1. Introduction

1.1. INTRODUCTION

Sol iustitiae illustra nos

‘May the Sun of Justice Enlighten Us,’ has been the motto of Utrecht University since its beginning in 1636, and indeed a comparatist could not find a more suitable motto for his own research. The quest for a new, deeper understanding of the apparent similarities and differences between different legal systems, between their doctrines, rules and decisions presents the ultimate challenge for every comparatist. A true comparatist should strive for this understanding, for the unraveling of seemingly widely accepted beliefs, follies and half-truths; he should, once he has isolated this quest from its national legal backgrounds, then bridge the apparent divisions; and he should fill in the gaps created by previous researches, where, indeed, the sun of justice should be the enlightening, inspiring motive.

A traditional handbook on comparative contract law usually contains short summaries of different legal systems and tries to demonstrate significant differences between the compared legal systems, and especially between civil and common law. What surprised me, however, was the lack of any deeper, methodological framework for the evaluation of the differences or similarities. Being trained in law and economics, the benefits of an interdisciplinary approach where an economically-inspired optimal model rule would serve as a uniform term of comparison for the assessment of pre-contractual duties of disclosure, unforeseen contingencies and unilateral termination of contracts, seemed clear. The more I analysed these differences from an economic perspective, the more I became convinced that many of them were matter-of-fact similarities.

The question arose in my mind as to whether compared legal systems are, in the field of contract law, indeed as different as many comparatists tend to believe and if there is, apart from the simple borrowing of historical and cultural reasons, something more at stake explaining established legal changes, inconsistencies and similarities.

This question soon became my inspiration and joy.
1.2. SUBJECT MATTER

Though great progress has been made, most work in comparative law even today still starts from a particular question or legal institution in national law, proceeds to treat it comparatively, and ends, after evaluating the discoveries made, by drawing conclusions for national law alone. This attitude could be called national comparative law. What we must aim for is a truly international comparative law which could form the basis for a universal legal science.1

The aim of finding a truly international comparative law which could form the basis of a universal legal science is also the aim of this book. Inserting new, economically-inspired contents into traditional, comparative contract law in order to understand the similarities, differences and evolutionary patterns of different legal systems presents the scope and the subject matter of this work. This book is primarily aimed at lawyers, both practitioners and scholars, and provides a deep analysis of the pre-contractual duties of disclosure, unforeseen contingencies and unilateral termination of the French, English, American and German law of contracts.

Contract law has long been one of the core subjects of comparative law, and among the most popular because it is, as Farnsworth notes, among the practically most salient areas of law, both in terms of economic importance and in terms of the realities of international negotiation and litigation.2 Almost all trade and economic relations nowadays depend on private contracts. Moreover, it may be argued that contracts are an essential part of the modern economy, where practical daily considerations call for further understanding of similarities and differences among the various national legal systems or legal families. Hence, legal practitioners, international business, the bench and the bar, and the legislators have an increasing interest in understanding contract law in a transnational context.

However, despite the importance of contract law in comparative law, an economic approach, that is to say comparative contract law and economics, is still relatively recent. Moreover, comparatists tend to believe that legal systems are profoundly different. Yet the Levmore thesis, which is the central thesis in comparative law and economics, states that in principle we can expect the same legal rules in all legal systems (of societies in the same stage of development).3 The reason for this is that all legal rules are confronted with essentially the same problems of self-interested behavior. According to Levmore, variety between

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Legal systems can be expected either when the content of the rule does not really matter (for example driving on the left versus the right side of the road), or when reasonable people (even in the same culture) disagree about the optimal rules (for example the optimal divorce rules). Levmore’s thesis provides a functional explanation for Schlesinger’s common core observations.4

The analysis provided confirms Levmore’s thesis by suggesting that the legal systems of France, England, the US and Germany differ less than comparatists tend to believe. Moreover, my analysis suggests that the compared legal institutions invariably tend towards efficiency, where the wealth maximization principle evolves as the actual operational mechanism of judicial decision-making. This, however, also confirms Judge Posner’s thesis on wealth maximization as the core judicial decision-making principle.5 The explanatory potential of this optimal model rule for established statutory and judicial inconsistencies and apparent differences becomes evident.

Employing an economically-inspired optimal model rule as the uniform term of comparison, the presented essays assess some of the most controversial contractual issues, that is pre-contractual duties of disclosure, unforeseen contingencies and unilateral termination of contracts. In each of these essays, law and economics literature is surveyed and systematized into a coherent optimal model rule, which then serves as a uniform term of comparison. After each legal system is compared, it is followed by an examination of the current legal doctrine, and of the related law in action. The law and economics, and comparative contract law literature on all of these issues provide several striking insights. However, although pre-contractual duties of disclosure and the problem of unforeseen contingencies present one of the old moral and legal cruxes of legal scholarship, many questions still need to be resolved and further elaboration is required.

Hence, the main purpose of this book is to provide an objective, economically-inspired assessment of the compared legal systems. My aim is to overcome inconsistencies resulting from subjectivity or nationalism, to challenge widely accepted comparative premises, and to shed light upon sometimes even parochial legal postulates and to contribute to comparative contract law research.

1.3. METHODOLOGY

Throughout this book, the approach is interdisciplinary, focusing on legal and economic issues. Whereas an economic approach is becoming increasingly

common and influential in the study of substantive contract law of the US and some European countries, its application in comparative contract law has, as a new discipline, evolved relatively recently and is positioned at the frontiers of progressive legal thought. This innovative scholarly paradigm, combining the analytical tools of adjoining and complementary social sciences in order to develop a critical approach to legal rules and institutions, conveys a distinctive comparative perspective on the theory, practice and understanding of the law of contracts of different legal systems. The approach utilized combines analytical methods and concepts used in the economic analysis of law with pure comparative contract law discussions. However, in order to provide an overview of applied methodology, the concepts and methods of both concepts will be briefly summarized and then combined in a unified methodological principle.

1.3.A. Methodology and concepts used in the economic analysis of law

The economic approach to law is one of the most ambitious and probably the most influential concepts that seek to explain judicial decision-making and to place it on an objective basis. It is regarded as the single most influential jurisprudential school in the US. Although a comprehensive examination of the field is beyond the scope of this book and can be found elsewhere, the basic approach will be outlined. The central assumption of economics is that all people (except children and mentally disabled) are rational maximizers of their satisfactions in all of their activities. In other words, the rational choice approach is the basic methodological principle in this book, which besides maximizing behavior and market equilibrium, also comprises the assumption of stable preferences. The notion of maximizing behavior comprises the principle of wealth maximization, where the measure for parties’ maximizing behavior is their willingness to pay. That is to say, if goods are in hands of the persons who were willing and able to pay the highest amount, wealth is maximized. Wealth maximization is also applied as the leading principle of comparison.

In order to make the economic analysis accessible to lawyers not acquainted with law and economics, some of the basic concepts used will be briefly summarized.

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Wealth maximization
The term ‘wealth maximization’ is often misunderstood, and confused with conscious calculations or selfishness. Moreover, many lawyers still think of economics as the study of inflation, extraction of profits, businesses and other mysterious phenomena, remote from the daily concerns of any legal system. Yet in economics the concept of a man as a rational wealth maximizer of his self-interest implies that people respond to incentives if a person’s surroundings change in such a way that he could increase his satisfactions by altering his behavior. It should also be noted that those decisions, in order to be rational, need not be well thought-out at the conscious level, in fact they need not be conscious at all, since as Posner states, ‘rational’ denotes suiting means to ends and that much of our knowledge is tacit. Moreover, it is evident that non-monetary as well as monetary satisfactions enter into such an individual’s calculus of maximizing. It should also be stressed out that, despite the valuable insights of new behavioral approaches, the main reason why I remain within the rational-choice framework is that it is the framework which makes my points sharper and it should not be understood as downplaying the importance of behavioral considerations. However, after defining ‘rational’ one should also assess the notion of ‘wealth maximization.’ One of the main fallacies is to equate business income to social wealth. Wealth maximization refers to a sum of all tangible goods and services, weighted by offer prices and asking prices. The notion of wealth maximization is that the value of wealth in society should be maximized. In this context wealth should be understood as the summation of all valued objects, both tangible and intangible, weighted by the prices they would command if they were to be traded in markets. The transaction is wealth maximizing, where, providing that it has no third-party effects and is a product of free, unanimous choice, has made two people better off and no one worse off. This is so-called ‘Pareto efficiency,’ where it is impossible to change it so as to make at least one person better off without making anyone worse off. Parties enter into transactions on the basis of rational self-interest where voluntary transactions tend to be mutually beneficial. Hence, the term ‘efficiency’ used throughout this book denotes that allocation of resources whose value is maximized. As is common in modern economics, I will use the Kaldor–Hicks variant of the Pareto optimality criterion, according to which it is sufficient that the winners could, in theory, compensate the losers, even if this compensation is not effectively paid.

The assumption that those entering into exchanges are rationally self-interested is the basic assumption of law and economics.
**Transaction costs**

Economic theory refers to the costs attached to any transaction as ‘transaction costs.’ The voluntary transaction is beneficial to both parties, but transaction costs reduce the value of an exchange and both contracting parties will want to minimize them. In other words, transaction costs slow the movement of scarce resources to their most valuable uses and should be minimized in order to spur allocative efficiency. This phenomenon was first discussed by Ronald Coase in his seminal articles \(^{15}\) and developed by other eminent authors. \(^{16}\) As shown, in a world of zero transaction costs parties would always produce economically efficient results without the need for legal intervention. However, since in reality transaction costs are imposed daily, intervention becomes necessary and the legal rules by reducing transaction costs imposed upon an exchange can improve allocative efficiency, and thus maximize social welfare. Hence, efficiency requires economizing on transaction costs.

**Uncertainty and risks**

Economists established that one of the basic characteristics of economic actors is their attitude towards risks. Economists believe that most people are risk-averse most of the time, although a number of institutional responses (such as insurance contracts and corporations) may make people act as if they are risk-neutral in many situations. \(^{17}\) Risk-averse people are willing to pay more than the expected value of a possible loss to eliminate the risk therein. \(^{18}\) A person will be risk-averse if the marginal utility of money to him declines as his wealth increases. The widespread use of insurances witnesses the value of this argument, where risk-averse persons are prepared to pay insurance premiums for not having to suffer the losses when risks occur. In contrast, a risk-loving person places a value on risk lower than the expected value of the losses, whereas a risk-neutral person places a value on risk equal to the expected value of the losses.

Economic theory suggests that whenever one person can bear the risk at lower costs than another, efficiency requires assigning the risk upon such a superior risk bearer. In such an instance there is an opportunity for mutually beneficial exchange, where risk-averse persons are willing to pay risk-neutral persons to bear such risks. In cases where transaction costs preclude parties from making such an arrangement, efficiency offers a hypothetical bargain approach of the most efficient risk bearer. Such a bearer is the party to an

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\(^{17}\) See generally Posner, supra note 7, p. 10 et seq.

\(^{18}\) For example you are risk-averse if you prefer to be given €5 million than a 10 percent chance of €25 million. See also Shavell, supra note 8, p. 258 et seq.
exchange who is best able to minimize the losses. It should be noted that almost any contract shifts risks, since contracts by their nature commit the parties to a future course of action, where the future is far from certain.

1.3.B. Methodology and concepts used in comparative contract law

An overview of comparative law theory reveals that there are, besides functionalism, several different approaches towards micro-comparison, for example comparative legal history, the study of legal transplants, and the comparative study of legal cultures. However, many experienced comparatists have noted that a detailed method cannot be laid down in advance, and that all one can do is to take a method as a hypothesis and test its usefulness and practicability against the achieved results. Hence, due to the efficient institution serving as a uniform term of comparison, the functionality principle appeared as a natural choice, and after testing it with achieved results its usefulness and practicability appear to be a sound decision.

Thus, the test of functionality, as emphasized by Markesinis, Zweigert and Kötz, and as has become both the mainstream and the bête noire of comparative law, is employed as a basic methodological comparative principle. Although debating functionalism is beyond the scope of this chapter, and although it should also be stressed that, as a theory, at least in its elaborated version it hardly exists, one should note that its major shortcoming is the surprising lack of proper evaluation tools for determining which of the compared laws is ‘better.’ This lack of a proper evaluation benchmark comes as no surprise, since the notion of which law is ‘better’ actually depends upon one’s preferences, opinions, cultural, religious background and so forth. Moreover, this lack of precise criterion actually hinders proper analytical discussion and evaluation. Instead, I propose that the ‘better law’ should be evaluated in terms of which one maximizes social welfare, that is the one which is more efficient. Hence, the efficiency as a uniform term of comparison may overcome this lack of proper evaluation tools, add to the functional micro-

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21 Markesinis, Basil S., ‘Foreign Law and Comparative Methodology: a Subject and a Thesis,’ Hart Publishing, 1997; Zweigert and Kötz, supra note 1, p. 34.


23 Michaels, supra note 22, p. 374.
comparison an additional perspective, and may actually overcome the analytical disadvantages of the functional method. Social welfare maximization as the central concept used in comparative contract law and economics will be introduced and elaborated in the next subsection. However, for reasons of structural consistency the principles of the fundamental functional method will be elaborated first.

According to functional micro-comparison, that which is incomparable cannot usefully be compared, and in law the only things which are comparable are those which fulfill the same function. Zweigert and Kötz’s proposition rests on what every comparatist actually learns, namely, that the legal system of every society faces essentially the same problems and solves these problems by quite different means, though with similar or identical results. They also pronounce the basic rule of comparative law, the so-called *praesumptio similitudinis*, which states that:

different legal systems give the same or very similar solutions, even as to detail, to the same problems of life, despite the great differences in their historical development, conceptual structure, and style of operation. It is true that there are many areas of social life which are impressed by especially strong moral and ethical feelings, rooted in the particularities of the prevailing region, in historical tradition, in cultural development, or in the character of the people.24

So, one should generally expect different legal systems to produce identical results. However, it should be stressed that the starting point of my analysis was one of objectivity where neither similarity nor difference was favored in advance, yet the results invariably tend towards similarity, and thus once again confirm this basic rule of functionalism. However, before elaborating three applied analytical stages in these comparisons, several methodological preliminaries will be illuminated.

**Macro- and micro-comparison**

Micro-comparison, with a focus on specific legal problems, is employed as the principal comparative technique. The related distinction between macro- and micro-comparisons was firstly drawn by Zweigert and Kötz in their seminal work on the introduction to comparative law in 1977.25 Micro-comparison aims at the specific legal institutions or problems, that is, with the rules used to solve actual problems or particular conflicts of interest, whereas macro-comparisons relate to the methods of handling legal materials, procedures for resolving and deciding disputes, or the roles of those engaged in law.26

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24 Zweigert and Kötz, supra note 1, p. 34.
25 Zweigert and Kötz, supra note 1, p. 4 et seq. See also Dannemann, Gerhardt, ‘Comparative Law: Study of Similarities of Differences,’ in Reimann and Zimmermann, supra note 19, p. 387.
26 Zweigert and Kötz, supra note 1, p. 4.
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Tertia comparationis: what matters?

The question to which any comparative study is devoted must be posed in purely functional terms; the problem must be stated without any reference to the concepts of one’s own legal system.27

The question of *tertia comparationis* is the substantive question of what is important in law and should reflect the author’s epistemological interests, which should be clearly and sincerely stated. The *tertia comparationis* is often implicit in the conceptual structure chosen, and is also a result of which aspect of law is relevant for a comparative lawyer. In addition, it is also a result of the question of possible beneficial contribution that such a comparative research may offer to these legal systems.28 The research questions are stated as problems without any reference to the concepts of any legal system. They are structured as universal concrete problems and as such form my *tertia comparationis*. What matters is the efficiency consideration of different rules and decisions, explaining why all the compared judiciaries have for concrete problems produced the same, welfare-maximizing legal solutions. The fruitfulness of the results justifies the applied method and the chosen *tertia comparationis*.

1.3.C. Steps of comparative enquiry

Presented comparative inquiry is structured into five main stages: (a) selection of topics and basis of comparison; (b) legal systems; (c) descriptive phase; (d) identification phase and (e) explanatory phase.

*Selection of topics and basis of comparison*

Due to an extensive amount of relevant topics and challenging problems in contract law which call for further comparisons, and where further instructive insights may be gained, a trade-off on the topics has to be made. Thus, after evaluating several different topics, the pre-contractual duties of information disclosure (Chapter 2), unforeseen contingencies (Chapter 3) and unilateral termination of contracts (Chapter 4) were selected as the most challenging topics. Moreover, these three different stages in the evolution of any contract (that is the pre-contractual stage, the performance stage and the dissolving, ending stage) also form a natural evolution of contractual relationships and enable instructive insights.

The selection of the basis of comparison strives for similarity and extends to legislation, judgments, and other decisions as primary sources, academic legal

27 Ibid. p. 34.
28 Jansen, Niels, ‘Comparative Law within the Field of Comparative Disciplines,’ in Reimann and Zimmermann, *supra* note 19, p. 314.
writing as secondary sources, and additionally to all other primary or secondary sources which can throw light on the research question.

Legal systems
Since there must be a minimum of difference between the compared systems to make a comparative enquiry worthwhile, and since compared legal systems should be at least at a similar stage of development, English and American law have been chosen as representatives of common law systems, and German and French law are representatives of civil law systems. Moreover, those four legal systems are so-called ‘mature’ or ‘parent’ legal systems which are extensively adopted or imitated by others, and hence the choice of comparison appeared as ‘value-maximizing.’ Furthermore, for reasons of objectivity, the Slovenian and Dutch legal systems have not been chosen. There was also an additional practical reason, namely the accessibility of legal materials, reports and comments.

Descriptive phase
Comparative analysis of each legal system starts with the descriptive phase, where an objective report on that system is offered, and where the norms, concepts and institutions of each of the compared systems are described. This description is free from any critical evaluation and contains all significant qualifications and modifications. This comprehensive portrayal of a legal solution to a practical problem, without commenting on the law of these various jurisdictions, is merely a necessary preliminary step in which the reader will be made familiar with the basic legal material.

Identification phase
After this preliminary juxtaposition, where apparent differences may be noted, the actual comparison begins with an economic assessment of general statutory provisions and doctrines, where an efficient optimal model rule is employed as the uniform term of comparison. This phase identifies differences and similarities with the optimal rule and answers which provisions or doctrines are closer to the efficient, optimal institution. This part will identify possible sources of inefficiencies and welfare losses which particular statutory provisions or doctrines may place on society, and will offer clear suggestions for statutory reforms.

Explanatory phase
In the last stage of comparison, the case law of each of the legal systems will be economically assessed. Comparison with the efficient institution leads to the conclusion that the compared systems reach the same practical results, and so confirm the praesumptio similitudinis hypothesis. Moreover, this part will also reveal a clear development pattern from less to more efficient law; will explain
apparent judicial inconsistencies; will offer an additional, efficiency-based explanation for those similarities; will offer additional analytical methods for addressing relevant practical issues, and will finally propose clear suggestions for judicial decision-making improvements.

1.3.D. Methodology and concepts used in comparative contract law and economics

The methodology and the concepts employed in comparative contract law and economics should be addressed thoroughly. The functional method itself lacks the proper evaluation tools for determining which of the compared laws is better, since the specific function itself cannot serve as a benchmark, and since as comparatists point out, once the similarity has been established the same function cannot determine superiority, making a comprehensive evaluation almost impossibly complex. Moreover, the evaluation criteria should be different from the criteria of comparability. Yet the evaluation criteria is defined as a ‘practical judgment’ or ‘policy decision’ under the conditions of partial uncertainty. In other words, as De Geest and Van den Bergh point out, when comparatists are to decide which of two different rules is the best one, they still make a choice on the basis of pure intuitive thinking.

Obviously, such evaluation criteria are subjective and vague. Instead, I argue, economic analysis of law offers efficiency as an objective and precise evaluation criterion for determining which of the compared legal systems is in economic terms ‘better,’ that is more efficient. Such a method is known in literature as comparative law and economics, which treats the legal and institutional backgrounds as dynamic variables and attempts to build models which reflect the ever-changing layered complexity of the real world of law. This method also broadens the horizon of the underlying legal discourse and confers a higher degree of realism to the theoretical analysis. The comparative contract law and economics employed in this book further develop these analytical methods, and apply them to contract law problems. A rather new

29 It is impossible first to isolate the function of a legal institution from its doctrinal formulation and to measure this remaining functional element against some ideal function, for no such ideal function exists beyond the mundane of the legal order; Michaels, supra note 22, p. 374.
30 Ibid.
31 Ibid.
32 They report that when the Lando commission, for example, had to decide which of two doctrines (leading to the same result) were to be chosen for the European contract code proposal, the choice was based on mere intuition (or even majority voting); De Geest and Van den Bergh, supra note 4.
33 For a synthesis see Mattei, Ugo, ‘Comparative Law and Economics,’ The University of Michigan Press, 1997. However, for diverse viewpoints see Faust, Florian, ‘Comparative Law and Economic Analysis of Law,’ in Reimann and Zimmermann, supra note 2, p. 837.
35 On the ideal comparative methodology see De Geest and Van den Bergh supra note 4.
Comparative contract law and economics employs analytical tools to evaluate and explain analogies and differences among alternative contract law patterns. This examination offers instructive insight into which of the compared legal systems is more or less efficient, provides economic explanations for judicial decisions and statutory provisions, enables measurement of the actual difference or analogy of the compared systems, offers a substantive insight into the actual driving force behind judicial decisions, and reveals the invariable tension of all compared legal systems towards efficiency. Furthermore, the analysis in this book is positive and normative. Hence, by supplementing traditional comparative contract law methodology with an economic analysis of law, this book offers additional instructive insights and supplements otherwise inconclusive evaluation. The analysis employs previously discussed steps of comparative research and enriches them with economically-inspired comparison.

Efficient optimal model rules as uniform terms of comparison
Economic tools are employed to build optimal model rules, which operate as uniform terms of comparison for the concrete solutions of analyzed legal institutions. The presented efficient optimal rules are complex enough to enable a completely factual analysis. However, since the book is aimed at lawyers, they are not at all technical and are deliberately simplistic in their approach. This book encompasses transaction costs, incentives and risks analysis, and provides an overall economic assessment of the examined subjects.

Positive and normative economic analysis
The comparative contract law and economic analysis in this book is equally positive and normative. It is positive (what the law is) since it explains the development of law as one of welfare-maximizing, and predicts what kinds of behavior (incentives) certain legal institutions will induce. Thus, it offers a model for predicting contracting parties’ behavior. It is also normative (what the law should be) since it provides optimal model rules, which promote efficiency and ‘increase the size of the pie.’ Hence, it provides rules which should govern in order to maximize social welfare.

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37 If this is, of course, also the legislator’s aim.
1.4. OUTLINE OF THE BOOK

This book is divided into five chapters; an introduction and conclusion, with the remaining chapters written in the form of three separate comparative contract law and economics’ analyses.

Chapter 2: Pre-contractual duty to disclose information
Pre-contractual duties to disclose information has been one of the most extensively debated questions among legal and economic scholars. Yet, despite this extensive amount of literature comparative lawyers still seems to be puzzled by the notion of when and where the party in possession of material information should disclose them or should have the right to keep them secret and profit from them.

This chapter provides a survey of law and economics scholarship and systematizes them into a coherent optimal model rule establishing when a party should have the right not to disclose material information and capitalize upon it, which then serves as a uniform term of comparison towards French, English, US and the German law on that issue.

Chapter 3: Unforeseen contingencies
This chapter discusses the phenomena of unforeseen contingencies that render performance much more onerous than was envisaged. The question of whether a contract where performance has become, due to unforeseen contingencies, excessively onerous, should be excused, adjusted or simply enforced has puzzled legal scholars for centuries.

This chapter offers a survey of law and economics scholarship and systematizes them into a coherent optimal model rule serving as the uniform term of comparison towards French, English, American and German law on unforeseen contingencies. These legal systems are thoroughly analyzed in order to explain different legal doctrines, to provide an objective, economically-inspired evaluation of each of them, and to explain strikingly similar outcomes of the related law in action. This approach also permits an additional, efficiency-based justification for the observed development pattern.

Chapter 4: Unilateral termination
This chapter addresses the questions of whether and under what conditions fixed-term and open-ended contracts may be unilaterally terminable. This chapter offers a survey of law and economics scholarship and supplies a set of economic criteria which is then synthesized into an optimal model rule. This optimal model rule then serves as a uniform term of comparison towards French, English, American and German law on unilateral termination of contracts. This approach permits us to redefine the concepts and to provide economically-inspired justification for compared doctrines, laws in action,
and observed development patterns. For each system it is investigated whether their current doctrine is an efficient one, whether there is a possible path for statutory reform and whether related decisions reach efficient outcomes.

Chapter 5: Summary and conclusions
In this concluding chapter the conclusions from previous chapters are brought together in order to provide an overall observation of this book.