economics 355.
[237] Cooter and Ulen, *Law and Economics* 322, 304; Hermalin, Katz and Craswell 114.

When actors are unable to classify their contractual partners by screening or identify themselves by signalling, the default foreseeability limitation on expectation damages also has the effect of separating different types of contracting parties.[238] As discussed in the previous section, even in a competitive spot market high-value Buyers may refrain from signalling for strategic reasons and low-value Buyers – simply because it is cost-ineffective. In such a market, the Seller, too, will commonly find screening prohibitively costly and will consequently charge all Buyers an average price calculated to reflect his expected liability costs to both types of promisees. As a result, heterogeneous Buyers remain pooled together, with low-value Buyers paying a price exceeding the one they would pay if they were distinguished and high-value Buyers paying a price lower than the one they would pay if they bore the expected cost of their own damages. In other words, low-value Buyers cross-subsidise high-value ones. The higher cross-subsidised price may even surpass the value some of them place on performance leading them eventually to leave the market. The foreseeability rule can thus be viewed as thwarting such adverse selection.[239] By limiting damages to the ordinary, foreseeable losses, it forces high-value Buyers to distinguish themselves, thus reducing cross-subsidisation and precluding low-risk parties from being driven out of the market. This suggests setting limits on full expectation damages and compensating only the losses commonly experienced by all promisees. It should not be forgotten, however, that such curbing of the recoverable damages may also incentivise the promisor to take suboptimal precautions as well as to breach too often.[240]

In short, from the standpoint of efficiency damages below the perfect expectation measure may be desirable to incentivise promisees to take precautions[241] as well as to prevent adverse selection. Another reason that may call for compensating less than the promisee's full expectation interest may be contracting parties' risk aversion.[242]

---

[238] Gwyn Quillen, 'Contract Damages and Cross-Subsidization' (1988) 61 California Law Review 1125.
[239] Akerlof.
[240] Quillen; Hermalin, Katz and Craswell 113-115. For the promisor's decisions to perform or breach and to take precautions, see respectively *supra* Section A. and B. of this Chapter.
[241] See *supra* Section E. of this Chapter.
[242] In this sense see also Quillen 1126, footnote 5.

J. Damages and risk allocation

Even if damages affected none of the incentives discussed above, they allocate the risk of contract breach between the parties. This effect is irrelevant if both parties are risk neutral;[243] yet, if one or both of them is risk averse, the way the remedy distributes risk between the contractual partners also matters in terms of efficiency.[244] The importance of this remedial effect can be appreciated better if considering that renegotiation cannot simply rectify an undesirable risk allocation. Indeed, where a very large risk is imposed on a risk-averse party, his possibility to renegotiate the contract tends to lessen the risk as he can make a side payment to avoid performing his obligation. Still, the magnitude of this payment being uncertain, upon renegotiation the risk is only tempered and not eradicated, so it is only the choice of a different remedy that can significantly improve risk-sharing between the parties and not renegotiation of the initial contract.[245]

To avoid complicating the analysis of remedies with additional risk insurance considerations, economists, however, commonly assume that parties are risk neutral. In case the reader has followed carefully the preceding discussion of the various parties' decisions, he must have noticed that economic scholars simply set the issue of risk allocation aside in order to focus only on the effect of damages on the particular incentives they wish to study.[246] Still, in a world in which insurance is so widespread, the automatic assumption of risk-neutrality seems too strong.[247] Bearing in mind that parties have different attitudes toward risk, it appears more plausible to speak of their relative risk aversion rather than their risk indifference.[248] In this sense, if contracting parties are risk averse to a different degree, it is efficient that they share the risk in a way that reflects their relative risk aversion.

---

[243] As shown by Polinsky, if both parties are risk neutral, all remedies are equally efficient as far as allocation of risk is concerned. A. Mitchell Polinsky, 'Risk Sharing through Breach of Contract Remedies' (1983) 12 Journal of Legal Studies 427, 431, 442 Table 4.
[244] Ibid; Steven Shavell, 'The Design of Contracts and Remedies for Breach' (1984) 99 The Quarterly Journal of Economics 121, 146; Shavell, *Foundations of Economic Analysis of Law* 351.
[245] Shavell, *Foundations of Economic Analysis of Law* 318, 366-367; Craswell, 'Contract Remedies, Renegotiation and the Theory of Efficient Breach' 645.
[246] See *supra* the introduction of this Chapter as well as footnote 205 in Section H.1. and footnote 212 in Section H.2. of this Chapter.
[247] In this sense see also Posner and Rosenfield, 'Impossibility and Related Doctrines in Contract Law: An Economic Analysis' 91.
[248] For a good and very concise explanation of risk aversity, see ibid 91 as well as Cooter, 'Unity in Tort, Contract, and Property: The Model of Precaution' 37.

Expectation damages, however, do not achieve such fine-tuned risk sharing. Assuming the uncertainty relates to Seller's production cost or Buyer's valuation, or to the appearance of a higher outside bid, perfectly calculated expectation damages allocate the entire risk to the breaching party. While his profit varies depending on whether the risk materialises, the non-breaching party receives her benefit from the contract irrespective of its performance or breach. Such allocation of risk is optimal if the breacher is risk neutral and the non-breacher is risk averse.[249] Assuming, however, the uncertainty relates to the possibility of a higher outside bid, where the third party can make an offer not only to the Seller but also to the Buyer, perfectly computed expectation damages allocate the risk entirely to the non-breacher. The reason is that in this situation they, having to put the Buyer in the position she would have occupied if she herself had recontracted with the outsider, amount to the third-party bid. Consequently, it is the Buyer's (*i.e.* the non-breacher's) profit that is uncertain as she is better off if a third party comes along while the Seller's profit remains the same: the difference between the contract price and his cost. Hence, in the event when the Buyer would have been able to resell to the outsider, expectation damages are optimal only if the breacher (the Seller) is risk-averse and the non-breacher is risk neutral.[250] In any case, the expectation measure is not optimal if contracting parties wish to share the risk because they are both risk-averse. In terms of risk allocation it is desirable only when one of the parties, being risk-neutral, acts as a perfect insurer of the other.[251]

Efficient risk sharing according to the parties' relative risk aversion can be achieved by a damage payment falling in between the damage measures that prove to be optimal in the two polar cases where either the promisor, or the promisee is risk-neutral.[252] However, in the case of a risk of a higher third party offer reliance damages and restitution always remain outside the optimal range since they are lower than the Buyer's benefit both when she is able to resell to the third party and when she cannot avail herself of the outside bid.[253] As a result, instead of leading to optimal risk sharing between the parties, reliance damages and restitution in fact

---

[249] Polinsky 434, 442; Shavell, *Foundations of Economic Analysis of Law* 351, footnote 13; Hermalin, Katz and Craswell 114.
[250] Polinsky 434, 442.
[251] Shavell, 'The Design of Contracts and Remedies for Breach' 127-128.
[252] Polinsky 433, 442-443; Shavell, 'The Design of Contracts and Remedies for Breach' 128.
[253] Recall that in the usual case expectation damages (measured by the benefit the Buyer would have realised had the contract not been breached) are higher than reliance damages, and reliance damages are higher than the payment under restitution. See *supra* the text accompanying footnote 100 in Section C.2. and footnote 136 in Section C.3. of Chapter III.

heighten the risk. Of the two, the restitution measure is inferior since being lower than reliance damages, it makes parties' profits even more varying and unstable.[254] Nevertheless, where the risk is one of extraordinary production cost and both the promisor and the promisee are risk averse, reliance damages and restitution may prove to be optimal since they fall within the range of the optimal damage payment. In the event of production cost uncertainty, this range is determined by a payment amounting to the Seller's normal production cost (leaving him with unvarying profit, equalling the difference between the contract price and the normal production cost irrespective of any cost increase) and a payment amounting to the Buyer's benefit (leaving her with unvarying profit, equalling the difference between her benefit and the contract price). With a damage payment within this range, the risk is absorbed by the Seller so far as the payment surpasses his normal production cost, and by the Buyer so far as it falls below her benefit. Sure enough, damages recovered under the reliance or the restitution measure may happen to coincide precisely with the intermediate transfer that shares optimally the risk between the two risk-averse parties. Yet, this would not necessarily be so, since the reliance and restitution payments depend on the parties' relative bargaining power and not on their relative risk aversion.[255] In any case, whatever the risk, when both parties are risk-averse, the optimal amount of compensation is below perfect expectation damages.

When it comes to allocation of risk, there is yet another reason that supports lowering damages below the perfect expectation measure. Even if the breaching party is risk neutral, when breach results in non-pecuniary loss, it may be optimal that the recovered damages do not recompense for it. Unless the promisee is risk-preferring, she may not be willing to pay a higher price in order to be insured against non-pecuniary losses that are not fully replaceable by money.[256] In this sense, compensating non-pecuniary losses will have an effect similar to that of punitive damages (in the event of only pecuniary losses) which are optimal if the non-breacher is risk-loving and hence ready to pay more upfront for the possibility to make a larger profit if breach occurs.[257] And since an assumption that promisees generally have a preference for risk would be equivalent to an assumption that they are motivated to contract

[254] Polinsky 435-436.
[255] Ibid 442-443.
[256] Philip Cook and Daniel Graham, 'The Demand for Insurance and Protection: The Case of Irreplaceable Commodities' (1977) 91 Quarterly Journal of Economics 143; Samuel Rea, 'Non-Pecuniary Loss and Breach of Contract' (1982) 11 Journal of Legal Studies 35, 37-40; Hermalin, Katz and Craswell 114.
[257] Craswell, 'Contract Remedies, Renegotiation and the Theory of Efficient Breach' 643-645.

by an unlikely desire to gamble,[258] it may be better that non-pecuniary losses remain excluded from expectation damages as they generally are.

In fact, whatever parties' taste for risk, the only damage measure that can always allocate risk optimally is liquidated damages, provided, of course, that it is set by the parties only in view of risk distribution.[259] To reiterate, if both parties are risk averse, the optimal liquidated damage payment will be less than full expectation damages, so courts may refrain from intervention.[260] Yet, the more important point is that with the optimal damage payment greatly dependent on contractual partners' characteristics, courts have to be able to verify and evaluate them in order to award compensation that optimises risk distribution. In this sense, parties are in a better position to find out the factors that determine their relative risk aversion and to agree on damages that allocate risk optimally between them.[261]

In sum, this short peek into the risk averse world reveals that damages also play an important risk distribution function. However, the damage payment that may be optimal in terms of risk sharing may not be optimal from the standpoint of some of the parties' decisions, discussed above. Thus, compensation below perfect expectation damages that may distribute risk between contractual partners in accordance with their relative risk aversion will compromise the promisor's incentive to perform and to take precautions. In this sense, risk allocation considerations complicate the choice of the efficient damage measure even further.

As is evident from the above account, remedies, and in particular damages, can be used to pursue different goals. Although efficient risk allocation may be important in many situations, contract law may also seek to stimulate optimal decision making with regard to breach, reliance, precautions, information gathering or disclosure, *etc*., thus there is not one single damage measure that can achieve all of these objectives sucessfully.[262] As shown, expectation damages, regularly imposed by courts in all three legal systems under comparison, induce efficient breach but also too early termination of the contract. They motivate efficient precautions on the side of the promisor but need to be reduced to ensure efficient precautions and mitigation on the side of the promisee. They incentivise selfish overreliance and

---

[258] Samuel Rea, ‘Efficiency Implications of Penalties and Liquidated Damages’ (1984) 13 Journal of Legal Studies 147, 152.
[259] Polinsky 436, 443-444.
[260] See *supra* footnotes 154-156 in Section C.4. of Chapter III.
[261] Kornhauser, ‘Reliance, Reputation, and Breach of Contract’ 701-703.
[262] Polinsky 444.

cooperative underreliance, as well as hardly optimising parties' information-related incentives. Damages, less than the expectation measure, are desirable when contractual partners are heterogeneous and when both of them are risk averse. In other words, expectation damages are not the best choice in all possible states of the world; yet, often when they do not optimise a party's decision, the reliance or restitution measures do not fare any better, either, or if they do, it is only coincidentally. Thus, ultimately there is not a first-best default measure of damages that can be favoured unconditionally.

Conclusion

In a nutshell, if damages are viewed in terms of the effects they produce, optimal damages are those that induce the optimal combination of all of the incentives elaborated above. Roughly speaking, any weakening of some incentive must be offset by an improvement in another incentive. [263] All these trade-offs considered, however, the optimal damages in the majority of circumstances would prove to constitute an amount that is neither of the three interest-based damage measures. Thus, the upshot from the above consequentialist rationalising of the remedy is that the damages that produce the optimal joint effect may turn out to be any figure. For this reason, the most recent economic scholarship envisages damages not as a set of measures, each protecting a particular interest, but as a continuum, on which the first-best remedy could possibly lie at any point.[264] With such an indeterminate result, however, one could say that a new set of legal rules improving the way courts award damages cannot be devised, so the choice of remedy should always be left in the hands of the parties who know best how to distribute the risk and balance their conflicting incentives. In this sense, the economic model could easily lead to the conclusion that liquidated damages represent the quick fix to all the tensions described above and that parties should simply be incentivised to always stipulate a damage payment with contract law mechanically enforcing their agreement as it is.

Such a universal normative recommendation, however, would be nothing else but mimicking a world which remains to a great extent frictionless and thus practically impossible to reproduce. Recall that the economic model above is only a normative construction, which though educational if one wants to view damages in instrumental terms, still largely assumes

[263] In this sense, see also Craswell, ‘Two Economic Theories of Enforcing Promises’ 28, 30-31.
[264] In this sense see also Craswell, ‘Against Fuller and Perdue’ 15-18.

a perfect-information, perfect-enforcement nirvana. In this world damages are always perfectly calculated and investment is not always strictly unverifiable. If transaction costs are assumed, this is done without investigating their sources and only for the purpose of excluding renegotiation. Once, however, we start accounting for transaction costs in a more disciplined way, it appears that results may turn out different. Thus, for example, liquidated damages may not be preferable in many situations since they require parties to bargain over them each and every time a contract is signed while the default damage measures generate costs only upon breach.[265] Also, in a context of information asymmetry and party heterogeneity, parties' unlimited freedom to stipulate damages entails the danger of huge efficiency losses, resulting from undesirable cross-subsidisation and adverse selection.[266] In fact, reducing the issue of remedial efficiency to the single solution of party-stipulated damages makes default damage measures futile at one stroke. Implicitly, it rules out not only the proposition that under some conditions it is efficient for default terms to regulate, it also wipes out the most conventional justification of defaults as facilitating gap-filling devices. Thus, once positive transaction-cost reality enters the model in a more complete manner, one-size-fits-all solutions begin to look fairly unconvincing.

To put it differently, rationalising damages as a legal instrument that affects contracting behaviour, the economic model evaluates the efficiency of the three interest-based damage measures with respect to ten identified incentive effects and shows that none of them is optimal in all circumstances. The model, however, has two important limitations. First, it does not represent a positive theory since it does not explain when courts actually use one or another damage measure. In fact, besides being anchored in the contractual interests, protected in all three jurisdictions, and besides touching briefly on some remedial default terms that are common for the selected legal systems, the model tells us very little about the way contract law is actually applied in the jurisdictions under comparison. It says nothing about how courts calculate compensation in concrete contractual disputes, how they deal with the challenge of asymmetric information, whether they discern opportunistic from cooperative behaviour. Thus, the model does not provide a truthful description and a valid explanation of reality.

---

[265] Polinsky 444.

[266] See *supra* Section I. of this Chapter as well as the text accompanying footnotes 84 and 85 in Section A.2. <u>Increased incompleteness</u> of Chapter IV.

The inadequate positive relevance of the model logically leads to its second limitation: the model also fails as a normative theory. Its restricted normative value stems from the fact that it does not systematically account for transaction costs and, consequently, does not identify the damage measure that is the most cost-economising in particular situations. To reiterate the significance of transaction costs it is enough to say that joint profitability alone cannot determine the efficiency of contractual performance.[267] In fact, even if the contract creates a joint surplus, where the latter is exceeded by contracting costs, the contract should not have been concluded at all. Or even if the contract produces a joint loss, it should still be performed where enforcement costs surpass the resulting waste.[268] In addition, as we move along the contractual continuum from spot to long-term contracts, rising *ex ante* and *ex post* transaction costs lead to increasing contractual incompleteness.[269] Informational asymmetry, which though assumed away in the economic model, is particularly grave in long-term contracting, motivates strategic behaviour, which in itself raises transaction costs. Thus, being inattentive to the significance of transaction costs as well as to their sources and magnitude according to the type of contract, the model does not permit adequate appreciation of default damage terms and of their ability to perform not only as facilitative but also as regulatory devices. For this reason, the model also fails in normatively justifying how courts should choose among the different damage measures in order to encourage efficient contracting behaviour.

In other words, once we have learned about the instrumental potential of remedies, we have reached the limits of the above economic model. As argued in Chapter II, the correct procedure now is not to jump to the conclusion that the most efficient remedial solution is the one to which the above largely frictionless construction points but to search for the basis of further normative conclusions by comparing the real-world remedies granted in similar factual situations across jurisdictions. Hence, in the following chapter I rush back to reality and embark on the comparative economic analysis of existing remedial alternatives supplied by the law in action in the selected legal systems.

The following chapter explores the availability of Buyer's termination as granted by US, English and Bulgarian courts in case of defective goods and construction work. Although

---

[267] Recall that the performance of a contract is efficient only if the promisee's value exceeds the promisor's cost, *i.e.* only if the contract produces a joint profit. See *supra* Section A. of Chapter III.
[268] In this sense, see George Cohen, 'Fault Lines in Contract Damages' (1994) 80 Virginia Law Review 1225, 1242-1244.
[269] See *supra* Section A.2. Increased incompleteness of Chapter IV.

turning away from damages, the comparison does not simply discard the lessons of the economic model regarding incentives. On the contrary, it uses them to develop the argument that, in allowing the non-breacher to walk away from what would be a losing contract, termination is normally chosen by the latter when it is more favourable to her than expectation damages and, thus, can be analysed as a remedy that is more generous to the promisee.[270] In this sense, it increases Seller's incentive to perform but also incentivises the Buyer to behave opportunistically. Thus, having demonstrated how to rationalise remedies as incentives, the thesis asks whether termination can be made available to an extent that resolves the conflict between optimal Seller's and Buyer's behaviour. In this respect, the emphasis is on the capacity of termination to discourage strategic conduct and reduce the costs associated with the latter. Or, put differently, the emphasis is on the regulatory function of termination.

[270] Hermalin, Katz and Craswell 124-125; Andrew Kull, 'Restitution as a Remedy for Breach of Contract' (1994) 67 Southern California Law Review 1465.

Chapter VI Termination or Damages within the Contract?

This chapter relates termination and quality. To the reader it may seem surprising and even somewhat incoherent that after such a long and detailed account of the effects produced by damages, the thesis abruptly turns to another remedy – termination. The choice, however, is a logical consequence of the author's stubborn determination to start in her empirical analysis from the existing legal institutions (and not from the imaginary world created by economists), as well as of the main research question driving the thesis.

In fact, the previous chapter could easily leave an innocent reader with the misconception that it is all about damages and that by tweaking their measure legislators and courts can and, perhaps even do, fine-tune every single aspect of the parties' behaviour. Having gone over the chapter, experienced lawyers, however, remain generally sceptical that all ten parties' decisions can be adjusted solely by damages and express concerns about vesting too much hope in one single remedy.[1] Indeed, one should constantly bear in mind, that damages became the focal point of contract law and economics largely due to the parochialism of US scholars who have naturally directed most of their efforts to the principal contractual remedy in their home country legal system.[2] Yet, ultimately, damages are not the only legal remedy for breach of contract and should not be seen as *the* solution which inevitably leads to the desired result. Thus, where in this thesis, the chief purpose of the elaborated economic model is to spotlight remedies as incentives, the acquired knowledge about the ways in which damages affect parties' motivation can readily be used to explore other remedies.[3] In this relation, it is useful to remind that upon breach a promisee often has several forms of relief at her disposal and that the manner by which her choice is structured also influences parties' behaviour.[4] Little, however, is done by neoclassical economists in researching precisely the effect of the availability of such choices among different remedies,[5] so this chapter can also be read as a modest contribution in this direction.

---

[1] I am indebted for this point to Professor George Triantis.

[2] See *supra* footnote 74 in Section C. and footnote 120 in Section D. of Chapter II as well as the text accompanying them.

[3] In a similar sense, see Hermalin, Katz and Craswell 125.

[4] On the choice between specific performance and damages, on one hand, and between specific performance and termination of the contract, on the other, in Bulgarian contract law, see *supra* Section A. of Chapter III.

[5] On Buyer's choice between specific performance and termination with restitution, see Stremitzer. On Buyer's choice between termination with restitution and damages within the contract, see Brooks and Stremitzer.

To be entirely correct, the termination remedy is not completely absent from the economic model in the previous chapter; yet, it is featured only with one of its elements – the monetary recovery. To blame economists alone for this half-hearted inclusion would be unfair. The term "rescission" has for long been disliked by the US legal doctrine,[6] which led to the subsuming of promisee's right to undo the contract under the term "restitution for breach", the latter emphasising only the restoration-of-the-price element of the termination remedy.[7] This attitude culminated in the Restatement which makes no mention of "rescission" (or any synonym) and uses the word solely with respect to "an agreement of rescission".[8] It is also not unusual for modern monographs on contract law to study restitution as a remedy for breach without accounting for "termination" as a separate remedy in its own right.[9] This, coupled with neoclassical economists' infatuation with damages, explains why termination entered their models mainly through its monetary component. Such neglect of the rescission building block, however, remains unfortunate as it masks the promisee's choice between enforcing and avoiding the bargain and dissipates the most characteristic feature of the remedy: the unwinding of the transaction. The obscuring of this effect hampers the efforts of making economic analysis more engaged with the real world as it makes it difficult to see the transaction costs that are specific to the complete reversing of the contract: transportation and de-installation costs related to returning the goods, costs related to their deterioration, costs related to shifting the risk. As it will be shown below, such costs may very well exceed the administrative costs of calculating damages, saved by nullifying the bargain and restitution of the price. In this sense, splitting the remedy and focusing only on one of its elements

[6] UCC § 2-608. Revocation of Acceptance in Whole or in Part., comment 1. For the objections to the use of the term "rescission", see Kull, 1491-1492.

[7] To be correct, in all three legal systems termination entails putting an end to the contract, the latter followed either by returning of the goods (in case of a sale-of-goods contract) and restitution of the price (as well as a right to recover expectation damages), or, in case of buyer's cover, by her receiving expectation damages. For the US, see UCC § 2-711. Buyer's Remedies in General; Buyer's Security Interest in Rejected Goods.; § 2-712. Cover. Buyer's Procurement of Substitute Goods.; § 2-713. Buyer's Damages for Non-Delivery or Repudiation. (sale-of-goods contract); Restatement (Second) of Contracts § 373 Restitution When Other Party Is in Breach; Scott and Kraus, *Contract Law and Theory* 909-910 (construction contract). For England, see Sale of Goods Act 1979 Section 51 Damages for non-delivery.; Section 54 Interest, etc.; Francis Dawson, 'Chapter 17. Remedies of the Buyer' in Michael Bridge (ed), *Benjamin's Sale of Goods* (Eighth edn, London: Sweet&Maxwell/Thomson Reuters 2010) 1108-1110 (sale-of-goods contract); Uff and Moran, 'Chapter 37. Construction Contracts' 817 (construction contract). For Bulgaria, see Art. 195(1)(2) Contracts Act; Art. 323 Commercial Act (sale-of-goods contract) as well as Art. 265(2) in relation to Art. 88 and Art. 82 Contracts Act (construction contract). Section B. of this Chapter focuses on the case in which the buyer terminates the sale-of-goods contract and receives back the price paid upfront or (in the absence of advance payment) refuses to pay it, at all.

[8] Id. § 283 Agreement of Rescission. In this sense, see also Kull 1491-1492. More generally, on the development of the components of the termination remedy (quasi-contract and rescission) in US law, see ibid 1484-1497.

[9] Farnsworth, *Farnsworth on Contracts*.

impoverishes the economic analysis and does not allow in-depth examination of the issue when a promisee should be given the right to terminate.

Still, although dwarfed by the existing research on damages and marked by controversial results, one strand of the law-and-economics literature strives to analyse the remedy of termination in its entirety, accounting for its elective nature and with greater focus on transaction costs.[10] It is this literature that the current chapter aims at extending by focusing on the Buyer's choice between termination of the contract and damages within the contract in case of the Seller's defective performance. The very framing of the choice opens room for objections to the analysis for being skewed toward common law legal systems in which the remedies of repair and replacement are not provided for by default in case of defective performance.[11] Admittedly, to the extent that, when remaining on the contract, the Bulgarian Buyer may, in principle, also elect to request one of the mentioned performance-oriented remedies, the economic analysis still remains limited.[12] But as time and space constraints exerted pressure, the thesis could not cover the entire remedial system, so preferences strayed away from the more extensively researched forms of specific performance and went to the much less studied; yet, highly controversial termination remedy. The boundary drawn is by no means arbitrary. The choice between termination and damages within the contract is at the core of the development of the seller's liability for defective performance from an entirely subjective, *caveat emptor* system, reflecting the pure spot contract, to an objective system, based on certain standards, set by law, and reflecting the executory contract, necessitated by the speeding of trade.[13] Whether this transformation took place on the basis of the *aeditilian* remedies (the Roman model) or of the concept of contractual term (the common law model), it was grounded in the election of seeking substitutionary relief within the contract or

[10] Alan Schwartz, 'Cure and Revocation for Quality Defects: The Utility of Bargains' (1975) 16 Boston College Industrial and Commercial Law Review 543; George Priest, 'Breach and Remedy for the Tender of Nonconforming Goods under the Uniform Commercial Code: An Economic Approach' (1978) 91 Harvard Law Review 960; Goetz and Scott, 'The Mitigation Principle: Toward a General Theory of Contractual Obligation'; Kull; Hermalin, Katz and Craswell 124-126; Gerhard Wagner, 'Termination and Cure under the Common European Sales Law: Consumer Protection Misunderstood' (2013) 50 Common Market Law Review 147.

[11] *Cf.* UCC § 2-711. Buyer's Remedies in General; Buyer's Security Interest in Rejected Goods. (the US) and Sale of Goods Act 1979 Section 11(3) in relation to Section 13 Sale by description., Section 14 Implied terms about quality or fitness. and Section 15 Sale by sample. (England), on one side, with the Bulgarian Art. 195(1) and Art. 265 Contracts Act, on the other side.

[12] See *supra* footnote 16 in Section A. of Chapter III and the text accompanying it.

[13] Where in spot contracts, executed mainly in local markets and fairs, buyers were able to examine the goods and assure themselves of their quality first hand, the "buyer beware" maxim made sense. Yet, with the spread of executory contracts, *caveat emptor* became too harsh a policy. In a similar sense, see Zimmermann 306-308.

abandoning it.[14] In fact, it was the performance-oriented remedies of repair and replacement that gained ground only later, after the industrial revolution had hit the pace and flooded the markets with manufactured goods.[15] And, although the specific performance principle was fetishised during the socialist period in Bulgaria, it has waned with the transition to market economy[16] making it important to study not only how specific relief relates to damages and rescission, but also how the latter two remedies correlate to each other. From this perspective, it is interesting how useful it is sometimes to return to the origins in order to see more clearly where law is going today. As it will be shown below, the choice between termination and damages within the contract continues to be a very relevant choice that merchants face, irrespectively of under which of the compared legal systems they do business.[17] More importantly, it is also a choice, the structure of which has seen substantial changes throughout the 20th century in all three jurisdictions and which permits a very close look at the changing ratio between the facilitative and the regulatory function of contractual remedies. For all these reasons, the decision was made to save performance-oriented remedies for another research indulgence and to concentrate on termination as opposed to damages within the contract.

Since the chapter, however, centres on the termination limb of the choice, a few words on the damage measures for accepted goods, used in the three jurisdictions, might at this point appear useful. Again, as law-and-economics writings are commonly based on US contract law, it is usually said that the promisee chooses between termination and expectation damages, the latter remedy normally being preferable (provided damages are calculated accurately)[18] since it gives the Buyer the value from performance instead of bringing her to the status quo ante.[19] Termination, followed by restitution, the argument goes, becomes favoured only when the contract turns out to be a losing one, as it permits the promisee to save considerable losses by walking away from the agreement.[20] Indeed, where the seller

---

[14] For a clear and concise account of this transformation of sales law, see Peter Huber, 'Comparative Sales Law' in Mathias Reimann and Reinhard Zimmermann (eds), *The Oxford Handbook of Compartive Law* (Oxford: Oxford University Press 2006) 955-960. For a greater focus on the *aedilitian* remedies: termination followed by restitution of the price (*actio redhibitoria*) and price reduction (*actio quanti minoris*), and their importance for the modern civil law tradition, see Zimmermann 305-337.
[15] In this sense, see Wagner 148. See also Huber 961.
[16] See *supra* Section A. of Chapter III.
[17] See *infra* the text accompanying footnotes 322-330 in Section B.1. of this Chapter.
[18] See *supra* the text accompanying footnote 31 in Section A. of Chapter V.
[19] On the ranking of expectation damages, reliance damages and restitution, see *supra* Chapter III and especially the text accompanying footnote 135 in Section C.3.
[20] Hermalin, Katz and Craswell 124; Kull. See also *supra* the text accompanying footnote 137 in Section C.3. of Chapter III.

delivers defective goods, both UCC and the Sale of Goods Act 1979 set out diminution in value as the *prima facie* measure for calculating damages,[21] leaving it open to courts to also resort, where the market thins or where the good is repaired, to other bases of assessment such as the cost of cure.[22] As for construction contracts, the typical basis for measuring damages in the event of defective or unfinished work is the reasonable cost of completing performance or remedying the defects, unless such cost proves to be clearly disproportionate to the loss in the property market value, in which case courts commonly constrain damages to the diminution in value.[23] In other words, in the US and English contract law, the promisee's damage claim is always for her expectation losses.[24] The position under Bulgarian contract law is, however, not quite the same. Whether defective performance is rendered in the context of a sale-of-goods or construction contract, the Buyer may, on her own choice, claim expectation damages, measured by the cost of repair/completion,[25] or price reduction, based on restitution.[26] It is this latter remedy that remains unrecognised in the common law legal systems under comparison[27] and is, thus, not taken into account in the above argument concerning the Buyer's choice between termination and damages within the contract. Price

---

[21] UCC § 2-714. Buyer's Damages for Breach in Regard to Accepted Goods. (2). In addition, UCC § 2-714.(1) provides for the way to calculate damages in case of "any non-conformity of tender". Subsection (1), however, is generally deemed to be relevant to non-conformity that does not relate to quality, but to other aspects of the tender, *e.g.* delay or the manner of delivery. In this sense, see Scott and Kraus, *Contract Law and Theory* 948. Sale of Goods Act 1979 Section 53 Remedy for breach of warranty. (3).

[22] For the US, see *Wagner Tractor Co. v Shields* 381 F2d 441 (CAOr 1967), at 444; *Tarter v. MonArk Boat Co.* 430 FSupp 1290 (EDMo 1977) at 1294. For England, see *Charterhouse Credit Co. v. Tolly* [1963] 2 QB 683. On the formulae for calculation of damages, see *supra* the text accompanying footnotes 132-141 and footnotes 160-171 in Section A.4. of Chapter IV.

[23] For the US, see Restatement (Second) of Contracts § 348(2) Alternatives to Loss in Value of Performance; *Jacob & Youngs, Inc. v. Kent* 129 NE 889 (NY 1921). For England, see Peel 1011.

[24] This chapter does not consider consequential damages. Neither of the legal devices elaborated on in Section B. is intended to solve problems related to such losses.

[25] On the way a promisee's right to repair commonly boils down to damages, see *supra* the text accompanying footnotes 38-49 in Section A. of Chapter III.

[26] Art. 195(1); Art. 265(1) Contracts Act.

[27] The closest analogy under US and English law is the Buyer's right to set off the damages to which she is entitled in case of Seller's defective performance against the price. See UCC § 2-717. Deduction of Damages from the Price.; Sale of Goods Act 1979 Section 53(1)(a); *Biggin & Co. Ltd. v. Permanite Ltd.* [1951] 1 KB 422 (sale-of-goods contract); *Gilbert-Ash (Northern) Ltd. v. Modern Engineering (Bristol) Ltd.* [1974] AC 689 (construction contract). On several occasions UCC mentions the buyer's right to accept non-conforming goods with an "allowance". See UCC § 2-508. Cure by Seller of Improper Tender or Delivery; Replacement. (2); § 2-613. Casualty to Identified Goods. (2). In compliance with the EU consumer legislation, in 2002 the English Sale of Goods Act introduced price reduction as a consumer remedy. See Sale of Goods Act 1979 Section 48A Introductory (2)(i). It remains unclear, however, whether in these cases price reduction would be calculated on the basis of common law damages or on the basis of the civil law price reduction principle. See also Peter Huber, 'Price Reduction' in Basedow Jürgen and others (eds), *The Max Planck Encyclopedia of European Private Law*, vol II (First edn, Oxford: Oxford University Press 2012) 1314; Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' 42-43; Reynolds 643-645.

reduction, however, cannot be simply bypassed in a comparative study, that includes a civil law legal system.

Unlike in the common law tradition, the Buyer, resorting to adjustment of the price, is entitled neither to the cost of cure, nor to the diminution in value. Her claim is to have the price reduced by the ratio of the value of defective performance to the value of conforming performance, multiplied by the contract price, thus seeking to restore the balance between performance and counterperformance established by the parties in the first place.[28] Despite the different method of calculation, however, price reduction leads to much the same results as those realised by common law damages.[29] The outcome may differ only if the value of performance changes between the date of contracting and the date of delivery. Thus, if the value of performance falls, the amount of the price reduction may very well be higher than the amount of common law damages, with this effect being additionally augmented by the fact that the proportion is determined with reference to the contracting time and not to the time of delivery (as in the case of damages).[30] Such a result naturally undermines the above argument about promisee's opportunistic incentive to elect termination simply because she has failed to

---

[28] Kojuharov, *Law of Obligations. Specific Contracts* 93-94; Krasen Stoychev, 'Price Reduction' [1984] Legal Thought 60; Decision №612 of 21.06.2011, app. comm. c. №631/2011 of District Court-Varna (sale-of-goods contract); Decision №137 of 01.10.2012, comm. c. №59/2012 of District Court-Pazardjik (sale-of-goods contract); Decision №501 of 07.11.2013, app. c. c. №686/2013 of District Court-Pazardjik (sale-of-goods contract); Decision №79 of 05.06.2009, app. c. c. №161/2009 of District Court-Varna (construction contract).

[29] Jan Kropholler, *Bürgerliches Gesetzbuch: Studienkommentar* (Ninth edn, Taschenbuch 2006) § 281 (citing Drucksachen und Protokolle 14/6040 (2001) 226); Huber, 'Price Reduction' 1314-1315. For those who would be more convinced by mathematics, here is the following example. Imagine that the conforming good has a value (purchase price) of 100 euros while in its defective state, it is worth only 90 euros. The diminution-in-value formula used in the common law tradition (value of conforming good – value of defective good) tells us that damages will amount to 10 euros (100 - 90 = 10). In the civil law tradition the price will be reduced by 10 euros, too (100 - 90/100 x 100 = 100 – 90 = 10).

[30] In the hypothetical *supra* in footnote 29 of this Chapter, imagine that at the time of delivery the market price of the good has fallen to 80 euros and in its defective state, the good can fetch a price of 75 euros. Damages in the common law tradition will amount to 5 euros (80 - 75 = 5) and the net price paid by the buyer will be 95 euros (100 - 5 = 95). In Bulgarian contract law, which determines the price reduction with reference to the contracting time, the price will, however, be reduced by 10 euros (100 – 90/100 x 100 = 100 – 90 = 10), the buyer paying a net price of 90 euros (100 – 10 = 90). If the relevant time for determining the price reduction was the time of delivery (as it is in the Vienna Convention on the International Sale of Goods), the amount of price reduction would be (100 – 75/80x100 = 100 - 93.75 = 6.25), yielding a net price of 93.75 euros (100 – 6.25 = 93.75). Note that the price reduction method produces a better result for the buyer when the relevant time for fixing the ratio is the contracting time. In any case, provided the price has fallen since the contracting time, the price reduction method always produces results that are more favourable to the buyer than damages. As to the relevant time for determining the amount of the price reduction in Bulgarian contract law, see *supra* footnote 28 of this Chapter. As to the time of delivery being the relevant time for determining diminution-in-value damages in the US and English contract law, see UCC § 2-714. Buyer's Damages for Breach in Regard to Accepted Goods. (2) and Sale of Goods Act 1979 Section 53(3). See also *Biggin & Co. Ltd. v. Permanite Ltd.* at 439-440.

predict the market. After all, where the price reduction remedy produces a better result for the Buyer than common law damages, the Buyer may choose to preserve the contract.

Nevertheless, although in comparison to common law damages, price reduction decreases the promisee's motivation to exit the contract, it does not eliminate it completely. On one hand, the Buyer still has the option to elect to convert her right to repair into expectation damages equal to the cost of cure. On the other hand, not so rarely, either due to absence of information about the value of the defective performance, or due to incompetence, Bulgarian courts simply lessen the price by the cost of repair[31] or by the diminution in value,[32] thus practically reducing the price reduction remedy to expectation damages. As it will be shown further, even though the former is a default remedy under Bulgarian law, Bulgarian courts still adjudicate disputes in which the Buyer has resorted to termination for strategic reasons and merchants still take care to limit the possibilities for walking away from the contract by providing for rates of price allowance in their standard form contracts.[33] In fact, what this chapter demonstrates is that whether Buyer's damages within the contract are calculated as common law damages or as civil law price reduction, an automatic right to terminate *per se* motivates the Buyer to end the contract opportunistically. In this sense, the differences in calculation of Buyer's damages across jurisdictions by no means make the issue of availability of termination irrelevant.

Neither is there any accident in the choice of examining termination precisely in the case of defective performance. Quality captures the essence of the problem of asymmetric information, which causes markets to produce inefficient allocations and calls for regulation. It suffices to remind that Akerlof's famous "lemons" article provides an analytical framework

---

[31] Decision №1163 of 1953 of the Supreme Court, II c.d., I p. (where the lower court had simply reduced the price for the two machines by the value of the delivered unusable machine, thus conflating the claim for the cost of cure and the claim for price reduction); Decision №10 of 05.05.1981, c. c. №83/1979, General Assembly of the Civil Chambers of the Supreme Court (saying that on account of defects the price of apartments was to be reduced according to the prices set for repairs by state organisations); Decision №1324 of 17.12.1985, c. c. №608/85 of the Supreme Court, I c. d. (where the court, conflating buyer's claim for reduction of the price and her claim for the cost of cure, denied the buyer's claim for reduction of the price on account that the sum necessary for correction of the defects did not lessen the lodging's value substantially); Ruling №482 of 27.07.2010, comm. c. №1009/2009 of the Supreme Cassation Court, II comm. d.; Decision №157 of 08.11.2010, comm. c. №1135/2009 of the Supreme Cassation Court, II comm. d.

[32] Decision №338 of 21.11.2014, comm. c. №470/2012 of District Court – Bourgas (where the newly built apartment was furnished with furniture of much lower quality than required by the contract, the court classified the breach as total and awarded compensation equal to the difference in value).

[33] See *infra* the text accompanying footnote 329 in Section B.1. of this Chapter.

of asymmetric information precisely with regard to quality.[34] Where goods have different grades, Akerlof points out, where high and low-quality items are offered on the market, the costs of information asymmetries augment.[35] It is from this emphasis on the aggravation of information problems that this chapter takes off, but while discarding perfect information, it also does not adopt the rigid economic assumption of absolute non-contractibility of investment.[36] On the contrary, striving to remain close to the real world, it takes as a starting point actual institutional arrangements (standardisation, form contracts, trade custom, warranties), used by the parties to deal with information asymmetries. Rooted in such an intermediate informational environment and assuming that high quality is a relevant objective, the chapter explores the efficiency of Buyer's termination right for defective performance in discrete and long-term contracts.

Indeed, quality of performance, whether delivery of good or service, is an important issue for contract law. Only five years after Akerlof published his article, the US enacted a federal "lemon" act, the Magnuson-Moss Warranty Act, governing warranties on consumer goods.[37] In Bulgaria legal scholars paid much attention to the regulation of quality of output in the 1980's[38] when quality improvement was proclaimed a goal of primary importance in the process of building a "mature" socialist society.[39] Most of the law-and-economics research, however, centres on removing advertising restraints, correction of misleading information, mandating disclosure of quality information, warranties and design of product labels.[40] Studies on the role of contractual remedies, and in particular damages, for stimulating investment in quality have picked up only since 1999 and have so far produced a number of

---

[34] Akerlof.
[35] "… even worse pathologies can exist" ibid 490.
[36] See *supra* the text accompanying footnotes 146-149 in Section D. of Chapter V.
[37] 15 U.S.C.A. Chapter 50. Consumer Product Warranties.
[38] Chudomir Goleminov, 'Business Contracts and the Struggle for Quality of Production' (1984) 2 Legal Thought 5; Georgi Petkanov, 'Finance Law Instruments for Regulating the Quality of Industrial Production' (1984) 2 Legal Thought 12; Hristo Nikolov, 'Regarding Legal Regulation of Quality of Production' (1984) 3 Legal Thought 98;Valentin Braykov, 'Issues of the Liability under Art. 193 ff. of the Act on Obligations and Contracts as an Instrument for Influencing the Quality of the Lodgings Sold' (1984) 3 Legal Thought 83; Filip Rachev, 'Issues of Legal Regulation of Quality of Production' (1985) 2 Legal Thought 74.
[39] Todor Jivkov, *Quality - Key Issue for Building a Mature Socialist Society. Speech at the National Conference of the Party, State, Economic and Society Most Active Members, Varna, 30.05.1983* (Sofia: Partizdat 1983); Long-Term Programme of the Party for Quality Improvement. National Party Conference 22-23 March 1984; Martin Ivanov, 'Socialist Welfare State and the "Consensus of Hypocrisy"' [2011] Sociological Problems 235.
[40] Sanford Grossman, 'The Informational Role of Warranties and Private Disclosure about Product Quality' (1981) 24 Journal of Law and Economics 461; Matthews and Moore; Wesley Magat, 'Information Regulation' in Peter Newman (ed), *The New Palgrave Dictionary of Economics and the Law*, vol II (New York: Stockton Press 1998) 307.

conflicting results, fuelling the general scepticism of legal scholars about law and economics.[41] Another neoclassical study, with which this account ultimately disagrees, concentrates on the relation between termination and quality.[42] Although framing the issue in a very similar manner, this chapter explores it, as promised, by rejoining comparative law not with Chicagoan but with New Institutional Economics.[43]

The chapter does not recount the story about the path from *caveat emptor* to an objective system of seller's liability, which is usually told when it comes to buyer's remedies for defective performance.[44] Instead it picks up from there and asks the question of when termination should be available to the Buyer. The Buyer's termination right constitutes the point of intersection of conflicting interests: on one hand, the interest of the Buyer to have an effective remedy which would ensure the quality of performance she bargained for and, on the other hand, the interest of the Seller to preserve the contract. Limiting the Buyer's termination right would spur the Seller's cavalier attitude toward his obligation to perform conformingly, thus increasing the so-called evasion costs (the costs resulting from the Seller's attempts to escape his obligation as to quality and from the Buyer's striving to counter these attempts). Expanding the Buyer's termination right would incentivise the Buyer to end the contract for her own selfish purposes, thus augmenting the so-called opportunism costs (the costs associated with the Buyer's strategic behaviour and the Seller's efforts to neutralise it).[45] The chapter explores these trade-offs in sale-of-goods and construction contracts. It argues that contract law in all three compared jurisdictions has developed in a way that is sensitive to the risk of strategic behaviour of any of the parties and, in this sense, is imputed with substantial regulatory function.

The chapter unfolds as follows. Section A. takes a bird-eye view on Buyer's termination remedy for defective performance in sale-of-goods (Section A.1.) and construction contracts (Section A.2.) and then discusses the economic rationale behind a broad and, respectively,

[41] Che and Hausch, ‘Cooperative Investments and the Value of Contracting’; Che and Chung, ‘Contract Damages and Cooperative Investments’; Schweizer; Stremitzer. See also *supra* Section D. of Chapter V.
[42] Brooks and Stremitzer.
[43] For the defence of this methodological approach, see *supra* Chapter II and especially Section C. of Chapter II.
[44] Ernst Rabel, ‘The Nature of Warranty of Quality’ (1960) 26 Tulane Law Review 273; Friedrich Kessler, ‘The Protection of the Consumer under Modern Sales Law (1964). Faculty Scholarship Series. Paper 2725. ’ <http://digitalcommons.law.yale.edu/fss_papers/2725/> ; Zimmermann 305-307; Huber, ‘Comparative Sales Law’.
[45] I borrow the designations of the costs from Goetz and Scott, ‘The Mitigation Principle: Toward a General Theory of Contractual Obligation’.

restricted right to terminate regarding each kind of contract (Section A.3). Section B. goes more in depth and rather focuses on termination followed by restitution. The section centres on sale-of-goods contracts and develops with the aggravation of the information asymmetry from raw materials, agricultural products and foodstuff ("commodities") to differentiated goods. Section B.1. takes a historical perspective, identifies trends in the development of the remedy in each of the jurisdictions and claims that these trends are generally efficient.

A. Common Choices of the Compared Legal Systems

Whether a party to a sale-of-goods or to a construction contract, the Seller in all three legal systems is responsible that his performance is in conformity with the contract. A buyer who is tendered a defective good, however, does not have the same remedies as a client who is delivered a defective building. While in all three compared jurisdictions the buyer is entitled to reject defective goods outright, the client may not refuse to accept and pay for non-conforming work unless the defect materially impairs the performance she expected under the contract. This section, therefore, juxtaposes the Buyer's termination remedy in sale-of-goods and construction contracts and discusses the economic rationale behind the restriction on the client's right to terminate, common to the compared legal systems.

1. The contract for sale of goods

During the nineteenth century common law developed the so-called "perfect tender" rule, which empowered the buyer to reject the goods for any non-conformity and terminate the contract.[46] Variations of this rule were adopted in the English Sale of Goods Act 1893[47] and the American Uniform Sales Act.[48] Today, to the extent that UCC allows the buyer to reject goods, failing in any respect to conform to the contract, it still preserves the perfect tender rule.[49] By classifying the implied terms, requiring conformity of the goods, as "conditions", the Sale of Goods Act 1979 also conserves the general solution of regarding delivery of non-

---

[46] For the earliest authorities, see Bowes v. Shand 2 App Cas 455 (HL 1877) for England and Norrington v. Wright 115 US 188 (1885) for the US. Under the rule perfection was required not only with respect to the quality of the goods, but also with respect to their quantity and shipment details. See Allan Farnsworth, *Farnsworth on Contracts*, vol II (Third edn, New York: Aspen Publishers 2004) 494.

[47] Section 13 Sale by description. and Section 14 Implied conditions of quality and fitness. (1) and (2).

[48] Uniform Sales Act § 69(1) (1906).

[49] See UCC § 2-601. Buyer's Rights on Improper Delivery. and *Ramirez v. Autosport* 440 A2d 1345 (NJ 1982) at 1349.

conforming goods as breach of an essential obligation, which entitles the buyer to choose to treat the contract as terminated and reject the goods.[50] In other words, even if subject to some qualifications,[51] the perfect tender rule is still retained by English and American sale-of-goods law, which permits the buyer to refuse to accept goods that are not in exact conformity with the contract and, thus, allows her to seek to end her contractual obligations.

As for Bulgaria, the buyer's right to reject defective goods has always been recognised by statutory law[52] and has been consistently upheld by courts.[53] When it comes to sale-of-goods agreements, the Contracts Act abandons the policy of rescission constituting a remedy of last resort. Recall that under general contract law termination is not simply one of the alternative courses of action open to the promisee upon breach.[54] By contrast, in case of the sale of defective goods, rescission is one of the several options that are equally available to the buyer: she can reject and claim the expenses made for the sale; she can keep the defective goods and demand price reduction or the expenses for their repair, or she can demand replacement.[55] The choice among these remedies is entirely within the discretion of the buyer.[56] Termination is available to her even if the defect is remediable.[57] Compared to general contract law, sale-of-goods law also makes access to termination easier by permitting the buyer to simply reject

---

[50] See Sale of Goods Act 1979 Section 13(1A) Sale by Description., Section 14(6) Implied terms about quality or fitness. and Section 15 (3) Sale by sample. For the classification of the terms of contract in English law and the difference between conditions and warranties, see Sale of Goods Act 1979 Section 61(1) Interpretation. and A. G. Guest, 'Chapter 12. Classification of Terms' in H.G. Beale (ed), *Chitty on Contracts General Principles*, vol I (Thirty-First edn, London: Sweet&Maxwell/Thomson Reuters 2012) 917. Note that the term "warranty" has a different meaning in English and in US law. While in English law it denotes a "collateral" contractual term, the breach of which entitles the promisee only to claim damages but not to treat herself as discharged, in the US it means any guarantee or promise, which provides assurance to the other party that specific facts are true or will happen.

[51] For the means by which UCC and the Sale of Goods Act 1979 mitigate the severity of the perfect tender rule, see *infra* Section B of this Chapter.

[52] See Art. 195(1) Contracts Act. For the express recognition of the buyer's right by the previously effective contracts act, see Art. 271 of Act on Obligations and Contracts, promulgated State Gazette №268 of 01.01.1892, repealed State Gazette №275 of 22.11.1950.

[53] See *e.g.* Decision №24 of 11.01.1982, c. c. №3194/1981, I c. d. of the Supreme Court (upholding the buyer's right to reject the defective good irrespectively whether the defect is removable or not); Decision №1231 of 10.07.1995, c. c. №2192/1994, V c. d. of the Supreme Court (saying that the buyer is not obliged to accept and pay for the goods when they are not in conformity with the agreed quality).

[54] See *supra* the text accompanying footnotes 19-21 in Section A. of Chapter III and Ordinance №3 of 29.03.1973, c. c. № 2/1973, Plenum of the Supreme Court.

[55] Art. 195(1) Contracts Act.

[56] Interpretative Decision №33 of 01.11.1973, c. c. №3/1973, General Assembly of the Civil College of the Supreme Court; Interpretative Decision №88 of 28.02.1984, General Assembly of the Civil College of the Supreme Court.

[57] Decision №24 of 11.01.1982, c. c. №3194/1981, I c. d. of the Supreme Court; Decision №136 of 15.07.2005, c. c. №118/2003 of District Court - Bourgas; Decision №870 of 09.06.2014, comm. c. №4088/2012 of Sofia City Court.

without requiring her to first give the promisor reasonable time to cure.[58] In other words, in case of delivery of defective goods, the remedy of termination is put on a par with damages within the contract.[59] Undoubtedly, this contrasts with the general position of Bulgarian contract law that, if possible, the contract should be kept alive.

Generally, it is safe to say that the starting point of all three legal systems is that buyers cannot be compelled to accept defective goods and should have the option to terminate if the seller does not perform in conformity with the contract. No doubt, such a solution has a disciplining effect on sellers, motivating them to deliver goods, which meet the contractual requirements as to quality.

2. The construction contract

All national laws under comparison, however, constrain the client's right to terminate the construction contract for defective performance. In the US and England, a client may not bring the contract to an end if the work is "substantially" performed, even though in some respects it is not in accordance with the contract.[60] In such cases the client is obliged to pay the price (if agreed as a lump sum) or the unpaid balance of it (if the parties have agreed on progress payments) and only has a claim for damages which can be deduced from the still outstanding accounts. What constitutes substantial performance depends on the particular circumstances; yet, a survey of the case law suggests that US and English courts have distilled very similar criteria to determine the issue: whether the constructor's breach is inadvertent,[61]

---

[58] *Cf.* Art. 87(1) with Art 195(1) Contracts Act. Under Art. 87(2) ibid, the promisee may not give the promisor additional time to cure before termination only if performance has become impossible, if, because of promisor's delay, it has become futile or when time is of the essence. See also Kojuharov, *Law of Obligations. Specific Contracts* 93; Decision №595 of 11.06.2004, c. c. № 2700/2008, of the Supreme Cassation Court, V comm. d.

[59] Recall also that although the Bulgarian legal doctrine considers repair of the good at the expense of the seller a form of specific performance, the remedy in fact boils down to damages. See *supra* the text accompanying footnotes 38-49 of Chapter III.

[60] For the US, see Restatement (Second) of Contracts § 237 Effect on Other Party's Duties of a Failure to Render Performance; *Della Ratta, Inc. v. American Better Community Developers, Inc.* 380 A2d 627 (Md 1977); *O.W. Grun Roofing & Construction v. Cope*. For England, see *H. Dakin & Co., Limited v. Lee* [1916] 1 KB 566; *Hoenig v. Isaacs* [1952] 2 All ER 176; *Bolton v. Mahadeva* [1972] 1 WLR 1009 (where the contractor could not recover because it was found he had not substantially performed); *Lawson v. Supasink* (1984) 3 TrL 37.

[61] For England, see *Sumpter v. Hedges* [1898] 1 QB 673 (where the constructor was found to have abandoned the contract, he not only did not perform substantially but could not recover on *quantum meruit*, either); *H. Dakin & Co., Limited v. Lee* (where the constructor has refused to complete the work, he cannot be said to have substantially performed). For the US, see *Della Ratta, Inc. v. American Better Community Developers, Inc.* ("The courts… will allow recovery under the contract, less allowance for deviations, where a party, in good faith, has substantially performed his obligation."); *Jacob & Youngs, Inc. v. Kent* at 891 ("The willful transgressor must accept the penalty of his transgression..."); *O.W. Grun Roofing & Construction v. Cope* at 262,

whether the work done is entirely different from the work contracted,[62] whether the defects are structural,[63] whether they are remediable,[64] the ratio between the cost of rectifying the defects/the money value of the work done and the contract price.[65] Undoubtedly, the doctrine of "substantial performance" contrasts sharply with the strict compliance requirement of the

---

citing *Atkinson v. Jackson Brothers* 270 SW 848 (Tex Comm App 1925) at 851 ("…the contractor must have in good faith intended to comply with the contract… Such performance permits only such omissions or deviations from the contract as are inadvertent and unintentional, are not due to bad faith…"); *Material Movers v. Hill* 316 NW 2d 13 (Minn 1982) (where the court decided that the trial court erred by not instructing the jury that a contractor who willfully or intentionally deviates from the terms of a contract cannot be said to have substantially performed); Restatement (Second) of Contracts § 241 Circumstances Significant in Determining Whether a Failure Is Material (e).

[62] For England, see *H. Dakin & Co., Limited v. Lee*; *Hoenig v. Isaacs* ("On any lump sum contract, if the work is not substantially performed and there has been a failure of performance which goes to the root of it, as, for instance, when the work … is entirely different in kind from that contracted for, then no action will lie for the lump sum."); *Bolton v. Mahadeva* (there was no substantial performance where the installed heating system was giving off fumes and was unable to heat adequately the house); *Cf.* with the Bulgarian Decision №1786 of 02.07.1970, c. c. 1148/1979, I c. d. of the Supreme Court (where the residential building was delivered with unfinished heating system and faulty elevator system, this was not a ground to terminate the contract). For England, see also *Lawson v. Supasink* (no substantial performance where the kitchen installed was not the one planned but a kitchen extemporised on the spot by the fitter and it was installed in a shocking and shoddy manner). For the US, see *Jacob & Youngs, Inc. v. Kent* at 891 ("Nowhere will change be tolerated, … if it is so dominant or pervasive as in any real or substantial measure to frustrate the purpose of the contract."); *O.W. Grun Roofing & Construction v. Cope* at 261 ("The deficiency will not be tolerated if it is so pervasive as to frustrate the purpose of the contract in any real or substantial sense."), at 262 ("…important factors, such as the purpose which the promised performance was intended to serve and the extent to which the nonperformance would defeat such purpose…"), at 262 citing *Atkinson v. Jackson Brothers* ("To constitute substantial compliance … in the sense that the defects are not pervasive, do not constitute a deviation from the general plan contemplated for the work…"); *Shaeffer v. Kelton* 619 P2d 1226 (NM 1980) at 1230 ("A building is substantially completed when all of the essentials necessary to the full accomplishment of the purpose for which the building has been constructed are performed."); Restatement (Second) of Contracts § 241 Circumstances Significant in Determining Whether a Failure Is Material (a).

[63] For England, see *H. Dakin & Co., Limited v. Lee* at 575, 578 (where the concrete depth was less than required, but safe, there was substantial performance); *Hoenig v. Isaacs* ("…if a man tells a contractor to build a ten foot wall for him in his garden …, it would not be right that he should be held liable for any part of the contract price if the contractor builds the wall … of a totally different material from that which was ordered…"). For the US, see *O.W. Grun Roofing & Construction v. Cope* at 262, citing *Atkinson v. Jackson Brothers* ("… such omissions or deviations … do not impair the structure as a whole…"); *Haymore v. Levinson* 328 P2d 307 (Utah 1958) (where the house had no structural defects, the clients could not deny "satisfactory completion of the work").

[64] For England, see *Bolton v. Mahadeva* at 1014 ("…if the putting right of those defects is not something which can be done by some slight amendment of the system, then I think that the contract is not substantially performed."); *Lawson v. Supasink* (no substantial performance where the remedial action was out of question on account of the poor design of the kitchen and poor workmanship). For the US, see *O.W. Grun Roofing & Construction v. Cope* at 262, citing *Atkinson v. Jackson Brothers* ("To constitute substantial compliance … in the sense that the defects … are not so essential that the object of the parties in making the contract and its purpose cannot, without difficulty, be accomplished by remedying them. Such performance permits only such omissions or deviations from the contract as … are remediable without doing material damage to other parts of the building in tearing down and reconstructing."); Restatement (Second) of Contracts § 241 Circumstances Significant in Determining Whether a Failure Is Material (d).

[65] For England, see *Bolton v. Mahadeva* as per Cairns L.J. (there was no substantial performance where the cost of remedying the defects was between one quarter and one third of the contract price); *Hoenig v. Isaacs* ("…[where] a sum of £ 55 18s 2d only was required to put right … defects in the work [done under a £ 750 contract]…, the defendant's contention [that he was not liable for the price] would appear on the face of it to be somewhat harsh"). For the US, see *O.W. Grun Roofing & Construction v. Cope* at 262 ("Also influential in many cases is the ratio of money value of the tendered performance and of the promised performance.").

perfect tender rule,[66] which, if applied to construction contracts, would result in the constructor being deprived of his right to payment for any defect, no matter how minor.[67] In fact, what the doctrine does is to state the principle of "material" (the US)[68] or "substantial" (England)[69] failure of performance in converse terms. The constructor's performance is substantial if it is a performance with no "material"/ "substantial" failure, capable of justifying termination of the contract.

Similarly to US and English law, Bulgarian contract law also limits the client's right to terminate in case of defective performance of construction agreements. In contrast to sale-of-goods contracts where rescission is simply one of the alternative remedies available to the buyer, the client in a construction contract has the right to terminate only if the deviation or the defects are so substantial that they render the work completely unfit for its ordinary or contemplated purpose.[70] Only then is the constructor's defective performance considered not to be immaterial with a view to the client's interest and to justify rescission.[71] In this sense, with respect to construction contracts, Bulgarian contract law returns to its general position, following from the underlying principle of specific performance,[72] that contract termination is an extreme remedy, allowed only when the breach defeats the very purpose of the contract.[73]

---

[66] See *supra* footnote 46-50 of this Chapter and the text accompanying it.

[67] To explain this harsh result: Under the default terms developed by common law courts the client's obligation to pay is conditional on full performance by the constructor. Thus, the client is entitled to refuse any request for payment by the constructor until the latter has performed his "entire" obligation. In this sense, see for the US: *Stewart v. Newbury* 220 NY 379 (Ct App 1917) at 384-385; *Coletti v. Knox Hat Co.* 169 NE 648 (NY 1930) at 649-650; Restatement (Second) of Contracts § 234 Order of Performances (2), comment e, and for England: *Sumpter v. Hedges* at 674; *Appleby v. Myers* at 660. Hence, if the issue of what constitutes full performance were resolved in accordance with the perfect tender rule, the client's payment obligation would become due only after the constructor has performed to the letter of the contract.

[68] Restatement (Second) of Contracts § 237 Effect on Other Party's Duties of a Failure to Render Performance, comment d; Farnsworth, *Farnsworth on Contracts* 518.

[69] Peel 866. This general principle goes back to *Boone v. Eyre* 126 Eng Rep 160(a) (KB 1777) and to a whole line of later cases, in which it was discussed, among which *Glazebrook v. Woodrow* (1799) 8 Term Reports 366, at 373-374, 375.

[70] Art. 265(2) Contracts Act.

[71] Art. 87(4) ibid. See Decision №1106 of 20.04.1957, c. c. № 2125/1957, IV c. d. of the Supreme Court (where relying on Art. 87(4) the court confirms that in case of constructor's defective performance the client has a right to rescind the construction contract only if the breach is material with a view to the client's interest). See also *supra* the text accompanying footnotes 19-21 in Section A. of Chapter III and the text accompanying footnote 54 of this Chapter.

[72] See *supra* Section A. of Chapter III.

[73] In this sense, see Ordinance №3 of 29.03.1973, c. c. № 2/1973, Plenum of the Supreme Court (where the dispute arose precisely because the construction work deviated substantially from the plan) *Cf.* with cases *supra* in footnote 62 of this Chapter: for England, *Hoenig v. Isaacs*, (according to which the contract is substantially completed and, hence, cannot be terminated when the failure of performance does not go to the root of it) and for the US, *Jacob & Youngs, Inc. v. Kent* at 891 and *O.W. Grun Roofing & Construction v. Cope* at 261-262

To evaluate the fitness of the construction for its ordinary or contemplated purpose, courts inquire as to whether the structure delivered is in essence what is agreed upon under the contract;[74] whether it conforms to the project designs, approved by the public administration, and to the mandatory rules and requirements provided with respect to construction work;[75] whether the defects are remediable (meaning *i.e.* whether their remedying entails serious difficulties, is technically possible or expedient from an economic perspective);[76] or whether

---

(according to which the extent to which the nonperformance frustrates the purpose of the contract is a factor when considering whether the contract is substantially completed).

[74] Ordinance №3 of 29.03.1973, c. c. № 2/1973, Plenum of the Supreme Court (where the obligation was to construct a lodging and the client was delivered a lodging that could satisfy his needs, the court denied the client the right to terminate even though the walls inside the lodging were misplaced, resulting in rooms of the same number and kind as per the plan, each fit for its purpose, but each having a size different from the plan) *Cf.* with *Plante v. Jacobs* 103 NW2d 296 (Wis 1960) at 297-298 (where the court decided that there was substantial performance since performance met the essential purpose of the contract, construction of a house, even though the house suffered from a number of defects, among which misplacement of the wall between the kitchen and the living room, which narrowed the living room in excess of one foot). Both courts found that the wall misplacement did not affect the value of the lodging. See also Decision №87 of 04.08.2010, c. c. №76/2010 of District Court – Smolyan (where since the constructed breeding pool was leaking and was unable to hold water at all, it was not fit for its purpose and the client had the right to terminate).

[75] Currently the mandatory rules and requirements to construction work are provided for in Art. 169 Spatial Development Act, promulgated State Gazette №1 of 02.01.2001, in force as of 31.03.2001, last ammended State Gazette №80 of 14.11.2011. See Decision №48 of 31.03.2011, c. c. №822/2010, II c. d. of the Supreme Cassation Court (where the court stated expressly that in order for the client's payment obligation to become due, the construction had to be in conformity with the approved project design and with the mandatory rules and requirements of the Spatial Development Act); Ordinance №3 of 29.03.1973, c. c. № 2/1973, Plenum of the Supreme Court (where the incorrect construction of some of the foundations of the building was remedied in the course of the court proceedings and the irremediable deviations from the plan did not affect the solidity of the building, the court denied the right to terminate the contract); Decision №87 of 04.08.2010, c. c. №76/2010 of District Court – Smolyan (where the breeding pool was unable to hold water because the constructor had deviated from the plan, used poor quality construction materials, had not adhered to the construction requirements for such structures and had not observed the proper technological order of building the pool, the client had the right to terminate). *Cf.* with the absence-of-structural-defect factor, determining substantial performance under English and US law (see *supra* cases in footnote 63 of this Chapter) as well as with the requirement that the construction does not deviate from the general plan (see *O.W. Grun Roofing & Construction v. Cope* at 262, citing *Atkinson v. Jackson Brothers supra* in footnote 62 of this Chapter).

[76] Ordinance №3 of 29.03.1973, c. c. № 2/1973, Plenum of the Supreme Court (where most of the deviations from the plan were remediable, the court denied termination of the contract); Decision №157 of 8.11.2010, comm. c. №1135/2009, II comm. d. of the Supreme Cassation Court (where the unevenness of the asphalt covering could be remedied without affecting its weight-carrying ability, the covering was not unfit for its purpose and the contract could not be terminated); Decision №348 of 04.04.2014, app. comm. c. №2090/2013 of District Court – Varna (where the constructed ventilation system could function even if it deviated from the plan and the deviation was remediable, the system was not unfit for its purpose and the client did not have the right to terminate); Decision №431 of 07.06.2006, comm. c. №1025/2005, II comm. d. of the Supreme Cassation Court (where the hydroisolation made could not be remedied and had to be entirely replaced, the court recognised the client's right to terminate); Decision №49 of 23.06.2011, comm. c. №7/2011 of District Court – Smolyan (where the client had the right to terminate since to make the pool fit for its purpose, the constructor first had to demolish it entirely). Recall that to determine whether the contract is substantially performed, US and English courts also inquire whether the defects are remediable. See *supra* cases in footnote 64 of this Chapter. See also Decision №87 of 04.08.2010, c. c. №76/2010 of District Court – Smolyan (where remedying the defects of the breeding pool was technically possible, but inexpedient from an economic viewpoint since the monetary value of the defective work exceeded half of the price for building the entire pool, the court recognised the client's right to terminate). *Cf.* with English and US cases *supra* in footnote 65 of this Chapter where the courts look at the cost

the work done is actually used.[77] Unlike in the US and England, the issue does not depend on whether the breach is wilful or inadvertent. In the case of defective performance, the breacher's fault determines the magnitude of the damages for which he is liable, but not his liability *per se* or the availability of the termination remedy.[78] Defects that do not make the construction completely unfit for its purpose do not extinguish the obligation of the client to pay the price; they only give her the rights to demand correction of the work for free or to demand damages.[79] In this sense, the right of the client to refuse to pay, the so-called "protest against breach of contract",[80] is only a right to withhold her own performance, not termination of her contractual obligation. It is an instrument to pressure the constructor to rectify defects, but if in the end he does not remedy them[81] and files a suit to claim payment, he will be awarded the (outstanding balance of the) price, less the amount necessary to compensate the client for the defective work.

In other words, in the context of construction contracts Bulgarian contract law, just like English and US law, allows contractual termination only for a material, grave deviation.

---

of remedying the defects or at the monetary value of the work done and compare it with the contract price. *Cf.* also the client's right to terminate with that of the buyer under Bulgarian contract law. Recall that termination is available to the buyer irrespectively of whether the defect is remediable or not. See *supra* the text accompanying footnote 57 of this Chapter.

[77] Decision №157 of 8.11.2010, comm. c. №1135/2009, II comm. d. of the Supreme Cassation Court (that the asphalt covering was actually used was emphasised by the court as a fact indicating that the covering was not completely unfit for its purpose); Decision №186 of 30.10.2013, comm. c. №820/2012, II comm. d. of the Supreme Cassation Court (where the court stated that the functioning of the constructed ventilation system and its use for its purpose indicated, in principle, acceptance of the work done, meaning that the client's obligation to pay had become due, subject to deductions for defects, and that the client did not have a right to terminate the contract. Following the instructions of the Supreme Cassation Court, District Court – Varna pointed out that by using the ventilation system, the client had accepted it as constructed and, therefore, her contractual obligation to pay was not terminated. See Decision №348 of 04.04.2014, app. comm. c. №2090/2013 of District Court – Varna. *Cf.* with *H. Dakin & Co., Limited v. Lee* at 569; *Hoenig v. Isaacs* (where the fact that the work done was used by the promisee and she had had the benefit of it was one of the factors taken into account by the court in deciding that the contract was substantially performed).

[78] Art. 193(3) in connection with Art. 265 in connection with Art. 82 Contracts Act. In this sense, see also Kalaydjiev 337; Decision №595 of 11.06.2004, c. c. №2700/2008, V comm. d. of the Supreme Cassation Court (the right to terminate does not depend on the seller's fault; despite the fact that the concrete case concerns a contract for sale of goods, this is a general principle with respect to defective performance in Bulgarian contract law, including when it comes to defective performance of construction contracts). *Cf.* with English and US cases *supra* in footnote 61 of this Chapter.

[79] In this sense, see Ruling №482 of 27.07.2010, comm. c. №1009/2009, II comm. d. of the Supreme Cassation Court; Decision №157 of 8.11.2010, comm. c. №1135/2009, II comm. d. of the Supreme Cassation Court; Decision №186 of 30.10.2013, comm. c. №820/2012, II comm. d. of the Supreme Cassation Court; Art 265(1) Contracts Act.

[80] Art. 90(1) ibid; Kojuharov, *Law of Obligations. Specific Contracts* 176.

[81] It is not unlikely that the constructor resists remedying the defects since he knows that even if the client obtains a judgment directing him to correct them, at the execution stage, the most she can achieve is to force him to pay her in advance the amount necessary for making the corrections. See *supra* the text accompanying footnotes 52-54 in Section A. of Chapter III.

Compared to sale-of-goods contracts, this is a significant limitation to the client's right to terminate. Such obliging of the client to accept deficient performance together with damages naturally incentivises the constructor to take less care of perfect performance. Is law less concerned with quality when it comes to construction as opposed to sale contracts?

3. The economic rationale

Indeed, what makes the construction contract so different from the sale-of-goods one that all three legal systems choose to limit the promisee's access to the termination remedy and to award damages within the frames of the contract? The explanation for this similar result can be looked for in the greater danger of Buyer's opportunism in the construction context.

Even though the US and English sale-of-goods law has moved to accommodate contracts falling in the long-term range,[82] the starting point of contract law in all three jurisdictions is that in a sale agreement delivery of the good and payment of the price occur concurrently.[83] Simultaneous performances are, however, by definition unfeasible in the construction, as well as in every service contract. The necessarily sequential character of economic activity naturally extends the duration of the contract and brings in uncertainty. Usually, construction is also a fairly complex economic activity, involving much risk and requiring specific skills. The greater the uncertainty and/or complexity, the more incomplete is the parties' construction agreement. And consequently, the smaller is parties' ability to foresee change in conditions and provide for it, the greater is the peril of *ex post* opportunistic attempts to revise the agreement.

In addition, where, as in construction contracts, performances are sequential simply because the performance of one of the parties requires some time, the constructor, who has to perform first,[84] runs the risk that once he has done the work, the client may refuse to perform. Since in

---

[82] See *supra* Section B.1. of Chapter IV about US and English law which, unlike Bulgarian law, accommodate specifically manufactured goods within the sale-of-goods contract.

[83] For the US, see Restatement (Second) of Contracts § 234 Order of Performances (1); UCC § 2-507. Effect of Seller's Tender; Delivery on Condition. (1); § 2-511. Tender of Payment by Buyer; Payment by Check. (1). For England, see Sale of Goods Act 1979 Section 28 Payment and delivery are concurrent conditions. For Bulgaria, see Art. 200(2).

[84] For the "work before pay" rule in the US, see *Stewart v. Newbury* at 384-385; *Coletti v. Knox Hat Co.* at 650 ("When the performance of a contract consists in doing (*faciendo*) on one side, and in giving (*dando*) on the other side, the doing must take place before the giving."); Restatement (Second) of Contracts § 234 Order of Performances (2). For England, see *Sumpter v. Hedges*, at 674; *Appleby v. Myers* at 660. For Bulgaria, see Art. 266(1) Contracts Act.

construction agreements performances are not due at the same time, contract law cannot give parties the assurance it provides in sale-of-goods contracts by allowing each of them to refuse performance if the other demands it without offering performance in return.[85] Thus, the constructor is by definition exposed to a hazard,[86] which the seller may avoid by agreeing, when feasible, on concurrent performances. Imagine now, an agreement, involving the construction of a building, and not involving only…, let's say, the painting of several rooms with materials of the client, which would also come under the broad definition of a construction contract, adopted by this thesis.[87] With payment due on completion, for this constructor the hazard is even greater as he cannot take the building back in case, once finished, the client refuses to pay. Being aware of this, the client can use some minor defect of the erected structure as an excuse as to why she would not perform her part of the bargain. The constructor, in other words, is at the mercy of the client – the latter can easily force him to lower the price even if the defect is not really there or even if it is worth much less than the demanded price reduction. Thus, the necessarily sequential order of performances coupled with specific investment opens plenty of room for opportunistic behaviour.[88] On its own turn, the threat of hold up discourages the constructor from investing in high quality performance.

By contrast, in sale contracts where there is an available market for the goods in question, it is much less likely that the buyer will behave opportunistically even if performances do not exactly overlap in time. In the absence of specific investment by the seller, the contract does not generally represent an opportunity for strategic gains unless some change of circumstances transforms it into one. After all, it implies contractual surplus comparable to that of the other contracts on the market. In case the buyer rejects the goods, the seller can always reduce her losses by reselling them. If they are really deficient, he can repair them and offer them elsewhere at a similar price or he can simply resell them at a price reflecting their

[85] For the US, see Restatement (Second) of Contracts § 238 Effect on Other Party's Duties of a Failure to Offer Performance and § 234 Order of Performances, comment a. For England, see *Paynter v James* (1866-67) LR 2 CP 348. For Bulgaria, see Art. 90(1) Contracts Act.

[86] Even an agreement stipulating progress payments instead of payment due on completion would only mitigate a constructor's risk as he will still have to perform the relevant part of the structure first and then receive the respective instalment.

[87] See *supra* the text right after footnote 112 of Chapter I.

[88] In fact, a hypothetical including a construction contract is the scholars' favourite example for opportunistic conduct. For law-and-economics scholars using such an example, see Posner, *Economic Analysis of Law* 93; Victor Goldberg, 'Relational Exchange: Economics and Complex Contracts' in Victor Goldberg (ed), Readings *in the Economics of Contract Law* (First edn, Cambridge: Cambridge University Press 1989) 17. For the same example used in a legal handbook not from the law-and economics field, see Farnsworth, *Farnsworth on Contracts* 488.

defective condition. In this sense, it is the market itself that deters the buyer's opportunistic conduct. For this reason, instead of seeking to engage in strategic games, which would increase her costs and hardly bring much benefit, upon defective delivery, the buyer would rather choose the least costly option, available to her. Out of the two remedies: acceptance of the goods together with damages or termination of the contract together with damages, she would most likely prefer the one that entails fewer losses, since these losses would be compensated to her only if the seller actually pays for the damages suffered.[89] Such motivation is in line with the common interest of minimising joint costs (or equivalently maximising joint benefits) and, thus, sharply contrasts with the motivation, directed toward appropriation of a bigger share of the contractual surplus, described in the construction context. In the latter context, the dependence of the Seller will incentivise the Buyer to use termination as a strategic move, threatening to impose on him significant costs, which the Seller would find difficult to recoup. Thus, where the market thins, it is no longer capable of curbing the Buyer's opportunism. Taking on this role, contract law in all three jurisdictions sets limits on the primary tool the client has to hold up the constructor. Whether by relaxing the Seller's standard of performance (the US and England) or by requiring a particularly grave defect (Bulgaria), it restricts the destructive termination remedy to situations where the Seller has deviated from his obligation to such an extent that the Buyer's desire to end the contract is most likely non-strategic. Contract law, in other words, regulates.

The propensity of parties to communicate relevant information is another manifestation of the problem of opportunism that arises in the context of construction contracts. In principle, once the contract is signed, the promisee does not have much incentive to readjust in order to reduce the promisor's suddenly increased costs.[90] Yet, where both parties have a readily available market for their performance, it is not so unlikely that they share information in order to find the most cost-effective way to adapt to a regret contingency.[91] If the seller is not afraid of buyer's opportunism, he would not be reluctant to explore the possibilities of modifying the contract. Thus, if the buyer's costs of cover are smaller than the seller's costs of procuring substitute non-deficient goods[92] or if the seller's costs of repair are smaller than the

[89] Goetz and Scott, 'The Mitigation Principle: Toward a General Theory of Contractual Obligation', 996.
[90] For the incentive of the insured promisee to take suboptimal precautions, see *supra* Section E. of Chapter V.
[91] In this sense, see also Goetz and Scott, 'The Mitigation Principle: Toward a General Theory of Contractual Obligation' 987-988.
[92] Both seller's and buyer's costs of purchasing substitute goods comprise two kinds of costs: the administrative costs of effectuating the substitute transaction and the difference between the price of the substitute goods and

costs of purchasing substitutes, then the seller would prefer to pay the buyer to readjust respectively instead of perform his original obligation at a higher cost or breach and pay damages. After all, it is always him who bears the bill, so why not communicate with the buyer to see whether there is a possibility to pay less.[93] In the absence of strategic opportunity, the buyer would also not be so unwilling to reveal the cost of her readjustment options. And when compensated for this, it is not unlikely that she actually agrees to readjust, thus saving the administrative and error costs associated with calculating her damages in case of seller's breach. In other words, in thick markets parties' renegotiation is not unlikely to be a cooperative action resulting in minimising transaction costs and not a means of exploiting the vulnerability of the contractual partner. In this sense, law prohibiting it is useless and even harmful. In addition, the right to terminate is likely not used as a tool for hold up. Rather, the potential for conflict it implies motivates the seller to take precautions against defective delivery and to approach the buyer looking for cost-effective modification of the contract. From this perspective, a broad right to terminate in sale-of-goods contracts appears optimal.

Conversely, being in the middle of a strategic situation, in case of renegotiation parties to a specialised construction contract would be reluctant to disclose pertinent information and would rather use the existing information asymmetries to their advantage. Exploiting the constructor's inability to verify the cost of her readjustment options, the client may very well sell her cooperation at much more than its market value. Not to mention that her methods of "bluffs, threats and games of 'chicken'"[94] in achieving this would be nothing but deadweight losses, consuming the joint benefits the contract could produce.[95] From this perspective, the described restriction of the right to end the contract and seek compensation out of it does at least three things. Firstly, the requirement that the client accept a defective structure together with damages (measured on the basis of objective criteria) expands her duty to mitigate[96] and prevents her from misrepresenting her mitigation costs in order to extract a higher price

---

the resale price of the defective ones. The buyer's costs of cover may be smaller because, for example, the buyer (unlike the seller) knows the other sellers in the business and does not have to incur search costs or because she can cover at a lower price due to already established good commercial relationships with other sellers.

[93] In this sense, see also Goetz and Scott, 'The Mitigation Principle: Toward a General Theory of Contractual Obligation' 977, 979-980.

[94] Goetz and Scott, 'Principles of Relational Contracting', 1101, footnote 26.

[95] In this sense, see also Goetz and Scott, 'The Mitigation Principle: Toward a General Theory of Contractual Obligation' 982-983, 984-985.

[96] In this sense, see also ibid 1009-1010. Indeed, this requirement to the client's *ex post* behaviour is additional to the promisee's general mitigation duty, provided in all of the compared legal systems. See *supra* footnote 174 in Section F. of Chapter V.

discount from the constructor. Secondly, the restriction restrains the strategic behaviour that would obstruct potential beneficial readjustment and inflate renegotiation costs. Thirdly, allowing termination only where the substantial performance standard is not satisfied (the US and England) or where the structure is unfit for its purpose (Bulgaria) stimulates idiosyncratic clients to bargain for higher protection at the time of contracting and, thus, forces them to reveal information about the magnitude of the losses they anticipate.[97] In this sense, the limits set on the client's right to terminate encourage parties to share (truthful) information, which is part of contract law's regulatory function of deterring opportunism.

One could say that where law curbs the Buyer's termination remedy, it does not care about ensuring quality of performance since deterrence of client's opportunism is attained at the expense of increasing the risk of Seller's moral hazard. Indeed, allowing termination only for substantial, material non-conformity naturally gives the constructor less incentive to make sure that his performance is flawless. Yet, recall that if a promisor expects to be held up in renegotiation, he has very weak incentive to invest cooperatively at all. The problem goes beyond reduction of the average quality of performance and affects the very size of the market.[98] In other words, where to perform promisors, just like constructors, need to make cooperative investment, the issue, first, is how to incentivise (more of) them to invest and only then how to incentivise them to invest efficiently. From this perspective, the restriction on termination still concerns quality of performance. But rather than focusing on *ex ante* investment inefficiencies, it centres on minimising the potential of hold-up in order to kick off the promisor's motivation for investment in quality.[99]

This is, in fact, the very essence of the regulatory function of contract law. It confines the worst threat the client can make, the threat to terminate, by assigning to her the liability for untoward ending of the contract. Thus, it decreases her short-term gains from opportunism and turns preservation of the contractual relationship into the more profitable line of behaviour. In this sense, contract law does not assign liability to the party that can prevent breach at the lowest cost (the constructor is still the one best able to take precautions against

[97] In this sense, see also ibid 985, footnote 43.
[98] Akerlof.
[99] In view of Klein this is also the role of contractual terms in incomplete contracts. Klein, 'The Role of Incomplete Contracts in Self-Enforcing Relationships' 62-64.

failure of performance),[100] but to the one that, by not taking precautions, destroys a larger share of the surplus (recall that the client's mitigation, which in case of wrongful termination is simply absent, is also a form of precaution).[101] So where law restricts the Buyer's right to end the contract, minimising transaction costs takes place not by mimicking the market (*i.e.* facilitating), but by making non-cooperative behaviour costly in order to curtail the losses resulting when the market fails (*i.e.* regulating).[102]

One could also say that where costs from the client's opportunism are decreased but costs from the constructor's evasion are increased, the overall reduction of transaction costs is rather questionable. Yet, at least in the case in which the client attaches market value to performance, it is fairly unlikely that the increase of costs, resulting from the constructor's higher chance to escape his contractual obligations, is greater than the reduction of costs, following from the client's diminished opportunity for strategic behaviour. If the greater part of the work is done and, overall, follows the plan, if defects are not structural, but only minor and remediable, then the promisee essentially receives what she bargained for and can be compensated for the deficiencies by sufficient damages. In this sense, the restriction on termination does not increase significantly the risk for constructor's defective performance. Such restriction, on the other hand, substantially reduces the risk of the constructor being either subjected to forfeiture (if he rejects the extortionate offers and the client really terminates), or deprived of almost all of the benefit (if he, after all, renegotiates with the client). This suggests that on balance the increase of losses from the constructor's shirking would be smaller than the reduction of losses from the client's opportunism.[103]

It is possible that the balance turn out differently where clients are idiosyncratic parties who value performance more than the market and whose losses are hard to measure. In such case deviations that might otherwise appear petty may actually destroy much of the client's value

[100] In the construction context, entailing customisation and heterogeneity, the decision to take precautions against breach is also a decision about investing cooperatively (in quality). It could be said, however, that the value of the investment on the continuous interval determines which aspect of the decision dominates. Until the threshold determining that performance occurred (in legal terms: until the threshold of "substantial performance" or "immaterial non-performance") the decision is primarily (though not only) precautionary. Once this threshold has been passed, the cooperative investment aspect, *i.e.* the aspect determining quality enhancement, dominates. See also *supra* the text right after footnote 104 in Section D. of Chapter V.

[101] See *supra* Section F. of Chapter V and the text accompanying footnote 166.

[102] According to Cooter, this is the way contract law should allocate liability under the so-called "Hobbes Theorem", as opposed to the way, suggested by the Coase Theorem. Cooter, 'The Cost of Coase', 18-19. See also *supra* footnote 82 of Chapter IV as well as Hviid 57.

[103] In this sense see also Goetz and Scott, 'The Mitigation Principle: Toward a General Theory of Contractual Obligation' 1010.

and at the same time give her considerable difficulty to prove her losses. This explains why when it comes to homeowners, US and English courts may sometimes consider personal taste, preference or fancy controlling. Unlike Bulgarian courts, which traditionally relate the client's right to terminate only to the fitness of the lodging to satisfy her residential needs,[104] US and English courts may be slow to find substantial performance where consumer clients receive a structure, which though meeting the objective standard of operative fitness, offends their aesthetic sensibility.[105] If under such circumstances clients are compelled to accept, there is significant risk that they remain undercompensated. Termination then appears the better choice as the client's restitution interest in any instalment payments made in advance is much

---

[104] See Ordinance №3 of 29.03.1973, c. c. № 2/1973, Plenum of the Supreme Court (where the court expressly stated that the judgement regarding the client's right to terminate depends not on her subjective attitude but on the objective fact of whether she actually receives a lodging, as contracted, and, if yes, whether the defect is such that the lodging cannot satisfy the client's residential needs; consequently, in the case at bench the court rejected termination because despite the defects, the lodging could satisfy the residential needs of the client). *Cf.* with *Tolstoy Construction v. Mamie Minter* 78 CalApp3d 665 (Cal 1978) (where the US court found there was no substantial performance since the accumulation of many defects, anyone of which standing alone would be minor in character, made the building and the carport so poorly constructed that it would take substantial amounts of money to make the dwelling reasonably tenantable). The explanation for this attitude of the Bulgarian courts can be found in the significant difficulties of the State during the socialist period to satisfy the residential needs of the fast-growing population in the cities. To allow termination of the contract for unsightly appearance where families waited for years, sometimes even more than a decade, to purchase a home, seemed to be waste. Thus, in 1984 the Act on Territorial and Settlement Development provided what was already accepted in the legal doctrine and court practice – that the contract could be terminated if the defect was irremediable and made the lodging **impossible to use**. See Art. 119(3) p. 4 Act on Territorial and Settlement Development, promulgated State Gazette №29 of 10.04.1973, in force since 01.06.1973, repealed State Gazette №1 of 02.01.2001, in force since 31.03.2001. Regarding the view taken in the legal doctrine, see Vladimir Petrov, *Prerequisites for Liability and Methods for Settling the Relations between Sellers and Buyers in Case of Sale of Newly Constructed Lodgings with Defects* (Sofia: "St. Kliment Ohridski" Press 1989) 151-152. That Bulgarian courts do not take into account subjective value in case of defective home construction is also evidenced by the fact that they do not award non-pecuniary damages. See Decision №1786 of 02.07.1970, c. c. 1148/1979, I c. d. of the Supreme Court; Decision №948 of 07.07.1998, c. c. 605/1998, V c. d. of the Supreme Cassation Court. This may change in the future as the Supreme Court has recently proclaimed that awarding non-pecuniary damages is admissible in case of contractual breach. See Interpretative Decision №4 of 2012 of the General Assembly of the Civil and Commercial Chambers of the Supreme Cassation Court. For the development of the legislative, court and doctrinal attitude toward non-pecuniary damages in Bulgaria, see *supra* footnote 156 of Chapter II.

[105] For the US, see *Smith v. Brady* 17 NY 173 (NY 1858) at 186 ("I suppose it will be conceded that every one has a right to build his house, his cottage or his store after such a model and in such style as shall best accord with his notions of utility or be most agreeable to his fancy. … If the owner prefers a plain and simple Doric column, and has so provided in the agreement, the contractor has no right to put in its place the more costly and elegant Corinthian."); *O.W. Grun Roofing & Construction v. Cope* (where the client received a weatherproof roof, which, however, was not of uniform colouring and could be remedied only if completely redone, there was no substantial performance); *Haymore v. Levinson* at 309 ("…where the undertaking is to do something of such a nature that pleasing the personal taste, fancy or sensibility of the other, which cannot be readily determined by objective standards, must reasonably be considered an element of predominant importance in the performance."). For England see *Lawson v. Supasink* (where the defects in the kitchen, consequence of poor design and workmanship, could be rectified, but the kitchen was not going to be "as good as it would have been in the first place", there was no substantial performance).

more clear-cut. Such restitution may be increased by damages for inconvenience (England),[106] or diminished by the *quantum meruit* claim of the constructor (the US),[107] but where the client is additionally entitled to non-pecuniary losses or the burden of proof is on the constructor, the error seems more likely to be in her favour.[108] Thus, if inadequate measurement of the Buyer's expectation damages may give a significantly suboptimal performance incentive to the Seller, making it questionable whether the Buyer's opportunism decreases by more than the Seller's evasion increases, US and English courts tend to allow clients in construction contracts to terminate. A test entailing only objective standards for habitation, such as the one applied by Bulgarian courts, prevents consumers from exaggerating their losses but it also stimulates constructors to lower quality and to invest less in satisfying the consumer's subjective preferences.

To put it briefly, the choice made by all three legal systems between a broad termination right of the Buyer and damages awarded to her within the contract is roughly optimal. In sale-of-goods contracts where the market is thick, law is plainly concerned with motivating Sellers to perform conformingly and, hence, makes the termination remedy available to Buyers. By contrast, in construction contracts, law stimulates Sellers to invest in quality performance somewhat indirectly. Where the market is thin and there is significant danger of Buyers' opportunism, law limits Buyers' right to terminate, requiring them to mitigate. Thus, reducing the risk of Buyers' strategic claims, it spurs the Sellers' unprecedentedly weak incentive to invest cooperatively.

---

[106] *Lawson v. Supasink*; *Bolton v. Mahadeva*; Beale 1846. US courts generally do not award damages for emotional distress in case of defective home construction. See *Elrich v. Mezenes* 981 P2d 978 (Cal 1999). For unusually generous decisions, see *B&M Homes v. Hogan* 376 So2d 667 (Ala 1979); *Salka v. Dean Homes of Beverly Hills* 22 Cal Rptr2d 902 (App Ct 1993). See also Farnsworth, *Farnsworth on Contracts* 291-293 and especially footnotes 13 and 14.

[107] Restatement (Second) of Contracts § 237 Effect on Other Party's Duties of a Failure to Render Performance, comment d. By contrast, in England the rule of *Sumpter v. Hedges* (see *supra* footnote 61 of this Chapter) is still valid and a constructor who has failed to complete performance of his "entire" obligation does not have rights even in restitution against the client. See *Cleveland Bridge UK Ltd v Multiplex Constructions (UK) Ltd* [2010] EWCA Civ 139 at [118]-[138].

[108] Even though the court may not estimate perfectly the client's damages for inconvenience, where, instead of awarding expectation damages which do not account for the client's subjective value and thus substantially undercompensating her, the court recognises her non-pecuniary interest in addition to her pecuniary restitution one, the calculation error is still in favour of the client.

B. Differences between the Legal Systems

Contract law has grappled with the problem about the circumstances under which to permit the promisee to terminate the contract for centuries. Under general contract law in all three jurisdictions, the right to terminate for breach arises when the deficiency of performance has assumed a certain degree of gravity. In the US, a promisee is entitled to terminate only after the promisor's material breach continued long enough to amount to the non-occurrence of a condition that can no longer occur.[109] In England, too, the failure of performance must be sufficiently serious or "substantially" deprive a party of what she bargained for.[110] The Bulgarian Contracts Act, on the other hand, provides when termination is not allowed, yet to the same effect: where the promisee may not end the contract if non-performance is immaterial with a view to her interest,[111] only material, substantial breach justifies termination. From this perspective, the client's right to terminate constrained by the doctrine of substantial performance (the US and England) or by the requirement for complete unfitness (Bulgaria) is in accordance with the position of general contract law. Rather, it is the sale-of-goods law giving the buyer a free choice between ending the agreement and damages within the contract that establishes an exception to the general principle.

Having drawn the picture of an expansive termination remedy in sales contracts, however, I am keen to stress that the above description is to some extent reductionist. In fact, a national lawyer, proficient in the details of contract law of any of the jurisdictions, may even argue that my report is highly misleading and inaccurate. Indeed, in the US White and Summers submit that "little is left of [the perfect tender rule]".[112] In England, too, Peel, points at a statutory restriction of the right to reject,[113] as well as at "some judicial reaction against the authorities which give [it] a wide scope".[114] The account with respect to Bulgarian sale-of-goods law also conveniently omits that, though broader than in construction contracts, the

---

[109] Farnsworth, *Farnsworth on Contracts* 509-511, 525; Restatement (Second) of Contracts § 237 Effect on Other Party's Duties of a Failure to Render Performance, comment a; § 225 Effects of the Non-Occurrence of a Condition (2).
[110] Peel 866. This general principle goes back to *Boone v. Eyre* and to a whole line of later cases. Among them see *e.g. Glazebrook v. Woodrow*, at 373-374, 375.
[111] Art. 87(4) Contracts Act. See also *supra* footnote 21 in Section A. of Chapter III and the accompanying text.
[112] James White and Robert Summers, *Handbook of the Law under the Uniform Commercial Code* (Second edn, St. Paul: West Piblishing Company 1980) 304-305.
[113] Sale of Goods Act 1979 Section 15A Modification of remedies for breach of condition in non-consumer cases., inserted by Sale and Supply of Goods Act 1994, Section 4(1) in response to recommendations of the Law Commission in *Sale and Supply of Goods. Law Commission №160* (1987), para. 4.21.
[114] Peel 881.

buyer's right to terminate is still limited by a requirement that the defect be "substantial".[115] Admittedly, since the goal was to contrast termination in sales and construction contracts, as well as its role regarding quality, the text saw neither to the qualifications of the right to terminate in the field of sale of goods, nor to the differences between the legal systems regarding these qualifications.

This section then goes beyond the common starting point of sale-of-goods law that buyers cannot be compelled to accept defective goods and illuminates different legal devices that the three legal systems have developed to narrow the buyer's broad termination right. It then discusses the factors that affect the efficiency of termination in sale of goods and draws a line to separate cases where a right to end the contract as extensive as described in the previous section is no longer optimal.

1. Executory contracts for sale of commodities

One could hardly think of commercial contracts standing closer to the spot end of the spectrum than contracts for sale of commodities (raw materials, agricultural products, foodstuffs). Where different quality grades are well understood and reflected in market prices, as it is in the case of such, commonly standardised, goods, information problems are also the smallest. Yet, since the market value of commodities is unstable in the short run, as soon as the time of performance parts from the time of contracting, the issue of when to permit the buyer to terminate becomes a difficult one.

Although in case of delivery of defective goods, sales law in all three jurisdictions provides the buyer with a choice between claiming damages within the contract and putting the latter to an end, there is a notable difference in approach. Under the Anglo-American perfect tender rule, still preserved in the UCC and the Sale of Goods Act 1979, the buyer has an absolute right to reject for *any* non-conformity. This, according to English case-law, is the distinctive property of conditions, such as the obligations as to conformity of goods:[116] every breach of them, "whatever the gravity", entitles the buyer to terminate.[117] In the US, the sweeping language, giving the buyer the right to reject for *any* breach related to conformity, found its

[115] Art. 193(1) Contracts Act.
[116] See *supra* footnote 50 of this Chapter and the text accompanying it.
[117] *Lombard North Central Plc. v. Butterworth* [1987] QB 527 at 535.

way directly into the Uniform Sales Act and then carried on to the UCC.[118] Under the Bulgarian Contracts Act, however, the buyer can elect to terminate only for a substantial defect, *i.e.* for a defect that substantially decreases the price *or* the fitness of the good.[119] Thus, it seems that under Bulgarian contract law it takes a higher level of inexactness in seller's performance in order for the buyer to be permitted to end her contractual obligations.

The *de minimis* exception

In fact, to the extent that all three legal systems bear the idea of ignoring trifling defects, the perfect tender rule and the Bulgarian provision regarding defective performance overlap. Even if requiring strict performance, American and English courts sometimes disregard insignificant variations on the basis of the maxim *De minimis non curat lex*.[120] Thus, English judges took the view that "microscopic"[121] deviations were not sufficient to permit rejection since the deviation needed to be "capable of influencing the mind of the buyer".[122] The latter formula strikingly resembles the test of the Bulgarian 1892 Contracts Act requiring the defect to be capable of affecting the buyer's decision about purchasing the good or about the

---

[118] Uniform Sales Act § 69(1) (1906) provided for the buyer's remedies "[w]here there is a breach of warranty" while simultaneously extending the term "warranty" to include not only the implied warranties as to merchantability and fitness, but also "any affirmation" and "any promise" of the seller regarding the goods on which the buyer relied; such affirmation and promise giving rise to an express warranty. See also UCC § 2-601. Buyer's Rights on Improper Delivery.

[119] Art. 195(1) in relation to Art. 193(1) Contracts Act.

[120] For the US, see *Van Clief v. Van Vechten* 29 NE 1017 (NY 1892) at 1019 ("While slight and insignificant imperfections or deviations may be overlooked, on the principle of *de minimis non curat lex*, the contract in other respects must be performed according to its terms."); *Frankel v. Foreman & Clark* 33 F2d 83 (2d Cir 1929) at 87 ("…if the goods in dispute were indistinguishable from the samples for mercantile purposes, trifling variations would not count."); *Intermeat v. American Poultry* 575 F2d 1017 (2nd Cir 1978) (where the court denied the buyer the right to reject a meat shipment marked "Tasmeats" rather than "Richardson Production" because the contract did not call for any particular marking on the cartons and because it was common knowledge in the trade that they were equivalent).

[121] *Arcos Ltd. v. Ronaasen & Son* [1933] AC 470 at 479 ("No doubt there may be microscopic deviations which business men and therefore lawyers will ignore.").

[122] *Shipton, Anderson & Co. v. Weil Bros. & Co.* 1 KB 574 (where under a contract for the sale of wheat, the sellers tendered a cargo weighing 55 lbs. more than the maximum quantity of 4950 tons and never claimed the sum payable thereof, which would have been about 4 s., the buyers could not reject the whole cargo under Section 30(2) of the Sale of Goods Act 1893, the latter allowing the buyer to reject if the seller delivered a quantity of goods larger than he contracted to sell). *Per* Lush J. at 577: "I think that the question is whether there has been a substantial departure from the contract. ... The tender of a wrong quantity …, in my opinion, must mean an excess or deficiency in quantity which is capable of influencing the mind of the buyer. … the doctrine of de minimis cannot, I think, be excluded merely because the statute refers to the tender of a smaller or larger quantity than the contract quantity as entitling a buyer to reject.". This was the case from which the judges in *Arcos Ltd. v Ronaasen & Son* derived the meaning of *de minimis* as "microscopic". See *supra* footnote 121 of this Chapter. See also *Ronaasen & Son v. Arcos Ltd.* [1932] LlLRep 163, at 169-170 ("… some microscopic variation may conceivably be permitted under the principle of *de minimis*."); *Ronaasen & Son v. Arcos Ltd.* [1932] LlLRep 1 at 5, per Scrutton LJ ("Then came an instance of what could be treated as microscopic, … "Microscopic differences the court will shut its eyes to."").

purchase price.[123] The word "substantial" in today's Contracts Act equally embraces the notion that an insignificant defect, not affecting the possibility to fully use the good or its price, is irrelevant.[124] In this sense, whether employing a bright-line rule or a vague standard, all three legal systems deny the buyer the right to terminate the contract for wholly trivial imperfections.

To limit termination under such circumstances appears optimal. Note that rejection imposes on the seller the costs of retrieving the goods, which, depending on the goods and the distance, may be considerable. The non-conformity, on the other hand, is a trifle. It is so negligible that it would not inflict costs on the buyer at all (either costs to adapt the good for use or losses at reselling it) or if it would, they would be so minute that damages would most probably be nominal.[125] Such damages do not imply any noteworthy error costs, related to their ascertaining, or risk, related to seller's solvency.[126] Both parties then would be better off if the buyer accepts the goods, possibly with damages, which would save the shipping-back costs that would otherwise reduce the contractual surplus.[127] Consequently, in such a scenario termination entails only economic waste and its constraining is optimal.

Under the Contracts Act, however, substantiality is not just a limitation to termination but a criterion that defines the very breach of defective performance. As a result, it is the seller's

---

[123] Art. 268 Act on Obligations and Contracts, promulgated State Gazette №268 of 01.01.1892, repealed State Gazette №275 of 22.11.1950. The article literally reproduces Art. 1641 of the French Civil Code.

[124] In this sense, see Decision of 03.03.1973 under c. №137/1973 of the State Arbitration Court. Consulting the French Civil Code, the 1942 Italian Civil Code and the German Civil Code, one can clearly see how Art. 193(1) Contracts Act came to be a product of the combined influence of both the French and the German legal tradition. The concept of "defect" as a non-conformity that decreases the price or the fitness of the good for its ordinary or contemplated use constitutes a direct reception of Art. 459 of the German Civil Code. In Art. 459, the requirement of the French Art. 1641 that the defect be capable of influencing the buyer's decision on making the purchase or on the purchase price appears as a straightforward statement that immaterial diminution in value or fitness is not to be taken into consideration. The Bulgarian Art. 193(1), however, omits that statement; yet, only to capture it in the word "substantially", the latter perfectly corresponding to the term *apprezzabile*, used by the 1942 Italian Civil Code. On reception by Bulgarian contract law, see *supra* the text accompanying footnotes 126-129 of Chapter I. For the State Arbitration Court as a substitute for today's commercial courts during the period of socialist development of Bulgaria, see *supra* footnote 130 of Chapter I.

[125] In *Shipton, Anderson & Co. v. Weil Bros. & Co.*, for example, the excess quantity of wheat was valued at about 4 s.

[126] John Honnold, 'Buyer's Right of Rejection: A Study in the Impact of Codification upon a Commercial Problem' (1949) 97 University of Pennsylvania Law Review 457, 469.

[127] For a detailed and very enlightening analysis of the costs imposed by termination and acceptance together with damages in relation to a defective tender, see [127] For a detailed and very enlightening analysis of the costs imposed by termination and acceptance together with damages in relation to a defective tender, see Priest, 'Breach and Remedy for the Tender of Nonconforming Goods under the Uniform Commercial Code: An Economic Approach', 963-968. For a similar analysis, though with an emphasis on buyer's adaptation costs, see , 963-968. For a similar analysis, though with an emphasis on buyer's adaptation costs, see Schwartz, 'Cure and Revocation for Quality Defects: The Utility of Bargains', 547-551.

liability in general, and not only the buyer's right to reject, which arises if the defect "substantially" impairs the buyer's interest, be it the interest in the use of the good or in its price.[128] This already makes the substantiality qualification in Bulgarian contract law different from the *de minimis* exception, used to constrain only the termination remedy. The reason for this difference can be found in the dissimilar conception for breach in the common law and the civil law tradition.[129] While, as typical for the common law tradition, US and English contract law adopt a unitary concept of breach, Bulgarian contract law, belonging to the civil law tradition, distinguishes different forms of breach and determines remedies with respect to each of these forms. Consequently, in case of a substantial defect, the buyer can resort either to termination, or to damages within the contract, but in case of insubstantial deviation, she has recourse to neither of them. As the buyer is left without any remedy at all, not even compensation, one may logically conclude, that an insubstantial defect can mean nothing but a defect, which is a trifle, and even then the limitation would go further than the *de minimis* exception to the perfect tender rule.

If Bulgarian courts were interpreting insubstantial defects to be only such that did not affect the fitness or the price of the good, denying seller's liability altogether might not be much of a problem since, as mentioned, in such cases the buyer's damages would be nominal anyway. Yet, although using the substantiality requirement with self-restraint and without generally permitting sellers to deliver goods of lower grade,[130] sometimes courts characterise the defect as "insubstantial" when the deviation, even if minor, does exist and decreases buyer's value from performance.[131] Normally these are cases in which the buyer knew of the defects at the

---

[128] Art. 193(1) in relation to Art. 195(1) Contracts Act.

[129] See *supra* footnote 104 and the text accompanying it as well as footnote 110 of Chapter III.

[130] Decision №881 of 21.05.2009, c. c. № 296/2009 of District Court - Plovdiv, 8 c. p. (where a part of the delivered wheat was not fit for bread-producing at all, the buyer was entitled to return it to the seller); Decision №1910 of 23.11.2001, c. c. №538/2001 of the Supreme court, V c. d. (where the maize delivered was of lower grade, the buyer was entitled to return it but her right was precluded since she did not notify the seller immediately of the defect). See also in this sense Hristo Kostov, 'Some Basic Questions Related to the Receipt of Defective Output in Contracts for Supply of Goods' [1959] Socialist Law 36; Goleminov, *Civil Liability for Defective Goods* 48, 58-59.

[131] Decision №3032 of 15.12.1973, c. c. №1437/1973, I c. d. of the Supreme Court (where it was proven that at the time of purchase the car did not have most of the defects claimed by the buyer and that the defects it had concerned only two car components, which could be substituted for less than 1% of the car price, these defects were considered insubstantial and the buyer's claim for termination or replacement denied); Decision №540 of 14.06.1985, c. c. №123/1985 of the Supreme Court, II c. d. (where the buyer had lived in the lodging for three years and obviously knew of its defects, but nevertheless purchased it without, as required by law, notifying the seller of them, the court denied the buyer's claim for the sum necessary to correct the defects, all the more that, the court stated, the defects did not affect the lodging's fitness for habitation and, having a value of 6.75% of the purchase price, did not lessen the lodging's value substantially); Decision №1324 of 17.12.1985, c. c.

time of contracting or in which the court suspects the buyer of wanting to return the good simply because her preferences have changed, but they open room for sellers to escape liability in general and, thus, bear the danger of significantly undermining the seller's incentive to meet his obligation as to quality. It is one thing if the buyer may remain undercompensated or may not go to court or may have difficulty collecting the compensation awarded, and it is another thing if she may be left without any course of action, at all. Indeed, it would save *ex post* costs if parties resolved petty troubles through negotiation, without bothering courts, but where sellers see a rising possibility to underperform without even having to pay damages, this may have a particularly demoralising effect on their motivation to perform conformingly. Note that under such conditions even out-of-court renegotiation could be rendered meaningless, so it is also not so unlikely that the gains from economising litigation costs be offset by the losses from systematic non-conforming performance which, however, is only narrowly below the required quality and is consequently characterised, in the spirit of previous court decisions, as "insubstantially" defective. In this sense, conditioning not only termination but also the remedy of damages on the presence of a substantial defect is not unproblematic.

It would be wrong to say that the disproportionality of giving the buyer all or nothing was not felt within the system of Bulgarian contract law. Indeed, in one 1970 case the Supreme Court stated that the buyer could ask for reduction of the price irrespectively of whether the defects were substantial or not and that the substantiality consideration was important only with

---

№608/1985 of the Supreme Court, I c. d. (where the buyer had lived in the lodging for six months and obviously knew of its defects at the time of purchase, the court denied the buyer's claim for the sum necessary to correct the defects, all the more that, the court stated, the defects did not affect the lodging's fitness for habitation and, being repairable for a sum equal to 1.53% of the purchase price, did not lessen the lodging's value substantially); Decision №4454 of 27.06.2011, app. c. c. №2069/2011 of Sofia City Court (a 4-mm tear of the lining of the cover of an expensive handbag did not give rise to seller's liability for defective performance at all because it was not considered a defect that substantially decreased the price or the fitness of the bag for use); Decision of 10.08.2011, c. c. №31689/2009 of Sofia Regional Court (where the buyer wanted to return a TV set on account of an irreparable defect more than two years after the purchase, the court said that the defect was insubstantial because even if it had existed at the time of contracting, the fact that it had not been noticed for more than two years showed that it did not decrease the fitness of the TV set for use); Decision №121 of 18.07.2012, comm. c. №67/2012 of District Court – Pazardjik (where the tomato paste delivered had all quality certificates and was conforming to all food safety requirements, but around 40 of the thousands of cans delivered had a bad commercial guise and the seller had already handled the breach as provided in the contract – by replacing the cans or by reducing the price accordingly, this was not a substantial defect, justifying buyer's rejection of the entire delivery or her alternative demand for 75% price reduction).

respect to the claim for termination.[132] But this decision remains a rare example in the context of a statutory language in the opposite sense as well as a whole line of court decisions that rely on the substantiality requirement to determine that the breach of defective performance did not occur at all, thus tacitly leaving promisees without any protection for defects, considered to be insubstantial. From this perspective, instead of using the significance of the non-conformity to delineate a particular form of breach, which entitles to certain remedies, the better approach appears to be adoption of a unified concept of breach, upon the occurrence of which damages are always available, but the right to terminate is limited where deviations are only trivial.

<u>Absolute termination right in England v. flexible termination right in Bulgaria</u>

Although all three legal systems appear to preclude the buyer from ending the contract in case of a trifling defect, the dissimilar legal technique by which they choose to provide for a broad termination right in sale-of-goods contracts – a clear-cut rule (England and US) and a vague standard (Bulgaria), makes a difference with respect to the risk of buyer's opportunism. Indeed, as said in Section A. of this chapter, in the absence of the promisor's specific investment, strategic behaviour by the buyer is much less likely than in construction contracts.[133] Renegotiation also appears feasible since information asymmetries are smaller and any significant exaggeration of administrative costs by the buyer may easily instigate seller's suspicion and raise renegotiation costs high enough to offset any strategic gains from the overstatement.[134] Still, even in executory contracts it is enough that a change of circumstances occurs, which makes the buyer regret the contract, so that opportunistic incentives arise. Needless to say, the longer the time period between performance and signing,

---

[132] Decision №2579 of 1970, c. c. №1842/1970 of the Supreme Court, I c. d. *Cf.* with Decision №540 of 14.06.1985, c. c. №123/1985 of the Supreme Court, II c. d. and Decision №1324 of 17.12.1985, c. c. №608/1985 of the Supreme Court, I c. d. (see *supra* footnote 131 of this Chapter).

[133] See *supra* the text accompanying footnote 89 of this Chapter.

[134] If the buyer accepts the defective goods, she would have to either repair them (adaptation costs), or resell them (administrative resale costs) and cover (administrative costs of effectuating the cover as well as costs equal to the difference between the cover and the resale price). In a competitive market the seller can approximate the cost of repair and the difference between the cover and resale price. What he does not know is buyer's administrative costs, so it is these costs that the buyer can exaggerate to extort a higher price reduction. In fact, to the extent the seller knows whether the buyer is a merchant or consumer and the nature of the buyer's business, he can also make an educated guess about the buyer's resale costs. Yet, he cannot know the buyer's search (administrative) costs in relation to cover as they depend greatly on the value the buyer assigns to her own time. In a similar sense, see Schwartz, 'Cure and Revocation for Quality Defects: The Utility of Bargains' 557-558. See also *supra* the text accompanying footnote 91-93 of this Chapter.

the higher the chance that some undesired contingency transforms the transaction into a less profitable one. Generally in such a situation, the buyer prefers to escape the bad bargain, so she tends to use any slight defect of the good to reject although her real motive is by no means related to the alleged imperfection. She may also prove to be particularly creative about the alleged of defects, even inventing them, or inflate the significance of real discrepancies even if they are only minor deviations from contractual details that were initially not important to her. From this perspective, a right to reject for *any* breach, as entailed by the perfect tender rule, only encourages the buyer to exploit slight non-conformities in order to evade the contract.

The issue of buyer's potential opportunism is particularly acute in the volatile markets of commodities where the buyer can easily find herself in a losing contract because of an unfavourable price fluctuation in between the time of signing and the time of performance. In principle, the very purpose of a contract for future delivery at a fixed price is to allow the buyer to avoid the risk of price increase, in exchange for which she assumes the risk of price decline. In a falling market, however, the buyer is eager to terminate forcing the seller to bear not only the loss from the reversed contract but also the loss from the price swing. She, on the other hand, gains from the contract more than if it was performed or, equivalently, if she was compensated for the alleged defects of the goods.[135] Permitting the buyer to take advantage of her termination rights and to upset the initial allocation of risks for such strategic reasons reduces the joint value not only of the respective contract, but also of similar contracts in the future.[136]

In this respect, English law reveals perfectly how an inflexible approach to termination incentivises the buyer to behave opportunistically. Once the 1893 Sale of Goods Act labelled the implied terms regarding conformity of the goods as conditions, it gave them the status of essential obligations which gave rise to the buyer's termination right regardless of the magnitude of the breach.[137] This naturally provided certainty as parties were clear about their rights, but it also encouraged courts to apply the law rather rigidly and permit cancellation of

[135] Once she has rejected, the buyer may purchase goods at the current lower price and fulfil her obligations in any resale contract, already made, or use the goods in her manufacturing process, thus gaining a windfall from the larger price difference between the sale and resale transaction or from the lower production cost.
[136] In this sense, see also Priest, 'Breach and Remedy for the Tender of Nonconforming Goods under the Uniform Commercial Code: An Economic Approach' 966-968.
[137] See *supra* the text accompanying footnotes 46-47, 50 in Section A.1. of this Chapter.

the contract irrespectively of the consequences of the deviation.[138] The stringency of such a position was particularly evident in the context of sale of goods by description, where the implied term as to conformity, unlike that requiring merchantable/satisfactory quality,[139] was itself devoid of any elasticity.[140] The courts adopted so stern a view regarding the seller's obligation that even the *de minimis* exception seemed to make no difference in case of deviation from the contractual description.[141] If the seller had not performed to the letter, English courts allowed the buyer to terminate even if she wanted to do it for an ulterior motive.

Two cases are particularly representative of the problem. In *Arcos v. Ronaasen*[142] the buyers had contracted for timber of a thickness of half an inch, but were delivered staves, most of which were 9/16 of an inch thick. The court held the buyers were entitled to terminate as the goods were not conforming to the description. There was no elasticity built into the specification as to thickness, the reasoning went, and unless the parties stipulated for a margin, the condition had to be strictly complied with.[143] The buyers had the right to receive goods that answered perfectly the description, not just something that was "commercially within and merchantable under the contract specification".[144] Neither did it matter that the

---

[138] In this sense, see also Michael Bridge, *The Sale of Goods* (First edn, Oxford: Clanderon Press 1997) 151.

[139] In response to the transformation of the standard from one applicable only between merchants into one that also ensures acceptable quality to consumers, the Sale of Goods Act 1979 substituted "merchantable quality", used in the Sale of Goods Act 1893, with "satisfactory quality". *Cf.* Sale of Goods Act 1979 Section 14(2), 14(2A) and 14(2B) with of Goods Act 1893 Section 14(2).

[140] In this sense, see also Reynolds, 'Chapter 10. Classification of Statements as to Goods' 523. In *Cehave N.V. v. Bremer Handelsgesellschaft M.B.H. (The Hansa Nord)* [1976] QB 44, for example, the cargo was not damaged in a minor way, but the various factors comprising the merchantable quality standard provided the judges with some leeway to escape the effect, prescribed by the statutory classification of the merchantability requirement. On this aspect of the case, see *infra* the text accompanying footnotes 178-184 of this Chapter.

[141] *Arcos Ltd. v. Ronaasen & Son* at 479-480, referring to the sections as numbered under the 1983 Sale of Goods Act ("… it is necessary to remember that description and quantity are not necessarily the same: and that the legal rights in respect of them are regulated by different sections of the code, description by s. 13, quantity by s. 30. It will be found that most of the cases that admit any deviation from the contract are cases where there has been an excess or deficiency in quantity which the Court has considered negligible. But apart from this consideration the right view is that the conditions of the contract must be strictly performed. If a condition is not performed the buyer has a right to reject."). Recall that *Shipton, Anderson & Co. v. Weil Bros. & Co.* where the *de minimis* rule was applied concerned deviation in quantity. See *supra* footnote 122 of this Chapter and the text accompanying it.

[142] [1933] AC 470.

[143] *Arcos Ltd. v. Ronaasen & Son* at 479. The case was distinguished from *Vigers Brothers v. Sanderson Brothers* [1901] 1 QB 608 where the purchased laths were stipulated to be of "about the specification stated below". The magic word "about" allowed "some departure from the strict figures of the specifications". Ibid at 611. Yet, no such word appeared in the contract in *Arcos Ltd. v. Ronaasen & Son*. Ibid at 474-475. *Per* Lord Atkin at 479: "A ton does not mean about a ton, or a yard about a yard."

[144] *Arcos Ltd. v. Ronaasen & Son* at 473. See also ibid at 474 ("it was those goods, and not their commercial equivalent, that the buyers were entitled to demand. … If the article they have purchased is not in fact the article

discrepancy did not in any way prejudice the fitness of the timber for the manufacture of cement barrels, the particular purpose for which the staves were purchased and of which the sellers had been informed.[145] Similarly in *Re Moore and Landauer*[146] the buyers were permitted to reject a consignment of Australian tinned peaches and other canned fruits because the contract required them to be packed in cases containing 30 cans each, while part of the cases tendered contained only 24 tins. The non-compliance with the description of the goods, the packing being part of it, might, the court said, cause the buyers considerable difficulty if they had resold under the same description. Yet, it was not established whether this was actually the case[147] or whether the packing requirement was of any importance in the trade.[148] It was also irrelevant that there was nothing wrong with the fruits or with the tins and that their market value was not in any way affected.[149] In other words, although in both cases the non-conformities caused little, if any, hardship to the buyers, the courts did not preclude termination. The judges were conjecturing that it was the falling market that triggered the disputes and that the buyers were in fact searching for an excuse to throw the risk of price decline back on the sellers.[150] Nevertheless, the law said that the buyers were entitled to terminate and the courts enforced it, thus permitting them to exercise their rights strategically and stimulating them to also do it in the future.

By contrast, if *Arcos v. Ronaasen*[151] and *Re Moore and Landauer*[152] had been resolved under Bulgarian contract law, the requirement for a substantial defect would have most probably brought exactly the opposite outcome. Recall that in order for the seller to be liable for defective performance, the non-conformity must substantially decrease the price or the fitness

---

that has been delivered, they are entitled to reject it, even though it is the commercial equivalent of that which they have bought."). There was evidence that the excessive thickness of the staves was partly caused by their 9-month exposure to weather, for which the buyers were also responsible as they examined the timber only after they had not succeeded to reject it on another ground in previous arbitration proceedings. In other words, at the time of shipment the staves' thickness was closer to half an inch. Ibid 478-479.

[145] Ibid at 480.

[146] *Re Moore and Landauer* [1921] 2 KB 519.

[147] Ibid 525.

[148] Ibid 523.

[149] Ibid 524.

[150] *Arcos Ltd. v. Ronaasen & Son* at 480 ("No doubt, in business, men often find it unnecessary or inexpedient to insist on their strict legal rights. In a normal market if they get something substantially like the specified goods they may take them with or without grumbling and a claim for an allowance. But in a falling market I find that buyers are often as eager to insist on their legal rights…").

[151] [1933] AC 470.

[152] [1921] 2 KB 519.

of the good for its ordinary or contemplated use.[153] In *Arcos v. Ronaasen*, however, the discrepancy in thickness made the staves no less fit for manufacturing cement barrels and no less valuable.[154] Similarly in *Re Moore and Landauer*, neither the fitness, nor the market value of the tinned peaches was in any way impaired. Where the deviation related only to the transportation packing (the number of cans in the cases) and by no means resulted in damage of the goods (goods, meaning the peaches and the tins in which they were canned), the seller performed his obligation as to quality.[155] If the seller's breach as to the packing of the goods had caused the buyer some other harm, unrelated to the quality of the goods, *e.g.*, as in the hypothesis of the court, it had given rise to the buyer's liability under a resale contract, the buyer would have had the remedies under general contract law. This means she would have been allowed to terminate only if the seller's breach was material to her interest,[156] which on the facts of the case seems fairly unlikely. Rather, under general contract law, the buyer, unless she claimed specific performance, would have been entitled to expectation damages and these in case of liability under a resale contract would have been, subject to foreseeability, damages for lost profits. Or to put it briefly, in both cases the court would have very likely found there was no substantial defect and would not have permitted the buyers to end the agreement. This also means that it would have refused to award damages for defective performance and would have granted compensation only if such could be substantiated under general contract law.[157] Yet, this does not change the cooling effect that the requirement for a

[153] See *supra* the text accompanying footnote 119 of this Chapter. Unlike the Sale of Goods Act and the UCC, which were drafted with the goal of remaining faithful to the technical distinctions, made by judges, the Bulgarian Contracts Act, drafted in the context of the civil law tradition, did not adopt a detailed catalogue of implied warranties (in the language of the English Sale of Goods Act "conditions"), but a unitary and flexible concept of defect. Thus, in disputes in which, according to English and American courts, the issue is one of conformity with description, Bulgarian courts would still apply the same test of substantial decrease in price or fitness for use to decide on a seller's liability for defective performance. For the US, see in the former Uniform Sales Act (1906) Section 12 on express warranties by affirmation and promise, Section 14 on the implied warranty of description and Section 15 on the implied warranty of merchantability. In the current UCC, see § 2-313. Express Warranties by Affirmation, Promise, Description, Sample.; § 2-314. Implied Warranty: Merchantability; Usage of Trade.; § 2-315. Implied Warranty: Fitness for Particular Purpose. For England, see Sale of Goods Act 1979 Section 13(1A) Sale by Description. (Section 13 in the Sale of Goods Act 1893), Section 14(6) Implied terms about quality or fitness. (Section 14(1) and (2) in the Sale of Goods Act 1893) and Section 15(3) Sale by sample. (Section 15 in the Sale of Goods Act 1893). For Bulgaria, see Art. 193(1) Contracts Act.

[154] *Ronaasen & Son v. Arcos Ltd.* at 170.

[155] Regulation 4/1980 of the General Assembly of the State Arbitration Court; Goleminov, *Civil Liability for Defective Goods* 59; Kostov, 37.

[156] Recall that under general contract law termination is a remedy of last resort. See Art. 87(4) and (1) Contracts Act as well as *supra* footnotes 19-21 and the text accompanying them in Section A. of Chapter III.

[157] See *supra* the text accompanying footnotes 128-129 of this Chapter.

substantial (and not just *any*) non-conformity has on the buyer's incentive to reverse the risk allocation of price changes, contemplated by the contract.

England. On the path to flexibility

It would be wrong, though, to leave the impression that *Arcos v. Ronaasen*[158] and *Re Moore and Landauer*[159] describe completely the current state of English law with respect to termination in sale-of-goods contracts. On the contrary, the risk of buyer's opportunism has led English courts to develop a new doctrine, which limits the right to terminate to cases in which the non-conformity causes substantial harm to the buyer and, thus, precludes her from ending the contract for her own selfish reasons. Since the buyer's right to terminate depended entirely on the classification of the breached term as condition, the courts shrank the number of contractual undertakings which could be categorised as such by introducing a new class of terms that did not fit the sharp condition/warranty dichotomy of the Sale of Goods Act.

The seeds of change were, indeed, planted in a service case, a time charter, but the dispute once again painfully revealed how in the context of market decline a rigid judicial attitude toward breach of the Seller's quality obligation does not produce an efficient result. Where in *Hongkong Fir Shipping v. Kawasaki Kisen Kaisha*[160] during the first four months of the 24-month charterparty, the ship could be at sea only for approximately half of the time and was then detained for some more months for further substantial repairs, the shipowner was in breach of his obligation to provide a seaworthy vessel. Yet, the fact that the charterer's true motive for insisting on termination was the "catastrophic fall in the freight market" was fairly transparent and this undoubtedly influenced the court.[161] By escaping the contract, the charterer was going to shift the market risk, lying in principle on her, on the shipowner and cause him great losses. At the same time despite the delays and the repairs, the ship was still available for the remaining 17 (out of 24) months under the charterparty, so the charter's purpose for entering the contract was not really frustrated.[162] It could even be argued that the charterer benefited rather than lost from the default as while the ship was being off hire on

[158] [1933] AC 470.
[159] [1921] 2 KB 519.
[160] *Hongkong Fir Shipping v. Kawasaki Kisen Kaisha* [1962] 2 QB 26.
[161] Ibid 39 ("I appreciate also that there was a catastrophic fall in the freight market between February and June, 1957, and that it would only be natural in these circumstances for the charterers to wish to escape from the charterparty if they lawfully may.").
[162] Ibid 40, 65.

account of unseaworthiness, she was released from paying the high rate of hire, set by the agreement.[163] Under these circumstances, the court denied that the obligation to provide a seaworthy vessel was a condition, a breach of which permitted the charterer at once to terminate and attributed it to a third, large category of intermediate terms, one breach of which might give rise to a termination right and another breach of which might give rise only to a right to damages.[164] The obligation, the court reasoned, could be broken by the presence of trivial, easily remediable defects, such as a missing nail from one of the timbers, as well as by defects that inevitably resulted in a complete loss of the ship.[165] The legal consequences of the breach of such a complex undertaking, then, depended on the gravity of the default and its impact. It was only when the breach of the intermediate term deprived the promisee of substantially the whole benefit of the contract that she could terminate and thus bring the same effect as that ascribed to a breach of condition.[166]

Any doubts that the more flexible approach in *Hongkong Fir* was applicable to contracts for sale of goods were eradicated in *Cehave N.V. v. Bremer Handelsgesellschaft M.B.H. (The Hansa Nord)*.[167] Had it not been for the arrogant behaviour of the buyers, the case, who knows, might well have gone the other way, but the court seemed scandalised by the blatantly opportunistic scheme fabricated in the context of the falling market.[168] Shortly after the buyer had rejected the whole shipment of citrus pulp pellets because part of it had been overheated, she repurchased the cargo through an intermediary at the distress sale for a price, far below its then market value even as damaged.[169] She then used all of the pellets, only in smaller percentages, as initially contemplated – for compounding cattle food. In other words, the buyer not only threw the risk from the steeply falling market back on the seller, but she also made substantial profit from the judicial sale and, in the end, by her own conduct, showed that

---

[163] In this sense, see also Peel 871, footnote 196.
[164] *Hongkong Fir Shipping v. Kawasaki Kisen Kaisha* at 71.
[165] Ibid 62, 71.
[166] Ibid 70-71.
[167] [1976] QB 44.
[168] Ibid. at 55-56 ("Now comes an astonishing sequence of events. … So the ubiquitous Mr. Baas had helped them greatly. … That is a devastating comment [of a comment made in the award of the board of appeals of the London Cattle Food Trade Association]. The buyers must have known the truth. But they did not tell it to the board of appeal. At any rate, not the whole truth.").
[169] The contract price was £100,000. At the time of delivery the market price for sound goods had already fallen to £86,000. A price allowance for the damaged goods was quantified in the region of £20,000. The intermediary, however, purchased the goods from the agents of the court for £33,720 and on the same day resold them to the buyer at the same price. In other words, ultimately the buyer had the citrus pulp pellets for about 30% of the contract price. *Cehave N.V. v. Bremer Handelsgesellschaft M.B.H. (The Hansa Nord)* at 55-56, 65, 68, 78.

had the strategic opportunity for extra benefit not been there, she would not have rejected but would have been satisfied with damages.

In court the buyer contended that the seller broke the express contractual requirement as to shipment "in good condition", any breach of which entitled her to terminate. Assisted by the absence of case-law labelling any similar clause as a condition[170] and relying on *Hongkong Fir*,[171] the judges, however, unanimously concluded that this contractual term was an intermediate stipulation which gave rise to the right to reject only if the breach "went to the root of the contract".[172] All arguments that *Hongkong Fir* did not apply as the wording of the Sale of Goods Act made the condition/warranty classification comprehensive[173] were rejected on the ground of Section 61(2) of the Act,[174] which allowed the rules of the common law, including the law merchant, that were not inconsistent with the express provisions of the Act, to still apply to sale-of-goods contracts.[175] In addition, a clause in the form contract providing for price allowance in case of certain percentages of contamination (but mentioning nothing of overheating)[176] was, according to the court, indicative as to the intention of the parties to qualify the buyer's right to reject only in cases of serious and substantial damage. And since the whole cargo was ultimately used for its intended purpose as animal feed, the breach of the intermediate term as to quality could not be deemed to go to the root of the contract; hence, the buyer was not entitled to reject but only to damages.[177] Thus, extending the *Hongkong Fir* approach to sale-of-goods contracts, the court took a major step toward mitigating the split between sales law and general contract law with respect to termination.

It is also necessary to point briefly at another aspect in which *Hansa Nord*[178] is important: the fairly inventive approach used by the court in order to find for the seller on the point of merchantability. In reality, the cargo was significantly damaged: the evidence suggested it lost

---

[170] Ibid at 61, 70.
[171] [1962] 2 QB 26.
[172] Or put differently "deprived [the buyers] of the whole of the benefit of the contract" or "destroyed the consideration which the buyers gave". See *Cehave N.V. v. Bremer Handelsgesellschaft M.B.H. (The Hansa Nord)* at 73. *Cf.* with *Hongkong Fir Shipping v. Kawasaki Kisen Kaisha*: see *supra* the text accompanying footnote 166 of this Chapter.
[173] Sale of Goods Act 1893 Section 11(1)(b), presently Sale of Goods Act 1979 Section 11 When condition to be treated as warranty. (3).
[174] Sale of Goods Act 1893 Section 61(2), presently Sale of Goods Act 1979 Section 62(2) Savings: rules of law etc.
[175] *Cehave N.V. v. Bremer Handelsgesellschaft M.B.H. (The Hansa Nord)* at 60, 68-73, 82-83.
[176] Clause 5 of the then used Form 100 of the Cattle Food Trade Association, now GAFTA №100.
[177] *Cehave N.V. v. Bremer Handelsgesellschaft M.B.H. (The Hansa Nord)* at 60, 73, 83.
[178] [1976] QB 44.

approximately 20% of its contract price and a reasonable seller would have hardly resold it without a "with all faults" or similar label.[179] The defect not being trivial at all, it appeared the court should decide the overheating rendered the goods unmerchantable.[180] Yet, the judges wanted to prevent the buyer's windfall and pointing that the citrus pulp pellets were reasonably usable and ultimately used for their common purpose, they held there was no breach of the implied condition of merchantable quality.[181] Lord Denning went as far as to say that the test should be whether a commercial man, having regard to all relevant circumstances, including a clause giving the buyer a price allowance for some deficiencies, would have thought the buyer should be able to reject.[182] Surely, there is value in this approach since it introduces context as a pertinent consideration when determining merchantable quality. But such an interpretation of the implied term in practice supplemented the standard form contract, which, recall, said nothing about overheating. Moreover, because of the status of the merchantability term as condition, in order to bar rejection, the court was forced to find that there was no breach, and consequently deny the buyer any remedy on this ground. In the particular case this was not so troublesome as she was awarded damages for breach of the shipment-in-good-condition clause. But the court created a precedent which binds lower courts and, therefore, opened the possibility that future buyers, having no such express clause in the contract, remain without remedy at all.[183] In this sense, such an escape from the consequences of the rigid classification by means of interpretation hides the danger of watering down the seller's incentive to perform conformingly.[184]

To find a Bulgarian court case with the peculiar factual situation of *Hansa Nord*[185] in order to make a perfect comparison is unfortunately impossible. Yet, it is highly unlikely that a Bulgarian court would permit the buyer to terminate where she rejected the goods but afterwards repurchased them and used them for their initial purpose in her manufacturing process. Firstly, where the dispute centres on whether the goods suffered from any deficiencies at the time of tender, Bulgarian courts are less inclined to find they were

---

[179] *Cehave N.V. v. Bremer Handelsgesellschaft M.B.H. (The Hansa Nord)* at 68. *Cf.* with *Jones v. Just* (1867-68) LR 3 QB 197 where the Manilla hemp lost 25% of their market value and was held unmerchantable. It was sold by auction as "Manilla hemp, with all faults". See ibid at 200.
[180] For such an assessment, see also Bridge 300.
[181] *Cehave N.V. v. Bremer Handelsgesellschaft M.B.H. (The Hansa Nord)* at 63, 79.
[182] Ibid at 63.
[183] In this sense, see also Bridge 300-301.
[184] For a similar danger created by the Bulgarian courts' interpretation of the requirement that the defect be substantial, see *supra* the text accompanying footnotes 128-132 of this Chapter.
[185] [1976] QB 44.

"substantially" defective and allow termination if the buyer after all used (some of) them in production.[186] Now, the goods in *Hansa Nord* were not insignificantly damaged and one cannot contend with certainty that a Bulgarian court would have found that the overheating was not a substantial defect. But, still, the point is that courts tend to interpret the fact of the processing of the goods as a proxy of opportunism of the buyer and to bar termination. In this sense, one could expect that in a case like *Hansa Nord* where the buyer, too, eventually used the goods, courts would not remain indifferent to her strategic behaviour. Secondly, in case the buyer has processed the defective goods, the Contracts Act straightforwardly restricts her rights to price adjustment (and other damages).[187] Indeed, this provision has been applied only to scenarios in which the buyer seeks to terminate after she accepted and processed the goods (and not to such in which she first terminates but then acquires the goods and uses them) as in such case their return to the seller, if possible at all, is likely to entail significant costs of unembedding, unfixing or uninstalling[188] while the goods themselves would have lost a substantial portion of their value. Yet, this statutory provision also reflects the increased risk of strategic termination by the buyer once she has accepted the goods.[189] From this perspective, it is sensitive to opportunism and despite that the circumstances of *Hansa Nord* are not exactly the factual scenario to which it is applied, a more resourceful court, faced with such a case, could use it as an argument against permitting the buyer's strategic termination. Thirdly, where, as in *Hansa Nord*, the buyer's rejection was part of an entire plan meant to enable her to acquire the goods at below the market price and make an extra profit, the buyer clearly violated her duty to perform her contractual obligations in good faith.[190] In this sense, a Bulgarian court, which takes the view that the substantiality requirement is not the proper

[186] Decision №136 of 08.04.2014, c. c. №1063/2013 of Regional Court-Dimitrovgrad (where the buyer sought to terminate long after acceptance of the goods and it was difficult to establish whether the goods were really defective at the time of tender, the court did not limit itself to rejecting the buyer's claim on the ground that it was filed after expiry of the statute of limitations, but also pointed that where the buyer had used the goods in her production process, she did not manage to provide undisputable evidence that the goods were not of the required quality).

[187] Art. 196(2) Contracts Act; Decision №4716 of 03.12.2013, c. c. №2347/2013 of Regional Court-Plovdiv (where the buyer had already planted the diseased plants, she could ask only for price reduction).

[188] On the magnitude and relevance of such costs, see also Wagner 156.

[189] Once the buyer has accepted the goods, she has them for a longer period of time than if she rejects them immediately upon tender. During this time the risk that she wants to terminate because of a regret contingency other than the defect (change in the market or discovery that the goods are not fit for her purpose) increases. In this sense, see also Priest, 'Breach and Remedy for the Tender of Nonconforming Goods under the Uniform Commercial Code: An Economic Approach' 972. The same rationale underlies the higher standard for buyer's revocation of acceptance, established by the UCC. *Cf.* UCC § 2-608. Revocation of Acceptance in Whole or in Part. (1) with § 2-601. Buyer's Rights on Improper Delivery.

[190] Art. 63(1) Contracts Act.

legal basis to disallow buyer's termination in this case, could plainly discourage her opportunism by finding her in breach of her duty of good faith. In a case like *Hansa Nord*, the latter legal institution would, in my view, be exactly on point and a court decision grounded on it would produce the desired deterrent effect while avoiding a stretch of other legal provisions, not intended to cover such extreme situations.

In this respect, it is worth pointing out that in the law and economics literature the good faith standard, requiring policing of the mental state of a party, is usually criticised as one which is very costly to enforce. The *Hansa Nord* case,[191] however, is a good example of how assuming *a priori* that bad faith is simply impervious to accurate proof (unverifiable) is far from reality.[192] On one hand, the case reveals that in some instances it is not so difficult to recognise bad faith behaviour. On the other hand, it shows the screening devices used by courts (a falling market combined with repurchase of the same good at below the market price, arrogant behaviour, use of the good) to discern undesirable conduct. Indeed, enforcement of the good faith standard is generally more costly than enforcement of the substantiality requirement, normally used in Bulgarian law, but the costs saved from preventing bad faith, which may otherwise not be captured by the substantiality requirement, are likely to exceed the increased enforcement costs. As for comparing the good faith standard (Bulgaria) and the standard, introduced by means of the intermediate terms doctrine (England),[193] where the latter is underlain by a bad faith element and, to apply it, English courts still have to first construe the intention of the parties, the difference in terms of *ex post* costs does not appear to be significant.

Still, to sum up the main point, two different approaches to termination compete in English commercial sale-of-goods law: on one hand, an approach, represented by cases like *Arcos v.*

---

[191] [1976] QB 44.

[192] On verifiability of standards, see *supra* Section A.3. Rules and standards of Chapter IV. With respect to the good faith standard, see Goetz and Scott, 'The Mitigation Principle: Toward a General Theory of Contractual Obligation' 1007, footnote 106.

[193] English scholars disagree whether the doctrine of substantial performance and the intermediate term doctrine imply standards that are different or not. At least one English scholar flatly equates the two standards. See David Campbell, 'Arcos v Ronaasen as a Relational Contract' in David Campbell, Linda Mulcahy and Sally Wheeler (eds), *Changing Concepts of Contract: Essays in Honour of Ian Macneil* (First edn, Houndmills, Basingtoke, Hampshire: Palgrave Macmillan 2013) 152. Edwin Peel also does not hesitate to join the substantial performance standard, the intermediate term doctrine standard ("substantially deprive a party of the benefit of the contract") and the *Reardon Smith* standard (the two-tier approach narrowing the scope of the implied condition as to correspondence with description) under a common term/principle, which he calls: "the requirement of "substantial failure" in performance". In other words, he seems to think the three tests are close enough to be unified under a common concept. Treitel, *The Law of Contract* 823, 866, 881. For the *Reardon Smith* test, see *infra* Section B.2..England of this Chapter. This is also the way this thesis approaches the matter.

Ronaasen[194] and *Re Moore and Landauer*,[195] which favours termination by permitting it for every and any breach, and, on the other hand, another approach, pushed forward by *Hansa Nord*,[196] which makes termination dependent on the gravity of the breach and is, hence, much more hostile to ending the contract. The "more modern doctrine"[197] of "intermediate or innominate terms"[198] was approved by the House of Lords, with Lord Wilberforce characterising some of the early authorities, among them *Re Moore and Landauer*, as "excessively technical and due for fresh examination".[199] It was also applied in a whole line of later court decisions.[200] This does not come to say that judges are always unanimous over whether a particular term should be interpreted as innominate or as condition.[201] But where they consistently emphasise that "a court should not be over ready, unless required by statute or authority so to do, to construe a term in a contract as a "condition"",[202] it will not be exaggerated to speak of a tendency toward "leaning in favour"[203] of categorising contractual stipulations as intermediate terms.[204] From this perspective, to the extent the doctrine of intermediate terms constitutes an instrument against buyer's strategic behaviour, which English courts seem inclined to use, English sale-of-goods law has moved closer to Bulgarian

---

[194] [1933] AC 470, at 479-480 as per Lord Atkin ("If the seller wants a margin he must and in my experience does stipulate for it…. in a falling market I find that buyers are often as eager to insist on their legal rights as courts of law are ready to maintain them.").

[195] [1921] 2 KB 519.

[196] [1976] QB 44, at 71 as per Lord Roskill ("In principle contracts are made to be performed and not to be avoided according to the whims of market fluctuation and where there is a free choice between two possible constructions I think the court should tend to prefer that construction which will ensure performance and not encourage avoidance of contractual obligations.").

[197] *Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen* [1976] 1 WLR 989, at 998 (as per Lord Wilberforce).

[198] *Bunge Corp. v. Tradax Export SA* [1981] 1 WLR 711, at 714 (as per Lord Wilberforce).

[199] Surprisingly, Lord Wilberforce did not mention *Arcos Ltd. v. Ronaasen & Son*. *Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen* at 998. See also *Bunge Corp. v. Tradax Export SA* at 715-716.

[200] *Tradax Internacional SA v. Goldschmidt SA* [1977] 2 LlLRep 604 (where the provision as to impurities in a contract for sale of barley was construed to be an intermediate term and the excess of foreign matter by 0.1 percent was not a breach substantial enough to entitle rejection); *Bremer Handelgesellschaft mbH v. Vanden Avenne-Izegem PVBA* [1978] 2 LlLRep 109, at 113; *Federal Commerce & Navigation v. Molena Alpha* [1979] AC 757.

[201] *B.S.&N. Ltd. v. Micado Shipping Ltd. (Malta) (The "Seaflower")* [2001] 1 Lloyd's Rep 341 (where the lower court judge held that the guarantee given by the owners to obtain Exxon approval was an innominate term, but the Court of Appeal characterised the term as condition).

[202] See *Cehave N.V. v. Bremer Handelsgesellschaft M.B.H. (The Hansa Nord)* at 70 (as per Lord Roskill); *Bunge Corp. v. Tradax Export SA* at 715-716 (as per Lord Wilberforce) and at 727 (as per Lord Roskill). In ibid the court only moderated somewhat the doctrine of intermediate terms without rejecting it.

[203] *Tradax Internacional SA v. Goldschmidt SA* at 612.

[204] In this sense, see also Peel 884, 886-887. When it comes to contracts for the supply of services, statutory terms are also said to belong to the class of intermediate terms. Such are the implied terms, providing that services will be carried out with due care and skill within a reasonable time, to which the Supply of Goods and Services Act 1982 refers as "terms" while defining as "conditions" the implied terms in contacts for the supply of goods. *Cf*. Section 13 and Section 14 with Sections 3-5 in the Supply of Goods and Services Act 1982. See also in this sense ibid 882.

sales law, which, as shown, has *ab initio* regulatory safeguards against buyer's self-interested termination of the contract.

Furthermore, the aspiration to prevent buyer's opportunistic rejections on purely technical grounds, which triggered the explained development in common law, also motivated a modification to the Sale of Goods Act 1979, which confined the buyer's termination remedy in the cases when the breached contractual term is not classified as intermediate but as a condition.[205] The common law and the statutory limitation, however, do not overlap. On the facts of *Hongkong Fir*[206] and *Hansa Nord*,[207] the doctrine of intermediate terms drastically constrained the buyer's right to reject, permitting it only for a very serious breach.[208] In this sense, the doctrine implicitly precludes rejection for defects, which, even if more than *de minimis*,[209] are only minor. By contrast, the statutory restriction covers a narrower part of the breach spectrum, entailing precisely minor deviations. Under Section 15A,[210] when the seller's breach of the implied conditions as to description, quality and fitness, and sample[211] is so "slight" that it would be "unreasonable" for the buyer to reject, her remedy will be only in damages within the contract. Section 15A, it is argued, would give courts a means to disallow buyer's strategic termination without stretching the meaning of "merchantable" (now, "satisfactory") quality and holding that there was no breach of this implied condition at all, as the court in *Hansa Nord* was forced to do.[212] It may also affect the early excessively technical authorities such as *Arcos v. Ronaasen*.[213] In other words, although the section was said not to change the general position of English sale-of-goods law that the buyer's motive for rejection

---

[205] *Sale and Supply of Goods. Law Commission Working Paper №85. Scottish Law Commission Consultative Memorandum №58* (1983).
[206] [1962] 2 QB 26.
[207] [1976] QB 44.
[208] Reynolds, 'Chapter 12. Remedies in Respect of Defects' 600.
[209] As for the *de minimis* exception to the perfect tender rule, see *supra* footnotes 120-122 of this Chapter and the text accompanying them.
[210] Section 15A of the Sale of Goods Act 1979 was inserted by Section 4(1) of the Sale and Supply of Goods Act 1994. Section 7(1) and Sch. 2, paras 4 and 6 of the same act also introduced similar statutory restrictions as regards other contracts for the supply of goods: see Section 11A of the Supply of Goods (Implied Terms) Act 1973 and Section 5A of the Supply of Goods and Services Act 1982.
[211] Sale of Goods Act 1979 Section 13 Sale by description., 14 Implied terms about quality or fitness., and 15 Sale by sample.
[212] See *supra* the text accompanying footnotes 179-184 of this Chapter. In this sense, see also Bridge 156, footnote 56. In view of the Law Commission, if the Sale of Goods Act 1979 did not give the implied term as to quality and fitness the status of a condition, an English court, nowadays, in light of the development of the common law doctrine of intermediate terms, would not classify it in this way unless there is a clear indication that this was the intention of the parties. , *Sale and Supply of Goods. Law Commission Working Paper №85. Scottish Law Commission Consultative Memorandum №58*, para. 2.30.
[213] [1933] AC 470. In this sense, see Bridge 156; Reynolds, 'Chapter 11. Terms as to Description and Quality Implied by the Sale of Goods Act' 543, footnote 98.

is irrelevant,[214] its enactment is part of the more general trend of limitation of the buyer's absolute right to reject, which infuses English sale-of-goods law with regulatory function.

Expansion of the termination right in Bulgaria

Interestingly, after the fall of communism in Bulgaria in 1989, the opposite trend of increasing the scope of the buyer's equal choice between termination and damages within the contract can be observed in Bulgarian sale-of-goods law. The trend is not just related to the enhanced position of the right to terminate as a result of revocation of the legislation which barred putting an end to any contract, executed on the basis of the plan, even if under this contract the seller delivered goods with incurable defects.[215] It entails widening the scope of seller's liability for defective performance under sale-of-goods law at the expense of his liability under general contract law where, recall, the right to terminate is a remedy of last resort.[216]

Thus, for a long time according to the Bulgarian legal doctrine and court practice, the breach of defective performance implied a defect which reduced the fitness of the good for its purpose but did not render it absolutely unfit.[217] Such a grave non-conformity led to total breach and not simply to defective performance; consequently, the buyer had the remedies under general contract instead of under sale-of-goods law.[218] In this respect, recall, that unfitness for purpose is also the test, used to confine termination in construction contracts, in case of which, as explained, the position of the right to end the agreement is in line with the

---

[214] , *Sale and Supply of Goods. Law Commission №160* para. 4.19. It was considerations about letting elements of subjectivity into the law that motivated the Law Commission to confirm the irrelevance of the buyer's motive. Ibid footnote 23.
[215] Art. 17 and Art. 44(1) Act on Contracts between Socialist Organizations. See also *supra* the text accompanying footnotes 30-34 in Section A. of Chapter III.
[216] See *supra* the text accompanying footnotes 19-21 in Section A. of Chapter III and Ordinance №3 of 29.03.1973, c. c. № 2/1973, Plenum of the Supreme Court.
[217] Goleminov, *Civil Liability for Defective Goods* 51, 53. For the opposite view, see Kostov 36.
[218] Decision of 24.06.1971, c. №153/1971 of the State Arbitration Court (where the court expressly stated that only a completely unfit good would justify total breach); Decision of 08.12.1962, c. №540/1962 of the State Arbitration Court (where some of the roof-tiles were broken and completely unfit for use, the court decided the dispute was falling under the legal rules concerning total breach and not defective performance); Decision of 13.08.1970, c. №445/1970 of the State Arbitration Court (where part of the glass delivered was broken, the court decided this part was not delivery of defective but of completely unfit goods and applied general contract law). For the different forms of breach in Bulgarian contract law, see *supra* the text accompanying footnote 128-129 of this Chapter as well as footnotes 104 (with the accompanying text) and 110 of Chapter III.

general policy of Bulgarian contract law envisaging it as an extreme remedy.[219] Where the non-conformity triggered the seller's liability for total breach under general contract law, the buyer was entitled to terminate (since delivery of an unfit good was a breach, material with a view to her interest); yet, she was not able to end to the contract immediately but only if the seller had not cured within the additional time given.[220] Granting buyers with different remedies depending on whether the goods delivered were defective or completely unfit was, however, severely criticised by some legal scholars. They pointed out that where unfit goods could also often be put to some other use, the distinction, determining the applicable remedial regime, was based on a very uncertain criterion.[221] It appears, however, that since the 1990s courts have started to take a different view considering that in case of non-conforming goods, all forms of breach, including total breach, are encompassed by the seller's liability for defective performance.[222] Even in the event of delivery of absolutely unfit articles, judges treat them as defective, so the buyer has the right to terminate under sale-of-goods and not under general contract law.[223]

In other words, when it comes to contracts for sale of goods the trends in Bulgarian and in English contract law go in the opposite directions. Despite the deeply entrenched perfect tender rule, English courts now lean toward limiting buyer's choice between termination and damages within the contract. By contrast, Bulgarian courts currently tend to permit the buyer to make such a choice in cases in which until recently they applied the general contract rule

---

[219] See *supra* the text accompanying footnotes 70-73 in Section A.2. of this Chapter. *Cf.* with the English doctrine of intermediate terms under which the test for a discharging breach is very close to, if not equivalent with, the test under English general contract law, applicable to construction contracts.

[220] Art. 87(4) and (1) Contracts Act.

[221] For example, castor oil which was unfit for use in the transportation sector, was fit for use in the manufacturing process of another state enterprise. See Decision under a. c. №5268/1956 of the State Arbitrage of Sofia City People's Council. In this sense, see Asen Nikolov and Lilyana Panova, 'Requirements to the Liability for Defects of the Output under the Supply Contract with a View to the Arbitration Practice' (1957) 3 Legal Thought 103, 106.

[222] Decision №547 of 07.07.1993, c. c. №1622/1992, V c. d. of the Supreme Court (where the rice delivered was of bad quality, the court expressly stated that the seller's liability for defective performance covered all forms of breach, including total breach); Decision №595 of 11.06.2004, c. c. №2700/2008, V comm. d. of the Supreme Cassation Court (where the label machine could not be put into operation and was completely unfit, the court expressly denied that the seller was liable for total breach under general contract law and grounded his liability on sale-of-goods law for defective performance).

[223] Decision №585 of 29.10.1992, V c. d. of the Supreme Court (where the concentrated syrup delivered was proven to be completely unfit, the court took the view that the buyer terminated on the ground of defective performance in sale-of-goods law); Decision №1246 of 16.10.2003, V c. d. of the Supreme Cassation Court (where the ice cream machine could not be put into operation and did not start functioning even after seller's two attempts to repair it, the court classified the breach as one for defective performance); Decision №73 of 13.06.2014, app. comm. c. № 221/2014 of District Court – Shumen (where the milk delivered was completely unfit for human consumption, the court treated the breach as one of defective performance).

restricting termination. Yet, even if opposite, these trends lead to similar outcomes. Where in Bulgarian sale-of-goods law seller's liability for defective performance embraces delivery of unfit goods and in English contract law the doctrine of intermediate terms constrains the buyer's right to reject only in breaches that would deprive her of the whole of the benefit of the contract, the ultimate result in both jurisdictions is that in the event of a very serious, material breach as to quality the buyer has a free choice between ending the contract and seeking damages within its frames. In this sense, even though the English trend is directed toward restricting while the Bulgarian trend is geared toward relaxing the right to terminate, the two legal systems converge with respect to the seller's gravest breaches concerning quality. One can only think that in the process of creation of market economy in Bulgaria, courts naturally responded to the speeding up of commercial exchange and the increasing availability of substitutes, so they became more willing to liberate parties from contractual relationships. Simultaneously, making it easier for promisees to break free and seek other opportunities, courts themselves promoted further contracting and thus encouraged the very process of market creation.

Generally, the tendency of expanding seller's liability for defective performance in Bulgarian sale-of-goods law seems to have a positive effect in terms of efficiency. It increases legal certainty and reduces the level of *ex post* enforcement costs. Courts now need to decide solely whether the good is non-conforming, without in addition having to worry about the vexing question of whether the non-conformity results in defective performance or total breach. In this respect, the trend only confirms the advantages of a unified concept of breach, under which the issue of distinguishing between a defective and an absolutely unfit good does not arise, at all. What is more important for the purposes of this chapter, however, is that while expanding the scope of the buyer's equal choice between termination and damages within the contract, the tendency increases seller's incentive to perform conformingly without sacrificing the regulatory potential of the Bulgarian remedial regime, implied in the substantiality requirement. It was indeed paradoxical that by applying general contract law and requiring that the seller be given an additional chance to cure, Bulgarian courts impeded the buyer's right to terminate precisely in the cases in which the seller's breach was most serious (it did not render the good less fit but completely unfit). In fact, in cases like these it is least likely that the buyer is opportunistic, so it is better that the law focuses on enhancing the seller's motivation to perform his obligations as to quality.[224] From this perspective, the trend of granting the buyer with a free choice between termination and damages in the event of delivery of unfit goods powerfully deters sellers' evasion. Simultaneously, as the tendency by no means eliminates the requirement that the defect of the good be substantial, the latter can still be used by courts to bar buyer's termination when it is strategic.

<u>The US. On the path to flexibility</u>

In the context of this complex picture of legal developments in English and Bulgarian sale-of-goods law, the question logically arises whether US law, while giving the buyer an absolute right to reject defective goods,[225] has also cultivated mechanisms to thwart the buyer's opportunistic incentive, spurred by this right. As it was already hinted, similarly to English law, US law has also moved toward mitigating the rigid perfect tender rule.[226] Yet, since, unlike in England and Bulgaria, in the US, the legal system's responsiveness to the risk of buyer's opportunism has led to the introduction of the intermediate remedy of the right to cure, US sale-of-goods law, as well as the changes characterising it, are looked at separately.

In fact, a trend toward a more flexible approach can be identified as early as the first US codification of sales law: the Uniform Sales Act. Indeed, as a reaction to the English 1893 Sale of Goods Act, whose technicalities were considered to rob parties of legal certainty,[227] the Uniform Sales Act proclaimed the perfect tender rule in a simple, clear-cut manner. It released the right to terminate from its limitation in case of sale of "specific goods, the property in which had passed to the buyer"[228] as well as from its dependency on the judicial determination of the breached contractual term as a condition or as a warranty.[229] The buyer was given the right, at his election, to accept the defective goods and recover damages or to rescind the contract for any "breach of warranty", where "warranty" referred to all obligations

---

[224] Goetz and Scott, 'The Mitigation Principle: Toward a General Theory of Contractual Obligation', 972. See also *supra* Section A.3. of this Chapter.

[225] See *supra* the text accompanying footnote 46-49 in Section A.1. as well as footnote 118 and the text accompanying it in Section B.1. of this Chapter.

[226] See *supra* the text accompanying footnote 51 of this Chapter.

[227] For more details on the reasons which produced the statutory language of the Uniform Sales Act (1906), setting out the perfect tender rule, see Honnold, 458-460.

[228] Sale of Goods Act 1893 Section 11 When condition to be treated as warranty. (1)(c).

[229] See Sale of Goods Act 1893 Section 11(1)(b) which provided that whether a contractual stipulation was a condition or a warranty depended in each case on the judicial construction of the contract. Thus, a stipulation, even though called a condition in the contract, might be classified as a warranty.

of the seller regarding the goods.[230] Such a clear, bright-line rule, correspondingly, gave rise to uncompromising judicial statements denying "[any] room in commercial contracts for the doctrine of substantial performance".[231] Nevertheless, in the decade following the First World War, US courts were already showing some sensitivity to surprise rejections, motivated by post-war market volatility.[232]

One should not fail to notice that at approximately the same time when English courts displayed the utmost strictness in *Arcos v. Ronaasen*[233] and *Re Moore and Landauer*,[234] US courts were not so disinclined to bar termination where the deviation from the contractual description, though existing, was too minor to impair the value of seller's performance, so the buyer most likely exploited it strategically.[235] Thus, in *Schmoll Fils v. L. S. Agoos Tanning*,[236] a buyer, who purchased dry Karachi hides as ranging between 13 and 20 pounds (13/20) but discovered, after the market had changed, that they were in fact between 12 and 20 pounds, was not permitted to terminate. To be correct, the sale agreement was not an executory one, so the buyer was able to examine the goods before making the contract and in fact did (even if not with respect to weight).[237] In similar cases at the time, judges often found that the seller complied with the contract on the ground that, having inspected the good, the buyer did not rely on its description, such reliance deemed necessary, even in the absence of explicit statutory requirement as to it, in order for a description to amount to a warranty that could be breached in the first place.[238] Yet, although emphasising that the buyer had been given an

---

[230] Uniform Sales Act (1906) Section 69(1). For the different meaning of the term "warranty" under US and English law, see *supra* footnote 50 in Section A.1. of this Chapter.
[231] *Mitsubishi Goshi Kaisha v. J. Aron* 16 F2d 185 (2 Cir 1926).
[232] In this sense, see Honnold 461-462.
[233] [1933] A.C. 470.
[234] [1921] 2 KB 519.
[235] In a similar sense, see Honnold 462-463.
[236] 152 NE 630 (Mass 1926).
[237] Ibid at 632 ("'The plaintiff was given unrestricted opportunity to examine the hides before making the contract, and it did, by an expert in hides, make an examination thereof, for the purpose of discovering whether there were winter hair in the lot. …' The hides were delivered and the purchase price paid."). Consider that the warranty of description first grew precisely in contracts for future delivery where the goods were not available for inspection at the time of dickering and the buyer needed assurance that the goods would be as contracted. Karl Llewellyn, 'On Warranty of Quality, and Society' (1936) 36 Columbia Law Review 699, 740-741. For an argument that where the buyer cannot examine the goods before contracting, strict performance is vital, see *Le Roy Dyal Co. v. Allen* 161 F2d 152 (4th Cir 1947) at 154 (in an f.o.b. contract for the sale of potatoes where inspection certificates were to be furnished "on each car as shipped", the buyer claimed that the fact that the inspection certificates were dated from one to three days prior to the date of shipment was a breach that entitled her to terminate because the very rationale of this contractual stipulation was to assure her as to the condition of the goods on the day of shipment when she also had to pay the draft).
[238] *Kraig v. Benjamin* 149 Atl 687 (1930); *Hellman v. Kirschner* 191 NY Supp 202 (Sup Ct 1921) at 203. Indeed, the provision of the Uniform Sales Act concerning the implied warranty as to correspondence with description

ample opportunity to examine the hides, the court in *Schmoll Fils v. L. S. Agoos Tanning* did not limit itself to pointing out the absence of the buyer's reliance in order to sustain enforcement of the contract. On the contrary, it recognised that the 13/20 description gave rise to a warranty and went on to inquire into the seriousness of the breach, ultimately deciding that the hides were "fairly and substantially of the character and description, contemplated by the contract".[239] In this sense, by taking an approach which could very well be applied to contracts for future delivery, the court pushed the flexible treatment of the clear-cut statutory language one step further. Where, the reasoning went, the difference between 13/20 and 12/20 hides was so slight that the trade did not consider them different in terms of the practical purposes for which they could be used, the hides delivered were in fact identical with the hides contracted to be sold.[240] With evidence suggesting that the fitness of the hides for use was not in any way diminished and in the absence of any indication that the price of the hides was affected, a Bulgarian court would have decided there was no substantial defect and rejected the buyer's claim, too. Contrast, however, *Schmoll Fils v. L. S. Agoos Tanning* with *Arcos v. Ronaasen*,[241] the latter case indeed entailing an executory contract but one under which, in the context of a falling market, the seller again delivered goods with minor non-conformity that did not really prejudice the buyer. Just as the 9/16 staves in *Arcos* were

---

did not contain any express requirement for buyer's reliance. Reliance was necessary in order for seller's affirmation or promise to amount to express warranties but not, at least on the face of it, with respect to the implied warranty as to description. *Cf.* Uniform Sales Act (1906) Section 12 with Section 14. Even in the absence of explicit language, however, the reliance test was imputed in the implied warranty as to correspondence with description to avoid inconsistency with the overlapping provision on express warranties. In this sense, see Honnold 462, footnote 26.

The origin of this overlap can be found in the case-law of "express warranties" which grew from 1873 on and gave the buyer in executory contracts remedies beyond acceptance. To prevent negation of the warranty of description, the Uniform Sales Act removed it from the field of "express warranties" and made it an immutable "implied" warranty. On this case-law and on the change, effected by the Uniform Sales Act, see Karl Llewellyn, 'On Warranty of Quality, and Society: II' (1937) 37 Columbia Law Review 341, 355-368, 384-387. UCC, however, reverted to the older case-law to the extent that it reunited "description" with "affirmation" and "promise" under the category of "express" warranties. See UCC § 2-313. Express Warranties by Affirmation, Promise, Description, Sample., comment 1. Since in England acceptance has always barred rejection (see Sale of Goods Act 1893 Section 11 When condition to be treated as warranty. (1)(c), presently Sale of Goods Act 1979 Section 11(4)), once compliance with description had been shifted from the category of "express" to the category of "implied" obligations, the issue of redesignating it as "express" obligation has never arisen. On these conceptual developments in English law, see Llewellyn, 'On Warranty of Quality, and Society', 724-726 and footnote 80.

[239] *Schmoll Fils v. L. S. Agoos Tanning* 152 NE 630 (Mass 1926) at 632.

[240] Ibid at 632 ("…other tanners used indiscriminately 12/20's and 13/20's … 12/20's were just as good as 13/20's.' … the leather trade does not think there is any difference between 13/20's and 12/20's dry Karachi hides; there is no practical difference between 12/20's and 13/20's dry Karachi hides; …hides in bulk baled in India as 13/20's or as 12/20's are indiscriminately described and are for all practical purposes of the trade identical.").

[241] [1933] A.C. 470.

commercially within the half-an-inch contract specification, in *Schmoll Fils* the leather trade considered a sale of hides in bulk as 13/20's to be satisfied by delivery in bulk of 12/20's. And just as the staves in *Arcos* were still fit for making cement barrels, there was "no practical difference" between 13/20 and 12/20 hides.[242] Yet, while the English court decided there was a breach warranting buyer's termination,[243] the US court did not allow the buyer to rescind the contract and impose on the seller her losses from the falling market. In other words, in contrast to their English colleagues at the time, US judges were not unwilling to restrict the buyer's termination where the risk of her being opportunistic was high.

Another way, used by US courts to compensate for the unwelcome effect of buyer's unlimited right to terminate under the Uniform Sales Act, was the doctrine of "waiver", by which they constrained buyers only to the objections raised at the time of rejection.[244] More importantly, however, unlike English judges who viewed the motive behind the buyer's resort to termination irrelevant,[245] US judges were carefully scrutinising the evidence to identify the buyer's real reason for wanting to exit the contract when she wished to do so in the context of market decline.[246] The buyer's demands that the seller reduces the price as well as her outright

---

[242] *Schmoll Fils v. L. S. Agoos Tanning* at 632.

[243] See *supra* the text accompanying footnotes 142-145 of this Chapter. To see that the reasoning of a Bulgarian court, faced with the factual situation of *Schmoll Fils v. L. S. Agoos Tanning* and with that of *Arcos v. Ronaasen*, would have been the same, see *supra* the text accompanying footnote 151-154 of this Chapter.

[244] See *e.g. Griffin Grocery v. Richardson* 10 F2d 467 (8 Cir 1926) at 472-473. For a thorough analysis of the cases in which the waiver doctrine was invoked, see Lawrence Eno, 'Price Movement and Unstated Objections to Defective Performance of Sales Contracts' (1935) 44 Yale Law Journal 782. In his article, published in 1935, Eno was arguing that in two thirds of the cases, there had been a decline in price between the time of contracting and the time of performance, which led him to the conclusion that the doctrine was employed by courts mainly to prevent buyer's opportunism. See also Llewellyn, 'On Warranty of Quality, and Society' 707, footnote 25; Llewellyn, 'On Warranty of Quality, and Society: II' 392 as well as Honnold 463-464, both referring to Eno. For today's version of the waiver doctrine but with limitations, see UCC § 2-605. Waiver of Buyer's Objections by Failure to Particularize. *Cf.* the US waiver doctrine with the English rule that a buyer, who, having become entitled to refuse performance of his contractual obligations, gives a wrong reason for his refusal, does not deprive herself of a justification which in fact existed, whether she was aware of it or not. *Taylor v. Oakes, Roncoroni & Co.* (1922) 38 TLR 517.

[245] See *supra* the text accompanying footnotes 142-150 of this Chapter.

[246] See *e.g. Griffin Grocery v. Richardson* at 471 (where the buyer accepted two cars and rejected three cars of sorghum cane seed in the context of a declining price of the seed, the court did not hesitate to admit evidence as to the fact whether the seed in all cars was of the same quality since this, according to it, had a material bearing upon the reason for the buyer's rejection); *Colorado Milling & Elevator v. Rapides Grocery* 142 So 626 (Lou 1932) (where the court analysed in detail the testimony and the actions of the manager of the buyer company to justify its conclusion that the real reason the buyer did not comply with the contract was not the grade of the flour, but the fact that the seller did not give her the benefit of the reduction in price to which she thought she was entitled); *Consolidated Flour Mills v. Di Marco* 136 So 657 (La App 1931) at 658 (where besides pointing at the evidence which showed that the flour was not below the required quality, the court also emphasised that the shipment "was never given a fair trial by the defendant" who refused to receive it without even looking at it); *McNeff v. White Eagle Brewing Co.* 13 NE2d 493 (Ill App 1938) (where the court again analysed the buyer's

rejection of shipments without any examination were commonly interpreted as proxies for strategic conduct. When judges believed that the buyer's motivation in rejecting the goods was to escape the bargain, rather than to avoid acceptance of a tender which in some respect impairs the value of the bargain to her, the buyer generally lost.[247] In the more recent cases, tried under the UCC, this attitude culminated in judicial statements, qualifying the buyer's right to reject the goods by a requirement of good faith.[248] Recall that in Bulgarian law the duty of good faith represents an additional safety-valve against buyer's opportunism besides the substantiality requisite.[249] Still, as the good faith standard is generally difficult to enforce,[250] the dicta of a US court pointing out that objective factors, such as rejection of goods on account of a minor defect in a falling market, would in some instances be sufficient to support a finding of buyer's bad faith behaviour, does not come as a much of a surprise.[251] Such dicta immediately brings to mind Section 15A of the English 1979 Sale of Goods Act: where "the breach is so slight that it would be unreasonable" for the buyer to reject, she is limited to the remedy of damages within the contract. The section was adopted on account of the absence of a general doctrine of good faith in English law[252] and although the Law Commission stressed that the buyer's motive in seeking to reject the goods continued to be irrelevant, her right to terminate was restricted precisely because of the possibility that she uses it abusively.[253] Section 15A, however, has never given rise to such a consistent trend of impatience with rejection in a falling market as that in US case-law.[254] Having started as early

---

demand for renegotiation as well as her other statements made upon refusing to take any more hops in order to conclude that she did not live up to her contract because of the market price drop).

[247] In this sense, see also Honnold 472; Schwartz, 'Cure and Revocation for Quality Defects: The Utility of Bargains' 541, footnote 47.

[248] *Printing Center v. Supermind Publishing* 669 SW2d 779 (Tex App 1984) at 784; *Neumiller Farms v. Cornett* 368 So2d 272 (Ala 1979) at 275. The courts relied on the obligation of good faith in performance of the contract, proclaimed by UCC § 1-203. For the obligation of good faith in the current UCC, see § 1-201. General Definitions. (20) and § 2-103. Definitions and Index of Definitions. (1)(b). Recall that under US law good faith is one of the criteria justifying substantial performance. See *supra* footnote 61 and the text accompanying it in Section A.2. of this Chapter.

[249] See *supra* the text accompanying footnote 190 of this Chapter.

[250] See *supra* the text accompanying footnotes 191-193 of this Chapter.

[251] *Printing Center v. Supermind Publishing* at 784.

[252] , *Sale and Supply of Goods. Law Commission Working Paper №85. Scottish Law Commission Consultative Memorandum №58* para. 4.57; , *Sale and Supply of Goods. Law Commission №160* para. 4.18.

[253] , *Sale and Supply of Goods. Law Commission №160* para. 4.19. See also *supra* footnote 214 of this Chapter and the text accompanying it.

[254] Intended not to be "a major alteration in the law", Section 15A of the 1979 Sale of Goods Act remains of infrequent application. As to the desire of the Law Commission for only a modest reform, see ibid paras 4.17, 4.19, 4.21. As to the narrow scope of Section 15A, see Peel 888-889. I have not been able to find a single reported court decision applying the section in case of sale of commodities. For a rare occasion of its application in the event of the sale of industrial equipment, see *Fiobake Ltd v. Rondo Ltd* [2004] EWHC 695 (TCC). Neither has the section created pressures at common law directing it towards deterrence of bad faith termination for

as the 1920s, this trend slowly but surely wended its way through US courts and was expounded in *Le Roy Dyal Co. v. Allen*.[255] The decision of whether a slight breach in prior performance excused the subsequent performance by the buyer, the court stated, depended on the importance and materiality of the prior breach, that materiality, on its own turn, depending on whether it was more just to free the buyer or to require her to perform and give her the right to damages within the contract. As the court itself emphasised, this retreat from the strict rule brought "the law of sales in closer harmony with the law of contracts generally",[256] an effect which English courts attained only in the 1970s by means of *Hansa Nord*.[257]

In a way, what the draftsmen of the UCC could do to ameliorate the concern with buyer's opportunism was simply to express as a written rule the above flexible approach, adopted by US courts. In fact, this was the line, in which fell Llewellyn's proposal of replacing the perfect tender rule with a standard of "commercial performance",[258] the latter similar to substantial performance but rooted in trade custom. Yet, although the commercial performance standard was discarded as apt to cause uncertainty and promote seller's moral hazard, the severity of the perfect tender rule, eventually retained,[259] was significantly mitigated by other methods. The buyer's ability to reject strategically was contained by providing the seller with a right to cure his defective performance.[260] Thus, under UCC the buyer is still entitled to reject goods

breach of a condition. In this sense, see Michael Bridge, 'Freedom to Exercise Contractual Rights of Termination' in Louise Gullifer and Stefan Vogenauer (eds), *English and European Perspectives on Contract and Commercial Law: Essays in Honour of Hugh Beale* (Oxfrord: Hart Publishing 2014) 90; David Hay, Siobhan McKeering and Mohini Tulloch (eds), *Halsbury's Laws of England. Contempt of Court. Contract*, vol 22 (Fifth edn, London: Lexis Nexis 2012) 544.

[255] 161 F2d 152 (4th Cir 1947) at 155. To be correct, *Le Roy Dyal Co. v. Allen* was not about sale of defective goods. The deviations from the contract concerned the time of shipment and the date of the inspection certificates. Nevertheless, when one reads the court decision, it is clear that in the dicta, referred to above, the court speaks of a more general tendency that is not limited only to these particular departures from the strict terms of the contract.

[256] The court itself put it: "amelioration of the strict rule". Ibid at 155.

[257] [1976] QB 44. See *supra* the text accompanying footnotes 196-204 of this Chapter.

[258] Llewellyn, 'On Warranty of Quality, and Society: II' 378, 398, footnote 146.

[259] For a more detailed history of Llewellyn's proposal, its implementation in the 1941 draft of the Code as well as its faith, see Schwartz, 'Cure and Revocation for Quality Defects: The Utility of Bargains' 555, footnote 37 and Priest, 'Breach and Remedy for the Tender of Nonconforming Goods under the Uniform Commercial Code: An Economic Approach' 971, footnote 27. See *supra* footnote 49 and the text accompanying it in Section A.1. of this Chapter.

[260] UCC § 2-508. Cure by Seller of Improper Tender or Delivery; Replacement. There was no right to cure under the Uniform Sales Act and the principal merit of UCC lies in recognising and resolving any doubts about the existence of such liberty of merchant sellers. White and Summers 318-319; Farnsworth, *Farnsworth on Contracts* 522. For an example of courts' willingness to grant sellers with a right to make amends in case of a non-conforming tender before the adoption of UCC, see *Lowinson v. Newman* 194 NYS 253 (App Div 1922) at 269 ("… where there has been a defective tender of goods contracted to be sold and delivered, and where the position of the buyer has not been altered by reason of such faulty tender, the seller may, within the contract period, rectify his mistake and make delivery of the goods covered by the contract."). For the motivation, which

for any non-conformity, but because of the seller's right to correct the deviation in the tender, her rejection does not automatically discharge the contract.[261] The Code gives the seller an absolute right to cure within the time set for performance.[262] After the expiration of that time, the seller may still substitute a conforming tender within "a further reasonable time"; yet, on the condition that he "had reasonable grounds to believe" the original tender would be acceptable "with or without money allowance".[263] Provided the seller corrects the non-conformity, the buyer cannot rightfully terminate; she is bound to accept the goods. It is precisely this opportunity of the seller to avoid forfeiture of his contractual rights which makes cure a deterrent against buyer's opportunism. Giving the seller a second chance to perform conformingly reduces the buyer's ability to escape a contract which the fall in market prices or some other contingency has turned into a bad bargain. In this sense, the right to cure represents a seller's entitlement to prevent termination even if this is exactly the remedy the buyer prefers.[264]

Especially praised for its potential to discourage surprise rejections was the truly innovative second subsection of the Code's provision on cure, which allowed the seller to correct his performance beyond the contract period.[265] However, the flexible standard, constituting the condition under which the section afforded protection to the seller, raised considerable doubts about the true case in which Section 2-508(2) could be invoked. When can the seller be deemed to have acted with "reasonable" expectations that the original goods will be acceptable? Is he entitled to be "surprised" when in a falling market the buyer requires strict

---

led to introducing the seller's right to cure in the UCC, see *T.W. Oil, Inc. v. Consolidated Edison Co. of New York* 57 NY2d 574 (NY 1982) at 582 ("…a seller's right to cure a defective tender, as allowed by both subdivisions of section 2–508, was intended to act as a meaningful limitation on the absolutism of the old perfect tender rule, under which, no leeway being allowed for any imperfections, …"). See also White and Summers 324.

[261] UCC § 2-106., comment 2; *Ramirez v. Autosport*.

[262] UCC § 2-508. Cure by Seller of Improper Tender or Delivery; Replacement. (1).

[263] UCC § 2-508. (2).

[264] Antonia Apps, 'The Right to Cure Defective Performance' (1994) Lloyd's Maritime and Commercial Law Quarterly 525, 554-555; Mak 149, 187; Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' 136. Even if cure commonly takes place by repair or replacement, it should be distinguished from the buyer's rights to repair or replacement, being sub-forms of the remedy of specific performance, normally available in civil law systems, including the Bulgarian one. Like them, cure is also a remedy oriented toward performance of the contract, but, unlike them, it is a right of the seller and the buyer cannot compel him to exercise it. In this sense, see Mak 149, 187. See also *supra* footnote 16 and the text accompanying it in Chapter III; Apps 555; Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' 136.

[265] See Ellen Peters, 'Remedies for Breach of Contracts Relating to the Sale of Goods under the Uniform Commercial Code: A Roadmap for Article Two' (1963) 73 The Yale Law Journal 199, 210 and comment 2 to UCC § 2-508.

compliance with the terms of the contract to which he agreed? Does he have to be ignorant of the defect or may he also satisfy the section requirement of "surprise" when he was aware of the non-conformity? And how serious is the non-conformity upon which the seller can claim a legitimate "surprise"? Indeed, despite the directions given by the official comments, it took substantial work on the side of courts to settle the multitude of issues that Section 2-508(2) gave rise to. It is clear from the case-law that the seller may know of the non-conformity and still have "reasonable" causes to think that the buyer will accept the goods.[266] Moreover, the reasonability of his expectations may be derived not only from trade custom and usage of trade. In fact, goods that failed to answer the precise specifications of the contract, but conformed to custom and usage of trade were generally held to be "conforming" even before the enactment of UCC,[267] and with the latter, expressly adopting usage of trade as a method of ascertaining the meaning of the parties' agreement,[268] courts continue to be fairly attentive to commercial practices.[269] Comment 4 to Section 2-508 also explicitly states that existing trade usages permitting variations without rejection but with price allowance become part of the agreement itself as contractual limitations of termination and are thus not covered by the section. The seller's right to cure after the contract time, therefore, extends to deviations that go beyond the leeway permitted by the commercial understanding adopted in the relevant trade. The seller's "reasonable grounds" can lie in prior dealings, course of performance, even in "particular circumstances surrounding the making of the contract".[270] Thus, where in a falling market the seller tendered oil with sulphur content of 0.92%, in deviation from the contract describing the oil to be sold as 0.5%, the court held that the seller had reasonable expectations that the buyer would accept the tender and, hence, could avail himself of the right to cure beyond the contract date, because in the course of negotiations he learned that the buyer was authorised to burn oil of sulphur content of up to 1%.[271] The tender, in other words, was undoubtedly defective and yet the seller was deemed to be legitimately surprised by the buyer's rejection. The legitimacy of this surprise stemmed, however, not from the rejection

---

[266] *T.W. Oil, Inc. v. Consolidated Edison Co. of New York* (where the court held that Section 2-508. (2) could apply to cases in which the seller knowingly tendered non-conforming goods as well as to cases in which he tendered such goods in good faith and without knowledge of the defect).
[267] *Electric Reduction Co. v. Colonial Steel Co.* 276 Pa 181 (1923) (where it was held that the words “free from tin” in a contract of sale of ferro-tungsten powder had the meaning recognised by the established custom in the trade, *i.e.* that the powder was to be free from tin in a quantity sufficient to impair the quality of finished steel).
[268] UCC § 1-303. Course of Performance, Course of Dealing, and Usage of Trade. (d).
[269] *Wakerman Leather Co. v. Irvin B. Foster Sportswear Co.* 34 AD2d 594 (NY 1970) (where it was held that in view of the usage and custom of the trade the leather was merchantable).
[270] UCC § 2-508. Cure by Seller of Improper Tender or Delivery; Replacement., comment 2.
[271] *T.W. Oil, Inc. v. Consolidated Edison Co. of New York*.

per se but from the fact that the buyer was able to make use of the oil, it was offered to her with price reduction compensating for the difference in sulphur reading,[272] and she still refused to take it.[273]

From this perspective, in comparison to the devices serving as limitations to buyer's termination in the other jurisdictions, the US right to cure puts great emphasis on the communication of information between the parties. On one hand, the flow of information determines the availability of the seller's right to correct his misperformance beyond the contract date. Thus, while any signals by the buyer that she requires strict compliance are considered relevant in defining the precision of seller's obligations,[274] in the absence of such signals, the seller, presumably, has reasonable cause to believe that the goods will be acceptable even if they deviate from the letter of the contract.[275] On the other hand, precluding immediate termination, cure stimulates parties to communicate and to try to find the most cost-effective way to resolve the problem.[276] In this sense, it encourages *ex post* cooperation where the traditional view is that the most efficient legal solution should endorse conflict.[277]

Despite the fact that the emphasis seems to be on information, the reasonability of the seller's expectations (and, hence his right to cure) is not unrelated to the nature and effect of the non-conformity, these, recall, being the basis on which Bulgarian and English sale-of-goods law restrict the buyer's right to terminate. Truly the wording of Section 2-508(2) offers no hint in this direction, but neither the legal doctrine, nor case-law remained indifferent to this criterion as a method of constraining the buyer's opportunism. It has generally been maintained that while cure within the contract period is unfettered by any limitations as to the magnitude of

---

[272] Ibid at 578. It is apparent from the case that the buyer's rejection was a means of extortion. Although the buyer had the practice of mixing oils to ensure that the sulphur content was no more than 1%, she wanted to take advantage of the rapidly falling price and refused all readjustment offers: the offered price adjustment as well as the offer to cure with a substitute shipment. Instead, she tried to renegotiate the contract and insisted on paying no more than the price prevailing at the time of performance, which was 25% lower than the price at the time of contracting.

[273] For a similar argument, see Goetz and Scott, 'The Mitigation Principle: Toward a General Theory of Contractual Obligation' 998-999.

[274] UCC § 2-508. Cure by Seller of Improper Tender or Delivery; Replacement., comment 2.

[275] In a similar sense, see White and Summers 321.

[276] *T.W. Oil, Inc. v. Consolidated Edison Co. of New York* at 586 (""… the code, …, seeks to discourage unfair or hypertechnical business conduct bespeaking a dog-eat-dog rather than a live-and-let-live approach to the marketplace… Overall, the aim is to encourage parties to amicably resolve their own problems"); *Ramirez v. Autosport* ("Underlying the right to cure in both kinds of contracts is the recognition that parties should be encouraged to communicate with each other and to resolve their own problems."); Restatement (Second) of Contracts, Chapter 10. Performance and Non-Performance, Introductory Note.

[277] See *supra* Section A.3. of this Chapter.

the defect,[278] the seller's right to correct his misperformance after this period has expired concerns minor deviations, representing "sudden technicalit[ies] on the buyer's part".[279] That the Code distinguishes substantial impairments, yet only as a ground for buyer's rescission after acceptance[280] is further pointed to as an argument supporting the view that the cases falling under Section 2-508(2) are those entailing slight non-conformities that do not affect seriously the practical purposes for which the goods could be used.[281] In line with this position, courts, too, have shown unwillingness to permit sellers to cure after the time set for performance where the defect proved to be substantial.[282]

Right to cure. England and Bulgaria

Although not mentioned until now, a doctrine of cure does operate in English sale-of-goods law.[283] The old common law rule that the seller is entitled to retender conforming goods within the contract time in which case the buyer is bound to accept them has recently been confirmed by the House of Lords in *Motor Oil (Hellas) Corinth Refineries S.A. v. Shipping Corp. of India*.[284] Arguably, by stating in its Section 11(3) that breach of a condition only *may* give rise to a right to treat the contract as discharged, the Sale of Goods Act 1979, too,

---

[278] Peters 210.

[279] UCC § 2-106., comment 2. See also ibid 210, footnote 42 as well as *T.W. Oil, Inc. v. Consolidated Edison Co. of New York* at 585, both citing William Hawkland, *Sales and Bulk Sales Under the Uniform Commercial Code* (1958), 120-122 ("… the policy of the code to prevent buyers from using insubstantial remediable or price adjustable defects to free themselves from unprofitable bargains …"). For a more recent scholarly position in the same sense, see White and Summers 321.

[280] UCC § 2-608. Revocation of Acceptance in Whole or in Part.

[281] Peters 211, footnote 42; *Ramirez v. Autosport* ("Although the Code permits cancellation by rejection for minor defects, it permits revocation of acceptance only for substantial impairments.").

[282] *Cf. Wilson v. Scampoli* 228 A2d 848 (DC 1967) (where the picture produced by a colour TV set had a reddish tinge, the seller was held to have "reasonable grounds") and *Appleton State Bank v. Lee* 148 NW2d 1 (Wis 1967) (where the sewing machine sold was of different brand but not of lesser value, the seller was deemed to have "reasonable grounds") with *Zabriskie Chevrolet, Inc. v. Smith* 240 A2d 195 (NJ 1968) (where the transmission of a perfectly new car was so defective that the car was practically inoperable, the seller was not permitted to cure). See also *Ramirez v. Autosport* ("… the remedy available to a buyer who rejects goods with *insubstantial* defects that the seller fails to cure within a reasonable time. … Because a buyer may reject goods with *insubstantial* defects, he also may cancel the contract if those defects remain uncured. Otherwise, a seller's failure to cure *minor* defects would compel a buyer to accept imperfect goods...", emphasis added).

[283] The earliest authority is perhaps *Tetley v. Shand* (1871) 25 LT 658 (where the court held that by making, after rejection, a subsequent tender, within the time for performance, of another 200 bales of cotton, conforming to the description, the seller did perform the contract because he immediately remedied the mistake).

[284] (1990) 108 NR 280, as per Lord Goff at 288 ("If the time for delivery has not yet expired, the seller is still entitled to make a fresh tender which conforms with the contract, in which event the buyer is bound to accept the goods so tendered"). See also Apps 525.

recognises that, in the absence of other repudiatory conduct,[285] the seller's defective tender does not necessarily confer the right to terminate and, thus, opens room for the seller's right to cure.[286] Nevertheless, compared to its US counterpart, cure in English law remains considerably less developed, its scope defined by the legal doctrine mainly on the basis of a certain amount of case-law concerning tender of goods without proper documents and not exactly tender of defective goods.[287] The period within which the seller of unascertained goods[288] is permitted to make a fresh tender in the event of breach of a condition (or sufficiently serious breach of an intermediate term)[289] as to quality of the goods is limited by the contract date where time is of the essence.[290] This is the respect in which the right to cure in the US is wider than in England since under the UCC the buyer's immediate termination, without giving the seller a second chance, may be held wrongful even if in the particular sale contract time is of the essence.[291] Where time is not of the essence (*i.e.* the time provision is not a condition), it is submitted that the seller may also cure beyond the contract period, with opinions differing as to whether he can do it within "reasonable time"[292] or within such time

---

[285] If the seller's defective tender amounts to anticipatory breach, the buyer is entitled to accept the seller's repudiation, thus terminating the contract and extinguishing the seller's right to cure. See *Ashmore & Son v C. S. Cox & Co.* [1899] 1 QB 436, at 443. On the seller losing his right to cure before the contract time on account of his anticipatory breach, see Apps 547-552.

[286] Reynolds, 'Chapter 10. Classification of Statements as to Goods' 523; Reynolds, 'Chapter 12. Remedies in Respect of Defects' 604.

[287] *Borrowman, Phillips & Co. v. Free & Hollis* (1878) 4 QBD 500 (rejection of tender because of absence of shipping documents); *Ashmore & Son v C. S. Cox & Co.*, at 440 (bad declaration of shipment); *E. E. & Brian Smith (1928), Ltd. v. Wheatsheaf Mills, Ltd.* [1939] 2 KB 302 (tender of provisional invoice which did not represent the contract goods), at 314-315; *Getreide Import GmbH v. Itoh & Co. (America) Inc.* [1979] 1 Lloyd's Rep 592 (a declaration of shipment applied by a stale notice); *SIAT di del Ferro v. Tradax Overseas SA* [1980] 1 Lloyd's Rep 53 (bad bills of lading). Despite the doubts, expressed by the Law Commission, as to whether the courts would be prepared to extend the cure doctrine, illustrated by these cases, to breach of an express or implied condition of quality, legal scholars consider them sufficiently similar to serve as a basis for outlining the seller's right to cure in the event of tender of non-conforming goods since the issue in them also boils down to the effect of buyer's refusal. *Cf.* , *Sale and Supply of Goods. Law Commission Working Paper №85. Scottish Law Commission Consultative Memorandum №58*, para. 2.38 with Bridge, *The Sale of Goods* 199; Reynolds, 'Chapter 12. Remedies in Respect of Defects' 605; Apps.

[288] There is no English authority sustaining the position that the seller has the right to cure when it comes to sale of specific goods. Treitel, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' 136; Bridge, *The Sale of Goods* 199.

[289] Apps 532-533.

[290] , *Sale and Supply of Goods. Law Commission Working Paper №85. Scottish Law Commission Consultative Memorandum №58* 34; Apps 535; Bridge, *The Sale of Goods* 197.

[291] Farnsworth, *Farnsworth on Contracts* 528. Although not expressly discussed in the case, it appears that in *T.W. Oil, Inc. v. Consolidated Edison Co. of New York*, time was of the essence since the contract for sale of oil was executed on a volatile market and in the midst of a fuel shortage. Nevertheless, the court held that the seller had the right to cure beyond the contract time. See *supra* footnotes 271-273 of this Chapter and the text accompanying them.

[292] , *Sale and Supply of Goods. Law Commission Working Paper №85. Scottish Law Commission Consultative Memorandum №58* 34-35; *McDougall v. Aeromarine of Emsworth Ltd.* [1958] 1 WLR 1126, at 1132.

until the delay amounts to a substantial failure in performance.[293] And although it seems the prevailing view is that as long as the delay does not deprive the buyer of substantially the whole benefit of the contract, she is not entitled to terminate, and so during this period seller's late cure is permissible,[294] this does not change the fact that in English law the institute of cure is generally clouded by a great deal of uncertainty.[295] The Law Commission in England did not put the matter on a more sound footing, either, as it rejected the statutory introduction of a seller's right to cure in sale-of-goods contracts.[296] Recognising the problem of opportunistic termination for minor non-conformities but fearing the number of issues, produced by the cure regime under the UCC, the Commission recommended the enactment of Section 15A of the 1979 Sale of Goods Act instead.[297] In this relation, the desire was rather to stimulate parties themselves to negotiate on cure since a buyer whose rescission may be held wrongful on account of too slight a defect will be more willing to agree on seller's amends.[298] The same function is vested in the substantiality requirement in Bulgarian sale-of-goods law.

Unlike in the US and in England, there is no seller's right to cure under Bulgarian contract law.[299] Even in the absence of an express legal provision in this sense, however, there seems to be no reason to deny the seller the liberty to substitute a conforming delivery within the time set for performance. Such time periods are by default in favour of the promisor,[300] meaning that the seller may deliver before the agreed date, in which case the buyer cannot

---

[293] Peel 913-914. Reasonable time is a period shorter than that required for the delay to "go to the root" or to "frustrate the object" of the contract. See *Universal Cargo Carriers Corp. v. Citati*, at 435 (as per Lord Devlin).

[294] It is said that courts accept the "reasonable time" test only when it is shown to be the same as the "frustration" yardstick. See *Universal Cargo Carriers Corp. v. Citati* at 434 (as per Lord Devlin). In fact, *McDougall v. Aeromarine of Emsworth Ltd.*, the authority supporting the view that the seller has a right to cure within reasonable time after the specified date, is completely in line with this conclusion of Lord Devlin. On the facts of the case, where the contract was for the sale of a pleasure yacht to be used during the yachting season and the buyer terminated at a time when four-fifths of the season had passed, it is fair to say that she, too, terminated when she had already been deprived of substantially the whole benefit of the contract. More generally on Lord Devlin's position requiring breach of a warranty to assume frustrating proportions in order for the termination right to arise, see also Lord Devlin, 'The Treatment of Breach of Contract' (1966) 24 Cambridge Law Journal 192, 202-203. See also Apps 535-537 and Bridge, *The Sale of Goods* 198, both supporting the stance that late cure is permissible if taking place before the delay amounts to substantial failure in performance.

[295] In this sense, see , *Sale and Supply of Goods. Law Commission Working Paper №85. Scottish Law Commission Consultative Memorandum №58*, para. 2.38.

[296] With respect to commercial sale-of-goods contracts, see , *Sale and Supply of Goods. Law Commission №160* paras 4.16 and 4.17; , *Sale and Supply of Goods. Law Commission Working Paper №85. Scottish Law Commission Consultative Memorandum №58* paras 4.51 – 4.55, footnote 231.

[297] See *supra* the text accompanying footnotes 265-266 of this Chapter.

[298] , *Sale and Supply of Goods. Law Commission Working Paper №85. Scottish Law Commission Consultative Memorandum №58*, para 4.55.

[299] In this respect Bulgarian contract law does not differ from French law. See Solène Rowan, *Remedies for Breach of Contract* (Oxford: Oxford University Press 2012) 105.

[300] Art. 70(1) Contracts Act.

refuse acceptance on account of the early performance, but the buyer herself cannot demand that the seller deliver earlier.[301] In other words, before the contract time has gone by, the buyer's right is not exigible, yet; any claim on her side will be refused, so within that time, there seems to be no obstacle that the seller makes a fresh conforming delivery. Such reasoning is also reinforced by the fact that, in accordance with the specific performance principle,[302] the Bulgarian buyer does not have the right to terminate in advance on account of some seller's behaviour that contradicts the terms of the contract.[303] It is far more difficult, however, to argue that, without a specific legal provision, a seller's cure may also be permissible beyond the contract time. In light of the courts' continuous emphasis that the choice of remedy in case of defective performance is solely in the hands of the buyer,[304] it is fairly doubtful that the seller would be allowed to redeliver after the contract date even if time in the particular sale contract is not of the essence. After all, such liberty of the seller would limit the buyer's full discretion.[305] It is also important not to forget that, unlike under general contract law, in a sale-of-goods contract, the buyer does not have to give the seller additional time to perform in order to terminate.[306] In this sense, a right to cure beyond the contract time would go against the very rationale of the current legal regime which permits buyers to exit the sale contract immediately. In any case, it must be admitted that all of the above attempts to accommodate a seller's right to cure in the present Bulgarian sale-of-goods law remain purely theoretical since neither the Contracts Act, nor case-law recognise such liberty of the seller.

Nevertheless, if one goes back to socialist times, it may come as a surprise to discover that a right to cure did exist under the then effective in Bulgaria Act on Contracts between Socialist Organizations. Thus, where the seller offered to substitute a new conforming good even

---

[301] Art. 70(2) ibid; Kalaydjiev 256-257; Goleva 82; Kojuharov, *Law of Obligations. General Theory of Obligations* 165.
[302] See *supra* Section A. of Chapter III.
[303] See *supra* footnote 177 of Chapter V. Again, in this respect Bulgarian contract law follows French law. As for French law, see Rowan 92-93.
[304] See *supra* footnote 56 in Section A.1. of this Chapter and the text accompanying it.
[305] Of course, it may also be argued that permitting the seller to cure beyond the contract time is in line with the principle for specific performance under which, even if the contract time has already expired, the promisor may offer the initial performance, provided the promisee still has interest in it, together with damages for the delay. See Art. 79(2) Contracts Act. See also *supra* footnotes 22-27 in Section A. of Chapter III and the text accompanying them. But where, in terms of remedies, courts have repeatedly contrasted the case of delivery of defective goods with the position in general contract law, it seems unlikely that, in the absence of an explicit legal provision, they would justify a new remedy in this case by relying precisely on general contract law principles.
[306] See *supra* footnote 58 in Section A.1. of this Chapter and the text accompanying it.

though the buyer rejected or demanded price adjustment or repair of the defect, she could not refuse to accept the fresh delivery unless it was unduly delayed.[307] That is, under the act, governing the trade relations between organisations which had a role similar to that, performed by merchants in a capitalist economy, the seller was entitled to cure even beyond the contract time. On one side, this liberty of his tamed the discretion of the buyer in choosing between the available remedies, on the other side, it limited her right to refuse acceptance by requiring her to give the seller a chance to correct his misperformance. At that time, the Contracts Act applied mainly to consumer sale contracts between a socialist organisation and a natural person or between natural persons[308] and the buyer's free choice between remedies in case of defective performance was intended to serve as an instrument for enhancing quality.[309] Yet, in the process of transition towards market economy in Bulgaria, the Act on Contracts between Socialist Organizations, setting out the seller's right to cure, was revoked and, since the Commercial Act did not provide otherwise, the remedial regime of the Contracts Act with respect to delivery of non-conforming goods extended to commercial contracts, too.[310] Thus, Bulgarian contract law lost a device by which it could constrain strategic terminations by the buyer precisely when it entered the world of volatile markets and price instability.

In short, as a result of concerns with buyer's opportunism, both the US and the English legal systems have moved away from the perfect tender rule and have found ways to limit the buyer's right to terminate. In England, courts lean toward classifying terms as intermediate, thus practically restricting termination to cases in which the breach is very serious. In addition, a more narrow statutory limitation of buyer's termination right was adopted, which similarly to the substantiality requirement in Bulgarian sale-of-goods law, gives courts a considerable margin of discretion to determine whether the buyer can end the contract where the implied conditions as to quality are only slightly breached. By contrast, in the US, buyer's right to terminate was curtailed by means of the standard of good faith and seller's right to cure. Yet, despite the different devices employed, the consequence of this common restrictive tendency is that in both jurisdictions sale-of-goods law is now closer to general contract law, which, recall, provides the basis for the constrained position of the termination remedy in

[307] Art. 44(4) Act on Contracts between Socialist Organizations; Decision of 25.03.1983 under sup. c. 98/1983 of the State Arbitration Court; Decision of 03.03.1973 under c. 137/1973 of the State Arbitration Court.
[308] Stalev, 'Characteristic Features of the New Legal Regime of the Sale Contract', 164-166.
[309] Interpretative Decision №88 of 28.02.1984, General Assembly of the Civil College of the Supreme Court.
[310] As for the Contracts Act and the Act on Protection of Consumers currently providing alternative sets of remedies to consumers, see *supra* footnote 277 of Chapter IV.

construction contracts. Bulgarian contract law, on the other hand, has shifted towards expanding the buyer's ability to end the contract: the commercial buyer is liberated from the iron grip of the state plan, his claims related to non-conformity are more readily relegated under sale-of-goods than under general contract law, the seller no longer has a right to cure. Nevertheless, legal instruments such as the substantiality requirement and the good faith obligation of the parties still allow courts to curb strategic termination by the buyer.[311] Thus, when one takes a closer look, it seems that what is really going on in the legal systems under comparison contradicts the conclusion of Section A. of this chapter that permitting the buyer to have a wide choice between termination and damages within the contract is optimal.

Table 1[312]

<table>
<tr><th>Device\Jurisdiction</th><th>the US</th><th>England</th><th>Bulgaria</th></tr>
<tr><td>de minimis</td><td>yes</td><td>yes</td><td rowspan="2">yes - no substantial reduction of the price or of the fitness of the good</td></tr>
<tr><td>no substantial failure to perform</td><td>yes- where the good has already been accepted</td><td>yes – where the breached term is intermediate
-- where the breach of condition is too slight – S. 15A SGA</td></tr>
<tr><td>good faith</td><td>yes</td><td>no</td><td>yes</td></tr>
<tr><td>right to cure</td><td>yes</td><td>yes</td><td>no</td></tr>
</table>

<u>The economic rationale</u>

It is important that while reading Section A.3., one remain attentive to the disclaimers therein: first, that the economic analysis is correct, in the absence of a contingency which transforms

---

[311] For the legal devices used to curb opportunistic termination by the buyer in each of the jurisdictions, see *infra* Table 1.

[312] Table 1 is meant to indicate the legal devices used to restrain opportunistic termination by the buyer in each of the jurisdictions but does not purport to say that where the same device is available in more than one jurisdiction, it implies absolutely the same standard across jurisdictions.

the contract into an occasion for making opportunistic profit[313] and, second, that the buyer's broad termination right is only *roughly* optimal. The present section takes a closer look at these disclaimers.

Indeed, the limitations on termination, identified above, suggest that sale-of-goods law is vested with regulatory function with respect to contracts, which even if executory are signed on a thick market and entail no relation-specific investment. These contracts have surely moved away from the purely discrete, present exchange but despite the element of futurity, they do not imply a relationship more valuable than any other on the market and have as their subject an easily monetised commodity.[314] Depending on the time period of the contract and the communication between the parties involved, these contracts may be situated at different points of the discrete range, but they have not yet landed in the long-term part of the continuum.[315] The steady recommendations of economic theory with respect to transactions, having such characteristics, whether they are occasional or recurrent, are that they are left to market governance where competition will police opportunism.[316] This is then interpreted as a prescription for adoption of the least interventionist legal rules possible, which in the case of the termination remedy translates into a right to end the contract for any deviation. One must be cautious, however, when confronted with theoretical normative predictions. Generally, authors do not assume away opportunism but take the stance that either because of the relatively short duration of the contracts,[317] or because of the thickness of the market,[318] opportunities for strategic gains are not likely to arise. Truly, taking a bird-eye view on discrete (in the case at hand – sale-of-goods) *versus* long-term (in the case at hand – service, construction) contracts, opportunism in sale contracts appears a lot less likely. Yet, price swings constitute precisely such opportunities for making strategic profit, which are generally seen as unlikely. Thus, where the market is volatile and the buyer has failed to predict it, court

---

[313] Read *supra* the paragraph accompanying footnote 89 in Section A.3 of this Chapter.
[314] Macneil himself defines a fixed-price contract for future delivery of a commodity for which there is a ready market both at the time of contracting and at the time of delivery as one lying closer the extreme spot pole. Macneil, 'The Many Futures of Contracts' 744-745.
[315] For the definition of spot contracts, see *supra* Section A.1. of Chapter IV. On the relevance of duration and contact between the parties for placing the contract along the continuum, see ibid 748-749.
[316] Williamson, 'Transaction-Cost Economics: The Governance of Contractual Relations' 241, 248-249, 253 Figure II; Williamson, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* 31-32, Table 1-1.
[317] Williamson, 'Transaction-Cost Economics: The Governance of Contractual Relations' 249, footnote 54; Macneil, 'Contracts: Adjustment of Long-Term Economic Relations under Classical, Neoclassical and Relational Contract Law', 860.
[318] Williamson, 'Transaction-Cost Economics: The Governance of Contractual Relations' 255; Goetz and Scott, 'The Mitigation Principle: Toward a General Theory of Contractual Obligation'.

disputes in which the buyer tries to exit the contract, motivated by the adverse market movement, are not difficult to find, at all. In such cases the availability of market alternatives turns out not to be a panacea, either. Indeed, the possibility to easily arrange new contracts does protect sellers against opportunistic buyers, but, in the event of a market fall, these alternative arrangements, even if available, prove to be very bad substitutes since the seller can only resell at a dramatically lower price. As shown, where in such case the absolute termination right, implied by the common law perfect tender rule, enhances the buyer's incentive to undo the contract by providing her with a convenient excuse to disguise her real reason to reject, it does not yield optimal results. Precisely due to the available, and now cheaper, market alternatives, buyers are not inclined to accept the goods at a price higher than the one prevailing at the time of performance.[319] As a result, even if the contract does not fall apart because the seller submits, the renegotiation costs, inflated by the buyer's opportunism, constitute nothing but losses decreasing the total value of the contract.[320] In addition, the buyer's absolute right to terminate works as supracompensatory damages. Anticipating the buyer's opportunism and striving not to provide the buyer with any occasion to end the contract, the seller overinvests in precautions.[321] The same motivation will drive similarly situated sellers in the future, increasing their *ex ante* costs, reducing the contractual surplus and eroding their general willingness to contract. From this perspective, a remedial solution more oriented toward preservation of the contract appears to be a better choice.

In fact, when it comes to sale of commodities, traded on volatile markets, there is abundant evidence that commercial people tend to dislike termination and to prefer damages within the contract. It is sufficient that one turns to rules of commodity exchanges and standard contracts of trade associations to see that commodity markets have developed sophisticated systems of grading goods, with each grade characterised by permissible ranges of certain quality parameters within which buyers may claim only price allowances. Such governing of commodity trade by detailed self-regulation setting forth careful tolerances of quality, for which the buyer's right to reject is excluded, can be observed in all three jurisdictions under comparison. As early as 1949, Honnold reported that in the US, rules and regulations of commodity exchanges and trade associations normally prescribed price adjustment to make

---

[319] *T.W. Oil, Inc. v. Consolidated Edison Co. of New York* (see *supra* footnote 272 of this Chapter); *Neumiller Farms v. Cornett* ("'I'm not going to accept any more of your potatoes. If you load any more I'll see that they're turned down.' . . . 'I can buy potatoes all day for $2.00.'").
[320] Goetz and Scott, 'The Mitigation Principle: Toward a General Theory of Contractual Obligation' 982-983.
[321] On the seller's incentive to take precautions, see *supra* Section B. of Chapter V.

up for quality deficiencies within a certain grade as well as for delivery of goods of different grade, permitting rejection only for deviations outside the specified tolerances.[322] No different is the situation in England as revealed by the standard forms of trade associations.[323] Recall, for example, that in *Hansa Nord*[324] the GAFTA 100 form contract, used for the sale of the citrus pulp pellets, set a maximum percentage of contamination of the goods, up to which rejection was precluded. Taking a look at the GAFTA 100 form as effective of 1 January 2006,[325] one notices that besides the caps set with respect to certain quality parameters, it also meticulously stipulates the rates of price allowance per units or percentages of deviation within the permissible tolerances. Clauses excluding the right to reject seem also to frequently appear in non-form commercial contracts.[326]

In Bulgaria despite the persistent emphasis on specific performance during the period of socialist planned economy, in sale-of-goods contracts between socialist organisations, the same tendency to curtail rejection and to substitute price adjustment existed, although directed by the ubiquitous State. The limits, within which rejection was not allowed and quality issues were resolved only by means of price allowances, were set forth by means of mandatory state standards, which entered the sale contracts between socialist organisations even in the absence of explicit reference to them.[327] Commodities with their relevant quality parameters varying within the permissible range were *ab initio* considered fit for use. Only deviations exceeding the specified tolerances could result in defective performance, giving the buyer the

---

[322] Honnold, 464, footnote 35. For even more evidence reported in 1975, see Schwartz, 'Cure and Revocation for Quality Defects: The Utility of Bargains' 561-562, footnote 49, footnote 50, footnote 53.

[323] Michael Bridge, 'The Evolution of Modern Sales Law' (1991) Lloyd's Maritime and Commercial Law Quarterly 52, 58, 55.

[324] [1976] QB 44. See *supra* footnote 176 of this Chapter and the text accompanying it. See also *Tradax Export SA v. European Grain & Shipping Ltd.* [1983] 2 Lloyd's Rep 100, at 103 (where the court recounted the clarification of the GAFTA Board of Appeal that in the trade of soya bean meal, fibre in excess of 7% and protein and fat deficiency below 44% were treated as matters of price allowance and not rejection).

[325] http://www.mega-tierernaehrung.com/upload/Gafta.pdf. Last accessed on 30/05/2015.

[326] Reynolds, 'Chapter 13. Exemption Clauses' 687. In *Ashington Piggeries Ltd. v. Christopher Hill Ltd.*, for example, the contract contained a clause providing: "The goods to be taken with all faults and defects, damaged or inferior, if any, at valuation to be arranged mutually or by arbitration." *Ashington Piggeries Ltd. v. Christopher Hill Ltd.* at 470.

[327] The parties could certainly agree on higher quality characteristics of the goods sold but as long as they remained silent the required quality was determined by the standard. Nikolov and Panova, 'Requirements to the Liability for Defects of the Output under the Supply Contract with a View to the Arbitration Practice', 105; Kostov 37-38; Chudomir Goleminov, 'Price Reduction on Account of Defects (in the Quality of Output) in Supply Contracts Between Socialist Organizations' (1960) 11 Bulletin of the Legal Institute 207, 213, footnote 1.

right to reject the good (or to claim damages within the contract or to demand correction).[328] Currently, in the context of market economy, price adjustment remains the preferred remedy when it comes to quality of commodities. The standard futures contracts for sale of grain of the Sofia Commodity Exchange, for example, provide for rates of price adjustment for deviations from certain base quality specifications. Prices vary either on the basis of quantity bonification (correction of the weight of the shipment, by reason of dampness or foreign material), or on the basis of value bonification (correction of the price by a certain percentage per each percentage departure from the base index).[329] In case of proven deviations from the contractual frames of the quality specifications, the buyer, besides price adjustment, may also request correction of the discrepancy or replacement of the commodity, but she may terminate the contract only if the claim chosen has not been satisfied.[330] In other words, when it comes to sale of commodities, merchants on all three markets show a similar affinity for constraining termination and substituting it with price adjustment.

This does not mean to say that there are no commercial buyers who attach special value to perfect performance and would like to have the right to terminate for any non-conformity. The problem is that where such right is given by default, it is less likely that the seller receives information about the type of buyer he deals with and, consequently, adjusts his level of precautions to the optimal level. Under an absolute termination right, the high-risk buyers, those who are likely to exercise it, would not have an incentive to distinguish themselves since they would have to pay more without gaining additional protection. Low-risk buyers, those who are not so fussy about quality and are inclined to take the goods with some discrepancies, may have an incentive to reveal their type, but being the majority, they may very well not do it because their benefit would be too small relative to the communication costs they would incur. In other words, strategic reasons (high-risk buyers) and transaction

[328] Art. 48 Act on Contracts between Socialist Organizations; Decision of 14.11.1970, c. №613/1970 of the State Arbitration Court; Decision of 10.07.1971, c. №245/1971 of the State Arbitration Court. See also Boris Burov, 'Civil Law Methods in the Struggle for Quality' in Boris Burov (ed), *Law in the Struggle for Quality of the Industrial Goods* (Sofia: Bulgarian Academy of Sciences Publishing House 1958) 105-106; Nikolov and Panova, 'Requirements to the Liability for Defects of the Output under the Supply Contract with a View to the Arbitration Practice', 104.

[329] For the practice of bonification, see Chudomir Goleminov, 'Bonification Issues in Arbitration Case-law' [1960] Legal Thought 93.

[330] Sofia Commodity Exchange standard contracts for sale-purchase of grain are available on http://www.sce-bg.com/?pid=41&l=en. Last accessed on 01/06/2015. See also Decision №121 of 18.07.2012, comm. c. №67/2012 of District Court – Pazardjik (where the contract between the parties provided that if the shipment contained defective goods (pepper puree and tomato puree in jars), they would either be replaced, or the price of the shipment would be adjusted).

costs (low-risk buyers) would deter conveyance of socially desirable information which would allow sellers to take optimal precautions with respect to each group. By contrast, a limitation to termination would require meaningful bargaining about an automatic right to end the contract, which high-risk buyers would be motivated to engage in as in a competitive market they would gain the entire surplus from the information disclosure. And since those buyers who do not divulge information about the group to which they belong must be low-risk buyers, the seller would be able to recognise the type of each buyer, fine-tune the precautions he takes and thus increase the gains from trade. In addition, not only would a limited termination right lead to more communication, allowing the seller to optimise his preventive measures against breach, it would also lead to less costly communication, since it would be the minority type of buyers, the high-risk ones, that would distinguish themselves.[331]

More importantly, where an absolute termination right prevents disclosing of information, it promotes inefficient cross-subsidisation. Insofar as buyers do not signal their type and screening is prohibitively costly, the different type of buyers would remain pooled together with the seller charging all of them an average price. This average price is higher than the price low-risk buyers would pay and lower than the price high-risk buyers would pay if they separated from the common pool. Low-risk buyers, in other words, would be effectively subsidising high-risk buyers who by strategically withholding information avoid bearing the full costs of their absolute termination right. An adverse selection may even ensue as the low-risk buyers who find the expansive termination right too expensive may drop out of the market. Conversely, by encouraging information communication and a separating equilibrium, a limited termination right would operate as a screen that prevents cross-subsidisation and falling out of the market of the marginal, presumably the small and less moneyed, businesses.[332]

The common preference of commercial people toward reining in termination may also be explained even if one ignores the risk of buyer's opportunism and takes a purely facilitative approach. Merchants purchase goods either to resell them, or to use them in their manufacturing process and in both cases damages within the contract are more likely to

---

[331] For the limitation of promisors' liability to the foreseeable damages having the same function, see *supra* Section H.3. of Chapter V.

[332] For the foreseeability limitation on expectation damages thwarting adverse selection, see *supra* Section I. of Chapter V.

minimise costs than termination. A buyer, who has purchased the commodities for resale, is, similarly to the seller, proficient in the trade and has, like him, information about potential customers, so more often than not, she is in just as good a position as the seller to dispose of subgrade or defective goods. Damages within the contract, then, will most probably be the cheaper remedy as it saves the costs of returning the goods to the seller and the buyer's costs of cover, which additionally encumber the remedy of termination. Of course, there may be cases in which because of the nature of the defect or the specialisation of her resale business, the buyer's costs of disposing of the non-conforming goods are higher than the seller's,[333] but, generally, if the buyer is a commodity broker, termination is less likely to maximise the contractual surplus.[334] Termination seems less unattractive when the commodities are purchased for use in the buyer's manufacturing process. In such case the buyer, unlike the seller, does not have distribution channels already available to her, so her costs of reselling the deviating goods may be considerably higher than the seller's, high enough to outweigh the costs of sending back the goods and covering.[335] Yet, again, where the non-conforming goods are commodities deviating from some quality parameter within reasonable commercial limits, buyers are often still able to make use of them.[336] The costs associated with termination (the costs of returning the goods, the seller's costs of reselling them and the buyer's costs of cover) are then again likely to offset the adaptation costs to the buyer, making termination the more expensive remedy. It may not be so where the buyer plans to manufacture a fine product and the substandard material will compromise its high quality.[337] But note that it is such buyers that are the idiosyncratic bargainers, so it is more cost-efficient if they need to negotiate *ex ante* a right to terminate for certain deviations, thus informing the sellers of their special interest.[338] Put shortly, the devised permissible ranges of deviations, within which claims are

---

[333] Suppose, for example, that the seller sends to a wine shop brandy instead of wine.
[334] Llewellyn, 'On Warranty of Quality, and Society: II', 389; Honnold 469; Priest, 'Breach and Remedy for the Tender of Nonconforming Goods under the Uniform Commercial Code: An Economic Approach' 963-965, 971, 974; Wagner, 155-156.
[335] Honnold 469; Priest, 'Breach and Remedy for the Tender of Nonconforming Goods under the Uniform Commercial Code: An Economic Approach' 965.
[336] Recall that even though the citrus pulp pellets in *Cehave N.V. v. Bremer Handelsgesellschaft M.B.H. (The Hansa Nord)* were substantially damaged, the buyers used them as initially planned by eking out smaller quantities of them when compounding the cattle food. See also *Tradax Export SA v. European Grain & Shipping Ltd.* (where despite the delivery of soya bean meal with fibre content higher than contracted, the buyers could still use it as an ingredient in animal feeding stuffs) as well as Llewellyn, 'On Warranty of Quality, and Society: II' 389.
[337] *Tradax Export SA v. European Grain & Shipping Ltd.* (where the court found that the buyer deliberately specified lower than usual maximum fibre content because she intended to depart from the usual practice and to use only the highest quality soya bean meal).
[338] In this sense, see also Llewellyn, 'On Warranty of Quality, and Society: II' 388-389.

settled only by price adjustment, are a method to expand a buyer's duty to mitigate. Where upon delivery of deviating commodities, the buyer broker or manufacturer is typically the better mitigator, the seller's autonomous readjustment, forced on him by termination will, more often than not, reduce the net benefits of contracting. In this sense, by making use of the buyer's relative advantage in decreasing losses, parties attempt to minimise costs from readjustment. Since a risk-averse seller, who anticipates bearing such excess costs less often, is able to offer a lower price, both parties gain from a more cooperative scheme of rights and obligations.

Comparing termination and damages within the contract in terms of costs, one should not forget that the latter also entails calculation costs as well as a risk of error. Yet, in reality, termination is also accompanied by awarding damages to the buyer, which in case she covers are no less costly to measure.[339] There is only a difference in calculation costs when upon termination the buyer requests solely to be given back the price,[340] but even then the costs of measuring buyer's damages within the contract are not dramatically higher. Where commodities are traded on thick markets, which readily provide price information, including information on prices of subgrade or defective goods,[341] such *ex post* costs do not appear decisive. They may be crucial where there is no market for the non-conforming good, which can supply a benchmark for ascertaining damages, or where the buyer is a consumer and his diminished utility is very subjective. However, on the active market of commodities, the risk

---

[339] In all three jurisdictions, upon termination the buyer may claim the difference between the market and the contract price of the good. In the US if the buyer justifiably rejects the goods, she may cancel and in addition to the price paid may recover damages under the UCC section concerning "cover" or damages for non-delivery. See UCC § 2-711. Buyer's Remedies in General; Buyer's Security Interest in Rejected Goods.; UCC § 2-712. “Cover”; Buyer's Procurement of Substitute Goods.; UCC § 2-713. Buyer's Damages for Non-Delivery or Repudiation. In England, too, a buyer who justifiably rejects goods may sue for damages for non-delivery. See Sale of Goods Act 1979 Section 51 Damages for non-delivery. (3) and Reynolds, ‘Chapter 12. Remedies in Respect of Defects’ 631. For Bulgaria, see Art. 323 Commercial Act.

[340] The buyer retains this possibility in all three jurisdictions. In England instead of suing for damages, a buyer, who justifiably rejects goods, may recover any money he has paid in restitution as upon total failure in consideration. See Reynolds, ‘Chapter 12. Remedies in Respect of Defects’ 631-632 and Sale of Goods Act 1979 Section 54 Interest, etc. Although under UCC the buyer can recover damages in addition to the price paid, nothing impedes her to limit herself to a restitution claim. See UCC § 2-711. as well as Dobbs 794-795. In Bulgaria instead of claiming damages under Art. 323 of the Commercial Act, upon termination a commercial buyer may claim only the price paid as well as his expenses related to conclusion and performance of the sale contract. See Art. 195(1) and (2) Contracts Act.

[341] Recall that in *Cehave N.V. v. Bremer Handelsgesellschaft M.B.H. (The Hansa Nord)* it was established that the overheating resulted in the loss of 20% of the purchase price of the citrus pulp pellets. See *supra* footnote 179 of this Chapter and the text accompanying it. In *Jones v. Just* the wetted hemp realised 75% of the price it would have fetched if undamaged. See ibid at 200. In this sense, see also Honnold 469.

of undercompensation is too low to endow termination with a critical advantage over damages within the contract.

It appears then that in contracts for sale of commodities both the facilitative and the regulatory viewpoint point to curbing the buyer's right to terminate. Nevertheless, both law-and-economics and mainstream scholars in the common law tradition have levelled strong criticism at the enacted limitations on the buyer's ability to put an end to the contract.[342] Even when admitting that such limitations will prevent the economic waste arising from her opportunism, they shrink away from any clear approval, fearing the generality and unpredictability of the new rules.[343] Appearing, however, in different versions, the invariable argument of the need for certainty deserves unpacking.

Many times the argument unfolds as a lamentation over the burden thrusted on the buyer. Since sale contracts often require payment upon delivery of the goods, constraining the buyer's right to terminate entails limiting her ability to avoid financing the seller when he delivers non-conforming goods worth less than the contract price. In the face of his breach, the argument goes, the buyer is left with the consolation of recovering damages only at a later date, until which she is forced to bear the risk of deterioration of the seller's creditworthiness.[344] In addition, a limited termination right deprives the buyer of the possibility to know where she stands at the moment when she needs to take the decision to reject. If she can be confident of the legal effect of her actions only in hindsight, she can easily accrue liability by interpreting erroneously the seller's breach as sufficiently material and making an attempt to terminate, which is eventually qualified by a court as wrongful.[345] In this way a buyer who honestly believes she is entitled to end the contract may incur great losses, especially on commodity markets where goods change hands quickly and actors have many ongoing contracts simultaneously.[346] Thus, since an absolute termination right entails

---

[342] Schwartz, 'Cure and Revocation for Quality Defects: The Utility of Bargains'; Goetz and Scott, 'The Mitigation Principle: Toward a General Theory of Contractual Obligation' 995-1000; Peel 888-889.
[343] Schwartz, 'Cure and Revocation for Quality Defects: The Utility of Bargains' 563-565; Goetz and Scott, 'The Mitigation Principle: Toward a General Theory of Contractual Obligation' 999-1000.
[344] Honnold 467.
[345] Goetz and Scott call this "the breacher-status problem". Goetz and Scott, 'The Mitigation Principle: Toward a General Theory of Contractual Obligation' 983.
[346] This concern is pervasive in English court cases. For only two examples, see *Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen* at 998 (where Lord Wilberforce, while criticising earlier authorities concerning conformity with description as "excessively technical", pointed at "unascertained future goods (*e.g.* commodities)" as a possible exception, regarding the description of which "a strict and technical view" may still need to be taken); *Bunge Corp. v. Tradax Export SA* at 718, 720.

neither the risks of an advance payment, nor the difficulties related to predicting one's own legal position, its undisputable advantage of certainty is asserted as a strong argument against constraining the termination remedy.

The conviction that sales law is different from the law concerning service contracts because it is called upon to ensure certainty[347] seems to originate in its ability to offer maximum security by providing for simultaneous performances.[348] If delivery of the goods and payment of the price are concurrent conditions, neither of the parties is forced to finance her contractual partner in case the latter is not able to fulfill his obligations in full.[349] Yet where, having started as a rule concerning the order of performances, the doctrine of conditions developed into a doctrine as to the effect of breach of particular contractual terms, the idea of certainty in sales law quickly extended to defective performance,[350] leading to genuine infatuation with the absolute right to terminate. Williston, the draftsman of the Uniform Sales Act, even went as far as to submit that the right of the buyer to reject goods not corresponding to description necessarily followed from the nature of her promise.[351] Indeed, as already mentioned, behind the buyer's absolute right to terminate, one can read the same policy against burdening her with extension of credit to the breaching seller.[352] But while recognising this, one should also not fail to acknowledge that when he uses this certainty rationale to justify the buyer's strict right to end the contract, he already applies it not to her obligation to pay but to her obligation to accept the goods.[353] In this sense, where the buyer's absolute right to terminate seems to have been determined to a large extent by path dependence, we should be careful not to endorse it as optimal simply out of inertia. To say the least, in today's commercial world it is fairly frequent that the buyer pays only after delivery, so she can avoid financing the seller and pursuing him for reimbursement by simply withholding from the price a sum which corresponds to the deviation of his performance. Neither does she bear the risk of the advance

---

[347] See also Schwartz, ‘Cure and Revocation for Quality Defects: The Utility of Bargains’ 565 referring to the function of sales law "to provide the parties with clear guidance as to what they can and cannot do.".
[348] Recall that all three legal systems endorse such a solution. See *supra* footnote 83 in Section A.3 of this Chapter and the text accompanying it.
[349] Restatement (Second) of Contracts § 234 Order of Performances, comment a.
[350] *Kingston v. Preston* (1773), unreported but discussed in detail in *Jones v. Barkley* (1781) 2 Dougl 684, at 689-691; *Boone v. Eyre*; *Duke of St. Albans v. Shore* (1789) 1 H Bl 273. For a concise explanation of the development of the doctrine, see Bridge, *The Sale of Goods* 148-150.
[351] See Honnold 466, citing Williston, Sales § 225. Williston also considered the approach of the English 1893 Sale of Goods Act as fraught with unpredictability, which was the other reason that led to the clear-cut, simple rule of the Uniform Sales Act (1906). See *supra* the text accompanying footnotes 227-230 of this Chapter.
[352] Ibid 467.
[353] Ibid 466.

payment when she is immediately granted a price allowance or has the good substituted.[354] In addition, the buyer considered is not a consumer: for her, receiving some non-conforming goods is usually a normal business risk, measurable in monetary terms, at the realisation of which she is typically able to take routine steps to mitigate losses. Her interest in certainty can be countered with the seller's, also legitimate, interest in not having his contractual rights forfeited in volatile markets. From this perspective, instead of automatically granting the buyer an absolute termination right, it would be better to ask the question of whether giving the buyer such a harsh remedy is worth the price.

Undoubtedly, a termination right, not dependent on the materiality of seller's breach, provides the buyer with clarity about her rights immediately, as the events unfold, and not only later, in hindsight. In fact, it is fair to say that it carries the benefit of predictability for both parties since a seller may also misinterpret his obligation and, contesting its scope, be characterised as a breacher. In this sense, when worrying about the burdens placed on the buyer, one should have in mind that a similar risk is also born by the seller. Of course, any limitation to the termination remedy compromises to some extent the advantage of certainty. Yet, one should be plainly aware about the cost at which this advantage comes. To summarise it all: an absolute termination right entails costs of inefficient autonomous readjustment by the seller and costs of buyer's opportunism (both concrete – for the particular transaction, and long-term – for the entire market) without at the same time avoiding any undercompensation risk worth of consideration. Thus, if the certainty advantage of strict termination is juxtaposed to the difficult-to-neglect inefficiencies the latter implies, the balance of benefits and costs does not speak in favour of endowing the buyer with unconditional protection. In this sense, an absolute termination right could be justified only if ensuring maximum quality performance is the one and only goal pursued irrespectively of the price it entails. A desire to optimise all parties' decisions, however, requires constraining of the termination remedy.

---

[354] Ibid 468. See *supra* the text accompanying footnotes 322-330 of this Chapter. See also for the US: *T.W. Oil, Inc. v. Consolidated Edison Co. of New York*; *Neumiller Farms v. Cornett* (where in both cases upon the buyer's objections about quality, the seller immediately offered price allowance); for England: *Hi-Flyers Ltd. v. Linde Gas U.K. Ltd.* [2004] EWHC 105 (QB) (where a few of the many cylinders of helium supplied were found to be nearly empty, they were not charged for and the problem was promptly remedied by a further delivery); for Bulgaria: Decision №121 of 18.07.2012, comm. c. №67/2012 of District Court – Pazardjik (where upon complaint by the buyer that some of the pepper/tomato puree jars had bad commercial guise, the seller immediately replaced them or adjusted the price). For the sake of good order, all these court cases were litigated under a softened right to terminate and in all of them the court eventually found for the seller. In this sense, it cannot be claimed that sellers were willing to resort to price adjustment and cure only because they had the threat of an absolute termination right pending over their heads.

Indeed, balancing the risk of buyer's opportunism and the risk of seller's evasion is a difficult task, with which, as is evident from the historical account above, all the legal systems under comparison struggle. An inattentive curbing of the buyer's option to end the contract may increase the seller's moral hazard by more than it reduces the buyer's strategic behaviour. But once opportunism is taken seriously, and once it is admitted that a strict right to terminate in fact constitutes a substantial part of the trouble, the issue rather becomes in what way and to what extent to limit termination and not whether to limit it at all. From this perspective, where the seller's breach is inadvertent and upon the buyer's complaints he offers cure or price reduction, or where the buyer attempts to exit the contract in the context of price decline while the defect is only minor and the goods remain useable (or are even used), denying termination appears to significantly reduce the risk of buyer's opportunism while only slightly increasing the risk of seller's shirking. It is all too easy to fall back on the same old perfect tender rule claiming that parties normally prefer clear-cut, categorical rules, especially when such an assertion is difficult to be tested.[355] Such firm faith in one's own knowledge of parties' preferences could very well be countered with the submission that, on the contrary, it is the rule's insensitivity to commercial practices that has caused the actors in the timber trade, and generally merchants, to massively flow out of courts, referring their disputes mainly to arbitration.[356]

In fact, what underlies the economic argument insisting on bright-line rules is the binary, exogenous concept of unverifiability, which approaches the matter by proclaiming quality as entirely unverifiable.[357] Parties, the argument goes, are averse to vague standards, conditioning their rights on unverifiable factors, because such standards create uncertainty and invite courts to rewrite their contracts. Yet, even the most detailed standard form sale contracts contain ambiguous terms as to quality.[358] In fact, it is fair to ask how much certainty

---

[355] Robert Scott, 'The Rise and Fall of Article 2' (2002) 62 Lousiana Law Review 1009; Schwartz and Scott, 'Contract Theory and the Limits of Contract Law'; Scott, 'Conflict and Cooperation in Long-Term Contracts', 2050.

[356] Wioletta Konradi, 'The Role of *Lex Mercatoria* in Supporting Globalised Transactions: An Empirical Insight into the Governance Structure of the Timber Industry' in Wolmark Gessner (ed), *Contractual Certainty in International Trade* (Oxford: Hart Publishing 2009); Reynolds, 'Chapter 11. Terms as to Description and Quality Implied by the Sale of Goods Act' 543, footnote 98.

[357] On the economic concept of verifiability and its connection to vague terms, see George Triantis, 'The Efficiency of Vague Contract Terms: A Response to the Schwartz-Scott Theory of UCC Article 2' (2002) 62 Lousiana Law Review 1065. See also *supra* Section A.3. Rules and standards of Chapter IV.

[358] See Clause 5 of GAFTA №100: "Shipment shall be made in good condition." at http://www.mega-tierernaehrung.com/upload/Gafta.pdf.; Clause 5 of GAFTA №64: "(fair average quality) of the season's shipments at time and place of shipment." at http://www.gtradesystem.com/commodities_files/gafta%2064.pdf.

an absolute termination right ensures where some deviations from the exact words of the contract did not prevent courts to hold for the seller even under the bluntest perfect tender rule, as formulated under the Uniform Sales Act.[359] In this respect, certainty can be achieved by courts endorsing commercial custom, usages of trade, standardisation, all of which are conventions invented by and known to business people, and not by adopting a strict right to terminate. After all, neither commodities, nor even manufactured goods of the same kind are uniform and it takes only sufficiently accurate measurement tools to demonstrate that a seller is not perfect in his performance. When it comes to quality the very idea of absolute precision is fairly deceptive.[360]

In addition, (re)negotiating is likely to be cheaper when taking place around a vague standard than around a precise term. A buyer, who knows that it is only probable (but not certain) that a court will decide in her favour, may be considerably more accommodating.[361] In this respect, a study on the true effect of Section 15A of the Sale of Goods Act 1979 is still missing. Indeed, litigation on the grounds of this statutory modification is scarce but this is precisely where the success of Section 15A might lie. A healthy dose of uncertainty might simply stimulate parties to resolve minor issues without going to court.

2. Contracts for sale of customised goods

When it comes to sale contracts, the issue of buyer's opportunism does not end with the world of commodities traded on volatile markets. A falling price is by no means the only

---

Last accessed on 17/08/2015. See also Clause 2.1. of the Standard Contract for Sale/Purchase of Feed Wheat of the Sofia Commodity Exchange: "As regards its quality, the wheat shall be a robust, standard commercial good, consumable at the very moment of delivery, …, having outward look, colour and odour that are characteristic of fresh and well preserved wheat…" at http://www.sce-bg.com/?pid=41&l=en. Last accessed on 17/08/2015. See also the other standard contracts for sale/purchase of grain of the Sofia Commodity Exchange.

[359] *Schmoll Fils v. L. S. Agoos Tanning* (see *supra* the text accompanying footnote 236 of this Chapter, where 12/20 Karachi hides were decided to be equivalent to 13/20 Karachi hides); *Electric Reduction Co. v. Colonial Steel Co.* (where the court decided that ferro-tungsten powder "free from tin" meant free from tin in a proportion that would impair the quality of finished steel).

[360] *Truax v. Corrigan* 257 US 312, 342 as per Justice Holmes ("Delusive exactness is a source of fallacy throughout the law."). In a similar sense, see Honnold 472.

[361] For studies which suggest that a probabilistic entitlement reduces parties' incentives to lie and increases the likelihood of efficient bargaining, see Ian Ayres and Eric Talley, 'Solomonic Bargaining: Dividing a Legal Entitlement to Facilitate Coasean Trade' (1995) 104 Yale Law Journal 1027; Jason Johnston, 'Bargaining Under Rules Versus Standards' (1995) 11 Journal of Law, Economics and Organization 256. For the opposite suggestion, see Lisa Bernstein, 'Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms and Institutions' (2001) 99 Michigan Law Review 1724, 1732-1734. For contracting around default standards being cheaper than contracting around a default precise rules in corporate law, see Ian Ayres, 'Making a Difference: The Contractual Contributions of Easterbrook and Fischel' (1992) 59 University of Chicago Law Review 1391, 1404-1407.

contingency that motivates buyers to walk away from a now disfavoured deal. Often in the period between contracting and tender the buyer realises that the purchased good is not suitable for her purposes[362] or that she has been overly optimistic about the added value it would bring to her business[363] and seeks to escape what has now become a bad bargain for her. Such strategic acting on her changed preferences is especially problematic when the contract envisages the sale of customised goods since where in these cases the buyer rejects for her own selfish reasons, the seller loses practically all of his investment (work and materials) specific to the contract. In other words, the same reason that justifies a constrained termination right in case of construction contracts also applies to contracts for sale of specifically manufactured goods. To what extent then is termination available in the three jurisdictions under comparison?

Bulgaria

In this respect Bulgarian contract law is very straightforward. It lumps contracts for the manufacturing of specialised goods together with construction contracts[364] in a common legal category, termed in this thesis "contracts for services", and thus limits the Buyer's right to terminate to cases in which the good made is completely unfit for its ordinary or contemplated purpose.[365] Where the good delivered generally conforms to the requirements and

---

[362] For the US, see *Beco v. Minnechaug Golf Course* 256 A2d 522 (Conn 1968) (where the buyer attempted to return the custom-made coffee shop equipment because she realiszed she needed equipment which that is arranged differently); *Sal Metal Products Co. v. Rennert* 5 UCC RepServ 826 (NY 1968) (where the buyer refused to pay for the hardware items produced according to her precise specifications because she found them unsuitable for the intended purpose); *Stephens Industries v. American Express Co.* 471 SW2d 501 (Mo 1971) (where the taping machine was produced according to buyer's specifications but then she attempted to reject it since she had not specified that the machine had to place tape on the back of the cards); *R. R. Waites Co. v. E. H. Thrift Air Conditioning* 510 SW2d 759 (Mo 1974) (where the buyer attempted to return the air cabinets conforming to her plans and specifications since on account of an architectural mistake they were of no use to her). For Bulgaria, see Decision №247 of 04.08.2008, c. c. №638/2007 of the Appellate Court – Plovdiv as well as Ruling №61 of 04.02.2009, comm. c. №812/2009 г., II comm. dep. of the Supreme Court (where the buyer attempted to terminate on account of the custom-made machine not reaching the desired productivity, the reason for this being that she had not agreed to the increase in power, as recommended by the seller).

[363] Decision №318 of 27.06.1994, c. c. №177/1994 of the Supreme Court (where the seller produced spare parts for the buyer's machinery according to buyer's specifications, yet the buyer rejected them because she had a lot "in storage").

[364] See *supra* the text accompanying footnotes 179-184 in Section B.1. of Chapter IV.

[365] Art. 265(2) Contracts Act. Decision №586 of 21.06.2007, c. c. №227/2007 of the Supreme Court (where the jib crane did not conform to the specified parameters and could not serve the purposes for which it was made, the Buyer had the right to terminate); Decision №247 of 04.08.2008, c. c. №638/2007 of the Appellate Court – Plovdiv as well as Ruling №61 of 04.02.2009, comm. c. №812/2009 г., II comm. dep. of the Supreme Court (where the machine could not reach the required productivity with the specified power and the Seller had informed the Buyer that an increase in power is needed, there was no total breach of the Seller which could justify termination of the contract by the Buyer, see *supra* footnote 362 of this Chapter); Decision №348 of

specifications of the Buyer,[366] where the defects are remediable,[367] or where the Buyer uses the good in her manufacturing process or business albeit with some corrections,[368] courts normally hold that the Buyer has no right to end the contract.[369] Before terminating the Buyer also needs to give the Seller an additional period of time to correct his performance.[370] Thus, unlike in sale contracts but consistently with the general contract law principle, in contracts for delivery of custom-made goods termination is available only as a remedy of last resort. In other words, by the very classification it adopts, Bulgarian contract law recognises that on the contractual continuum contracts for manufacturing of specialised goods stay much closer to construction than to discrete sale contracts. This is not the case, however, in English and US

04.04.2014, app. comm. c. № 2090/2013 of District Court – Varna as well as Decision №186 of 30.10.2013 of the Supreme Cassation Court, II comm. dep. (where the ventilation system was defective but the Buyer corrected the defects and eventually used the system, the Buyer had a claim for the expenses for correction of the defects but not the right to terminate the contract).

[366] Decision №318 of 27.06.1994, c. c. №177/1994 of the Supreme Court (where the produced spare parts conformed to the agreed specifications, the buyer was liable for the price, see *supra* footnote 363 of this Chapter); Decision №586 of 21.06.2007, c. c. №227/2007 of the Supreme Court (where the jib crane did not have the required lifting height and microspeed, had asymmetric stops, a longer hook and an unsuitable electric hoist, it materially diverged from the agreed specifications, so the Buyer had the right to terminate, see *supra* footnote 365 of this Chapter); Decision №247 of 04.08.2008, c. c. №638/2007 of the Appellate Court – Plovdiv as well as Ruling №61 of 04.02.2009, comm. c. №812/2009 г., II comm. dep. of the Supreme Court (where the Seller made the machine in conformity with the technical terms of references, provided by the Buyer and the latter did not agree to the alteration suggested by the Seller, the Buyer was not entitled to terminate, see *supra* footnote 365 of this Chapter); Decision №348 of 04.04.2014, app. comm. c. № 2090/2013 of District Court – Varna as well as Decision №186 of 30.10.2013 of the Supreme Cassation Court, II comm. dep. (where the ventilation system deviated from the plan only in its part outside the building, the defect was not so substantial that to make the work unfit and to justify termination, see *supra* footnote 365 of this Chapter).

[367] Decision of 26.06.1964, c. №340/1964 of the General Assembly of the State Arbitration Court (where the court expressly stated that the Buyer might have been entitled to terminate if the defects were irremediable); Decision №348 of 04.04.2014, app. comm. c. № 2090/2013 of District Court – Varna as well as Decision №186 of 30.10.2013 of the Supreme Cassation Court, II comm. dep. (see *supra* footnote 365 of this Chapter).

[368] Decision №247 of 04.08.2008, c. c. №638/2007 of the Appellate Court – Plovdiv as well as Ruling №61 of 04.02.2009, comm. c. №812/2009 г., II comm. dep. of the Supreme Court (where the Buyer used the machine in her manufacturing process for more than four months after delivery, she was not entitled to terminate, see *supra* footnote 365 of this Chapter); Decision №348 of 04.04.2014, app. comm. c. № 2090/2013 of District Court – Varna as well as Decision №186 of 30.10.2013 of the Supreme Cassation Court, II comm. dep. (see *supra* footnote 365 of this Chapter); Decision №9 of 10.09.2010, comm. c. №150/2009 of the Supreme Cassation Court, II comm. dep. (where the Seller remedied the defects of the three custom-made squirts and they were used in the Buyer's manufacturing process, the Buyer was liable for the price and had the right only to damages for the delay).

[369] The criteria are essentially the same as those used by courts to evaluate the fitness of construction. *Cf. supra* with the text accompanying footnotes 74-77 of this Chapter.

[370] Decision №1917 of 15.10.2013, app. comm. c. №1221/2013 of the Sofia Appellate Court (where the termination notice sent by the Buyer did not give the Seller any additional time to correct his performance, the Seller, by sending the missing technical documentation for the machine, cured while the contract was still effective).

law where contracts entailing the creation of a new good especially for the Buyer are outright sale contracts.[371]

England

Surely in English contract law the doctrine of intermediate terms and Section 15A can very well be used to curb termination when it comes to sale of specifically manufactured goods, too. But what begs to be discussed here is the House of Lords' concern that the law on description with respect to goods other than commodities keeps pace with the wind of change brought by *Hongkong Fir*[372] and *Hansa Nord*.[373] Indeed, the dispute in *Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen*[374] did not arise out of a sale contract but out of an agreement for sub-charter of a tanker, yet the dictum by which Lord Wilberforce, speaking for the majority of the House of Lords, limited the scope of the implied condition as to description seems to have a much more general meaning and to be relevant to sale contracts, too. At the time of concluding the charter party the ship was still under construction and not yet named, so it was referred to in the contract as "Yard No. 354 at Osaka …" (the name of the shipbuilding company). By the time the vessel was completed and ready for delivery, however, the market had collapsed and the charterer sought to reject it[375] on the ground that it did not conform to the description because it was built at an Oshima yard (a shipbuilding company in which Osaka had 50% interest) where it had a serial number 004 (though still referred in the Osaka books as 354). Since the ship complied in all respects with the contractual requirements as to tonnage, equipment and performance, the House of Lords decided the charterer was not entitled to refuse to take delivery. Yet, how did English judges reach this result?

To be fully precise, in a previous case, *Ashington Piggeries Ltd. v. Christopher Hill Ltd.*,[376] the House of Lords had already trimmed down the definition of description by taking away

---

[371] See *supra* Section B.1. in Chapter IV.
[372] [1962] 2 Q.B. 26.
[373] [1976] Q.B. 44.
[374] [1976] 1 W.L.R. 989.
[375] *Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen* at 993 (Per Lord Wilberforce: "By the time the tanker was ready for delivery the market had collapsed, owing to the oil crisis of 1974, so that the charterers' interest was to escape from their contracts by rejecting the vessel."), at 1000 (Per Lord Wilberforce: "If the market had risen instead of fallen, it would have been quite impossible for Osaka … to refuse to tender the vessel … on the ground that it did not correspond with that contracted for. No more on a falling market is there, in my opinion, any ground on which the charterers can reject the vessel. In the end I find this a simple and clear case.").
[376] [1972] A.C. 441.

words indicating quality characteristics.[377] There was no misdescription, the court decided, since the fact that the herring meal sold contained a substance poisonous to mink did not render it erroneous to describe as herring meal.[378] In addition, the description by which the goods were sold was limited to the words "Norwegian herring meal", with the words "fair average quality" and the minimum, respectively maximum, percentage of protein, fat and salt not constituting part of it.[379] "Description", therefore, represented only those words which were intended "to identify the kind of goods" to be supplied.[380] However, while *Ashington Piggeries* distinguished between description and quality, the "identification" terminology the court used to do this presented a problem in *Reardon Smith Line*.[381] After all, the words, which became the bone of contention in the latter case, "Yard No. 354 at Osaka …", were used precisely to identify the ship, subject to the charter party. To sort out the conflict between the two cases, Lord Wilberforce drew a line between words whose purpose was "to state (identify) an essential part of the description of the goods" and words which simply provided "one party with a specific indication (identification) of the goods so that he can find them and if he wishes sub-dispose of them."[382] Only words in the first sense provided essential elements of the description and had the contractual force of conditions. Words in the second sense merely provided a means of identifying the good and hence could be construed

---

[377] The case concerned two connected contracts. In one contract, the plaintiffs, who were feeding-stuff compounders, agreed with the defendants, who were mink breeders, to compound for and deliver to them an animal foodstuff for minks prepared according to a formula provided by the defendants. Under the terms of another contract, the plaintiffs purchased from a third party "Norwegian herring meal fair average quality of the season, expected to analyse not less than 70 per cent. protein, not more than 12 per cent. fat and not more than 4 per cent salt." However, the herring meal, which was an ingredient in the animal foodstuff, turned out to be contaminated by a poisonous chemical and caused the deaths of thousands of mink.

[378] *Ashington Piggeries Ltd. v. Christopher Hill Ltd.* at 467 (Per Lord Hodson).

[379] Ibid, at 503, 511 (Per Lord Diplock: "Where a contract contains an express statement about the quality of the goods to be supplied the prima facie inference is that this was intended by the parties not as an identification of the kind of goods that are alone the subject-matter of the contract, but as an express stipulation as to the standard of quality to which goods of that kind supplied under the contract shall conform. Such an express stipulation may be intended as a condition or as a warranty. Which it is, depends upon the construction of the contract.").

[380] Ibid at 503-504 (Per Lord Diplock: "The "description" by which unascertained goods are sold is, in my view, confined to those words in the contract which were intended by the parties to identify the kind of goods which were to be supplied. … ultimately the test is whether the buyer could fairly and reasonably refuse to accept the physical goods proffered to him on the ground that their failure to correspond with that part of what was said about them in the contract makes them goods of a different kind from those he had agreed to buy. The key to section 13 is identification."), at 475 (Per Lord Guest: "description" implies a specification whereby the goods can be identified by the buyer. … Neither f.a.q. nor the expected analysis provision identifies the goods. They prima facie indicate the quality of the goods"), at 489 (Per Lord Wilberforce: "The test of description, … is intended to be a broader, more common sense, test of a mercantile character. The question whether that is what the buyer bargained for has to be answered according to such tests as men in the market would apply, leaving more delicate questions of condition, or quality, to be determined under other clauses of the contract or sections of the Act.").

[381] [1976] 1 W.L.R. 989.

[382] *Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen* at 999.

much more liberally.[383] Thus, where the yard number and the shipbuilding company had no special importance to the parties at the time of contracting, where the phrase used in the particular contract was merely a substitute for a name that served no function but to enable the charterer to identify the ship, where eventually the ship tendered was the ship contracted for, the charterer failed to bring the case within the strictest rules as to "description" and could not refuse to take the vessel.[384] In other words, by adopting a two-tier approach – a strict one to words related to the essential nature of the goods and a flexible one to words not concerning their essence, the court practically built the test of substantial failure of performance into the definition of "description", thus restricting the range of this implied condition.[385] In this respect, Lord Wilberforce emphasised, the law relating to sale of goods (other than commodities) and their correspondence with description should be in line with the general law of contract and the "more modern doctrine" of intermediate terms it had developed.[386] Thus, when it came to specifically manufactured goods, courts were presented with yet another means to confine buyer's termination right.

It would be wrong, however, to think that *Reardon Smith Line*[387] does not have implications for contracts for sale of commodities. One should not overlook that while characterising some description cases, such as *Re Moore and Landauer*,[388] as "excessively technical", Lord Wilberforce still doubted whether "a strict and technical view" was not appropriate regarding description of commodities.[389] In this sense, he thought commodities deserve a special mention even if *Reardon Smith Line* itself concerned unascertained future goods. Yet, his dictum should be properly understood. Although in contracts for sale of commodities a strict attitude might be necessary with respect to the kind of goods sold, their geographical origin and grading,[390] nothing in *Reardon Smith Line* implies that in such contracts phrases like "fair average quality" or "in good condition" should be considered descriptive and construed

---

383 Ibid at 999.
384 Ibid at 998-1001.
385 Bridge, *The Sale of Goods* 287; Peel 881.
386 *Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen* at 998.
387 [1976] 1 W.L.R. 989.
388 [1921] 2 K.B. 519.
389 *Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen* at 998.
390 *Berger and Co. v. Gill & Duffus SA* [1984] AC 382, at 394 (per Lord Diplock); *Tradax Export SA v. European Grain & Shipping Ltd.* (where "max. 7.5% fibre" was decided to be part of the description of the goods); *Toepfer v. Warinco* [1978] 2 LlLRep 569 (where the words "fine-ground" were decided to be part of the description of the soya bean meal). *Cf.* with *Tradax Internacional SA v. Goldschmidt SA* (where it was conceded by the buyers that the provision "4% foreign matters" was not part of the description).

strictly.[391] Certainly, commodities may also require more extensive descriptions than specific goods,[392] but this does not mean that words not related to their essential nature do not deserve a more relaxed interpretation. Moreover, what is important here is that while in *Arcos v. Ronaasen*[393] the court required compliance to the letter of the contract, in *Reardon Smith Line* Lord Wilberforce sought to bring the requirement of substantial failure in the law on decsription.[394] In this sense *Reardon Smith Line* is yet another drop in the bucket of precedents which raise suspicions as to whether *Arcos* is still good law.

The US

Even under the bright-line perfect tender rule of the Uniform Sales Act,[395] US courts were not wholly insensitive to the seller's strong interest in acceptance when he had invested in making a specialised good. In some cases they limited termination by applying the substantial performance standard despite the absence of any legal basis. Thus, in *Harrild v. Spokane School District*[396] where the seller undertook to manufacture and deliver drawing tables and desks made in accordance with plans and specifications furnished to him, the court decided that substantial compliance was all that was required from the seller and, therefore, the buyer had no right to refuse to accept and pay. The court considered that little differentiated the contract in dispute from construction contracts since although the seller could carry away the chattel, he could not resell it as it was made to meet the buyer's requirements. Hence, the same grounds that made the substantial performance doctrine applicable to construction contracts, justified its application to contracts for manufacturing chattels for special use. Thus, referring

---

[391] In this sense, see Bridge, *The Sale of Goods* 288.
[392] Ibid 288.
[393] [1933] A.C. 470.
[394] *Cf. Arcos Ltd. v. Ronaasen & Son* at 479 (Per Lord Atkin: "It was contended that in all commercial contracts the question was whether there was a "substantial" compliance with the contract: there always must be some margin: and it is for the tribunal of fact to determine whether the margin is exceeded or not. I cannot agree.") with *Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen* at 998 (Per Lord Wilberforce: "… in my opinion is, right to treat other contracts of sale of goods in a similar manner to other contracts generally so as to ask whether a particular item in a description constitutes a substantial ingredient of the "identity" of the thing sold, and only if it does to treat it as a condition … I would respectfully endorse what was recently said by Roskill L.J. in *Cehave N.V. v. Bremer Handelsgesellschaft m.b.H.* [1976] Q.B. 44 , 71: … The general law of contract has developed, along much more rational lines (*e.g.*, *Hongkong Fir Shipping Co. Ltd. v. Kawasaki Kisen Kaisha Ltd.* [1962] 2 Q.B. 26), in attending to the nature and gravity of a breach or departure rather than in accepting rigid categories which do or do not automatically give a right to rescind, and if the choice were between extending cases under the Sale of Goods Act 1893 into other fields, or allowing more modern doctrine to infect those cases, my preference would be clear.").
[395] See *supra* the text accompanying footnotes 227-230.
[396] 192 Pac. 1 (Wash. 1920).

to the specific investment that characterised the contractual relationship and noting the already emerging tendency of relaxing the rigour of the rule that required literal performance, the court did not hesitate to bar the buyer from forfeiting the seller's right to compensation.[397]

Under the UCC US courts exhibit the same tendency to strengthen buyer's obligation of acceptance when it comes to specially manufactured machinery and equipment. Not so rarely, when the court concludes that the buyer is uncooperative and attempts to avoid her payment obligation, the court finds that she failed to make an effective rejection because of an untimely notice.[398] In this way, the court can either treat the issue as revocation of acceptance and, consequently, charge the buyer with the heavier burden of proving that the non-conformity substantially impaired the value of the good to her,[399] or can infer that acceptance has occurred and the buyer is liable for the price. Thus, in *Beco v. Minnechaug Golf Course*[400] the court arrived at the conclusion that the buyer had not rejected the goods within reasonable time although upon delivery and setting up the equipment the buyer had stopped the works and complained of defects. The seller agreed to correct the nonconformities as well as to see whether the equipment could be converted from a "wall" type to an "island" type but the buyer refused to deal any further with the seller and in a month attempted to return the equipment. Now, there really were defects and the court could decide that by its very objections and dissatisfaction the buyer had rejected right there on the spot. To compare, in another case, *Alliance Tractor & Implement v. Lukens Tool & Die*,[401] in which, however, the court considered the seller's performance slovenly, the court found that the buyer did not at any time accept the machine, although it was in her possession, she used it and produced articles that were in fact sold. But in *Beco*[402] the seller's willingness to rectify the defects and the buyer's sharp refusal to allow such curative tender made the court interpret the buyer's

---

397 But see *Corbett v. Freedman & Sons* 161 NE 415 (Mass 1928) (where in an action for the price of a remodelled second-hand shoe lasts, not retained by the buyer, instruction authorising seller's recovery on substantial performance was erroneous as inapplicable).
398 White and Summers 304.
399 UCC § 2-608. Revocation of Acceptance in Whole or in Part. (1); § 2-607. Effect of Acceptance; Notice of Breach; Burden of Establishing Breach After Acceptance; Notice of Claim or Litigation to Person Answerable Over. (4). See also *Axion Corp. v. GDC Leasing Corp.* 269 NE2d 664 (Mass 1971) (where notice of rejection was given after 14 months, the court treated it as notice of revocation of acceptance but decided there was insufficient evidence that the alleged nonconformity substantially impaired the value of the machine to the buyer). Where the policy behind the rejection and revocation-of-acceptance notice requirement is to give the seller an opportunity to cure or permit him to assist in minimiszing the buyer's losses, courts can become very demanding about the technicalities. See *Desilets Granite Co. v. Stone Equalizer Corp.* 340 A2d 65 (Vt 1975).
400 256 A.2d 522 (Conn. 1968).
401 233 NW2d 299 (Neb 1975).
402 256 A.2d 522 (Conn. 1968).

behaviour as evidence of election to accept and decide that she was obliged to pay the price less the cost of correcting the defects. Thus, by manipulating the procedural requirements for rejection, the court effectively achieved the outcome that would have resulted from application of the substantial performance standard and imposed a duty to deal on the buyer. Where the goods were specially manufactured and could not be resold at reasonable prices, the buyer should have permitted the seller to eliminate the defects.

While in *Beco v. Minnechaug Golf Course*[403] the court constrained the buyer's right to termination in a somewhat roundabout way, in *Alliance Tractor & Implement v. Lukens Tool & Die*,[404] it was explicit in applying the standard of substantial performance despite the fact that the contract was one for sale. Alas the seller could not benefit from the more generous rule as the court found his performance to be shoddy. The buyer had the right to receive at least approximately what she bargained for, the court said, but where the machine never reached the required productivity, broke down repeatedly, and manufactured products that did not conform to the specifications, this was not the case. The court, in other words, found no substantial performance; yet, the point is that where the dispute arose out of a contract for the construction of a specialised good, it was prepared to stray away from the perfect tender rule and not to turn the seller away if he in good faith had substantially complied with the contract.

<u>The economic rationale</u>

To put it briefly, it appears that all legal systems under comparison respond to sale contracts' crossing over to the long-term range. The adaptation to the specialised context is most pronounced in Bulgarian contract law, where customisation of performance determines the grouping of contracts for production and delivery of bespoke goods together with construction contracts and thus limits the Buyer's termination right to for particularly grave defects. Sensitive to the character of the market, English and US contract law also find ways to drift from the perfect tender rule. Whether by limiting the scope of the implied condition as to description (England), manipulating the procedural requirements for effective rejection or outright substitution of the performance standard (the US), English and US law manage to introduce the requirement for "material"/"substantial" breach and curb the Buyer's termination to an extent similar to that in construction contracts.

---

[403] 256 A.2d 522 (Conn. 1968).
[404] 233 NW2d 299 (Neb. 1975).

The parallel made with construction contracts is by no means accidental. If contracts exhibit similar characteristic features (extended duration, higher incompleteness, specific investment), as it is the case with contracts for sale of customised goods and construction contracts, the same economic analysis applies,[405] so to the reader, who is by now used to the economic rationalising of legal rules, the pointed confining of the Buyer's right to terminate is perfectly sensible. Where the market for substitute performance thins and the complexity of performance gives rise to ever present grounds for alleging default, an unlimited option to terminate would give the Buyer an excellent opportunity to act on her reversed preferences and hold up the Seller. The Seller would either be left with a customised good that has little, if any, value to him outside the particular contract, or, at best, would lose a substantial part of the purchase price if the Buyer uses her leverage to sell her cooperation at a premium. Such gloomy prospects would naturally undermine the Seller's incentive to invest cooperatively in high quality performance (as the surplus resulting from his efforts would most likely be appropriated by the Buyer) and even to contract at all. To reduce the Buyer's potential strategic behaviour, contract law in all three jurisdictions withdraws her termination right whenever the risk of her opportunism is most likely – when the good, although suffering from some minor and remediable infirmities, generally conforms to the plan and to the Buyer's specifications (the US and Bulgaria) or when the good is in its essence the same (England). Or put otherwise, contract law contains the worst threat of the Buyer exactly when it is most destructive – when the Seller has produced a good fit for its purpose; yet, with some slight deficiencies (the US and Bulgaria) or when the discrepancy concerns only words identifying the good (England). The Buyer is then liable for the price (less the losses brought about by Seller's breach) not because she is the better insurer against defective performance but because her non-cooperation causes more net damage than the Seller's imperfect performance. What we observe, in other words, is the regulatory function of contract law in its prime. In English and US law, however, such regulation of opportunism takes place at the price of higher uncertainty and error costs than in Bulgarian law. After all, where in sale-of-goods contracts courts may grant either a broad, or a restricted termination right, insecurity and the probability of error rise.

Still what is the lesson that can be drawn from all this?

---

[405] *Cf.* with the economic rationale of construction contracts *supra* in Section A.3.

Conclusion

One of the aims of this thesis was to provide a methodology for understanding shifts in contract law from facilitative to regulatory. Chapter II develops the comparative law and economics method which, in the following chapters, is extended to remedies. Chapters III, IV and V supply the building blocks necessary to perform a meaningful comparative law and economics analysis. Chapter III strengthens the comparative limb of the methodology. Ensuring that the economic model of incentives, employed in Chapter VI of the thesis, is not based on a taxonomy that is incompatible with a civil law jurisdiction, Chapter III shows the ability of the functional method to bridge different legal traditions and, thus, presents a lesson for the comparative lawyer. Chapters V and VI are rather directed to the law reformer. They critically reconstruct the economic theory that helps perform the analysis and point at two major themes that should be considered by the law reformer when seeking to improve an existing or designing a new contract law system: the classification of different types of contract (Chapter IV) as well as the way parties' motivation is affected by remedies (Chapter V). Chapter VI represents an exemplary application of the so-developed method to contractual termination. The chapter contextualises the acquired economic knowledge in the contract law systems of three jurisdictions and demonstrates how one can trace and evaluate ongoing transformations of contract law.

It might seem that the thesis pulls in too many directions. Indeed, having spent so much time and so many pages to damages (Chapter III and Chapter V), the account abruptly directs the reader to another remedy: termination. Admittedly, the author could not resist the temptation to tell precisely this story of the Buyer's right to end the contract, as from the start it seemed to fit so well with the hypothesis with which this research started.[1] Yet, if the thesis also purported to make a methodological contribution, Chapter V could not be omitted. If one is to adopt a consequentialist outlook on remedies, one needs to be conscious of the different incentives a remedy generates. For better or for worse, damages is the remedy on which economic analysis centred. In fact, the path of its development constituted the identification of an ever growing number of incentives created precisely by damages. Indeed, while becoming

[1] See *supra* the text accompanying footnote 109 of Chapter I.

acquainted with the economic literature, one may think at times that law has at its disposal no other remedy but damages. Yet, there are no other reasons for this expansion of economic analysis but its origins in a common law jurisdiction for which damages is the principal remedy as well as the susceptibility of damages to be measured, the latter naturally corresponding with economists' affinity to numbering and mathematical calculation.[2] In this sense, if one is to learn to predict the consequences from adopting a given remedy, one needs to pass through the economic model of incentives as induced by damages but does not need to stop there. There is nothing to impede the adaptation and application of the knowledge, so densely concentrated in the economic model, to other remedies. From this perspective, the value of Chapter VI also lies in it extending the understanding, steadily built in the previous chapters, to a different remedy: termination.

More importantly, aside from this economic model, there is hardly any other tool that demonstrates so well the very essence of the economic approach to law. An economist does not start his analysis by enquiring what the prescribed legal remedy is and which interest (expectation, reliance, restitution) it protects. Rather, he asks which the desired effect is and from there reasons backwards to fine-tune the remedy (in the model: the remedy of damages) which would produce such an effect. This thesis, for example, focused on the curbing of strategic behaviour and asked how this can be achieved by tweaking the termination remedy. Economists' fine-tuning, however, remains a largely theoretical construction, difficult, if at all possible, to apply. Resolving legal issues on a daily basis, judges, on the other hand, are the masters of adjusting remedies. Starting from a bright-line rule that allows a free choice between termination and damages, US and English courts curb the Buyer's right to end the contract whenever the breach is not substantial enough. Bulgarian courts, on the other hand, apply a vague standard; yet, they use it with self-restraint to deny termination. That judges continuously fine-tune the remedy does not mean that they always get it right or that they even think in instrumental terms. We have no reason to believe that they adopt such a conscious consequentialist view; yet, this does not change the fact that their decisions produce effects that are relevant from an economic perspective. It

[2] In a way, it is much easier to determine that the optimal amount of damages, all incentives considered, is "x"% of expectation damages; yet, how do you limit the right to terminate by "x"%?

is for academics then to bridge the two skills, the economist's skill to rationalise remedies as instruments to achieve certain goals and the lawyer's skill to constantly tweak remedies, and it is for lawmakers to translate the results of academic studies into concrete policies. This, however, requires that, having understood the economic issues (Chapter IV and Chapter V), scholars leave their comfortable theoretical world to relentlessly study reality and then reconstruct it in economic terms (Chapter VI) in order to see where the distance from efficiency can be shortened.

The thesis commenced with the hypothesis that all national contract laws under comparison have been progressively re-oriented to perform efficiency-driven regulatory function. Having tested the claim in only one contract law area, the availability of the Buyer's termination right, I hasten to emphasise that the findings in this regard can be only tentative and further research is needed to confirm or refute them. Still, at the end of this humble research exercise, I am prepared to revise the hypothesis and state it more subtly: the compared national contract laws converge in charging the termination remedy with regulatory function. They converge in that all three of them regulate Buyer's strategic behaviour by restricting her right to terminate to a similar extent (Chapter VI). In contracts entailing customised performance (construction contracts and contracts for manufacturing and delivery of customised goods) a Seller who has substantially performed is plainly guaranteed his contractual gains less the losses caused by his breach. In contracts for sale of standardised goods national courts, too, struggle to find the balance between adhering to the principle that buyers should not be compelled to accept defective performance and preventing buyers from using a minor breach to coercively rewrite the contract. Indeed, convergence there is. But to reach a common meeting point, national contract laws start from opposite positions. While the common law legal systems move to emphasise deterrence by containing the buyer's unlimited option to terminate, Bulgarian contract law, having experienced a transition from planned to market economy, makes termination more readily available to the buyer and thus has become more facilitative. In this sense, it is difficult to speak of one unitary trend toward more regulation. The mentioned convergence is rather underlain by different tendencies in the legal systems going in different directions.

In fact, if there is something to be learned from the messy reality described in the last chapter, it is that the efficiency of the legal rule largely depends on the institutional framework to which it refers. Notice how the different legal devices restricting the Buyer's right to terminate depend on the deep structure of the respective national legal regime. This can be traced best in the last century's development of the availability of buyer's termination in contracts for sale of standardised goods. Where, consistently with the specific performance principle, the Bulgarian general contract law posits termination as a remedy of last resort, in sales contracts courts use the substantiality criterion as a way to deny the buyer her, otherwise equally available with the other remedies, right to end the contract. The common law legal systems, on the other hand, would not part easily with the buyer's free choice between termination and damages. Clinging to the perfect tender rule, the drafters of the UCC did not abandon it altogether but eroded it by introducing the intermediate remedy of cure. In England where the buyer's right to terminate has always depended on the status of the contractual term, courts introduced flexibility in the rigid condition/warranty distinction by inventing the new category of intermediate terms. There is not, then, one single efficient legal institution but a host of institutions implementing trends in the legal systems which are generally efficient.

Surely, not everything is perfect and many would pose the question about recommended changes to the legal regimes. "It all depends." I would answer lawyerishly, with a wink. A right to cure could be integrated in Bulgarian contract law without much friction, all the more that the legal regime used to employ it in the past. A seller would exercise his liberty to cure only if this is less costly than the termination remedy chosen by the buyer. Simultaneously a right to cure would not noticeably reduce the seller's incentive to tender conforming goods as it would always be cheaper to the seller to perform conformingly from the start rather than breach and cure later.[3] In the US, the section on cure could be spelled out more clearly and, in this respect, it is a pity that the 2003 amendments to the UCC were withdrawn. In England, if ousting the condition/warranty categories appears as too excessive a measure, a more limited adjustment can be made by not treating breach of the section on correspondence with description as a breach of implied condition. The efficient legal reform, in other words, would again depend on the institutional background and the issues faced by each contract law system.

---

[3] Wagner, 163.

This thesis can also be read as a plea that contract law reforms, including new integrated contract law instruments on the European level, reflect the differences between types of contracts (spot v. long-term) with the status of the parties (businessmen v. consumers) introduced only as a second order variable. As limited as the current study is, Chapters IV and VI demonstrated that national contract laws can be rethought within this frame. In this relation the Draft Common Frame of Reference also deserves a mention as it conceptualised service contracts, the construction contract being one of them, as continuous relationships that require legal rules different from those that govern one-shot exchange.[4] This move was lost when the DCFR was scaled down to the Commission's Proposal for Common European Sales Law. As for the CESL, the Commission's efforts to push it forward have so far been unsuccessful. How the Member States will receive the promised "modified" proposal of the Commission concerning online sales only is yet to be seen.[5] And although this thesis does not express any opinion on the need of such a European measure, it raises another more general point. With its Proposal for CESL, the Commission attempted to slip in a good deal of general contract law rules. Whether it will feel brave enough to try something similar with the new "policy mix" it plans to put forward is at this point unclear. Yet, this research suggests that there is a new, important shift going on in contract law. While the sale-of-goods contract used to serve as the paradigm of contracts in general and its case-law laid the foundation assisting the development of the general law, the tendency now seems to go in the opposite direction. This seem to be the heyday of the service contract as legal rules invented in service contract cases now inform the sales case-law[6] and governance mechanisms typical of continuous relationships of cooperation, such as services, are now applied to the increasingly

---

[4] In this sense, see also Möslein 1551.

[5] Eric Clive, 'Proposal for a Common European Sales Law withdrawn' <http://www.epln.law.ed.ac.uk/2015/01/07/proposal-for-a-common-european-sales-law-withdrawn/> accessed 23.09.2015; Paul Caddy, 'Online sales law: out with the old, in with the … ?' <http://blogs.lexisnexis.co.uk/comet/online-sales-law-out-with-the-old-in-with-the/> accessed 23.09.2015; 'Common European Sales Law proposals to be replaced as new consultation is opened on online sales barriers' <http://www.out-law.com/en/articles/2015/june/common-european-sales-law-proposals-to-be-replaced-as-new-consultation-is-opened-on-online-sales-barriers/> accessed 23.09.2015.

[6] Recall *Hongkong Fir Shipping v. Kawasaki Kisen Kaisha* and *Cehave N.V. v. Bremer Handelsgesellschaft M.B.H. (The Hansa Nord).*

long-lived sales contracts.[7] Should not then service contracts be the paradigmatic case on which to build general rules on remedies?

[7] Recall the good faith principles in US and Bulgarian contract law.

Bibliography

Cases

Accurate Bailiffs & Collection Agency Ltd v. ITM Industries Ltd. (1993) 78 BCLR (2d) 1

Aced v. Hobbs-Sesack Plumbing Co. 360 P2d 897 (Cal 1961)

Addis v Gramophone Co. Ltd AC 488 (House of Lords)

Aluminum Co. of America v. Electro Flo Corp. 451 F2d 1115 (10th Cir 1971)

Anthony Pools v. Sheehan 455 A2d 434 (Md 1983)

Appleby v. Myers (1866-1867) LR 2 CP 651

Appleton State Bank v. Lee 148 NW2d 1 (Wis 1967)

Arcos Ltd. v. Ronaasen & Son [1933] AC 470

Ashington Piggeries Ltd. v. Christopher Hill Ltd. [1972] AC 441

Ashmore & Son v C. S. Cox & Co. [1899] 1 QB 436

Atkinson v. Bell (1828) 8 B & Cr 277, 108 ER 1046

Atkinson v. Jackson Brothers 270 SW 848 (Tex Comm App 1925)

Att-Gen v Blake [2001] 1 AC 268

Axion Corp. v. GDC Leasing Corp. 269 NE2d 664 (Mass 1971)

B&M Homes v. Hogan 376 So2d 667 (Ala 1979)

B.S.&N. Ltd. v. Micado Shipping Ltd. (Malta) (The "Seaflower") [2001] 1 Lloyd's Rep 341

Bander v Grossman 161 Misc2d 119 (NY 1994)

Beatty v. Guggenheim Exploration Co. 122 NE 378, 381 (NY 1919)

Beco v. Minnechaug Golf Course 256 A2d 522 (Conn 1968)

Belmont Industries v. Bechtel Corp. 425 FSupp 524 (ED Pa 1976)

Berger and Co. v. Gill & Duffus SA [1984] AC 382

Biggin & Co. Ltd. v. Permanite Ltd. [1951] 1 KB 422

BMC Industries v. Barth Industries 160 F3d 1322 (11th Cir 1998)

Bols Distilleries BV v. Superior Yacht Services Ltd [2006] UKPC 45

Bolton v. Mahadeva [1972] 1 WLR 1009

Bonebrake v. Cox 499 F2d 951 (8th Cir 1974)

Boone v. Eyre 126 Eng Rep 160(a) (KB 1777)

Borrowman, Phillips & Co. v. Free & Hollis (1878) 4 QBD 500

Bowes v. Shand 2 App Cas 455 (HL 1877)

Bremer Handelgesellschaft mbH v. Vanden Avenne-Izegem PVBA [1978] 2 LlLRep 109

British Westinghouse Electric Co Ltd v. Underground Electric Rys [1912] AC 673

Bunge Corp. v. Tradax Export SA [1981] 1 WLR 711

Buxton v. Bedall (1803) 3 East 303, 102 ER 613

Cambridge Plating Co. v. Napco 991 F2d 21 (Mass 1993)

Cehave N.V. v. Bremer Handelsgesellschaft M.B.H. (The Hansa Nord) [1976] QB 44

Charterhouse Credit Co. v. Tolly [1963] 2 QB 683

Clark v. Bulmer (1843) 11 M & W 243, 152 ER 793

Clay v. Yates (1856) 1 H & N 73

Cleveland Bridge UK Ltd v Multiplex Constructions (UK) Ltd [2010] EWCA Civ 139

Co-operative Insurance Society Ltd v Argyll Stores (Holdings) Ltd [1998] AC 1 (House of Lords)

Coakley and Williams, Inc. v Shatterproof Glass Corp. 778 F2d 196 (4th Cir 1985)

Cober v. Corle 610 A2d 1036 (Pa Super 1992)

Coletti v. Knox Hat Co. 169 NE 648 (NY 1930)

Collins Trading Co. v. Maher [1969] VR 20

Colorado Milling & Elevator v. Rapides Grocery 142 So 626 (Lou 1932)

Consolidated Flour Mills v. Di Marco 136 So 657 (La App 1931)

Corbett v. Freedman & Sons 161 NE 415 (Mass 1928)

Davis Contractors v Fareham Urban DC 1956 WL 17734 House of Lords

Della Ratta, Inc. v. American Better Community Developers, Inc. 380 A2d 627 (Md 1977)

Desilets Granite Co. v. Stone Equalizer Corp. 340 A2d 65 (Vt 1975)

Deta Nominees Pty Ltd. v. Viscount Plastic Products Pty Ltd. [1979] VR 167

Dixie Lime & Stone Co. v. Wiggins Scale Co. 240 SE2d 323 (Ga App 1977)

Dodd and Dodd v. Wilson and McWilliam [1946] 2 All ER 691

Duke of St. Albans v. Shore (1789) 1 H Bl 273

Dunlop Pneumatic Tyre Co Ltd v New Garage and Motor Co Ltd [1915] AC 79

Duyck v. Northwest Chem Corp. 764 P2d 943 (Or App 1988)

E. E. & Brian Smith (1928), Ltd. v. Wheatsheaf Mills, Ltd. [1939] 2 KB 302

Electric Reduction Co. v. Colonial Steel Co. 276 Pa 181 (1923)

Elkins Manor Assoc. v. Eleanor Concrete Works 396 SE2d 463 (W Va 1990)

Elrich v. Mezenes 981 P2d 978 (Cal 1999)

Entron, Inc. v. General Cablevision 435 F2d 995 (5th Cir 1970)

Experience Hendrix LLC v PPX Entrerprises Inc and Edward Chaplin [2003] EWCA Civ 323, [2003] 1 All ER (Comm) 830

F. D. Borkholder Co., Inc. v. Sandock 413 NE2d 567 (Ind 1980)

Federal Commerce & Navigation v. Molena Alpha [1979] AC 757

Fiobake Ltd v. Rondo Ltd [2004] EWHC 695 (TCC)

Forslind v. Becheley-Crundall (1922) SC 173 HL

Foster Wheeler Group Engineering v. Chevron UK Unreported February 29, 1996

Frankel v. Foreman & Clark 33 F2d 83 (2d Cir 1929)

Freeman v. Shannon Construction 560 SW2d 732 (Tex 1977)

Frommert v. Bobson Construction 558 NW2d 239 (Mich App 1996)

G Scammell&Nephew Ltd v. Ouston [1941] AC 251

Gassner v. Lockett 101 So2d 33 (Fla 1958)

Getreide Import GmbH v. Itoh & Co. (America) Inc. [1979] 1 Lloyd's Rep 592

Gilbert-Ash (Northern) Ltd. v. Modern Engineering (Bristol) Ltd. [1974] AC 689

Glazebrook v. Woodrow (1799) 8 Term Reports 366

Glover School & Office Equipment Co. v. Dave Hall 372 A2d 221 (Del Super 1977)

Grafton v. Armitage (1845) 2 CB 336

Griffin Grocery v. Richardson 10 F2d 467 (8 Cir 1926)

H. Dakin & Co., Limited v. Lee [1916] 1 KB 566

H. Parsons (Livestock) Ltd. v. Uttley Ingham & Co Ltd [1978] QB 791

Hadley v Baxendale (1854) 9 Ex 341

Haymore v. Levinson 328 P2d 307 (Utah 1958)

Hellman v. Kirschner 191 NY Supp 202 (Sup Ct 1921)

Hensley v. Ray Motor's Co. 580 SE2d 721 (NC App 2003)

Herman v. Bonanza Buildings 390 NW2d 536 (Neb 1986)

Hi-Flyers Ltd. v. Linde Gas U.K. Ltd. [2004] EWHC 105 (QB)

Hibschman Pontiac, Inc. v. Batchelor 362 NE2d 845 (Ind 1977)

Hoenig v. Isaacs [1952] 2 All ER 176

Hongkong Fir Shipping v. Kawasaki Kisen Kaisha [1962] 2 QB 26

Hooker & Sons v. Roberts Cabinet 683 So2d 396 (Miss 1996)

Hyundai Heavy Industries v. Papadopoulos [1980] 1 WLR 1129

In re Trailer & Plumbing Supplies 578 A2d 343 (NH 1990)

Insurance Co. of North America v. Radiant Electric Co. 222 NW2d 323 (Mi 1974)

Intermeat v. American Poultry 575 F2d 1017 (2nd Cir 1978)

Interpretative Ordinance №1 of 19.02.2010, comm c №1/2009, General Assembly of the Civil and Commercial Chambers of the Supreme Cassation Court

Interpretative Ordinance №2 of 29.09.2011, comm c №2/2010, General Assembly of the Civil and Commercial Chambers of the Supreme Cassation Court

Isaacs v. Hardy (1884) Cab & El 287

Jackson Hole Traders v. Joseph 931 P2d 244 (Wyo 1997)

Jacob & Youngs, Inc. v. Kent 129 NE 889 (NY 1921)

Jones v. Barkley (1781) 2 Dougl 684

Jones v. Just (1867-68) LR 3 QB 197

Kaye v Hosier & Dickinson [1972] 1 WLR 146

Kingston v. Preston (1773), unreported

Kraig v. Benjamin 149 Atl 687 (1930)

Krell v. Henry 1903 WL 12966 Court of Appeal

Langhals v. Holt Roofing Co. 47 Ohio App 3d 114, 547 NE2d 401 (6th Dist Lucas County 1988)

Lawson v. Supasink (1984) 3 TrL 37

Le Roy Dyal Co. v. Allen 161 F2d 152 (4th Cir 1947)

Lee v. Griffin (1861) 1 Best and Smith 272, 121 ER 716

Lombard North Central Plc. v. Butterworth [1987] QB 527

Love v. Norman Wright (Builders) Ltd. [1944] KB 484

Lowinson v. Newman 194 NYS 253 (App Div 1922)

Marcel Furriers Ltd v. Tapper [1953] 1 WLR 49

Material Movers v. Hill 316 NW 2d 13 (Minn 1982)

McDougall v. Aeromarine of Emsworth Ltd. [1958] 1 WLR 1126

McNeff v. White Eagle Brewing Co. 13 NE2d 493 (Ill App 1938)

Meyers v. Henderson Construction 370 A2d 547 (NJ Super 1977)

Milau Assoc. v. North Ave. Dev. Corp. 368 NE2d 1247 (NY 1977)

Millar's Machinery Co Ltd v David Way & Son (1935) 40 Com Cas 204

Mitsubishi Goshi Kaisha v. J. Aron 16 F2d 185 (2 Cir 1926)

Neumiller Farms v. Cornett 368 So2d 272 (Ala 1979)

Newman v. Lipman [1951] 1 KB 333

Nitrin, Inc. v. Bethlehem Steel Corp. 342 NE2d 65 (Ill App 1976)

Norrington v. Wright 115 US 188 (1885)

North Am. Leisure Corp. v. A&B Duplicators 468 F2d 695 (2d Cir 1972)

O.W. Grun Roofing & Construction v. Cope 529 SW2d 258 (Tex 1975)

Ogden Martin Systems of Indianapolis v. Whiting Corp. 179 F3d 523 (7th Cir 1999)

Osterholt v. St. Charles Drilling Company 500 FSupp 529 (Miss 1980)

Paynter v James (1866-67) LR 2 CP 348

People v. Howard 451 P2d 401 (Cal 1969)

Philip Head & Sons v. Showfronts [1970] 1 Lloyd's Rep 140

Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co. 532 F2d 572 (7th Cir 1976)

Pittsley v. Houser 875 P2d 232 (Idaho App 1994)

Plante v. Jacobs 103 NW2d 296 (Wis 1960)

Printing Center v. Supermind Publishing 669 SW2d 779 (Tex App 1984)

Pritchett & Gold v. Currie [1916] 2 Ch 515

R. R. Waites Co. v. E. H. Thrift Air Conditioning 510 SW2d 759 (Mo 1974)

Ramirez v. Autosport 440 A2d 1345 (NJ 1982)

Ranger Construction v. Dixie Floor 433 F Supp 442 (DSC 1977)

Re Moore and Landauer [1921] 2 KB 519

Reardon Smith Line Ltd. v. Yngvar Hansen-Tangen [1976] 1 WLR 989

Robinson v. Graves [1935] 1 KB 579

Rockingham County v. Luten Bridge Co. 35 F2d 301 (4th Cir 1929)

Ronaasen & Son v. Arcos Ltd. [1932] LlLRep 1

Ronaasen & Son v. Arcos Ltd. [1932] LlLRep 163

Sal Metal Products Co. v. Rennert 5 UCC RepServ 826 (NY 1968)

Salka v. Dean Homes of Beverly Hills 22 Cal Rptr2d 902 (App Ct 1993)

Schebsman (Deceased) Ex p. Official Receiver, Re [1944] Ch 83

Schenectady Steel Co. v. Bruno Trimpoli Gen. Constr. Co. 350 NYS2d 920 (NYAD 1974)

Schmoll Fils v. L. S. Agoos Tanning 152 NE 630 (Mass 1926)

Shaeffer v. Kelton 619 P2d 1226 (NM 1980)

Shipton, Anderson & Co. v. Weil Bros. & Co. 1 KB 574

SIAT di del Ferro v. Tradax Overseas SA [1980] 1 Lloyd's Rep 53

Smith v. Brady 17 NY 173 (NY 1858)

Smith v. Union Supply 675 P2d 333 (Colo App 1993)

Space Leasing Associates v. Atantic Building Systems, Inc. 241 SE2d 438 (Ga App 1977)

Stephens Industries v. American Express Co. 471 SW2d 501 (Mo 1971)

Stewart v. Newbury 220 NY 379 (Ct App 1917)

Stocznia Gdanska v. Latvian Shipping [1998] 1 WLR 574

Sullivan v. O'Connor 296 NE2d 183 (Mass 1973)

Sumpter v. Hedges [1898] 1 QB 673

T.W. Oil, Inc. v. Consolidated Edison Co. of New York 57 NY2d 574 (NY 1982)

Tarter v. MonArk Boat Co. 430 FSupp 1290 (EDMo 1977)

Taylor v. Caldwell 1863 WL 6052 Court of King's Bench

Taylor v. Oakes, Roncoroni & Co. (1922) 38 TLR 517

Tetley v. Shand (1871) 25 LT 658

Toepfer v. Warinco [1978] 2 LlLRep 569

Tolstoy Construction v. Mamie Minter 78 CalApp3d 665 (Cal 1978)

Tradax Export SA v. European Grain & Shipping Ltd. [1983] 2 Lloyd's Rep 100

Tradax Internacional SA v. Goldschmidt SA [1977] 2 LlLRep 604

Tripp v. Armitage (1839) 4 M & W 687, 150 ER 1597

Truax v. Corrigan 257 US 312

Universal Cargo Carriers Corp. v. Citati [1957] 2 QB 401

Van Clief v. Van Vechten 29 NE 1017 (NY 1892)

Varco-Pruden, Inc. v. Hapmshire Construction Co. 50 Cal App 3d 654 (Cal 1975)

Varney v. Ditmars 111 NE 822 (NY 1916)

Vigers Brothers v. Sanderson Brothers [1901] 1 QB 608

Wagner Tractor Co. v Shields 381 F2d 441 (CAOr 1967)

Wakerman Leather Co. v. Irvin B. Foster Sportswear Co. 34 AD2d 594 (NY 1970)

Wells v. 10-X Mfg. Co. 609 F2d 248 (6th Cir 1979)

Wilson v. Scampoli 228 A2d 848 (DC 1967)

Young & Marten Ltd. v. McManus Childs Ltd. [1969] 1 AC 454

Zabriskie Chevrolet, Inc. v. Smith 240 A2d 195 (NJ 1968)

Zum-winkel v. Legget 345 SW2d 89, 93-94 (Mo 1961)

Statutes and Government Documents

Act on Amending and Supplementing the Act on Obligations and Contracts, promulgated State Gazette №12 of 12.02.1993

Act on Contracts between Socialist Organizations, promulgated State Gazette №85 of 01.11.1963, revoked State Gazette №18 of 02.03.1992

Act on Obligations and Contracts, promulgated State Gazette №2 of 03.01.1950, in force since 01.01.1951, last amended State Gazette №50 of 30.05.2008

Act on Obligations and Contracts, promulgated State Gazette №268 of 01.01.1892, repealed State Gazette №275 of 22.11.1950

Act on Protection of Consumers, promulgated State Gazette №99 of 09.12.2005, in force since 10.06.2006, last amended State Gazette №18 of 01.03.2011

Act on Standardization, promulgated State Gazette №48 of 19.06.1964, revoked State Gazette №55 of 18.06.1999, in force since 19.09.1999

Act on State Arbitration, promulgated State Gazette №127 of 31.05.1950, revoked State Gazette №85 of 15.10.1991

Act on Territorial and Settlement Development, promulgated State Gazette №29 of 10.04.1973, in force since 01.06.1973, repealed State Gazette №1 of 02.01.2001, in force since 31.03.2001

Act on the Organization of the Court System, promulgated State Gazette №23 of 19.03.1976, revoked as of 22.07.1994

Act on the Organization of the Court System, promulgated State Gazette №92 of 07.11.1952, revoked as of 19.03.1976

Act on the Organization of the People's Courts, promulgated State Gazette №70 of 26.03.1948; revoked as of 07.11.1952

Code of Civil Procedure, promulgated State Gazette №59 of 20.07.2007, in force since 01.03.2008, last ammended State Gazette №5 of 14.11.2011

Commercial Act, promulgated State Gazette №114 of 01.01.1897, revoked State Gazette №78 of 28.09.1981

Commercial Act, promulgated State Gazette №48 of 18.06.1991, in force since 01.07.1991, last amended State Gazette №34 of 29.04.2011

Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, Official Journal L 241/26 of 02.09.2006

Commission Regulation (EC) No 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive, Official Journal L 241/1 of 02.09.2006

Commission Regulation 461/2010 on the application of Article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices in the motor vehicle sector, Official Journal L 129/52 of 28.05.2010

Commission Report of 23 September 2005: First Annual Progress Report on European Contract Law and the Acquis Review, COM(2005) 456 final, Not published in the Official Journal

Commission Report of 25 July 2007: Second Progress Report on the Common Frame of Reference [COM(2007) 447 final - Not published in the Official Journal]

Common European Sales Law to Boost Trade and Expand Consumer Choice. Press Release (Justice Newsroom http://ec.europa.eu/justice/newsroom/news/20111011_en.htm Last updated on 03/02/2012. Last accessed on 04/08/2012 2011)

Communication from the Commission to the Council and the European Parliament on European contract law COM(2001) 398 final, Official Journal C 255/1 of 13.09.2001

Communication from the Commission to the Council and the European Parliament. Prospects for the internal gas and electricity market, COM(2006) 841 final, Brussels, 10.01.2007 (2.6.2)

Communication from the Commission to the European Parliament and the Council - A more coherent European contract law - An action plan, COM(2003) 68 final, Official Journal C 63/1 of 15.03.2003

Communication from the Commission to the European Parliament and the Council - European Contract Law and the revision of the acquis: the way forward, COM(2004) 651 final, Not published in the Official Journal

Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. A Common European Sales Law to Facilitate Cross-Border Transactions in the Single Market, COM(2011) 636 final, Brussels, 11.10.2011, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0636:FIN:en:PDF

Constitution of the Republic of Bulgaria, promulgated State Gazette №56 of 13.07.1991, in force as of 13.07.1991, last ammended State Gazette №12 of 06.02.2007

Council Directive 85/577/EEC of 20 December 1985 to protect the consumer in respect of contracts negotiated away from business premises, Official Journal L 372/31 of 31.12.1985

Council Directive 90/314/EEC of 13 June 1990 on package travel, package holidays and package tours, Official Journal L 158/59 of 23.06.1990

Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, Official Journal L 95/29 of 21.04.1993

Council Regulation (EC) No 44/2001of 22 December 2000 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, Official Journal L 12/1 of 16.01.2001

Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market ('Directive on electronic commerce'), Official Journal L 178/1 of 17.07.2000

Directive 2003/54/EC of the European Parliament and of the Council concerning common rules for the internal market in electricity, Official Journal L 176/37 of 15.07.2003

Directive 2003/55/EC of the European Parliament and of the Council of 26 June 2003 concerning common rules for the internal market in natural gas and repealing Directive 98/30/EC, Official Journal L 176/57 of 15.07.2003

Directive 2004/18/EC of the European Parliament and of the Council of 31 March 2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts, Official Journal L134/114 of 30.04.2004

Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, Official Journal L 145/1 of 30.4.2004

Directive 2005/29/EC of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market and amending Directives 84/450/EEC, 97/7/EC, 98/27/EC and 2002/65/EC and Regulation (EC) No 2006/2004 (Unfair Commercial Practices Directive), Official Journal L 149/22 of 11.06.2005

Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market, Official Journal L 376/36 of 27.12.2006

Directive 2009/24/EC of the European Parliament and of the Council of 23 April 2009 on the legal protection of computer programs, Official Journal L 111/16 of 05.05.2009

Directive 97/7/EC of the European Parliament and of the Council of 20 May 1997 on the protection of consumers in respect of distance contracts, Official Journal L 144/19 of 04.06.1997

Directive 99/44/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 171/12 of 07.07.1999

Drucksachen und Protokolle 14/6040 (2001)

European Parliament resolution of 8 June 2011 on policy options for progress towards a European Contract Law for consumers and businesses (2011/2013(INI)), http://www.europarl.europa.eu/sides/getDoc.do?type=TA&language=EN&reference=P7-TA-2011-0262

Green Paper on policy options for progress towards a European Contract Law for consumers and businesses, http://ec.europa.eu/justice/news/consulting_public/news_consulting_0052_en.htm

Judiciary Act, promulgated State Gazette №64 of 07.08.2007, last ammended State Gazette №93 of 25.11.2011

Law on Normative Acts, promulgated State Gazette №27 of 03.04.1973, last ammended State Gazette №46 of 12.06.2007

Long-Term Programme of the Party for Quality Improvement. National Party Conference 22-23 March 1984

Opinion of the European Economic and Social Committee on the Green Paper from the Commission on policy options for progress towards a European contract law for consumers and businesses COM(2010) 348 final, Official Journal C 84/1 of 17.03.2011

Ordinance №3 of 31.07.2003 on Drawing Up Acts and Protocols in the Course of Construction, promulgated State Gazette №72 of 15.082003, last ammended State Gazette №29 of 07.04.2006

Ordinance on the Specific Rules for Governing the Business Organizations and Units in the Transportation Branch, promulgated State Gazette №101 of 21.12.1979, revoked State Gazette №1 of 04.01.1991

Parliament Resolution of 26 May 1989, Official Journal C 158/400 of 26.06.1989

Parliament Resolution of 6 May 1994, Official Journal C 205/518 of 25.07.1994

Proposal for a Regulation of the European Parliament and of the Council for a Common European Sales Law, COM(2011) 636 final, Brussels, 11.10.2011, http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2011:0635:FIN:en:PDF

Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations, Official Journal 177/6 of 04.07.2008

Regulation on Capital Construction, promulgated State Gazette №44 of 01.06.1951

Regulation on Capital Construction, promulgated State Gazette №55 of 15.07.1980, revoked State Gazette №16 of 27.02.1987

Regulation on Capital Construction, promulgated State Gazette №98 of 11.12.1973, revoked State Gazette №55 of 15.07.1980

Sale and Supply of Goods. Law Commission №160 (1987)

Sale and Supply of Goods. Law Commission Working Paper №85. Scottish Law Commission Consultative Memorandum №58 (1983)

Spatial Development Act, promulgated State Gazette №1 of 02.01.2001, in force as of 31.03.2001, last ammended State Gazette №80 of 14.11.2011

The Gallup Organization H, *Flash Eurobarometer Series #320. European Contract Law in Business-to-Business Transactions. Analytical Report Conducted Upon the Request of the DG JUSTICE-A-2: Civil Law and Contract Law* (http://eceuropaeu/public_opinion/flash/fl_320_enpdf, 2011)

The Gallup Organization H, *Flash Eurobarometer Series #321. European Contract Law in Business-to-Consumer Transactions. Analytical Report Conducted Upon the Request of the DG JUSTICE-A-2: Civil Law and Contract Law* (http://eceuropaeu/public_opinion/flash/fl_321_enpdf, 2011)

Treaty on the Functioning of the European Union, Official Journal C 115/70 of 09.05.2008

UK ST 1982 c. 29 The Supply of Goods and Services Act 1982

Books and Articles

Adams D, *The Hitchhiker's Guide to the Galaxy* (25th Anniversary edn, Crown 2004)

Adler B, ‘The Questionable Ascent of Hadley v. Baxendale’ (1999) 51 Stanford Law Review 1547

Akerlof G, ‘The Market for "Lemons": Quality Uncertainty and the Market Mechanism’ (1970) 84 The Quarterly Journal of Economics 488

Alchian A and Demsetz H, ‘Production Information Costs and Economic Organization’ (1972) 62 American Economic Review 777

Anonymous, ‘Common European Sales Law proposals to be replaced as new consultation is opened on online sales barriers’ <http://www.out-law.com/en/articles/2015/june/common-european-sales-law-proposals-to-be-replaced-as-new-consultation-is-opened-on-online-sales-barriers/> accessed 23.09.2015

Aoki M, *Toward a Comparative Institutional Analysis* (First edn, Cambridge, Massachusetts; London: MIT Press 2001)

Apostolov I, ‘Grounds of Contractual Liability’ (1940/1941) 34 Yearbook of "St Kliment Ohridski" University - Sofia, Law Department 3

Apostolov I, ‘On the Theory of the Creditor's Pecuniary Interest in Contract’ (1937/1938) 33 Yearbook of "St Kliment Ohridski" University - Sofia, Law Department 3

Apostolov I, *Law of Obligations. First part. General Theory of Obligation* (Second edn, Sofia: Bulgarian Academy of Sciences Publishing House 1990)

Apps A, ‘The Right to Cure Defective Performance’ (1994) Lloyd's Maritime and Commercial Law Quarterly 525

Atiyah P and Summers RS, *Form and Substance in Anglo-American Law - A Comparative Study of Legal Reasoning, Legal Theory and Legal Institutions* (First edn, Oxford: Clanderon Press; New York: Oxford University Press 1987)

Atiyah P, ‘Common Law and Statute Law’ (1985) 48 Modern Law Review 1

Atiyah P, *Promises, Morals and the Law* (Oxford: Clanderon Press 1981)

Ayres I and Gertner R, ‘Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules’ (1989) 99 Yale Law Journal 87

Ayres I and Talley E, ‘Solomonic Bargaining: Dividing a Legal Entitlement to Facilitate Coasean Trade’ (1995) 104 Yale Law Journal 1027

Ayres I, ‘Making a Difference: The Contractual Contributions of Easterbrook and Fischel’ (1992) 59 University of Chicago Law Review 1391

Ayres I, 'Valuing Modern Contract Scholarship' (2003) 112 Yale Law Journal 881

Baird D, 'Self-Interest and Cooperation in Long-Term Contracts' (1990) 19 The Journal of Legal Studies 583

Bakardjieva Engelbrekt A, 'Toward an Institutional Approach to Comparative Economic Law' in Bakardjieva Engelbrekt A and Nergelius J (eds), *New Directions in Comparative Law* (First edn, Cheltenham: Edward Elgar 2009)

Barnett R, 'A Consent Theory of Contract' (1986) 86 Columbia Law Review 269

Beale H, 'Chapter 26. Damages' in Beale H (ed), *Chitty on Contracts General Principles*, vol I (Thirty-first edn, London: Sweet&Maxwell; Thomson Reuters 2012)

Bebchuk L and Shavell S, 'Information and the Scope of Liability for Breach of Contract: The Rule of Hadley v. Baxendale' (1991) 7 The Journal of Law, Economics and Organization 284

Ben-Shashar O and Bernstein L, 'The Secrecy Interest in Contract Law' (2000) 109 Yale Law Journal 1885

Berkowitz D, Pistor K and Jean-François R, 'The Transplant Effect' (2003) 51 American Journal of Comparative Law 163

Berkowitz D, Pistor K and Richard J-F, 'Economic Development, Legality and the Transplant Effect' (2003) 47 European Economic Review 165

Bernstein L, 'Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms and Institutions' (2001) 99 Michigan Law Review 1724

Binmore K, *Playing for Real. Game Theory* (First edn, New York: Oxford University Press 2007)

Black J, 'Regulatory Conversations' (2002) 29 Journal of Law and Society 163

Blackstone W, Sir, *Commentaries on the Laws of England*, vol 4 (Oxford: Clarendon Press 1765-1769)

Braucher J, 'Contract versus Contractarianism: The Regulatory Role of Contract Law' (1990) 47 Washington and Lee Law Review 697

Braykov V, 'Issues of the Liability under Art. 193 ff. of the Act on Obligations and Contracts as an Instrument for Influencing the Quality of the Lodgings Sold' (1984) 3 Legal Thought 83

Braykov V, *The Sale Contract - Companion of Civilization* (First edn, Sofia: Sibi 2014)

Bridge M, 'Freedom to Exercise Contractual Rights of Termination' in Gullifer L and Vogenauer S (eds), *English and European Perspectives on Contract and Commercial Law: Essays in Honour of Hugh Beale* (Oxfrord: Hart Publishing 2014)

Bridge M, ‘The Evolution of Modern Sales Law’ (1991) Lloyd's Maritime and Commercial Law Quarterly 52

Bridge M, *The Sale of Goods* (First edn, Oxford: Clanderon Press 1997)

Brooks R and Stremitzer A, ‘Remedies On and Off Contract’ 120 The Yale Law Journal 690

Brousseau E, ‘Contracts: From Bilateral Set of Incentives to the Multi-Level Governance of Relations’ in Jean-Michel Glachant and Brousseau E (eds), *New Institutional Economics: A Guidebook* (First edn, Cambridge, UK/New York: Cambridge University Press 2008)

Burov B, ‘Civil Law Methods in the Struggle for Quality’ in Burov B (ed), *Law in the Struggle for Quality of the Industrial Goods* (Sofia: Bulgarian Academy of Sciences Publishing House 1958)

Caddy P, ‘Online sales law: out with the old, in with the … ?’ <http://blogs.lexisnexis.co.uk/comet/online-sales-law-out-with-the-old-in-with-the/> accessed 23.09.2015

Cafaggi F and Muir Watt H, ‘The Making of European Private Law: Regulation and Governance Design’ EUROGOV Working paper, 20 March 2007 <http://www.ihs.ac.at/publications/lib/ep13.pdf> accessed 17.09.2012

Cafaggi F and Muir-Watt H (eds), *Making European Private Law: Governance Design* (Cheltenham: Edward Elgar 2008)

Cafaggi F and Muir-Watt H (eds), *The Regulatory Function of European Private Law* (Cheltenham/Nothampton: Edward Elgar 2009)

Cafaggi F, ‘A Coordinated Approach to Regulation and Civil Liability in European Law: Rethinking Institutional Complementarities’ in Cafaggi F (ed), *The Institutional Framework of European Private Law* (First edn, Oxford/New York: Oxford University Press 2006)

Cafaggi F, ‘From a Status to a Transaction-Based Approach? Institutional Design In European Contract Law’ (2013) 50 Common Market Law Review 311

Cafaggi F, ‘Private Regulation in European Private Law’ EUI Working Papers, RSCAS 2009/31, Robert Schuman Center for Advanced Studies, Private Regulation Series-01

Cafaggi F, ‘Rethinking Private Regulation in the European Regulatory Space’ in Cafaggi F (ed), *Reframing Self-regulation in European Private Law* (The Hague: Kluwer Law International 2006)

Cafaggi F, ‘The Making of European Private Law: Governance Design’ in Cafaggi F and Muir-Watt H (eds), *Making European Private Law: Governance Design* (First edn, Cheltenham, UK; Northhampton, MA, USA: Edward Elgar 2008)

Cafaggi F, Nicita A and Pagano U, 'Law, Economics, and Institutional Complexity. An Introduction' in Cafaggi F, Nicita A and Pagano U (eds), *Legal Orderings and Economic Institutions* (First edn, London and New York: Routledge 2007)

Calabresi G and Melamed D, 'Property Rules, Liability Rules, Inalienability: One View of the Cathedral' (1972) 85 Havard Law Review 1089

Calabresi G, *A Common Law for the Age of Statutes* (First edn, Cambridge, Massachusetts: Harvard University Press 1982)

Calabresi G, *The Cost of Accidents: A Legal and Economic Analysis* (Fifth edn, New Haven: Yale University 1977)

Camerer C and others, 'Regulation for Conservatives: Behavioural Economics and the Case for Asymmetric Paternalism' (2003) 151 University of Pennsylvania Law Review 1211

Camerer C, *Behavioural Game Theory: Experiments in Strategic Interaction* (New York: Russel Sage Foundation; Princeton, New Jersey: Princeton University Press 2003)

Che Y-K and Chung T-Y, 'Contract Damages and Cooperative Investments' (1999) 30 The Rand Journal of Economics 84

Che Y-K and Hausch D, 'Cooperative Investments and the Value of Contracting' (1999) 89 American Economic Review 125

Cheung S, 'On the New Institutional Economics' in Cheung S (ed), *Economic Explanations: Selected Papers of Steven Cheung* (First edn, Hong Kong: Arcadia Press Ltd. 2005)

Chirico F, 'The Function of European Contract Law - An Economic Analysis' in Chirico F and Larouche P (eds), *Economic analysis of the DCFR: the Work of the Economic Impact Group within CoPECL* (München: Sellier European Law Publishers 2010)

Clive E, 'Proposal for a Common European Sales Law withdrawn' <http://www.epln.law.ed.ac.uk/2015/01/07/proposal-for-a-common-european-sales-law-withdrawn/> accessed 23.09.2015

Coase R, 'Coase on Posner on Coase: Comment' (1993) 149 Zeitschrift für die GesamteStaatswissenschaft (Journal of Institutional and Theoretical Economics) 96

Coase R, 'Concluding Comment' (1993) 149 Zeitschrift für die GesamteStaatswissenschaft (Journal of Institutional and Theoretical Economics) 360

Coase R, 'Law and Economics and A. W. Brian Simpson' (1996) 25 Journal of Legal Studies (Oxford University Press, Oxford, UK, January 1996) 103

Coase R, 'The Nature of the Firm' (1937) 4 Economica 386

Coase R, ‘The New Institutional Economics’ (1998) 88 The American Economic Review 72

Coase R, ‘The Problem of Social Cost’ (1960) 3 The Journal of Law and Economics 1

Coase R, *The Firm, the Market and the Law* (First edn, Chicago: University of Chicago Press 1988)

Cohen G, ‘Fault Lines in Contract Damages’ (1994) 80 Virginia Law Review 1225

Cole D and Grossman P, ‘The Meaning of Property "Rights": Law vs. Economics’ (2002) 78 Land Economics 317

Collins H, ‘Governance Implications for the European Union of the Changing Character of Private Law’ in Cafaggi F and Muir-Watt H (eds), *Making European Private Law: Governance Design* (Cheltenham: Edward Elgar 2008)

Collins H, ‘Regulating Contract Law’ in Parker C and others (eds), *Regulating Law* (First edn, Oxford: Oxford University Press 2004)

Collins H, ‘The Alchemy of Deriving General Principles of Contract Law from European Legislation: In Search of the Philosopher's Stone’ (2006) 2 European Review of Contract Law 213

Collins H, *Regulating Contracts* (First edn, Oxford/New York: Oxford University Press 1999)

Cook P and Graham D, ‘The Demand for Insurance and Protection: The Case of Irreplaceable Commodities’ (1977) 91 Quarterly Journal of Economics 143

Cooter R and Eisenberg M, ‘Damages for Breach of Contract’ (1985) 73 California Law Review 1432

Cooter R and Eisenberg M, ‘Damages for Breach of Contract’ (1985) 73 California Law Review 1432

Cooter R and Ulen T, *Law and Economics* (Fifth edn, Pearson/Addison-Wesley 2008)

Cooter R and Ulen T, *Law and Economics* (Sixth edn, Boston: Pearson Education, Inc. 2012)

Cooter R, ‘The Cost of Coase’ (1982) 11 Journal of Legal Studies 1

Cooter R, ‘The Future of Law and Economics’ in Cafaggi F, Nicita A and Pagano U (eds), *Legal Orderings and Economic Institutions* (First edn, London and New York: Routledge 2007)

Cooter R, ‘Unity in Tort, Contract, and Property: The Model of Precaution’ (1985) 73 California Law Review 1

Corbin A, *Contracts* (St. Paul, Minnesota: West Publishing 1963)

Craswell R and Schwartz A, *Foundations of Contract Law* (First edn, New York/Oxford: Oxford University Press 1994)

Craswell R, 'Against Fuller and Perdue' (2000) 67 The University of Chicago Law Review 99

Craswell R, 'Contract Law, Default Rules and the Philosophy of Promising' (1989) 88 Michigan Law Review 489

Craswell R, 'Contract Remedies, Renegotiation and the Theory of Efficient Breach' (1988) 61 Southern California Law Review 629

Craswell R, 'Insecurity, Repudiation and Cure' (1990) 19 Journal of Legal Studies 399

Craswell R, 'Performance, Reliance and One-Sided Information' (1989) 18 The Journal of Legal Studies 365

Craswell R, 'Precontractual Investigation as an Optimal Precaution Problem' (1988) 17 The Journal of Legal Studies 401

Craswell R, 'Two Economic Theories of Enforcing Promises' in Benson P (ed), *The Theory of Contract Law New Essays* (First edn, Cambridge, UK: Cambridge University Press 2001)

Daintith T, 'Chapter 10 Regulation' in Buxbaum R and Mádl F (eds), *International Encyclopedia of Comparative Law* vol XVII State and Economy (First edn, Tübingen: J. C. B. Mohr (Paul Siebeck); Dordrecht/Boston/Lancaster: Martinus Nijhoff Publishers 1997)

David R and Brierley J, *Major Legal Systems in the World Today* (Third edn, London: Stevens 1985)

Dawson F, 'Chapter 17. Remedies of the Buyer' in Bridge M (ed), *Benjamin's Sale of Goods* (Eighth edn, London: Sweet&Maxwell/Thomson Reuters 2010)

Dawson J, *The Oracles of the Law* (Second edn, Westport, Connecticut: Greenwood Press 1978)

Deakin S and Wilkinson F, 'Labour Law and Economic Theory: A Reappraisal' in De Geest G, Siegers J and van den Bergh R (eds), *Law and Economics and the Labour Market* (First edn, Northampton, MA: Edward Elgar 1999)

Deakin S, 'Law *versus* Economics? Reflections on the Normative Foundations of Economic Activity' in Richardson M and Hadfield G (eds), *The Second Wave of Law and Economics* (First edn, Sydney: The Federation Press 1999)

Deakin S, *Law and Economic Growth* (Presentation, European University Institute March 2011)

Devlin L, 'The Treatment of Breach of Contract' (1966) 24 Cambridge Law Journal 192

Diamond P and Maskin E, 'An Equilibrium Analysis of Search and Breach of Contract II. A Non-Steady Example' (1981) 25 Journal of Economic Theory 165

Diamond P and Maskin E, 'An Equilibrium Analysis of Search and Breach of Contract, I: Steady States' (1979) 10 The Bell Journal of Economics 282

Dimitrov M, *The Construction Contract* (First edn, Sofia: Sibi 2012)

Djankov S and others, 'The New Comparative Economics' (2003) 31 Journal of Comparative Economics 595

Dobbs D, *Law of Remedies: Damages, Equity, Restitution* (Second. An Abridgement edn, St. Paul, Minnesota: West Publishing 1993)

Dworkin R, 'Is Wealth a Value?' (1980) 9 Journal of Legal Studies 323

Edlin A and Reichelstein S, 'Holdups, Standard Breach Remedies and Optimal Investment' (1996) 86 The American Economic Review 478

Edlin A, 'Aspects of the Efficient Recovery of Fixed Costs: A Collection of Essays' (Stanford University 1993)

Edlin A, 'Breach Remedies' in Newman P (ed), *The New Palgrave Dictionary of Economics and the Law*, vol I (First edn, London: Macmillan Reference Limited 1998)

Edlin A, 'Cadillac contracts and Up-Front Payments: Efficient Investment under Expectation Damages' (1996) 12 Journal of Law, Economics and Organization 98

Eisenberg M and McDonnell B, 'Expectation Damages and the Theory of Overreliance' (2002) 54 Hastongs Law Journal 1335

Eisenberg M, 'Relational Contracts' in Jack B and Friedmann D (eds), *Good Faith and Fault in Contract Law* (First edn, Oxford: Clanderon Press 1995)

Eisenberg M, 'The Limits of Cognition and the Limits of Contracts' (1995) 47 Stanford Law Review 211

Eisenberg MA, 'The Theory of Contracts' in Benson P (ed), *The Theory of Contract Law: New Essays* (First edn, Cambridge: Cambridge University Press 2001)

Enneccerus L and Lehman H, *Recht der Schuldverhältnisse* (Fifteenth edn, Tübingen: Mohr 1958)

Eno L, 'Price Movement and Unstated Objections to Defective Performance of Sales Contracts' (1935) 44 Yale Law Journal 782

Farnsworth A, *Farnsworth on Contracts*, vol I (Third edn, New York: Aspen Publishers 2004)

Farnsworth A, *Farnsworth on Contracts*, vol II (Third edn, New York: Aspen Publishers 2004)

Farnsworth A, *Farnsworth on Contracts*, vol III (Third edn, Aspen Publishers 2004)

Farrell J, ‘Cheap Talk, Coordination and Entry’ (1987) 18 The Rand Journal of Economics 34

Faust F, ‘Comparative Law and Economic Analysis of Law’ in Reimann M and Zimmermann R (eds), *The Oxford Handbook of Comparative Law* (First edn, Oxford: Oxford University Press 2006)

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

Fudenberg D and Tirole J, ‘Moral Hazard and Renegotiation in Agency Contracts’ (1990) 58 Econometrica 1279

Fuller L and Perdue W, ‘The Reliance Interest in Contract Damages: 1’ (1936) 46 Yale Law Journal 52

Fuller L and Perdue W, ‘The Reliance Interest in Contract Damages: 2’ (1937) 46 Yale Law Journal 373

Gaius, *Institutes of Roman Law*, vol III

Ganev V, *Course in General Theory of Law* (Sofia: "Prof. Marin Drinov" Academic Publishing House 1995)

Geest GD, ‘Specific Performance, Damages and Unforeseen Contingencies in the Draft Common Frame of Reference’ in Chirico F and Larouche P (eds), *Economic analysis of the DCFR: the Work of the Economic Impact Group within CoPECL* (Sellier European Law Publishers 2010)

Gerdjikov O and Buzeva T, ‘The Amendments and Supplements to the Act on Obligations and Contracts’ (1993) 2 Contemporary Law 15

Gilson R, Sabel C and Scott R, ‘Contracting for Innovation: Vertical Disintegration and Interfirm Collaboration’ (2009) 109 Columbia Law Review 431

Gintis H, *The Bounds of Reason: Game Theory and the Unification of the Behavioral Sciences* (Princeton, NJ: Princeton University Press 2009)

Glenn HP, ‘A Concept of Legal Tradition’ (2008) 34 Queen's Law Journal 427

Glenn HP, ‘Chapter 12 Comparative Legal Families and Comparative Legal Traditions’ in Reimann M and Zimmermann R (eds), *The Oxford Handbook of Comparative Law* (First edn, Oxford: Oxford University Press 2006)

Goetz C and Scott R, ‘Enforcing Promises: An Examination of the Basis of Contract’ (1980) 89 The Yale Law Journal 1261

Goetz C and Scott R, 'Principles of Relational Contracting' (1981) 67 Virginia Law Review 1089

Goetz C and Scott R, 'The Mitigation Principle: Toward a General Theory of Contractual Obligation' 69 Virginia Law Review 967

Goldberg V, 'Relational Exchange: Economics and Complex Contracts' in Goldberg V (ed), *Readings in the Economics of Contract Law* (First edn, Cambridge: Cambridge University Press 1989)

Goleminov C, 'Bonification Issues in Arbitration Case-law' [1960] Legal Thought 93

Goleminov C, 'Business Contracts and the Struggle for Quality of Production' (1984) 2 Legal Thought 5

Goleminov C, 'Price Reduction on Account of Defects (in the Quality of Output) in Supply Contracts Between Socialist Organizations' (1960) 11 Bulletin of the Legal Institute 207

Goleminov C, *Civil Liability for Defective Goods* (First edn, Sofia: Romina 2001)

Goleva P, *Law of Obligations* (Sofia: Feneya 2008)

Golobardes MAi and Pomar FG, 'Long-Term Contracts in the Law and Economics Literature' in Geest GD (ed), *Contract Law and Economics Encyclopedia of Law and Economics*, vol VI (Second edn, Cheltenham, UK/ Northhampton, MA, USA: Edward Elgar 2011)

Gomez F and Ganuza J-J, 'The Economics of Private Law Harmonised Law-making: Mechanisms, Modes and Standards' in Brownsword R and others (eds), *The Foundations of European Private Law* (First edn, Oxford and Portland, Oregon: Hart Publishing 2011)

Gomez F, 'Breach of Contract Issues in Long-Term Distribution Contracts' (Presentation, EUI, Florence, 22 January 2010)

Gomez F, 'Cooperation, Long-Term Relationships and Open-Endedness in Contractual Networks' in Cafaggi F (ed), *Contractual Networks, Inter-Firm Cooperation and Economic Growth* (First edn, Cheltenham: Edward Elgar 2011)

Gomez F, 'Termination and Compensation in Long-Term Distribution Contracts: An Economic Perspective of EU Law' in Larouche P and Chirico F (eds), *Economic Analysis of the DCFR The Work of the Economic Impact Group within CoPECL* (München: Sellier European Law Publishers 2010)

Goodman J, 'An Economic Theory of the Evolution of Common Law' (1982) 7 Journal of Legal Studies 393

Gordley J, 'The Functional Method' in Monateri PG (ed), *Methods of Comparative Law* (First edn, Cheltenham: Edward Elgar Publishing 2012)

Gotsev V, *Contractual and Delictual Liability: Comparison and Competition* (First edn, Sofia: Science and Art 1979)

Grossman S, 'The Informational Role of Warranties and Private Disclosure about Product Quality' (1981) 24 Journal of Law and Economics 461

Grundmann S, 'European Contract Law(s) of What Colour' [2005] European Review of Contract Law 184

Grundmann S, 'Regulating Breach of Contract - the Right to Reject Performance by the Party in Breach' (2007) 3 European Review of Contract Law 121

Grundmann S, 'The Structure of European Contract Law' (2001) 9 European Review of Private Law 505

Grundmann S, 'Transaction Costs and Economic Theory' in Grundmann S, Micklitz H-W and Renner M (eds), *Grand Theories of Private Law* (forthcoming)

Grundmann S, *Europäisches Schuldvertragsrecht - das Europäische Recht der Unternehmensgeschäfte (nebst Texten and Materialen zur Rechtsangleichung)* (First edn, Berlin: Walter de Gruyter 1999)

Guest AG, 'Chapter 12. Classification of Terms' in Beale HG (ed), *Chitty on Contracts General Principles*, vol I (Thirty-First edn, London: Sweet&Maxwell/Thomson Reuters 2012)

Guest AGR, F. M. B.; Beale, H. G., 'Chapter 43. Sale of Goods' in Beale HG (ed), *Chitty on Contracts*, vol II (Thirty-first edn, London: Sweet&Maxwell/Thomson reuters 2012)

Guriev S, 'Incomplete Contracts with Cross-Investments' (2003) 3 Contributions to Theoretical Economics

Hadfield G, 'Judicial Competence and the Interpretation of Incomplete Contracts' (1994) 23 Journal of Legal Studies 159

Halsbury's Law of England. Damages, vol 12(1) (Fourth. Reissue edn, London: Butterworths 1998)

Hart O and Moore J, 'Incomplete Contracts and Renegotiation' (1988) 56 Econometrica 755

Hart O, *Firms, Contracts and Financial Structure* (First edn, Oxford: Clanderon Press 1995)

Hausman D and McPherson M, 'Taking Ethics Seriously: Economics and Contemporary Moral Philosophy' (1993) 31 Journal of Economic Literature 671

Hawkland W, *Sales and Bulk Sales Under the Uniform Commercial Code* (1958)

Hay D, McKeering S and Tulloch M (eds), *Halsbury's Laws of England. Contempt of Court. Contract*, vol 22 (Fifth edn, London: Lexis Nexis 2012)

Hermalin B, Katz A and Craswell R, ‘Contract Law’ in Polinsky AM and Shavell S (eds), *Handbook of Law and Economics*, vol 1 (First edn, Amsterdam/London: North-Holland 2007)

Honnold J, ‘Buyer's Right of Rejection: A Study in the Impact of Codification upon a Commercial Problem’ (1949) 97 University of Pennsylvania Law Review 457

Huber P, ‘Comparative Sales Law’ in Reimann M and Zimmermann R (eds), *The Oxford Handbook of Compartive Law* (Oxford: Oxford University Press 2006)

Huber P, ‘Price Reduction’ in Jürgen B and others (eds), *The Max Planck Encyclopedia of European Private Law*, vol II (First edn, Oxford: Oxford University Press 2012)

Hviid M, ‘Long-Term Contracts and Relational contracts’ in Bouckaert B and Geest Gd (eds), *The Encyclopaedia of Law and Economics*, vol III (First edn, Edward Elgar/University of Ghent 2000)

Ivanov M, ‘Socialist Welfare State and the "Consensus of Hypocrisy"’ [2011] Sociological Problems 235

Jivkov T, *Quality - Key Issue for Building a Mature Socialist Society. Speech at the National Conference of the Party, State, Economic and Society Most Active Members, Varna, 30.05.1983* (Sofia: Partizdat 1983)

Johnston J, ‘Bargaining Under Rules Versus Standards’ (1995) 11 Journal of Law, Economics and Organization 256

Johnston J, ‘Strategic Bargaining and the Economic Theory of Contract Default Rules’ (1990) 100 Yale Law Journal 615

Kahan M and Klausner M, ‘Standardization and Innovation in Corporate Contracting (Or the Economics of Boilerplate)’ (1997) 83 Virginia Law Review 713

Kalaydjiev A, *Law of Obligations. General Part* (Third edn, Sofia: Sibi 2005)

Kaplow L and Shavell S, *Fairness versus Welfare* (First edn, Cambridge, MA: Harvard University Press 2002)

Kaplow L, ‘Rules versus Standards: An Economic Analysis’ (1992) 42 Duke Law Journal 557

Kelsen H, *General Theory of Law and State* (New York: Russel and Russel 1961)

Kerber W, ‘European System of Private Laws: An Economic Perspective’ in Cafaggi F and Muir-Watt H (eds), *Making European Private Law: Governance Design* (Cheltenham: Edward Elgar 2008)

Kessler F, ‘The Protection of the Consumer under Modern Sales Law (1964). Faculty Scholarship Series. Paper 2725. ’ <http://digitalcommons.law.yale.edu/fss_papers/2725/>

Klein B, 'The Role of Incomplete Contracts in Self-Enforcing Relationships' in Brousseau E and Glachant J-M (eds), *The Economics of Contracts: Theories and Applications* (First edn, Cambridge/New York: Cambridge University Press 2002)

Klein B, Crawford R and Alchian A, 'Vertical Integration, Appropriable Rents and the Competitive Contracting Process' (1978) 21 Journal of Law and Economics 297

Kojuharov A, *Law of Obligations. General Theory of Obligations*, vol I (Sofia: Science and Art 1958)

Kojuharov A, *Law of Obligations. General Theory of Obligations*, vol I (Gerdjikov O ed, 2nd edn, Sofia: Sofi-R 1996)

Kojuharov A, *Law of Obligations. Specific Contracts*, vol III (Gerdjikov O ed, 2nd edn, Sofia: Sofi-R 1996)

Konov T and Kalaydjiev A, 'Liability in Case of Infringed Negative Interest' (1988) 11 State and Law 24

Konov T, *Selected Works. Grounds of Civil Liability* (Third edn, Sofia: Reguli 2002)

Konradi W, 'The Role of *Lex Mercatoria* in Supporting Globalised Transactions: An Empirical Insight into the Governance Structure of the Timber Industry' in Gessner W (ed), *Contractual Certainty in International Trade* (Oxford: Hart Publishing 2009)

Kornhauser L, 'An Introduction to the Economic Analysis of Contract Remedies' (1986) 57 University of Colorado Law Review 683

Kornhauser L, 'Reliance, Reputation, and Breach of Contract' (1983) 26 Journal of Law and Economics 691

Korobkin R and Ulen T, 'Law and Behavioural Science: Removing the Rationality Assumption from Law and Economics' (2000) 88 California Law Review 1051

Korobkin R, 'The Status Quo Bias and Contract Default Rules' (1998) 83 Cornell Law Review 608

Kostov H, 'Some Basic Questions Related to the Receipt of Defective Output in Contracts for Supply of Goods' [1959] Socialist Law 36

Kraus JS, 'Philosophy of Contract Law' in Coleman JL and Shapiro S (eds), *The Oxford Handbook of Jurisprudence and Legal Theory* (New York: Oxford University Press 2002)

Kronman A, 'Mistake, Disclosure, Information, and the Law of Contracts' (1978) 7 The Journal of Legal Studies 1

Kropholler J, *Bürgerliches Gesetzbuch: Studienkommentar* (Ninth edn, Taschenbuch 2006)

Kull A, ‘Restitution as a Remedy for Breach of Contract’ (1994) 67 Southern California Law Review 1465

La Porta R and others, ‘Judicial Checks and Balances’ (2004) 112 Journal of Political Economy 445

La Porta R and others, ‘Law and Finance’ (1998) 106 Journal of Political Economy 1113

La Porta R and others, ‘Legal Determinants of External Finance’ (1997) 52 Journal of Finance 1131

La Porta R and others, ‘The Quality of Government’ (1999) 15 Journal of Law, Economics and Organization 222

Landes W, ‘An Economic Analysis of the Courts’ (1971) 14 Journal of Law and Economics 61

Lando H and Rose C, ‘On the Enforcement of Specific Performance in Civil Law Countries’ (2004) 24 International Review of Law and Economics 473

Leiter D and Warin T, ‘An Empirical Study of Price Dispersion in Homogenous Goods Markets’ Middlebury College Economics Discussion Paper No 07-10 <http://cat2.middlebury.edu/econ/repec/mdl/ancoec/0710.pdf> accessed 22.03.2013

Llewellyn K, ‘On Warranty of Quality, and Society: II’ (1937) 37 Columbia Law Review 341

Llewellyn K, ‘On Warranty of Quality, and Society’ (1936) 36 Columbia Law Review 699

Lord RA, ‘Chapter 26 The Statute of Frauds: Contracts for the Sale of Goods V. Exceptions and Exclusions from the Statute’ in *9 Williston on Contracts § 26:20 Contracts for Services* (Fourth edn, Thomson Reuters 2011)

Lorenz W, ‘Chapter 8 Contracts for Work on Goods and Building Contracts’ in Zweigert K (ed), *International Encyclopedia of Comparative Law Specific Contracts*, vol VIII (First edn, J. C. B. Mohr (Paul Siebeck), Tübingen, and Sijthoff & Noordhoff, Alpen a/d Rijn 1980)

Macaulay S, ‘Non-Contractual Relations in Business: A Preliminary Study’ (1963) 28 American Sociological Review 55

Macneil I, ‘Contracts: Adjustment of Long-Term Economic Relations under Classical, Neoclassical and Relational Contract Law’ (1978) 72 Northwestern University Law Review 854

Macneil I, ‘Economic Analysis of Contractual Relations: Its Shortfalls and the Need for a "Rich Classificatory Apparatus"’ (1981) 75 Northwestern University Law Review 1018

Macneil I, ‘The Many Futures of Contracts’ (1974) 47 Southern California Law Review 691

Macneil I, *Contracts: Exchange Transactions and Relations* (1977)

Magat W, ‘Information Regulation’ in Newman P (ed), *The New Palgrave Dictionary of Economics and the Law*, vol II (New York: Stockton Press 1998)

Magnus U (ed) *Unification of Tort Law: Damages* (First edn, The Hague; Boston: Kluwer Law International 2001)

Mak V, *Performance-Oriented Remedies in European Sale of Goods Law* (First edn, Oxford and Portland, Oregon: Hart Publishing 2009)

Malcomson J and Spinnewyn F, ‘The Multiperiod Principal-Agent Problem’ (1988) 55 The Review of Economic Studies 391

Marshall R, ‘The Applicability of the Uniform Commercial Code to Construction Contracts’ (1979) 28 Emory Law Journal 335

Mattei U and Cafaggi F, ‘Comparative Law and Economics’ in Newman P (ed), *New Palgrave Dictionary of Economics and the Law*, vol 1 (London: Macmillan Reference 1998)

Mattei U, *Comparative Law and Economics* (First edn, Ann Arbor: The University of MIchigan Press 1997)

Matthews S and Moore J, ‘Monopoly Provision of Quality and Warranties: An Exploration in the Theory of Multidimensional Screening’ (1987) 55 Econometrica 441

McKendrik E, ‘Chapter 24. Discharge by Breach’ in Beale H (ed), *Chitty on Contracts General Principles*, vol I (Thirty-First edn, London: Sweet&Maxwell/Thomson Reuters 2012)

Mercuro N and Medema SG, *Economics and the Law. From Posner to Post-Modernism and Beyond* (Second edn, Princeton and Oxford: Princeton University Press 2006)

Metzger A, ‘Contract for Work and Labour’ in Basedow Jürgen and others (eds), *The Max Planck Encyclopedia of European Private Law*, vol I (First edn, Oxford: Oxford University Press 2012)

Michaels R, ‘Legal Culture’ in Basedow J and others (eds), *The Max Planck Encyclopedia of European Private Law*, vol II (First edn, Oxford: Oxford University Press 2012)

Micklitz H-W, ‘European Regulatory Private Law: The Transformation of European Private Law from Autonomy to Functionalism in Competition and Regulation’ European Regulatory Private Law Project; http://blogseuieu/erc-erpl/ accessed 18.09.2012

Micklitz H-W, ‘Regulatory Strategies on Services Contracts in EC law’ in Cafaggi F and Muir-Watt H (eds), *The Regulatory Function of European Private Law* (Cheltenham/Nothampton: Edward Elgar 2009)

Micklitz H-W, ‘The Concept of Competitive Contract Law’ (2005) 23 Penn State International Law Review 549

Milgrom P and Roberts J, *Economics, Organizations and Management* (First edn, London: Prentice-Hall International 1992)

Monateri PG, ‘Methods in Comprative Law: an Intellectual Overview’ in Monateri PG (ed), *Methods of Comparative Law* (First edn, Cheltenham: Edward Elgar Publishing 2012)

Möslein F, ‘Service Contracts’ in Basedow J and others (eds), *The Max Planck Encycopedia of European Private Law*, vol II (First edn, Oxford: Oxford University Press 2012)

Mueller D, *Public Choice III* (First edn, Cambridge, UK; New York: Cambridge University Press 2003)

Neyer J, ‘Europe's Justice Deficit: Justification and Legitimacy in the European Union’ in Neyer J and Wiener A (eds), *Political Theory of the European Union* (First edn, Oxford: Oxford University Press 2011)

Niblett A, Posner R and Shleifer A, ‘The Evolution of a Legal Rule’ (2010) 39 Journal of Legal Studies 325

Nicita A and Pagano U, ‘Law and Economics in Retrospect’ in Brousseau É and Glachant J-M (eds), *New Institutional Economics: A Guidebook* (First edn, Cambridge, UK; New York: Cambridge University Press 2008)

Nikolov A and Panova L, ‘Requirements to the Liability for Defects of the Output under the Supply Contract with a View to the Arbitration Practice’ (1957) 3 Legal Thought 103

Nikolov A, *Liability of the Contractor in the Manufacture Contract* (Sofia: Science and Art 1970)

Nikolov H, ‘Regarding Legal Regulation of Quality of Production’ (1984) 3 Legal Thought 98

Nöldeke G and Schmidt K, ‘Option Contracts and Renegotiation - A Solution to the Hold-up Problem’ (1995) 26 Rand Journal of Economics 163

North D, ‘Prologue’ in Drobak J and Nye JVC (eds), *The Frontiers of the New Institutional Economics* (First edn, San Diego: Academic Press 1997)

North D, *Institutions, Institutional Change and Economic Performance* (First edn, Cambridge: Cambridge University Press 1990)

Ogus A, *Regulation: Legal Form and Economic Theory* (First edn, Oxford: Clanderon Press 1994)

Pagano U, 'Legal Positions and Institutional Complementarities' in Cafaggi F, Nicita A and Pagano U (eds), *Legal Orderings and Economic Institutions* (First edn, London and New York: Routledge 2005)

Palmer VV, 'From Lerotholi to Lando: Some Examples of Comparative Law Methodology' (2004) 4 Global Jurist Frontiers 1

Pavlova M, 'On the Role of Case-law' [1998] 2 Contemporary Law 79

Pavlova M, *Civil Law. General Part* (First edn, Sofia: Sofi-R 2002)

Peel E, *Treitel. The Law of Contract* (Thirteenth edn, London: Sweet&Maxwell/Thomson Reuters 2011)

Peters E, 'Remedies for Breach of Contracts Relating to the Sale of Goods under the Uniform Commercial Code: A Roadmap for Article Two' (1963) 73 The Yale Law Journal 199

Petkanov G, 'Finance Law Instruments for Regulating the Quality of Industrial Production' (1984) 2 Legal Thought 12

Petrov V, 'Development of the Idea on Civil Law Codification in the Republic of Bulgaria' in Novkirishka-Stoyanova M and Kolev T (eds), *Roman Law and Modern Codifications* (First edn, Sofia: "St. Kliment Ohridski" University Press 2008)

Petrov V, *Compensation for Non-Pecuniary Damages in Contract* (First edn, Sofia: "St. Kliment Ohridski" University Press 1991)

Petrov V, *Prerequisites for Liability and Methods for Settling the Relations between Sellers and Buyers in Case of Sale of Newly Constructed Lodgings with Defects* (Sofia: "St. Kliment Ohridski" Press 1989)

Polinsky AM, 'Risk Sharing through Breach of Contract Remedies' (1983) 12 Journal of Legal Studies 427

Popov L, 'Forty Years Of Socialist Civil Law' (1984) 4 Legal Thought 34

Popov L, 'Non-Pecuniary Damages in Contract' (1987) 6 Socialist Law 26

Posner E, 'Economic Analysis of Contract Law after Three Decades: Success or Failure' (2003) 112 The Yale Law Journal 829

Posner R and Rosenfield A, 'Impossibility and Related Doctrines in Contract Law: An Economic Analysis' (1977) 6 The Journal of Legal Studies 83

Posner R, 'The New Institutional Economics Meets Law and Economics' (1993) 149 Zeitschrift für die GesamteStaatswissenschaft (Journal of Institutional and Theoretical Economics) 73

Posner R, ‘What Do Judges Maximize (The Same Thing Everybody Else Does)’ (1993) 3 Supreme Court Economic Review 1

Posner R, *Economic Analysis of Law* (First edn, Boston: Little, Brown 1972)

Posner R, *Economic Analysis of Law* (Fourth edn, Boston: Little, Brown 1992)

Posner R, *Economic Analysis of Law* (Sixth edn, New York: Aspen Publishers 2003)

Priest G, ‘Breach and Remedy for the Tender of Nonconforming Goods under the Uniform Commercial Code: An Economic Approach’ (1978) 91 Harvard Law Review 960

Priest G, ‘The Common Law Process and the Selection of Efficient Legal Rules ’ (1977) 6 Journal of Legal Studies 65

Quigley C, *European Community Contract Law* (First edn, London: Kluwer Law International 1997)

Quillen G, ‘Contract Damages and Cross-Subsidization’ (1988) 61 California Law Review 1125

Rabel E, ‘The Nature of Warranty of Quality’ (1960) 26 Tulane Law Review 273

Rachev F, ‘Issues of Legal Regulation of Quality of Production’ (1985) 2 Legal Thought 74

Rawlings P, ‘Chapter 1. The Contract of Sale of Goods’ in Bridge M (ed), *Benjamin's Sale of Goods* (Eighth edn, London: Sweet&Maxwell/Thomson Reuters 2010)

Rea S, ‘Efficiency Implications of Penalties and Liquidated Damages’ (1984) 13 Journal of Legal Studies 147

Rea S, ‘Non-Pecuniary Loss and Breach of Contract’ (1982) 11 Journal of Legal Studies 35

Reich N, ‘Transformation of Contract Law and Civil Justice in the new EU Member Countries: The Example of the Baltic States, Hungary and Poland’ in Cafaggi F (ed), *The Institutional Framework of European Private Law* (First edn, Oxford/New York: Oxford University Press 2006)

Rey P and Salanie B, ‘Long-term, Short-term and Renegotiation: On the Value of Commitment in Contracting’ (1990) 58 Econometrica 597

Reynolds FMB, ‘Chapter 10. Classification of Statements as to Goods’ in Bridge M (ed), *Benjamin's Sale of Goods* (Eighth edn, London: Sweet&Maxwell/Thomson Reuters 2010)

Reynolds FMB, ‘Chapter 11. Terms as to Description and Quality Implied by the Sale of Goods Act’ in Bridge M (ed), *Benjamin's Sale of Goods* (Eighth edn, London: Sweet&Maxwell/Thomson Reuters 2010)

Reynolds FMB, ‘Chapter 12. Remedies in Respect of Defects’ in Bridge M (ed), *Benjamin's Sale of Goods* (Eighth edn, London: Sweet&Maxwell/Thomson Reuters 2010)

Reynolds FMB, ‘Chapter 13. Exemption Clauses’ in Bridge M (ed), *Benjamin's Sale of Goods* (Eighth edn, London: Sweet&Maxwell/Thomson Reuters 2010)

Rifkin J, *The Age of Access: The New Culture of Hypercapitalism, Where All of Life is a Paid-for Experience* (First edn, New York: J. P. Tarcher/Putnam 2000)

Rogerson W, ‘Efficient Reliance and Damage Measures for Breach of Contract’ (1984) 15 The Rand Journal of Economics 39

Rogerson W, *Efficient Reliance and Contract Remedies* (1980)

Rowan S, *Remedies for Breach of Contract* (Oxford: Oxford University Press 2012)

Rubin P, ‘Why Is the Common Law Efficient?’ (1977) 6 Journal of Legal Studies 51

Ruschev I, ‘Classification of the Internal Normative Sources of Private Law’ in Novkirishka-Stoyanova M and Kolev T (eds), *Roman Law and Contemporary Codifications* (First edn, Sofia: "St. Kliment Ohridski" University Press 2008)

Ruschev I, *Liability for Eviction* (First edn, Sofia: Reguli 1995)

Sacco R, ‘Legal Formants: A Dynamic Approach to Comparative Law’ (1991) 39 American Journal of Comparative Law 343

Schelling T, *The Strategy of Conflict* (Fifth edn, Cambridge, MA: Harvard University Press 1976)

Schmidt JP, ‘Code Unique’ in Jürgen B and others (eds), *The Max Planck Encyclopedia of European Private Law*, vol I (First edn, Oxford: Oxford University Press 2012)

Schwartz A and Scott R, ‘Contract Theory and the Limits of Contract Law’ (2003) 113 Yale Law Journal 541

Schwartz A and Watson J, ‘The Law and Economics of Costly Contracting’ (2004) 20 Journal of Law, Economics and Organization 2

Schwartz A, ‘Cure and Revocation for Quality Defects: The Utility of Bargains’ (1975) 16 Boston College Industrial and Commercial Law Review 543

Schwartz A, ‘Relational Contracts in the Courts: Analysis of Incomplete Agreements and Judicial Strategies’ (1992) 21 The Journal of Legal Studies 271

Schwartz A, ‘The Enforcement of Contracts and the Role of the State’ in Cafaggi F, Nicita A and Pagano U (eds), *Legal Orderings and Economic Institutions* (First edn, London/New York: Routledge 2007)

Schweizer U, ‘Cooperative Investments Induced by Contract Law’ (2006) 37 The Rand Journal of Economics 134

Scott R and Kraus J, *Contract Law and Theory* (Fourth edn, Matthew Bender & Co 2007)

Scott R and Triantis G, ‘Anticipating Litigation in Contract Design’ (2006) 115 The Yale Law Journal 814

Scott R and Triantis G, ‘Incomplete Contracts and the Theory of Contract Design’ (2005) 56 Case Western Reserve Law Review 187

Scott R, ‘A Theory of Self-Enforcing Indefinite Agreements’ (2003) 103 Columbia Law Review 1641

Scott R, ‘Conflict and Cooperation in Long-Term Contracts’ (2009) 75 California Law Review 2005

Scott R, ‘The Rise and Fall of Article 2’ (2002) 62 Lousiana Law Review 1009

Sen A, *On Ethics and Economics* (Oxford, UK; New York, NY, USA: B. Blackwell 1987)

Sen A, *The Idea of Justice* (First edn, London: Allen Lane 2009)

Shavell S, ‘Damage Measures for Breach of Contract’ (1980) 11 Bell Journal of Economics 466

Shavell S, ‘Liability for Harm versus Regulation for Safety’ (1984) 13 Journal of Legal Studies 357

Shavell S, ‘The Design of Contracts and Remedies for Breach’ (1984) 99 The Quarterly Journal of Economics 121

Shavell S, ‘Why Breach of Contract May Not be Immoral Given the Incompleteness of Contracts’ in Shashar O-B and Porat A (eds), *Fault in American Contract Law* (First edn, New York: Cambridge Univesity Press 2010)

Shavell S, *Foundations of Economic Analysis of Law* (First edn, Cambridge, Massachusetts: Belknap Press of Harvard University Press 2004)

Shopov A, ‘Consumer Contracts in Bulgarian Law’ (2010) 1 Legal World 141

Simon H, *Administrative Behaviour* (Second edn, New York: Macmillan 1961)

Smith A, *An Inquiry into the Nature and Causes of the Wealth of the Nations* (First edn, 1776)

Smits J, 'Diversity of Contract Law and the European Internal Market' in Smits J (ed), *The Need for a European Contract Law* (First edn, Groningen: Europa Law Publishing 2005)

Somma A, *Temi e problemi di diritto comparato*, vol IV: Diritto comunitario vs. diritto comune europeo (First edn, Turin: Giappichelli 2003)

Spence M, 'Job Market Signaling' (1973) 87 Quarterly Journal of Economics 355

Stalev J, 'Case-law as a Source of Law' 6 Contemporary Law 7

Stalev J, 'Characteristic Features of the New Legal Regime of the Sale Contract' (1951) 3-4 Bulletin of the Economic and Legal Institute 161

Stalev J, 'Contractual Liability for Non-Pecuniary Damages' (1990) 1 State and Law 3

Stapleton J, 'Regulating Torts' in Parker C and others (eds), *Regulating Law* (First edn, Oxford: Oxford University Press 2004)

Stigler G, 'The Economics of Information' (1961) 69 The Journal of Political Economy 213

Stigler G, 'The Theory of Economic Regulation' (1971) 2 The Bell Journal of Economics and Management Science 3

Stoychev K, 'Change in Trends or Trends towards Change in Contractual Legislation?' (1995) 3 Legal Thought 49

Stoychev K, 'Contracts. Bulgaria' in Blanpain R, Colucci M and Herbots J (eds), *International Encyclopaedia of Laws*, vol I (First edn, The Hague: Kluwer Law International 1999)

Stoychev K, 'Price Reduction' [1984] Legal Thought 60

Stoychev K, 'Review of the Case-Law Regarding Non-Pecuniary Damages' (1982) 5 Legal Thought 79

Stoychev K, 'The Content of the Specific Performance Principle in the Contractual Obligations Between Socialist Organizations' [1986] Legal Thought 79

Stremitzer A, 'Standard Breach Remedies, Quality Thresholds and Cooperative Investments' 28 The Journal of Law, Economics, and Organization 337

Sukareva Z, *Civil Law Protection of Consumers* (First edn, Sofia: Feneya 2001)

Sweet J, *Legal Aspects of Architecture, Engineering and the Construction Process* (Sixth edn, Brooks/ Cole Publishing Company 2000)

Tadjer V, 'Case-law and General Acts of the Supreme Court of the National Republic of Bulgaria' in *Yearbook of Sofia University*, vol 69 (First edn, Law Department of Sofia University 1977)

Tadjer V, *Civil Law of National Republic of Bulgaria. General Part*, vol 1 (First edn, Sofia: Science and Art 1972)

Takov K, 'Rights of the Consumer Buyer in Case of Non-Conforming Goods' (2007) 2 Commercial Law 35

Tashev R, *Jurisprudence* (Fourth edn, Sofia: Sibi 2010)

Teubner G, 'Legal Irritants: Good Faith in British Law, or How Unifying Law Ends Up in New Divergences' in Snyder F (ed), *The Europeanisation of Law: the Legal Effects of European Integration* (First edn, Oxford: Hart Publishing 2000)

Tokushev D, *History of the New Bulgarian State and Law 1878-1944* (First edn, Sofia: Sibi 2008)

Tokushev D, *The Judiciary in Bulgaria: from Antiquity to the Present* (First edn, Sofia: Sibi 2003)

Tormanov Z, *The Contract in Construction and Real Estate* (Sofia: Sibi 2008)

Treitel G, 'Chapter 16 Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)' in Mehren Av (ed), *International Encyclopedia of Comparative Law*, vol VII Contracts in General (First edn, The Hague: Mouton; Tübingen: J. C. B. Mohr (Paul Siebeck) 1976)

Treitel G, 'Chapter 27. Specific Performance and Injunction' in Beale H (ed), *Chitty on Contracts General Principles*, vol I (Thirty-first edn, London: Sweet&Maxwell, Thomson Reuters 2012)

Treitel G, *The Law of Contract* (Eleventh edn, London: Sweet&Maxwell 2003)

Triantis A and Triantis G, 'Timing Problems in Contract Breach Decisions' (1998) 41 Journal of Law and Economics 163

Triantis G, 'Contractual Allocations of Unknown Risks: A Critique of the Doctrine of Commercial Impracticability' (1992) 42 Toronto Law Journal 450

Triantis G, 'The Efficiency of Vague Contract Terms: A Response to the Schwartz-Scott Theory of UCC Article 2' (2002) 62 Lousiana Law Review 1065

Tsankova T, 'Civil Code? Let Us Start a Discussion' in Novkirishka-Stoyanova M and Kolev T (eds), *Roman Law and Modern Codifications* (First edn, Sofia: "St. Kliment Ohridski" University Press 2008)

Uff J and Moran V, 'Chapter 37. Construction Contracts' in Beale HG (ed), *Chitty on Contracts Specific Contracts*, vol II (Thirty-first edn, London: Sweet&Maxwell/Thomson Reuters 2012)

Uff J, *Costruction Law* (Tenth edn, London: Thomson Reuters; Sweet & Maxwell 2009)

Ulen T, ‘The Future of Law and Economics’ in Cafaggi F, Nicita A and Pagano U (eds), *Legal Orderings and Economic Institutions* (First edn, London and New York: Routledge 2007)

Unberath H, ‘Reparation in Kind’ in Jürgen B and others (eds), *The Max Planck Encyclopedia of European Private Law*, vol II (First edn, Oxford: Oxford University Press 2012)

van Caenegem R, *Judges, Legislators, and Professors: Chapters in European Legal History* (First edn, Cambridge (Cambridgeshire); New York: Cambridge University Press 1987)

Van Gerven W, ‘Bringing (Private) Laws Closer at the European Level’ in Cafaggi F (ed), *The Institutional Framework of European Private Law* (First edn, Oxford: Oxford University Press 2006)

Vasilev L, *Civil Law of National Republic of Bulgaria. General Part* (First edn, Sofia: Science and Art 1956)

Vogenauer S, ‘Common Law’ in Jürgen B and others (eds), *The Max Planck Encyclopedia of European Private Law* vol I (First edn, Oxford: Oxford University Press 2012)

Vogenauer S, ‘Judge-Made Law’ in Baird D and others (eds), *The Max Planck Encyclopedia of European Private Law*, vol II (First edn, Oxford: Oxford University Press 2012)

Vogenauer S, ‘Precedent, Rule of’ in Baird D and others (eds), *The Max Planck Encyclopedia of European Private Law*, vol II (First edn, Oxford: Oxford University Press 2012)

Vogenauer S. and Weatherill S (eds), *The Harmonisation of European Contract Law: Implications for European Private Laws, Business and Legal Practice*, First edn, Hart Publishing 2006)

von Bar C and others (eds), *Principles, Definitions and Model Rules of European Private Law; Draft Common Frame of Reference (DCFR) Outline Edition* (First edn, Munich: Sellier 2009)

von Bar C, *The Common European Law of Torts*, vol II (First edn, Oxford/New York: Oxford University Press 2000)

von Mehren AT and Gordley J, *The Civil Law System. An Introduction to the Comparative Study of Law* (Second edn, Boston/Toronto: Little, Brown and Company 1977)

Wagner G, ‘Termination and Cure under the Common European Sales Law: Consumer Protection Misunderstood’ (2013) 50 Common Market Law Review 147

Watson A, ‘Comparative Law and Legal Change’ (1978) 37 Cambridge Law Journal 313

Weatherhill S, ‘European Private Law and the Constitutional Dimension’ in Cafaggi F (ed), *The Institutional Framework of European Private Law* (First edn, Oxford: Oxford University Press 2006)

Weatherhill S, ‘Reflections on the EC's Competence to develop a "European Contract Law"’ (2005) 13 European Review of Private Law 405

White J and Summers R, *Handbook of the Law under the Uniform Commercial Code* (Second edn, St. Paul: West Piblishing Company 1980)

Williamson O, ‘Comparative Economic Organization: The Analysis of Discrete Structural Alternatives’ (1991) 36 Administrative Science Quarterly 269

Williamson O, ‘Credible Commitments: Using Hostages to Support Exchange’ (1983) 73 The American Economic Review 519

Williamson O, ‘The Vertical Integration of Production: Market Failure Considerations’ (1971) 61 The American Economic Review 112

Williamson O, ‘Transaction Cost Economics Meets Posnerian Law and Economics’ (1993) 149 Zeitschrift für die GesamteStaatswissenschaft (Journal of Institutional and Theoretical Economics) 99

Williamson O, ‘Transaction-Cost Economics: The Governance of Contractual Relations’ (1979) 22 The Journal of Law and Economics 233

Williamson O, *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting* (New York: Free Press, London: Collier Macmillan 1985)

Williamson O, *The Mechanisms of Governance* (First edn, New York: Oxford University Press 1996)

Wittman D, ‘Optimal Pricing of Sequential Inputs: Last Clear Chance, Mitigation of Damages, and Related Doctrines in the Law’ (1981) 10 The Journal of Legal Studies 65

Wurmnest W, ‘Damages’ in Jürgen B and others (eds), *The Max Planck Encyclopedia of European Private Law*, vol I (First edn, Oxford: Oxford University Press 2012)

Zimmermann R, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (First edn, Oxford: Oxford University Press 1996)

Zweigert K and Kötz H, *Introduction to comparative law* (Third rev. edn, Oxford: Clarendon Press; New York: Oxford University Press 1998)