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REMOTENESS OF DAMAGE IN CONTRACT AND ITS FUNCTIONAL EQUIVALENTS: A CRITICAL ECONOMIC APPROACH

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Abstract: *Hadley v Baxendale* remoteness is generally regarded favourably in the law and economics literature. Orthodox theory views remoteness as an efficient rule, although its purported efficiency virtues vary. Most economic models portray remoteness as an information disclosure device which bridges information asymmetry and regulates rates of contracting, precautions against breach and even reliance by promisees. Yet the assumptions of economic models are denied by the content that courts attribute to the doctrine. This paper suggests that remoteness is an inefficient rule which entails certain costs, particularly through its impact on performance/breach decisions, but only uncertain and modest efficiency gains. It is argued that a more efficient default rule would allow full recovery of expectation damages. The paradigm-changing judgment in *The Achilleas* could pave the way for such superior rule rather than add an imprecise test of remoteness to the existing *Hadley* rule. The paper contrasts the English and US solutions with functional equivalents of remoteness from Germany, France and Quebec, which come closer than the common law to the economic models' version of remoteness or the expectation damages rule. The analysis shows, perhaps surprisingly, that the efficiency of the common law of contract is too often taken for granted.

A. INTRODUCTION

Despite historic entrenchment, the remoteness rule and its functional equivalents in US, German, French, and Quebec law – liability-limiting devices that employ foreseeability criteria to determine compensable damage – remain obscure figures. The unstable foundations of remoteness – and its conceptually similar US counterpart, unforeseeability of damage[1] – were abruptly revealed when, in *The Achilleas*,[2] the House of Lords departed from the over 150-year old precedent of *Hadley v Baxendale*.[3] It sought to base remoteness on an agreement-centred test[4] to avoid what was believed to be, on the facts, an abnormal result deviating from the general market understanding. On a similar note, functional equivalents of remoteness found

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[1] Allan E Farnsworth, *Contracts* (4th edn, Aspen Publishers 2004) 792-99.
[2] *Transfield Shipping Inc v Mercator Shipping (The Achilleas)* [2008] UKHL 48, [2009] 1 AC 61 (HL).
[3] (1854) 9 Exch 341.
[4] Paul CK Wee, 'Contractual Interpretation and Remoteness' (2010) LMCLQ 150, 156ff.

in the German, French, and Quebec legal systems[5] are rarely used by the courts[6] or conflated into other requirements for damages, such as causation.[7] Furthermore, the French and Quebec civil codes make the requirement of foreseeability inapplicable in cases of intentional or grossly negligent breach, and additional exceptions have been carved up in case law and jurisprudence.[8]

Judicial unease with remoteness and its functional equivalents is in line with these doctrines' ambiguous economic implications. Taking the remoteness of common law as a prototype, this paper will first critically assess such doctrines' rationale, as well as the arguments against the traditional rule of remoteness and foreseeability-based equivalents, concluding that these liability-limiting devices are inferior to a rule of full expectation damages. This economic framework will then be employed to critically assess the positive law of remoteness in England and Wales, as well as functional equivalents in the US, Germany, France, and Quebec. The economic and comparative analysis leads (perhaps surprisingly) to the conclusion that as concerns the examined subject, the civil law systems of Germany, France, and Quebec provide the more efficient solutions.

B. IS THE DEFAULT RULE OF REMOTENESS DESIRABLE?

Traditional *Hadley* remoteness famously prescribes compensation for such damage as may fairly and reasonably be considered as arising naturally – in the usual course of events – from the breach or which may reasonably be supposed to have been in the contemplation of the parties when the contract was made. Underlying the judicial acceptance of remoteness is a moral judgment expressed, for example, in *The Heron II:*[9] it would be too 'harsh' to hold a promisor liable for the unforeseeable consequences of his breach of contract. This judgment encapsulates a form of distributive justice. However, quite apart from expressions of scepticism towards the assumptions and means of distributive justice,[10] it is not clear that morality or distributive justice requires that, following a breach of contract, some of the damage – the

[5] Such functional equivalents should be examined in the contextualised settings provided by the theory and practice of the compared legal systems, as prescribed by comparative methodology; see Konrad Zweigert and Hein Kötz, *Introduction to Comparative Law* (Tony Weir tr, 3rd edn, OUP 1998) 35-36.

[6] Sir Basil Markesinis, Hannes Unberath and Angus Johnston, *The German Law of Contract: A Comparative Treatise* (2nd edn, Hart Publishing 2006) 457; Genavième Viney, *Traité de droit civil (sous la direction de Jacques Ghestin)*, tome 5 (LGDJ 1989) 423.

[7] Jean-Louis Baudouin, *Les obligations* (Pierre-Gabriel Jobin and Nathalie Vézina eds, 7th edn, Thomson Reuters 2013) 934.

[8] ibid 933.

[9] *Koufos v C Czarnikow* [1969] 1 AC 350 (HL) 414 (Lord Pearce); see also John Cartwright, 'Remoteness of Damage in Contract and Tort: A Reconsideration' (1996) 55 CLJ 488, 490.

[10] Richard A Posner, *Economic Analysis of Law* (9th edn, Wolters Kluwer 2014) 638-41, 644-46.

unforeseeable part – should be left to lie with the innocent promisee rather than be shifted onto the promisor who caused the damage. Considering the frail moral and distributive basis for remoteness, it is not surprising that most analyses of remoteness turn on matters of allocative efficiency. The efficiency arguments in favour of or against remoteness will be critically examined in this part of the paper. The balance of these considerations suggests that the default rule of remoteness is inferior to a rule allowing full recovery of expectation damages.

1. The Economic Rationale of Remoteness

Hadley remoteness – with the insights of this analysis being equally applicable to functional equivalents in the US, Germany, France, and Quebec – is claimed to address three types of inefficiencies: the preclusion of efficient contracts with promisees who place a below-average value on performance;[11] the taking of inefficient precaution against breach by promisors who are unaware of the risk of unusual loss;[12] and inefficient reliance on performance by promisees.[13] These inefficiencies are considered to flow from either of two forms of market failure, ie information asymmetry or externalisation by the promisee of costs of inefficient reliance.

a) Information Asymmetry and Rates of Contracting and Precaution

In real-world settings, contractual parties have imperfect information. In general, only the promisee, and not the promisor, has cost-justified access to information concerning that promisee's specific circumstances, which might lead to higher-than-average loss incurred in case of breach. This information asymmetry can give rise to the 'market for lemons' famously explained by Akerlof.[14] Unsure of the subjective valuation of performance by any individual promisee and therefore of his own expected cost of breach, the rational promisor will use statistical inferences from market data to determine an average expected cost of breach. On this basis, he will charge an average price for his performance and will take an average level of precaution against breach. This may drive out of the market promisees that value performance at less than such average price,[15] and the process can replicate until the market is shrunk out of existence.[16] Regarding the fewer contracts that are concluded, high-value promisees have no

[11] Eric A Posner, 'Contract Remedies: Foreseeability, Precaution, Causation and Mitigation', *Encycopaedia of Law and Economics* (2000), <http://encyclo.findlaw.com/4620book.pdf> accessed 17 January 2016.
[12] John H Barton, 'The Economic Basis of Damages for Breach of Contract' (1972) 1 J Leg Stud 277, 295-96; E Posner (n 11).
[13] Robert B Cooter Jr and Thomas Ulen, *Law and Economics* (6th edn, Pearson Education Limited 2014) 327-29.
[14] George A Akerlof, 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism' (1970) 84 Q J Econ 488.
[15] E Posner (n 11) 165-66.
[16] Akerlof (n 14) 490.

incentive to communicate their subjective expectation regardless of what low-value promisees do. The former will simply prefer the combination of a lower price, subsidised by low-value promisees, and expectation damages which make them indifferent towards the level of precaution against breach that promisors adopt.[17] The average level of precaution that would become generalised in a no-communication equilibrium would be socially suboptimal.[18] In the case of contracts with high-value promisees, there would be room for incremental precaution, the cost of which would be offset by the greater losses thus averted. Remoteness is thought to address this inefficiency by acting, in Ayres and Gertner's terminology, as a 'penalty default' rule meant not to mirror a complete contract,[19] but to induce high-value promisees to disclose their potential consequential damages.[20] The result, the argument goes, is that promisors will thus distinguish between the different types of promisees, with all those not revealing their higher-than-average expectation being treated as low-value promisees. A communication[21] and separation [22] equilibrium will emerge wherein different price, precaution and damages packages will be offered to the different categories of promisees, ensuring efficient rates of contracting and differentiated precaution.[23]

b) Reliance costs

In an original approach to remoteness, Cooter and Ulen view this liability-limiting doctrine as a possible partial solution to the 'paradox of compensation'.[24] In the economics of law, this paradox stems from the fact that no particular measure of damages can successfully provide incentives for both efficient performance/breach decisions by the promisor and efficient reliance decisions by the promisee. In particular, expectation damages – the general measure of damages in contract[25] – cause the promisee to treat performance as certain. Because they are meant to act as a substitute for all the benefits of specific performance, perfect expectation damages provide the promisee with the guarantee that the full subjective value of performance is forthcoming whether the promise is actually performed or not. Therefore, the promisee will

[17] Lucian A Bebchuk and Steven Shavell, 'Information and the Scope of Liability for Breach of Contract: The Rule of *Hadley v Baxendale*' (1991) 7 J L Econ & Org 284, 286.
[18] ibid 291.
[19] The notion is discussed, for example, in Steven Shavell, 'Damage Measures for Breach of Contract' (1980) 11 Bell J Econ 466, 466-67.
[20] Ian Ayres and Robert Gertner, 'Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules' (1989) 99 Yale LJ 87, 101-102, 111-12, 118; see also Lisa Bernstein, 'Social Norms and Default Rules Analysis' (1993) 3 S Cal Interdisc LJ 59, 64ff.
[21] Bebchuk and Shavell (n 17) 290.
[22] Ayres and Gertner (n 20) 111-12.
[23] E Posner (n 11).
[24] Cooter and Ulen (n 13) 325, 327-29.
[25] *Robinson v Harman* (1848) 1 Exch 850, 855; Ewan McKendrick, *Contract Law* (10th edn, Palgrave Macmillan 2013) 334.

invest in reliance up to the point where the marginal cost of reliance equals the marginal increase in the expected benefit of performance, which he is sure to receive. Yet reliance expenditure is socially wasteful unless actual performance, the value of which it is supposed to augment, is carried out. In conclusion, efficiency requires that, in the promisee's calculation of the limits of reliance investments, marginal increases in the expected benefit of performance should be discounted by the probability of performance.[26] By limiting recovery to a level below the expectation measure, remoteness causes the promisee to internalise the cost of incremental reliance once damages, having reached the remoteness barrier, become invariable. Consequently, remoteness serves to correct the negative externality which the expectation measure enables the promisee's reliance decisions to produce.

2. The Bigger Picture: Why Remoteness Is Inefficient

Principled attacks on remoteness are rare in the law and economics movement. Eric Posner, for example, while accepting that *Hadley* remoteness can successfully perform its information-revealing function, argues that this function could be fulfilled equally efficiently by a rule of unlimited liability for expectation damages. The latter might, however, prove preferable in light of its greater clarity and ease of administration.[27] More vigorously, Johnston contends that traditional remoteness fails to overcome the strategic incentives that the parties to a transaction have in withholding valuable private information. Such problem is exacerbated if the promisor has market power.[28] Eisenberg explores the shortcomings of remoteness in an unambiguous challenge of the doctrine.[29] He convincingly argues that, in light of the information which it incentivises the promisee to disclose, remoteness misses its economic point. It is, in any case, of little practical use in the contemporary economy, the scale of which renders stratified pricing and precaution too costly. Finally, it distorts incentives for the performance of promises and for investment in private information.[30]

In the bigger picture, when the actual content of remoteness is accounted for – something that economic models generally fail to do – the doctrine's efficiency justifications are negated. Crucially, it only requires the communication of the promisee's special circumstances which may lead to consequential loss, and not of the extent of loss. The shortcomings of remoteness would only be partly mitigated if the doctrine were understood as

[26] Alan Devlin, *Fundamental Principles of Law and Economics* (Routledge 2015) 201.
[27] E Posner (n 11) 166-69.
[28] Jason Scott Johnston, 'Strategic Bargaining and the Economic Theory of Contract Default Rules' (1990) 100 Yale L J 615, 630-34.
[29] Melvin Aron Eisenberg, 'The Principle of Hadley v Baxendale' (1992) 80 Cal L Rev 563.
[30] ibid 602-603.

requiring disclosure of the promisee's expected loss. Even if the efficiency justifications of remoteness were conceded in principle, they are outweighed by the inefficiency that the doctrine generates with respect to performance/breach decisions, as well as communication, stratification and litigation costs.

a) Remoteness and Rates of Contracting, Precaution and Reliance

Economic models favourable to remoteness assume that the object of the communication which renders a certain loss recoverable is the extent of such loss consequent upon breach.[31] That, however, is not what the rule requires to make loss recoverable. The requirement, as set out by Scarman LJ in *Parsons (Livestock) Ltd v Uttley Ingham & Co Ltd*,[32] is that the type of loss be reasonably contemplated, even if the specific consequences for which the promisee claims compensation are not foreseeable. In *Parsons*, therefore, it did not matter that the parties could not contemplate that the defective storage hopper would lead to Parsons incurring the loss of the 254 pigs killed by the outbreak of E. coli, so long as injury to or death of the animals was a reasonably contemplated result of Uttley Ingham's breach of their obligation to supply a hopper fit for purpose. The same result was reached in *Brown v KMR Services Ltd*.[33] The rule applies to types of damage foreseeable under either of the limbs of *Hadley*, which are deemed to embody a single rule prescribing recoverability of reasonably contemplated loss.[34]

It follows that how remoteness actually operates is disconnected from how economic models generally portray its mechanism. Based on the imputed knowledge of ordinary circumstances, the promisor is liable for ordinary loss, regardless of its extent; if the promisee reveals his special circumstances, the promisor becomes liable for such type of consequential loss as can be reasonably contemplated, again regardless of its extent. The net result is that, irrespective of whether or not the promisee reveals his special circumstances which indicate that consequential loss may occur, the promisor will not have a representation of the extent of his liability.[35] Yet it is exactly this cost of breach that the promisor needs to determine in order to take the optimal level of precaution.

The lack of any necessary correlation between ordinary and below-average damages or between consequential and above-average damages was arguably the underlying problem

[31] Barton (n 12) 295-96; Jeffrey M Perloff, 'Breach of Contract and the Foreseeability Doctrine of *Hadley v Baxendale*' (1981) 10 J Leg Stud 39, 40-42; Ayres and Gertner (n 20) 101-102; Bebchuk and Shavell (n 17) 285-87.
[32] [1978] QB 791 (CA) 813.
[33] [1995] 4 All ER 598 (CA).
[34] *Jackson v Royal Bank of Scotland plc* [2005] UKHL 3, [2005] 1 WLR 377 (HL) [46]-[49] (Lord Walker).
[35] Eisenberg (n 29) 600, 603.

which led the *Victoria Laundry* court to an awkward solution. It treated lost profits corresponding to the highly lucrative potential contracts with the Ministry of Supply as a kind of consequential loss, different from usual profits. To recover the former, the claimant would have had to inform the defendant 'of the prospect and terms of such contracts'.[36] It is odd to suggest that, in commercial relations, the defendant could not contemplate that the claimant would pounce on a lucrative opportunity arising in his usual course of business. The court drew a line in the sand to separate ordinary and consequential losses on the criterion of extent. This approach was not followed subsequently in cases such as *Parsons* and *Brown*. Both involved direct or ordinary damages which were held to be recoverable despite being unusually extensive.

Against this backdrop, the distinction between high-valuation and low-valuation promisees cannot serve to justify remoteness on efficiency grounds. By creating incentives for the promisee to reveal only circumstances that make it possible to reasonably contemplate a certain type of loss, remoteness does not cure the information asymmetry concerning the promisee's expected loss. Hence, it does not enable promisors to offer differentiated price, precaution, and liability packages and is inadequate for the economic function of inducing efficient rates of contracting and precaution.

The same problem, arising from the actual content of the doctrine of remoteness, makes it easy to dismiss the efficiency justification concerning the promisee's level of reliance. This justification requires that foreseeable reliance equate efficient reliance.[37] However, the obvious objection to this proposition is that, within the terminology of remoteness, foreseeable reliance must mean foreseeable types of reliance expenditure, and not some definite amount. There is no reason to suppose that reliance subsumed to a certain type is precisely what efficient reliance of that type would be.

To conclude, the actual content of *Hadley* remoteness, very much an issue even after *The Achilleas,* as the case of *Supershield* demonstrates,[38] is inaccurately reflected in economic models which present remoteness as an efficient rule. Such models are predicated on an alternative understanding of remoteness, one requiring promisees to disclose the extent of the damage that they are exposed to. This, however, is not the court-adopted understanding. Despite the isolated side-stepping of the problem in *Victoria Laundry*, the existing law is that

[36] *Victoria Landry (Windsor) Ltd v Newman Industries Ltd* [1949] 2 KB 528 (CA), 543 (Asquith LJ).
[37] Cooter and Ulen (n 13) 328.
[38] *Supershield Ltd v Siemens Building Technologies FE Ltd* [2010] EWCA Civ 7, [2010] 1 CLC 241 (CA) [43] (Toulson LJ).

only the type of damage – not its extent – must be foreseeable, meaning that remoteness cannot systematically promote efficiency as regards rates of contracting, precaution and reliance.

b) Adopting the Alternative Understanding

It might appear from the analysis made above that remoteness could be redeemed economically if, perhaps by reviving the reasoning that underpinned the *Victoria Laundry* judgment, it were understood as requiring the promisee to reveal the extent of his expected loss. There are, however, multiple reasons why the benefits of this version of remoteness are likely to be trivial compared to the efficiency loss that the doctrine engenders. The only redeeming quality of this alternative rule is that, by limiting recovery to the extent of the loss communicated by the promisee, it enables the promisor to identify promisees who make no communication as those who expect below-average damages in case of breach. These promisees can therefore be drawn into ex ante efficient contracts by a low price and low precaution package. As concerns reliance, there is, in this version of remoteness also, no reason to believe that the foreseeable damage is limited to the efficient reliance investment. For instance, there will generally be some net expectation (profit) that, regardless of reliance, will be foreseeable, as the 'normal' profit reasoning of *Victoria Laundry* demonstrates. This efficiency justification of remoteness thus remains unproved. Most importantly, even this version of remoteness cannot, with any certainty, address the problem of efficient precaution taken by the promisor.

One reason for this resides in possible post-contractual fluctuations in the promisee's gross expectation interest[39] due to unforeseeable contingencies. These can mean that, when the contract is concluded, there is no genuine information asymmetry concerning the promisee's gross expectation interest at the future time of performance/breach decisions, which is the actual information needed for efficient precaution (*The Achilleas* exemplifies this problem). Put differently, when the contract is concluded, the promisee may be no more aware than the promisor of future circumstances that will render performance more or less valuable, such as an unexpected increase in the market price at which the promisee could resell purchased goods.

Another reason why this purported efficiency gain from remoteness is uncertain is that, when the parties' strategic incentives to exploit their private information are considered, the information-revealing mechanism of remoteness cannot function as intended. Richard Posner alludes to this problem when noting that should remoteness require disclosure of foreseeable lost profits, it would then deprive the promisee of the benefits of being a good bargainer.[40]

[39] LL Fuller and William R Perdue, 'The Reliance Interest in Contract Damages: 1' (1936) 46 Yale L J 52, 73-74.
[40] R Posner (n 10) 139-40.

Johnston demonstrates that the parties' strategic incentives to exploit the value of private information are at odds with the information-revealing rationale of remoteness.[41] Most importantly, the promisee has the natural incentive – contrary to that provided by remoteness – not to reveal his own private information concerning expected losses. Such revelations would signal his willingness to pay and enable the promisor to bargain for a larger share of the joint surplus created by the contract. This problem will be exacerbated if the promisor has market power.[42] Such conflicting incentives make it difficult to believe that remoteness runs smoothly to provide the promisor with a representation of his expected cost of breach. More probably, the promisee will reason at the margin and send what Johnston calls 'fuzzy messages'.[43] He will disclose such losses (assuming, implausibly, they are accurately known when the contract is concluded) only up to the point where the marginal benefit of the additional expected loss that can be recovered in case of breach equals the marginal cost to the promisee, consisting of a higher price. This is a further reason to believe that remoteness fails in ensuring communication of the information necessary for efficient precaution.

c) The Costs of Remoteness

At best, remoteness carries the benefit of increasing the rate of ex ante efficient contracts by enabling promisors to distinguish between promisees exposed to above-average or below-average damage. Even this efficiency gain is merely theoretical, being the product of a version of remoteness which, although depicted in economic models, does not accurately reflect the legal doctrine applied by the courts. In contrast, the efficiency losses flowing from remoteness are substantial: this rule precludes efficient breach/performance decisions, entails high communication and stratification costs, and leads to costly litigation.

First, remoteness is at odds with the theory of efficient breach. Postulated by Robert Birmingham in 1970,[44] the theory of efficient breach explains the expectation measure of damages as the only one capable of inducing efficient performance/breach decisions, by causing the promisor to internalise the entire cost of breach and only choose to breach if, in an alternative use, the value of his performance is greater than such cost.[45] Although strongly criticised by more traditional contract theorists,[46] the theory remains a cornerstone of contract

[41] Johnston (n 28).
[42] ibid 633-34.
[43] ibid 630.
[44] Robert Birmingham, 'Breach of Contract, Damage Measures and Economic Efficiency' (1970) 24 Rutgers L Rev 273.
[45] R Posner (n 10) 131.
[46] Daniel Friedmann, 'The Efficient Breach Fallacy' (1989) 18 J Legal Stud 1.

law and economics. Recent explanations show that, once understood in all its implications, particularly from the perspective of the price effects of different remedial measures, the efficient breach theory is in line with the conceptions of autonomy of will and does not necessarily depend on justification from a social welfare perspective.[47] The desirability of efficient breach reflects badly on remoteness, which, by limiting recovery below the expectation measure, allows the promisor to externalise the unforeseeable costs of breach. Remoteness thus lowers the private cost of breach to the promisor and induces inefficiently high levels of contractual non-performance.

Second, the operation of remoteness as an information-revealing device necessarily implies the cost of promisees collecting, sorting, and transmitting the information relevant to their expected losses.[48] Transaction costs are increased by the parties' conflicting strategic incentives,[49] as promisors attempt to capture more of the consumer surplus that remoteness incentivises promisees to reveal. Remoteness thus becomes a 'sticky' default rule, expensive to contract around.[50]

Third, the correlative of the promisee's communication costs are the costs incurred by promisors for using the information provided by stratifying precaution.[51] These would be particularly high in modern economies of scale and scope, which make it unrealistic to expect high-volume producers of homogenous goods to collect information from individual purchasers and adjust individual products accordingly. Promisors would prefer the alternative of more cost-efficient, uniform precautionary measures, coupled with insurance, including self-insurance, with premiums built into the price.[52] Spread across high volumes of output, the price effects of such insurance would be sufficiently low to render negligible any loss of efficiency in the form of foregone contracts.

Finally, remoteness is a source of considerable litigation costs, invariably raising the difficult issue of the foreseeability test and its relation to the corresponding test in tort.[53] At least three levels of foreseeability can be distinguished in the abstract,[54] and cases such as

[47] Gregory Klass, 'Efficient Breach', in Gregory Klass, George Letsas, Prince Saprai (eds), *Philosophical Foundations of Contract Law* (OUP 2015) 362.
[48] Eisenberg (n 29) 594.
[49] Ronald H Coase, 'The Problem of the Social Cost' (1960) 3 J L & Econ 1, 15-19.
[50] Omri Ben-Shahar and John AE Pottow, 'On the Stickiness of Default Rules' (2005) 33 Fla St U L Rev 651-52, 662.
[51] Eisenberg (n 29) 593.
[52] ibid 593-95.
[53] Cartwright (n 9) 492-96.
[54] Eisenberg (n 29) 566-67.

Victoria Laundry, *Monarch Steamship*,[55] and *The Heron II* illustrate the judicial uncertainty in framing any specific test. This adds to the equally difficult question of what must be established – the specific information communicated, the possible additional test of assumption of risk – to determine whether the remoteness limit on recovery has been displaced.

Against this background, the conclusion of economic analysis appears straightforward. At best, remoteness presents uncertain efficiency gains, for which better tools are available in modern economies. The costs of remoteness are, in contrast, both certain and sufficiently great to offset the possible gains. Economic analysis therefore suggests that the doctrine is inefficient and undesirable from a normative legal standpoint.

3. A Better Rule

Of itself, the negative efficiency outcome of remoteness might appear sufficient to advocate in favour of the rule being discarded. However, a further question is whether alternative rules fare any better in terms of efficiency. Eisenberg supports a regime of 'proximate cause, contractual allocation of loss and fair disclosure',[56] which is still short of what is sometimes termed 'unlimited liability',[57] ie a rule of full expectation damages. It is suggested that this latter rule is the most efficient and should therefore provide the benchmark for the positive and normative assessment of the law of remoteness and its functional equivalents.

As concerns the issue of reliance on the promise, any rule expanding liability admittedly is in danger of inducing inefficiently high levels of reliance. Yet, because there is no way of determining if and by how much the limit set to recovery by remoteness is below or above the level of efficient reliance, it is also not possible to determine whether a more expansive default rule would be more or less efficient than remoteness. On the matter of reliance, the comparison can only be indeterminate. In terms of bridging information asymmetry, however, Eisenberg's proximate cause regime and the rule of full expectation damages are effective in incentivising the revelation of information and therefore in addressing the market failure which upsets rates of contract formation and precaution.[58] However, Eisenberg's proposition, centred on a reasonable foreseeability test imported from the law of tort, appears to simply substitute one costly legal mechanism for another and preserves the problem of preclusion of efficient breach.

The system advocated by Eisenberg is founded on the idea that recoverable damage in contract should comprise only consequences that have the breach of contract as their proximate

[55] *Monarch Steamship Co v Karlshamns Oljefabriker (A/B)* [1949] AC 196 (HL).
[56] Eisenberg (n 29) 598.
[57] Bebchuk and Shavell (n 17) 285.
[58] Eisenberg (n 29) 598-604; E Posner (n 11) 168; Cooter and Ulen (n 13) 329.

cause. Proximate causation is determined using the reasonable foreseeability test applicable in tort and the moment of breach rather than the conclusion of the contract as the reference point for applying the test. Generating a wider scope for liability compared to the reasonable contemplation test, Eisenberg's proposed rule of recovery would be accompanied by clauses allocating losses. But because such liability-limiting clauses depress the promisee's expected benefit from the contract, they should be enforceable only if subject to sufficient notice to the promisee.[59] Although superficially attractive, this system fails to resolve pressing efficiency problems raised by remoteness and is therefore inferior to the full expectation damages rule.

Apart from the arguable confusion between remoteness and causation, which English law appears to have overcome after *Quinn v Burch Bros (Builders)*[60] and *Galoo v Bright Grahame Murray,*[61] Eisenberg's alternative regime has one important deficiency when examined against the theory of efficient breach. Specifically, by employing a test of reasonable foreseeability, it precludes the proper application of the theory, which Eisenberg himself supports. Eisenberg's rule remains undercompensatory compared to the expectation measure, the use of which is a premise of efficient breach. Although less than that entailed by the more stringent reasonable contemplation test of traditional remoteness, the efficiency loss still exists. It concerns cases of highly sophisticated promisors who, at the time of breach, can and perhaps actually do foresee losses beyond the threshold of the reasonable foreseeability test. They could ignore such losses because the test is objective and, apart from the commercial capacity of the promisor, does not make allowance for individual characteristics.[62] By comparison, a rule of full expectation damages would not provide a foreseeability threshold for recovery. It would thus ensure that promisors, including highly sophisticated ones, take into account all losses actually foreseen, an incentive which supports the efficient breach theory.

As concerns litigation costs, Eisenberg's system appears to be as inefficient as remoteness. It merely replaces one, more rigid, foreseeability test with a laxer one: the risk of the damage occurring should be 'more than marginal' or 'not insignificant'.[63] There is little reason to believe that it would be easier for the courts to determine a 'not insignificant' prospect of damage than, for example, the 'not unlikely' prospect referred to by Lord Reid in *The Heron II*. These costs are not incurred in the application of a full expectation damages rule, which

[59] Eisenberg (n 58).
[60] [1966] 2 QB 370 (CA), 393-94.
[61] [1994] 1 WLR 1360 (CA), 1369-75.
[62] Guenter H Treitel, *The Law of Contract* (Edwin Peel ed, 12th edn, Sweet & Maxwell 2011) 1053 and fn 536.
[63] Eisenberg (n 29) 599.

would only raise the issue of causation, a common denominator (and therefore a basic cost) for regimes of damages in contract.

In this context, of the available regimes, the preferable one is that which allows recovery for full expectation damages. It has already been shown that the expectation damages rule is best suited to incentivise efficient breach/performance decisions. Certainly, this system cannot cure the problem of inefficient reliance on the promise, but this shortcoming is also common to the remoteness regime and Eisenberg's proposed rule, and is a manifestation of the known 'paradox of compensation'.[64] In terms of bridging information asymmetry and thus inducing efficiency in rates of contracting and precaution, this proposed system fares better than both remoteness and Eisenberg's proposed regime, reaching similar results at lower costs. Game theory shows that the information-revelation process sought through remoteness is also achieved by the expectation damages rule.[65] Under this rule, promisees expecting above-average losses have no incentive to disclose such losses only to pay a higher price for no additional benefit. Promisors will thus be induced to self-protect by treating every promisee that does not disclose expected losses as one with above-average losses and consequently charging a high price. Knowing this, promisees expecting below-average losses at the time of contract conclusion will be driven by self-interest to communicate this information and to make this signal reliable by agreeing to clauses limiting liability. Consequently, the expectation damages rule cures the information asymmetry regarding the promisee's exposure to loss known at the time of contracting. Thus, it ensures that ex ante efficient contracts are not foregone and that the promisor is provided with the information necessary for efficient precaution at this initial contractual stage. Conceding this, the proponents of remoteness argue that stimulating the communication of information in this way is more costly than under remoteness.[66] The reasoning is that, while incurring the same individual cost of communication as promisees with below-average expected loss, those with above-average loss are fewer and should therefore, collectively, incur lower communication costs than promisees with below-average loss. Yet there are good reasons to doubt this. The degrees of loss that promisees can be exposed to are as varied as the myriad idiosyncratic preferences that people may have. Therefore, as Eric Posner correctly points out, the supposition that low loss promisees outnumber the high loss ones is unsupported and a more appropriate premise of the analysis should be a normal distribution of the exposure to loss and therefore equal proportions of low

[64] Cooter and Ulen (n 13) 323-25; Devlin (n 26) 203.
[65] Cooter and Ulen (n 13) 329.
[66] Bebchuk and Shavell (n 17) 291-92.

and high loss promisees.[67] Contrary to Eric Posner's conclusion, however, there are two reasons why this does not necessarily render the comparison of the rules indeterminate.

First, the comparison clearly favours the expectation damages rule once the actual legal content of the doctrine of remoteness is accounted for.[68] Specifically, because contracting around remoteness implies the communication of special circumstances leading to consequential loss and not of any upper limit of expected loss, the promisor still faces open-ended damages. The communicating promisee is insured against uncapped losses and, as such, will not have an incentive to offer limitations of liability. Negotiations will therefore extend to a price increase which the promisor charges as an insurance premium, generating additional transaction costs. Conversely, no such subject arises when the parties contract out of the expectation damages rule. Transaction costs should therefore be lower. The limitation of liability offered by the promisee expecting below-average losses will place an upper limit on the promisor's expected cost of breach, such that the parties will not also bargain over an insurance premium charged by the promisor.

Second, costs of contracting around the relevant default rules are just one dimension of the comparison. Another is the overall efficiency gain (or loss) that the default rules entail when not displaced.[69] On this front also, the expectation rule demonstrates superiority. Unlike remoteness and Eisenberg's intermediate regime, the expectation rule can incentivise efficient performance/breach decisions and avoids important litigation costs because it does away with the need for additional, invariably ambiguous tests of foreseeability.

In conclusion, remoteness, even in the idealised version portrayed in economic models, is inefficient. Eisenberg's system addresses some of the problems of remoteness but stops short of what is necessary to enable efficient breach/performance decisions and cost savings, especially concerning litigation. A better, more efficient system is that which takes the extra step and employs the expectation damages rule.

C. LESSONS FROM ECONOMIC ANALYSIS

The value of economic analysis generally resides in providing the tools for positive assessment of how legal rules work or normative recommendations for how they should be structured,

[67] E Posner (n 11) 167.
[68] It should be conceded, however, that even the expectation damages rule may not overcome the problem of strategic incentives concerning privately valuable information; see Ben-Shahar and Pottow (n 50) 662.
[69] E Posner (n 67).

interpreted and applied.[70] The following sections aim to apply the economic framework built thus far to the relevant rules in the English, US, German, French, and Quebec legal systems.

1. English Law

The conclusions of economic analysis apply squarely to *Hadley* remoteness, as developed by the courts. It is arguably an inefficient default rule. The question, therefore, is whether recent developments in English law enable changes which can accommodate normative recommendations resulting from economic analysis. The most important such development is the case of *The Achilleas*.[71] It raised the question of damages for a nine-day delay in the redelivery of a chartered vessel, which, due to unusual market fluctuations, caused the follow-on charter to be cancelled and re-contracted at a rate much lower than that prevailing at the contractual redelivery date. The owners claimed the difference, for the entire four-month duration of the follow-on charter, between the high rate initially agreed with the follow-on charterers and the low one eventually agreed after renegotiations following late redelivery. The defaulting charterers conceded only the difference between the market rate and their own charter rate for the nine-day delay in redelivery, a calculation which was purportedly the clear market understanding. Lords Hoffmann and Hope found for the charterers by applying a limit to recovery different from *Hadley* remoteness, ie an assumption of responsibility test which asked what loss the charterers could be taken to have assumed liability for.[72] Lord Rodger and Baroness Hale preferred the traditional remoteness approach and produced a reasoning similar to that of *Victoria Laundry*,[73] which was meant to overcome the difficulties arising from the *Hadley* remoteness doctrine leaving the promisor exposed to open-ended damages.[74] Lord Walker is generally considered to have agreed with both lines of reasoning.[75] However, despite the mentioning of Lord Hoffmann's assumption of responsibility test, the ratio of Lord Walker's judgment is quite clearly akin to the reasoning of *Victoria Laundry*. Specifically, the basis of the judgment was a distinction between the normal profit flowing foreseeably from a follow-on fixture and unforeseeable 'loss of unusually profitable contracts' or of 'extraordinary profit',[76] effectively viewed as a different type of loss.

[70] Cento Veljanovski, *The Economics of Law* (2nd edn, The Institute of Economic Affairs 2006) 56-57.
[71] McKendrick (n 25) 350-53.
[72] *The Achilleas* (n 2) [11]-[13], [21]-[23], [35]-[36].
[73] Edwin Peel, 'Remoteness Revisited' (2009) 125 LQR 6, 8.
[74] *The Achilleas* (n 2) [58]-[60], [63], [93].
[75] Andrew Burrows, *A Casebook on Contract* (3rd edn, Hart Publishing 2011) 402.
[76] *The Achilleas* (n 2) [82]-[86].

Lord Hoffmann based his reasoning in *The Achilleas* on jurisprudential criticism of *Hadley* remoteness by Kramer[77] and Tettenborn.[78] The starting point of Kramer's theory is Pothier's grounding of the foreseeability rule on a presumption concerning the parties' agreement on the limits of compensation. Building on this idea, he argues that remoteness is not a default rule, external to the agreement, but merely a 'rule of thumb' for determining what the parties wanted.[79] Tettenborn's similar theory is that promises should be viewed as 'instrumental' or aimed at satisfying a certain purpose sought by the promisee, with liability thus being circumscribed to the consequences of a failure to satisfy that particular purpose.[80]

As the solution devised in *Victoria Laundry*, such views on the limits of damages in contracts have been developed for purely practical reasons, in response to the perceived shortcomings of remoteness. Lord Hoffmann acknowledges this when stating that *Victoria Laundry* 'helps a bit, but not all that much' in a factual context such as that of *The Achilleas*, where there was clearly a single type of loss.[81] In fact, as Kramer mentions, the judicial origins of such challenges of *Hadley* remoteness are almost as old as the *Hadley* case itself.[82] They can be traced, for example, to the case of *Nettleship*, where Bovill CJ added to remoteness the caveat that the promisor's liability for the foreseeable loss must be something 'to which he assented expressly or impliedly by entering into the contract'.[83] The problem, however, is that all the analyses which converge on the equivalent conceptions of assumption of responsibility, the agreement-centred approach or instrumental promises, assume that damages must be limited below the expectation measure, more so than *Hadley* remoteness allows. This is at odds with the teachings of economic analysis. The following paragraphs aim to show that, while the assumption of responsibility approach taken by Lords Hoffmann and Hope in *The Achilleas* is not tenable as a matter of legal reasoning or as an economic proposition, elements of it do open the way for an efficient legal solution.

From a legal reasoning perspective, the assumption of responsibility approach has come under strong criticism both before and after *The Achilleas* for artificially finding agreement-

[77] Adam Kramer, 'An Agreement-Centred Approach to Remoteness and Contract Damages', in Nili Cohen and Ewan McKendrick (eds), *Comparative Remedies for Breach of Contract* (Hart Publishing 2005) 249.
[78] Andrew Tettenborn, 'Hadley v Baxendale Foreseeability: A Principle Beyond Its Sell-by Date?' (2007) 23 JCL 120.
[79] Kramer (n 77) 249-50.
[80] Tettenborn (n 78) 134ff.
[81] Lord Hoffmann, 'The Achilleas: Custom and Practice or Foreseeability?' (2010) 14 Edin L Rev 47, 52.
[82] Kramer (n 77) 250.
[83] *The British Columbia and Vancouver's Island Spar, Lumber and Saw-Mill Co v Nettleship* (1867) LR 3 CP 499, 506.

based solutions in cases where the agreement must obviously 'run out'.[84] The frailty of Kramer's contention that the parties can intend or mean something that has not even crossed their minds becomes apparent when one considers the result of always imputing to the parties an agreement on the apportionment of all losses flowing from breach.[85] Such losses may be absolutely unforeseeable when the contract is made, meaning that the assumption of responsibility test must effectively assume an agreement concerning elements which, at the conclusion of the contract, are both counterfactual and unforeseeable. Cases like *Brown*, as Wee points out,[86] and *Jackson*, could hardly accommodate the assumption of responsibility approach.

A related problem stems from Lord Hoffmann's reliance on the *SAAMCO* case.[87] In that instance, the limitation of damages to which lenders were entitled for negligent valuation of the land brought as security was effected by Lord Hoffmann through the concept of the scope of the duty of care. According to Lord Hoffmann, only the consequences of the advice being wrong are within the scope of such duty, and not all the consequences of the lender's granting the secured loan.[88] This reasoning extends the parties' agreement not only to 'primary rights', but also to what, in *The Heron II*, Diplock LJ in the Court of Appeal termed 'secondary rights', ie the remedies consequent upon breach.[89] Always imputing to the parties an agreement on secondary rights is not only unrealistic, but also unnecessary on the facts of *SAAMCO*. Indeed, once the primary duty had been interpreted in *SAAMCO* as a duty of care in providing correct advice, the further question of damages for the breach of that duty could be answered on the basis of causation. The breach of such limited primary duty was an immediate and dominant cause only for the damage resulting from the information being wrong, and not for the damage that would have occurred even if the informant had given correct information. The assumption of responsibility test perpetuates the prospect of an overlap between causation and the scope of the duty.

Yet another problem of this novel approach, pointed out by Lord Walker in *The Achilleas*, is that the assumption of responsibility test is essentially a 'watered-down' version of the *Nettleship* proposition, which was rejected by a long line of cases.[90] This, together with

[84] Andrew Robertson, 'The Basis of the Remoteness Rule in Contract' (2008) 28 J Legal Stud 172, 178-80; Wee (n 4) 167-68.
[85] Adam Kramer, 'The New Test of Remoteness in Contract' (2009) 125 LQR 408, 410.
[86] Wee (n 4) 174-75.
[87] *South Australia Asset Management Corp v York Montague Ltd* [1996] CLC 1179 (HL).
[88] ibid 1184.
[89] Lord Hoffmann (n 81) 60.
[90] Notably, by Lord Upjohn in *The Heron II*; see also *The Achilleas* (n 2) [68].

the existence of precedents such as *Jackson*, also a House of Lords case, brings into question the theory of precedent and the issue of whether the pressing need for judicial change, required by the 1966 Practice Statement, has been duly made out.[91]

From an economic perspective, the assumption of responsibility theory appears to eliminate remoteness and any substitute default rules.[92] Admittedly, Lord Hoffmann views this as a 'default provision' that 'should reflect what the parties would have assumed to be their respective rights and liabilities'.[93] But a default rule which merely asks what the parties' agreement is and thus requires tailored application on a case-by-case basis is, economically, equivalent to the absence of a default rule. The economic function of default rules is either to economise on transaction costs by providing the gap-filling rule that most parties would want or to provide a purposely undesirable rule in order to induce the parties to negotiate a different clause on that particular element of their contract.[94] A default rule based on the assumption of responsibility test has none of the economic benefits of the former type of (majoritarian) default rules, since it implies case-by-case inferences concerning the parties' agreement. It is also a flagrant contradiction of the economic function of the latter type of (penalty) rules, which provide precisely the solution that the parties do not want. Furthermore, the assumption of responsibility test grounds the limitation of damages in the parties' agreement and therefore assumes the ex ante efficiency of such limitation. This is as unrealistic as the supposition that parties always agree in any meaningful sense on the counterfactual and partly unforeseeable consequences of breach. The new test thus runs the risk of injecting inefficient solutions into contracts, under the guise of ex ante efficient terms.

Perhaps even more damaging economically than the lack of any real default rule is the idea that the assumption of responsibility test is actually an autonomous limit on recovery. If that were the case, it would simply add to remoteness in certain scenarios. This is the view that the courts have adopted, for example, in *Supershield*, and that appears to be accepted by the editors of Chitty on Contracts.[95] However, this understanding would preserve all of the efficiency problems of remoteness, but would add the burden of a further, even vaguer test, without as much as a clear scope of application. Surely 'exceptional circumstances' is an unsatisfactory definition of such scope.[96] The uncertainty would not only greatly increase

[91] Practice Statement (Judicial Precedent) [1966] 3 All ER 77.
[92] Wee (n 4) 169.
[93] Lord Hoffmann (n 81) 59.
[94] Ayres and Gertner (n 20); Bernstein (n 20).
[95] Joseph Chitty, *Chitty on Contracts* (Hugh Beale and others eds, 31st edn, Sweet & Maxwell 2012) 1842-43.
[96] ibid 1843.

litigation costs, but would render the law of remedies unpredictable, inducing higher transaction costs.

The assumption of responsibility theory is, in conclusion, untenable as either a legal or an economic proposition. The question, then, is how *The Achilleas* can be interpreted to comply with the normative prescriptions of economic analysis. Wee suggests that what should be taken from *The Achilleas* is the so-called 'soft' version of the assumption of responsibility test. This merely preserves remoteness under a different guise – that of the subject of a presumptive agreement on recoverable damages – but allows the implication (in fact) of terms further limiting liability, under the more stringent tests that common law has developed for such implication.[97] In practice, this is no different from the rule of remoteness. It is suggested that the better option, in light of economic analysis, is to consider that the assumption of responsibility reasoning displaces remoteness or other such liability-limiting defaults.[98] The background default rule thus activated is none other than the expectation measure of damages as per *Robinson v Harman*. This can be displaced not only by express terms limiting liability, but also by terms implied according to existing law, ie by custom[99] or under the stringent officious bystander[100] or business efficacy[101] test. Such rigorous tests will minimise the possibility that a liability limiting clause is imputed outside the sphere of cases where the parties genuinely must have intended such limitation as an ex ante efficient solution. This proposition is compatible with the facts of *The Achilleas*. There, no reference was made by Lords Hoffmann and Hope to any liability-limiting default rule replacing remoteness, with the emphasis being placed on the parties' agreement. According to Lord Hoffmann, all the cases and textbooks suggested damages are limited to the difference between the market rate and the charter rate for the period of delay. Furthermore, all market participants understood the same and there was no suggestion anywhere of even the theoretical possibility of recovering the full loss of profit from a follow-on fixture.[102] Against this backdrop, the limitation of liability could arguably be implied by custom or at least under the officious bystander or the business efficacy test, due consideration being given to Lord Hoffmann's own principles of contextual objective interpretation.[103] The assumption of responsibility test does not, therefore, need to be anything

[97] Wee (n 4) 168-69.
[98] This is the 'hard' version of the assumption of responsibility theory which results from *The Achilleas*: Wee (n 97)
[99] *Hutton v Warren* (1836) 1 M&W 466.
[100] *Shirlaw v Southern Foundries* [1939] 2 KB 206 (CA).
[101] *The Moorcock* (1889) 14 PD 64 (CA).
[102] *The Achilleas* (n 2) [10].
[103] *Investors Compensation Scheme v West Bromwich Building Society* [1998] 1 WLR 896 (HL) 912-13.

more exotic than the existing law on the implication of terms, applied to the limitation of liability.

In conclusion, it is suggested that, rather than merely complicating the landscape of liability-limiting devices, *The Achilleas* could be interpreted in line with the normative prescriptions of economic analysis. It could support an economically efficient regime that combines two elements: the rule of expectation damages and possible terms limiting liability, implied by custom or in fact under the stringent tests developed in the common law.

2. US Law

Despite interstate variations in contract law, the functional equivalent of remoteness in the US – unforeseeability as a limit on damages – displays certain common features that enable a critical economic assessment. These can be derived from unifying, although not formally binding, instruments such as the Restatement (Second) of the Law of Contracts (Restatement) and the Uniform Commercial Code (UCC).[104]

The Restatement provides in § 351 that recoverable damages are limited to the loss that the promisor had reason to foresee as a probable result of the breach when the contract was made. This includes loss that follows from breach in the ordinary course of events or as a result of special circumstances, beyond the ordinary course of events, that the promisor had reason to know. The third paragraph of § 351 allows the courts to place further limitations on recoverable damages if justice so requires, for example by granting only reliance damages or, more generally, by reducing damages below the foreseeability threshold. Under § 2-713 and § 2-715 UCC, a buyer can recover both incidental and consequential damages. The latter category includes 'any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise' and 'injury to the person or property proximately resulting from any breach of warranty.' The rules of the Restatement and the UCC are substantially similar. Incidental damages in the terminology of the UCC correspond to those that the official comments to the Restatement deem 'general' damages, which are the natural result of breach.[105] The unforeseeability limitation on damages in US law is thus very similar to traditional *Hadley* remoteness, with some subtle differences that have both negative and positive consequences as concerns efficiency.

[104] American Law Institute, *Restatement Second of the Law of Contracts* (1981 American Law Institute Publishers) (*Restatement*).
[105] ibid 136, comment b.

As the traditional remoteness rule of English law, unforeseeability in the US is judged at the time of contracting and employs an objective test of what the promisor had reason to foresee based on the facts available to him.[106] The parole evidence rule does not bar use of evidence extrinsic to the contract to prove what facts were brought by the promisee to the attention of the promisor.[107] No actual foresight is required.[108] US courts do not require foreseeability of either the precise nature of the damage or its extent.[109] Incidentally, the generalised reasoning is that suggested by Richard Posner, ie the idea that a promisee would be placed at a disadvantage if, to be able to recover damages, he were forced to disclose the profit expected from the contract.[110]

A few key differences from English law can be identified. An essential feature of US law is the present-day generalised rejection of the tacit agreement test, which corresponds to the assumption of responsibility theory of *The Achilleas*. Justice Holmes had adopted the tacit agreement test at the beginning of the 20th century, in the *Globe Refining* judgment. It required that circumstances be such that the promisor may be presumed to have assented to the extent of liability imposed by the court.[111] Although reiterated in some states,[112] this view is now generally dismissed on grounds reminiscent of the jurisprudential criticism directed at *The Achilleas*.[113] The tacit assumption test is squarely rejected in the comments to both the Restatement[114] and the UCC.[115] Unlike the English system, US law has therefore not experienced a revival of the contractual solution that prevailed in the early Anglo-American law on the limitation of damages under the influence of the autonomy of will theory advocated by French lawyers of the 18th and early 19th centuries.[116] Some reserves have to be made with regard to the implications of the Restatement's authorisation for further limitations on damages, discussed below.

A second notable difference from English law resides in the generalisation of the attempt to overcome the shortcomings of remoteness with respect to what exactly must be foreseeable. The widespread solution of US courts is to treat unforeseeable harm due to

[106] ibid 136-37.
[107] Farnsworth (n 1) 795.
[108] Joseph M Perillo, *Corbin on Contracts*, vol 11 (rev edn, Matthew Bender and Co 2005) 93-95.
[109] ibid 108.
[110] Farnsworth (n 1) 796.
[111] *Globe Refining Co v Landa Cotton Oil Co* 190 US 540 (1903) 543.
[112] Farnsworth (n 1) 794.
[113] Perillo (n 108) 96.
[114] Restatement (n 104) 135, comment a.
[115] Farnsworth (n 112).
[116] Franco Ferrari, 'Comparative Ruminations on the Foreseeability of Damages in Contract Law' (1992) 53 La L Rev 1257, 1264.

extraordinary circumstances as effectively loss of a different kind.[117] This is, to all intents and purposes, the *Victoria Laundry* approach to dealing with the problem of excessive liability.[118] Its questionable applicability in English law after cases such as *Parsons*, *Brown* and *Jackson* arguably led to the solution applied in *The Achilleas*.[119]

A third difference is – at least apparently – the use of a more stringent test of foreseeability in US law. § 351 of the Restatement requires that the loss be foreseeable as a 'probable' result of breach. It is tempting to believe that, in substance, this test requires a greater degree of foreseeability than the reasonable contemplation approach taken by English courts. However, such difference may be overstated. The comments to the Restatement suggest that this terminology was meant merely to indicate a more stringent test of foreseeability than the one prevailing in tort law under the notion of 'proximate causation'.[120] If that is the case, then 'probable' may express no higher degree of foreseeability than the various expressions used by the House of Lords in *The Heron II*. Such formulations were also meant to contrast the test of remoteness in contract with the reasonable foreseeability requirement in tort.[121]

Finally, a more substantial difference is the authorisation given by the Restatement for further limitations on damages, as justice requires. Interestingly, the formulation of this authorisation is reminiscent of the assumption of responsibility theory in so far as it concerns, for example, cases of extreme disproportion between the price received and the liability that the promisor stands to incur.[122]

From the standpoint of economic analysis, the picture of unforeseeability in US law is very similar to that of traditional remoteness in English law. The fact that the required foreseeability concerns, at least as a rule, the type of loss rather than its extent undermines the purported economic functions of remoteness. The promisor is left with little indication as to his expected liability. This outcome goes against the idea that this limit on damages is genuinely workable as an information-disclosure mechanism that supports efficient rates of contracting and precaution. Some aid is given by the greater inclination of courts to resort to solutions similar to that adopted in *Victoria Laundry*. Such solutions tend to place a cap, however unclear, on the extent of damages, thus bringing unforeseeability closer to the idealised image of remoteness that economic models tend to present. Whereas in English law *The Achilleas*

[117] Farnsworth (n 110); Perillo (n 108) 119ff.
[118] Farnsworth (n 110) fn 22.
[119] Lord Hoffmann (n 81).
[120] *Restatement* (n 104) 136, comment a.
[121] Treitel (n 62) 1046-47.
[122] *Restatement* (n 104) 141, comment f.

might mark an opportunity for efficient adaptations of the law through a more widespread use of the expectation measure combined with the implication of terms limiting liability, no such prospect is apparent in US law. Notably, the only currently accepted trace of the assumption of responsibility approach seems to consist of certain applications of the Restatement's authorisation for further limitations on damages. These, however, merely add to the default rule of unforeseeability, making the net result similar to the inefficient and costly 'soft' version of the assumption of responsibility theory.[123]

3. German Law

It is sometimes considered that German law contains no rule of foreseeability akin to the one present in the French Civil code and borrowed by the common law.[124] This statement is inaccurate when viewed through the lens of the functionality approach of comparative methodology.[125] There are three elements of German contract law which converge to fulfil a function similar to that of remoteness.

The first such element is the doctrine of adequate causation ('Ädaquanztheorie').[126] Developed by legal scholars as a limitation on damages both in tort and in contract, this doctrine is not, on a proper construction, a theory of cause, but rather one of limitation of liability on equitable grounds.[127] Alternatively, it is treated as a mechanism for the apportionment or imputation of loss depending on its extent.[128] The doctrine functions as an exclusionary rule which bars from recovery consequences exceeding all human experience,[129] with the foresight imputed to the promisor being that of an 'optimal' or 'ideal' observer ('optimale Beobachter').[130] The adequate causation test is applied at the time of the wrong, which, in contract, is the time of breach.[131] This point of reference, combined with the very high standard used for imputing knowledge to the promisor, means that the doctrine very rarely functions as an effective limitation on damages.[132]

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[123] Wee (n 97).
[124] Ronald J Scalise Jr, 'Why No 'Efficient Breach' in the Civil Law? A Comparative Assessment of the Doctrine of Efficient Breach of Contract' (2007) 55 Am J Comp L 721, 743-44.
[125] Zweigert and Kötz (n 5) 32-47.
[126] Markesinis (n 6) 473.
[127] ibid 474.
[128] Tobias Wagner, 'Limitations of Damages for Breach of Contract in German and Scots Law' (2014) 10 Hanse LR 73, 87; cf Manfred Pieck, 'A Study of the Significant Aspects of German Contract Law' (1996) 3 Ann Surv Int'l & Comp L 111, 119-20.
[129] Markesinis (n 127); Wagner (n 128) 83.
[130] Markesinis (n 127).
[131] Wagner (n 128) 90-91.
[132] Markesinis (n 127).

A second device used to limit liability in ways that are functionally similar to how remoteness has developed in the common law is the doctrine of the aim or purpose of the rule ('Schutzzweck der Norm').[133] It makes the extent of liability dependent on the purpose of contractual undertakings,[134] an approach resonant of both *SAAMCO* and *The Achilleas*. How this more generous limitation on damages correlates with the doctrine of adequate causation is controversial. The prevailing opinion is that, in theory, both limitations apply,[135] although the purposive approach to liability is of greater practical importance.[136]

Finally, a third liability-limiting device akin to remoteness can be found in § 254 (2) I of the BGB, which provides one of the three modalities of contributory negligence. Under this provision, contributory negligence is deemed to include failure by the promisee to inform the promisor of the danger of abnormally extensive damage, if the promisor was not and ought not to have been aware of such damage. The underlying rationale is one of causation.[137] The damage is considered as caused, at least in part, by the promisee's failure to draw attention to extensive loss which may have warranted special precaution by the promisor. Judicial inquiry into the knowledge that should be imputed to the promisor makes allowance for the particular circumstances of the promisor, suggesting a more subjective test compared to remoteness.[138] For example, in a famous case, a jeweller's employee left valuable jewellery in the boot of his car, that he requested the hotel's staff to park without drawing attention to the valuables. These were subsequently stolen. The Bundesgerichtshof remanded the case for consideration of whether and how the loss should be apportioned, account being taken, inter alia, of the hotel's standing and the justified expectation of high quality service held by customers.[139] The same case suggests that the limitation can operate with respect to the extent of the loss and not necessarily with respect to a certain type of loss, since the issue of apportionment was raised despite the case involving only one type of loss. Because § 254 is also applicable to torts, there is no reason in principle to limit this particular instance of contributory negligence to the failure to communicate information at the moment when the contract is concluded. Instead, it should occur where there is a failure to communicate information at any time prior to breach. Despite

[133] ibid.
[134] Reinhard Zimmermann, 'Limitation of Liability for Damages in European Contract Law' (2014) 18 Edin L Rev 193, 206.
[135] Wagner (n 128) 93.
[136] Markesinis (n 127).
[137] Wagner (n 128) 86.
[138] BGH NJW 1969, 789, in Markesinis (n 6) 725.
[139] ibid.

the wide theoretical field of application of § 254 BGB, it is worth noting that, as Professor Markesinis points out, this particular provision is rarely applied in German law.[140]

The doctrines of adequate causation and the purpose of the norm, as well as § 254 BGB demonstrate that, contrary to what a superficial analysis might suggest, German law does contain at least partial functional equivalents of remoteness. A number of conclusions of economic analysis are possible with regard to these. A preliminary observation should be that damages in German contract law are, as a rule, assessed in line with the expectation measure.[141] In addition, notwithstanding nominal preference for specific performance, German contract law is, functionally, less hostile to efficient breach than sometimes assumed by common lawyers.[142] It might actually be better suited to align damages with the expectation interest particularly because of the self-selection – as opposed to court selection – of promisees who resort to the remedy of damages. Economic analysis of the equivalents of remoteness should therefore not shy from an assessment against, among others, the benchmark of efficient breach. The doctrine of adequate causation, with its very high standard of an ideal observer and its application at the time of breach, is in line with the theory of efficient breach stretched to its practical limits. It therefore appears not to interfere with the expectation measure's aptitude for regulating rates of contracting and precaution. The doctrine of the purpose of the norm is similar to the assumption of responsibility theory.[143] It can, from a practical perspective, offer the same opportunities as *The Achilleas* in terms of combining an expectation damages rule with exceptional instances of implied limitations of liability, as this German doctrine is not a sweeping default limitation such as remoteness. Rather, it is an exceptional device developed by jurisprudence precisely to contain unusual cases of excessive damages. Seen from the perspective of the law in action, § 254 BGB is rarely applied in practice and is not anchored in either the time of the contract as a reference point for foreseeability or the type (rather than extent) of loss as its object. As such, it is closer to the intermediate system proposed by Eisenberg than to pure *Hadley* remoteness and should therefore be more efficient than the latter.

In conclusion, the overall exceptional nature – in relation to the rule of expectation damages – of foreseeability-related limitations of liability in German law, as well as their specific features, provide arguments to the effect that German contract law can, as concerns this particular problem, be more efficient than both the English and US functional equivalents.

[140] Markesinis (n 6) 475.
[141] ibid 470.
[142] Scalise (n 124) 731ff.
[143] Zimmermann (n 134) 207.

This conclusion must, however, be accompanied by the reservation concerning the costs (and efficiency losses) which may result from the three devices' theoretical aptitude for simultaneous application.

4. French and Quebec Law

It is perhaps appropriate to end the comparative analysis with the legal system that first deployed, as positive law, a foreseeability-based limitation on liability. Distilled by Du Moulin and subsequently Pothier,[144] this limitation was absorbed into the 1804 French Civil code (FCC) and successfully infused into Anglo-American law on the basis of Pothier's works,[145] and into civil law systems which used the FCC as a prototype for their own codifications of civil law.[146] The province of Quebec in Canada provides one example of such influence. This illustration is made more interesting by the contemporary perspective offered by its recodification of private law in the 1991 Civil code (QCC), which proves the impressive durability of Pothier's proposition.

Article 1150 FCC provides that the promisor is only liable for damages that were foreseen or could have been foreseen at the time of the contract, so long as the breach was not fraudulent. The Quebec counterpart of the rule is codified in Article 1613 QCC. In the relevant part, it provides that the promisor 'is only liable for damages that were foreseen or foreseeable at the time when the obligation was contracted, where the failure to perform does not proceed from intentional or gross fault on his part'.

On its face, apart from its application being circumscribed to negligent breach, the foreseeability limitation on damages seems strikingly similar to traditional *Hadley* remoteness and unforeseeability in US law. As these common law functional equivalents, the foreseeability limitation employs the abstract (or objective) standard of foresight of the reasonable promisor, and uses the moment of contracting rather than breach as its reference point, in both France[147] and Quebec.[148] The rule allows use of extrinsic proof of facts that, being known to the promisor at the time of contracting, made it possible to deduce the damage (eg the promisee's declarations as to the use that performance would be put to, or the exterior appearance of the goods transported by a carrier).[149] The source of unforeseeability can be both uncommunicated

[144] Scalise (n 124) 739-43.
[145] Richard Danzig, 'Hadley v Baxendale: A Study in the Industrialization of the Law' (1975) 4 J Legal Stud 249, 257-58.
[146] Ferrari (n 116) 1264-65.
[147] Viney (n 6) 424, 432.
[148] Maurice Tancelin, *Des obligations en droit mixte du Québec* (7th edn, Wilson & Lafleur 2009) 738; Baudouin (n 7) 931-32.
[149] Viney (n 6) 431-32.

peculiarities of the promisee's expectations and entirely extrinsic events which augment the promisee's interest in performance.[150]

Despite such superficial similarities, the French and Quebec rules exhibit fundamental particularities from the viewpoint of economic analysis. First, as early as 1924, the French Cour de cassation, going against the opinions of early commentators of the FCC, held that the object of foreseeability is the extent and not merely the cause or type of the damage.[151] In that instance, the court denied recovery beyond the declared value of the lost goods to a shipper who had understated such value to the carrier in an attempt to subsequently pay lower customs duties.[152] A second important particularity is the seemingly wider allowance made in practice for the subjective characteristics of the promisor, specifically those enabling the imputation of better foresight than that warranted by a strict application of the objective test.[153] Yet another difference from the common law equivalents is the limited practical applicability of the foreseeability limitation. Foreseeability is, in both France and Quebec, plainly a default rule of positive law, but its scope of application is, in practice, very limited. The express exception to the limitation contained in Article 1150 FCC, concerning cases of fraudulent breach, has been extended by French case law to instances of gross negligence. Article 1613 QCC codifies this assimilation. Since a 1969 judgment of the Cour de cassation, fraud or intent itself is interpreted widely as merely the intention to breach, for whatever reason (for example, to make a more profitable contract with a third party), rather than a direct intent to harm the promisee.[154] The solution is equally applicable in Quebec.[155] Other judge-made restrictions are also noteworthy. In France, as a result of the wider allowance made for individual above-average foresight abilities, there is a tendency for professional negligence to be treated as an instance of gross negligence. This results in a practical exclusion of the benefit of Article 1150 for promisors acting in a professional capacity.[156] In Quebec, there is widespread agreement on the inapplicability of the foreseeability limitation in cases of harm concerning physical integrity,[157] an exception which appears similar to the (isolated) approach taken by Lord Denning in *Parsons.*

[150] ibid 428-29.
[151] François Terré, Philippe Simler, Yves Lequette, *Droit civil: les obligations* (11th edn, Dalloz 2013) 611.
[152] Viney (n 6) 425-26; see also Philippe Le Tourneau, *La responsabilité civile* (3rd edn, Dalloz 1982) 91.
[153] Le Tourneau (n 152) 90.
[154] Viney (n 6) 433-34.
[155] Tancelin (n 148) 738-39.
[156] Viney (n 6) 434-35.
[157] Aline Grenon, Louise Bélanger-Hardy, *Elements of Québec Civil Law: a Comparison with the Common Law of Canada* (Thomson Carswell 2008) 394-95; Baudouin (n 7) 933.

Superficial similarity to Anglo-American equivalents thus masks differences with important implications in terms of economic efficiency. Certainly, as in the case of German law, complex debates can be framed on the extent to which French law is compatible with the theory of efficient breach.[158] Nevertheless, considered in itself, the foreseeability limitation of French and Quebec law is arguably more conducive to efficiency than its common law counterparts, although less so than the rather marginal limitations that exist in German law. Indeed, because it emphasises foreseeability of the extent of damage, and not its type, the rule of French and Quebec law is actually closer than its common law equivalents to the idealised version of remoteness that economic models portray. It can, therefore, stimulate efficiency in the rates of contracting and precaution. Its inapplicability in a considerable range of cases, especially in instances of intentional breach, is conducive to efficient breach, which raises precisely the issue of a calculated choice between performance and breach.

In conclusion, perhaps curiously given, that it was the remoteness/unforeseeability rule of common law that spawned a wide range of economic analyses, the French and Quebec law on this subject is arguably superior from an efficiency standpoint. These systems afford a wider scope for the protection of the expectation interest and for (more) efficient rates of contracting and performance.

D. CONCLUSION

This paper sought to argue that economic models of remoteness are perhaps overly optimistic as concerns the economic efficiency of this doctrine and of its functional equivalents. A closer inspection reveals a contrast between what the doctrine is supposed to achieve in terms of efficient rates of contracting, precaution against breach and reliance, on one side, and how the rule actually operates compared to other possible regimes, on the other. Against this background, the traditional doctrine of *Hadley* remoteness is less efficient than it might appear from economic models. Even the idealised version of remoteness of such models is less efficient than regimes such as that suggested by Eisenberg and especially that of the full expectation damages rule. Applying the economic analysis framework to the relevant rules of English, US, German, French, and Quebec law, an argument can be made to the effect that, from the perspective of the particular problem subject to analysis, the English and the US systems fare worst in terms of efficiency. With respect to the former, however, the judgment in *The Achilleas* has injected an element of flexibility that, from a normative perspective, opens

[158] Scalise (n 124) 728ff.

the door to more efficient interpretations of the law. German law, with its very restricted application of foreseeability-based limitations of damages and, correspondingly, its broader protection of the expectation interest, is arguably the most efficient, while the French and Quebec systems occupy the middle ground.

Some overarching points of a more general nature arise from this analysis. First, the law and economics movement often takes for granted the idea that economic efficiency is somehow built into the common law. Second, economic analysis would benefit from the broader view of comparative law as much as legislators and courts would benefit, in turn, from the positive interpretations and the normative recommendations that economic analysis can provide.