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THE FAULT PRINCIPLE AS THE CHAMELEON OF CONTRACT LAW: A MARKET FUNCTION APPROACH

Stefan Grundmann*

This Article begins with a comparative law survey showing that all legal systems do not opt exclusively for fault liability or strict liability in contract law, but often adopt a more nuanced approach. This approach includes intermediate solutions such as reversing the burden of proof, using a market ("objective") standard of care, distinguishing between different types of contracts, and providing a "second chance" to breaching parties. Taking this starting point seriously and arguing that it is highly unlikely that all legal systems err, this Article argues that the core question is how and when each liability regime should prevail or how and when the regimes should be combined. It then argues that there is no either-or, but only the question of intelligent combination. When asking how best to combine the regimes, the simple answer is that market expectation, and specifically the ability to compare offers, should be the core criterion. This Article therefore argues that a market function approach is needed. Such an approach answers the question of which factors are most important in which situations and thus helps to shape the combination. Some core criteria are developed in a last, more concrete section.

INTRODUCTION

Some seventy-five years ago, Ernst Rabel came from Berlin to the United States as director of the famous "Schloss Institutes" for comparative and international law, the forerunner of the Max Planck Institutes. Since Michigan became what was likely his strongest link to the United States, it seems fitting to begin with his contributions. Rabel brought with him his conception of comparative law as a discovery device for all countries,¹ and sought to develop this international discussion into more concrete results, namely, into a unification of sales law as the core area of contract law.²

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1. See Ernst Rabel, Aufgabe und Notwendigkeit der Rechtsvergleichung, 13 Rheinische Zeitschrift für Zivil-und Prozessrecht 279, 283 (1924), reprinted in 3 Ernst Rabel, Gesammelte Aufsätze 1, 5 (1967) ("In thousands of shadows, you see flickering and shimmering the law of any developed people. All these vibrating bodies in their unity form a whole which nobody yet has grasped and modelled." (translation by author)).

2. Rabel initiated his work on sales law unification in 1929 with his so-called "Blue Report." 3 Ernst Rabel, Rapport sur le droit comparé en matière de vente, in Gesammelte
Moreover, when Rabel later wrote his treatises on international private law and (comparative) sales law—which became highly influential for the Hague Uniform Sales Law of 1964 and subsequently the Vienna Convention on the International Sale of Goods of 1980 ("CISG")—one of the core questions where his new surroundings heavily influenced him was fault. In fact, he strongly advocated a strict liability regime, a trademark of Anglo-American contract law, which was ultimately introduced into article 79 of the CISG. And because of the eminence of the CISG, this regime has remained on the international agenda; it is evident in more general sets of contract law principles developed over the last decades at the Unidroit level and in Europe. The Principles of European Contract Law opt for a strict liability regime in which the only permissible excuse is force majeure, and

AUFSÄTZE, supra note 1, at 381. See also the announcement in 3 RABELS ZEITSCHRIFT FÜR AUSLÄNDISCHES UND INTERNATIONALES PRIVATRECHT 405 (1929). Rabel is considered to be the "mastermind behind the draft uniform international sales law." Bernhard Grossfeld & Peter Winship, The Law Professor Refugee, 18 SYRACUSE J. INT'L. L. & COM. 3, 11 (1992). See also the contributions by Ole Lando, Ulrich Drobnig, Ulrich Magnus and also Axel Flessner in EUROPÄISCHES KAUFGEWÄHRLEISTUNGSRECHT: REFORM UND INTERNATIONALISIERUNG DES DEUTSCHEN SCHULDRRECHTS (Stefan Grundmann et al. eds., 2000).


6. After the war, Rabel lived and split his research rather evenly between the United States and Germany—probably more than most German emigrants. See, for instance, the most recent report on him by Gerhard Kegel. Gerhard Kegel, Ernst Rabel (1874-1955), in 1 DEUTSCHSPRACHIGE ZIVILRECHTSLEHRER DES 20. JAHRRHUNDERTS IN BERICHTEN IHRER SCHÜLER: EINE IDEENGESCHICHTE IN EINZELDARSTELLUNGEN 17 (Stefan Grundmann & Karl Riesenhuber eds., 2007).


8. For the influence of the CISG, see PRINCIPLES OF EUROPEAN CONTRACT LAW, PART I (Ole Lando & Hugh Beale eds., 1995); PART II (Ole Lando et al. eds., 1999); PART III (Ole Lando et al. eds., 2003). While the Unidroit and the so-called Lando principles are not official and are not law, the role of the UN Convention as a model for future EC legislation is accepted also officially. Commission of the European Communities, Communication from the Commission to the Council and the European Parliament on European Contract Law, para. 18-20, COM (2001) 398 final (July 11, 2001), available at ec.europa.eu/consumers/policy/developments/contract_law/cont_law_02_en.pdf.

9. PRINCIPLES OF EUROPEAN CONTRACT LAW, PART II, supra note 8, art. 8:101.
the breaching party bears the burden of proof.\textsuperscript{10} The Unidroit Principles share, in principle, this singular focus on \textit{force majeure},\textsuperscript{11} but they do so in a more refined manner: article 5.1.4 distinguishes "obligations de resultat" (promises of result) from "obligations de moyen" (promises of best efforts). The addition of this distinction is important. But it should be kept in mind that these terms could be bargained for in a contract under any regime.\textsuperscript{12}

The importance of another development for which Rabel strongly advocated, the introduction of the so-called German "Nachfrist" into the CISG regime, is less obvious. But in fact, this was no less influential on the current European regime than the incorporation of the strict liability approach. \textit{Nachfrist} limits, in principle, the most onerous sanctions for breach of contract to those cases where the party not only breached but also did not cure when given a "second chance" (after an additional period of time), both in the CISG and in the current European system.\textsuperscript{13}

Several questions arise from this cross-Atlantic trip into history. The first is whether the example of Rabel and the contract law developments he spawned speak in favor of the superiority of a strict liability regime.\textsuperscript{14} The second question is whether the core argument advanced by Rabel, i.e., that only strict liability can mirror the promise initially given, is one that works particularly well in sales law (and in an industrial society), but less well in services (and in a service society). A third question is whether, instead of following Rabel's regime, all legal systems really follow a nuanced approach with a mixture of strict liability and fault liability elements, and utilize other governance devices such as the "second chance" principle. Finally, a fourth question is what guidelines can be given for a satisfactory combination of the two liability regimes.

This Article suggests that the answer to this final question is that market expectations should be the core criterion for combining strict and fault liability and that, therefore, legal scholarship and legal regimes should take a market function approach. Part I takes a comparative law approach to show the range of possibilities in choosing between liability regimes, and examines their relative advantages. Part II proposes a market function approach.

\begin{itemize}
\item \textsuperscript{10} PRINCIPLES OF EUROPEAN CONTRACT LAW, PART I, supra note 8, art. 1:108.
\item \textsuperscript{11} Unidroit Principles, supra note 7, art. 7.1.7.
\item \textsuperscript{12} Some scholars interpret the Principles of European Contract Law to mirror this approach. See Ole Lando, \textit{Non-Performance (Breach) of Contracts}, in TOWARDS A EUROPEAN CIVIL CODE 505, 509 (Arthur Hartkamp et al. eds., 3d ed. 2004).
\item \textsuperscript{14} This Article does not speak to the merits of a strict liability regime in torts; in fact, it gives ample justification for distinguishing between torts and contracts in this respect.
\end{itemize}
based on these systems to balance elements of strict liability and fault liability.

I. NUANCE AS THE COMMON DENOMINATOR 
IN A COMPARATIVE LAW PERSPECTIVE

The traditional view among contract scholars is that civil law systems opt for fault liability in contract law while common law systems opt for strict liability. Yet this impression is the result of too much abstraction on both sides. Upon closer inspection, the common denominator between civil and common law systems is that all systems opt for a nuanced combination of the two. Contract law development in Europe now often occurs at the European Community ("EC") level. EC contract law is an amalgam of the civil law and common law systems of its member states and thus provides a valuable additional perspective.

A. The Most Important Nuances in Civil Law Systems

The nuanced approach is evident in several civil law systems. The core breach-of-contract rule in the German Civil Code (section 276), after the fundamental reform in 2002, reads as follows:

(1) The obligor is responsible for intention and negligence, if a higher or lower degree of liability is neither laid down nor to be inferred from the other subject matter of the obligation, including but not limited to the giving of a guarantee or the assumption of a procurement risk. . . . (2) A person acts negligently if he fails to exercise reasonable care. (3) The obligor may not be released in advance from liability for intention.

The practical impact of this rule is heavily influenced by the second phrase of section 280(1), which says that, in contracts, the burden of proof for negligence is the reverse of the burden in tort law. Therefore, absent a provision to the contrary, the breaching party is responsible for any

15. Because this is an American journal, explaining the civil law side is probably more necessary, and I do that in some detail—but even here, the rules I have chosen are meant to be paradigmatic and the overview is admittedly far from systematic.

16. The German law (and more) can be found in English. E.g., CASES, MATERIALS AND TEXT ON CONTRACT LAW 659–63, 667–69 (Hugh Beale et al. eds., 2002); BASIL S. MARKESINIS ET AL., THE GERMAN LAW OF CONTRACT 444–51 (2d ed. 2006). See also Stefan Grundmann, Commentary, in 2 MÜNCHENER KOMMENTAR ZUM BÜRGERLICHEN GESETZBUCH (Wolfgang Krüger ed., 5th ed. 2008) (providing a more extensive commentary on section 276). The commentary does not, however, represent the majority view in Germany in that, from a policy point of view, the country favors strict liability in principle.


18. See id. § 280(1). The second phrase of the section says that damages are owed unless the debtor proves absence of fault; thus the phrase is really about the burden of proof with respect to fault. Id.
non-conformity with the contract unless he can prove that no negligence can be imputed to him.

The German Law is interesting in three respects here. First, it is a law that has been reformed very recently and therefore reflects current policy, not outdated views. For instance, C.W. Canaris, the scholar who was most influential in the legislative process, has very strong feelings about the ethical superiority of the fault principle over strict liability. Second, notwithstanding Canaris's apparent preference for fault liability, section 276 is very clear in that liability is neither entirely based on fault nor entirely based on strict liability, but a nuanced combination of both approaches. As section 276(1) states, German law tolerates regimes more favorable to the breaching party—such as assigning responsibility only where there is gross negligence or even willful conduct, or alternatively simple negligence with the burden of proof on the nonbreaching party—but it also tolerates a regime more favorable to the nonbreaching party—namely strict liability, the so-called liability by warranty, or “Garantiehaftung.” Rules that are more favorable to the breaching party are not commonly part of the German legal scheme (the Code itself), but rather appear in the terms of individual contracts. Conversely, rules favoring the nonbreaching party, namely those introducing strict liability, can be found both in the Code—namely, in case law interpreting the Code—and, most important in the context of our discussion here, in an agreement between the parties either implicitly or explicitly.

Third, German law is in fact rather close to a strict liability regime even where it formally provides exclusively for fault liability. The reversal of the burden of proof, mentioned above, is a first factor in this regard. A second factor is that, in fault liability, the standard of care applied is a market, or “objective,” standard. Therefore, behavior is negligent if it does not meet the standards that the market would expect of good contract partners—and if the partners are professionals, by good professional partners in a particular business sector. A third factor is that fault is irrelevant for the duty to perform in the first place as well as for the availability of rescission as a remedy. This has repercussions for damages because restitution awards that accompany rescission are often an equivalent to damages for breach and because, at least when the breaching party is given a second chance after performance has fallen short of the terms of the contract, any noncompliance

19. Canaris recently discussed his ideas on (a core feature of) the new section 276 in a long article. Claus-Wilhelm Canaris, Die Einstandspflicht des Gattungsschuldners und die Übernahme eines Beschaffungsrisikos nach § 276 BGB, in NORM UND WIRKUNG: FESTSCHRIFT FÜR WOLFGANG WIEGAND 179 (Eugen Bucher et al. eds., 2005). For discussion of the argument of ethical superiority, see infra Part II.

20. BGB § 276(1).


22. BGB § 323.
outside cases of *force majeure* gives rise to damages (at least if the contract is about the supply of goods in mass transactions).\(^2\) There is also a lesser-known fourth factor that makes German contract law converge with a strict liability regime. Despite Canaris's opposition to strict liability, a rule slipped into the Code of 2002 that is highly sensible but converges considerably with the common law approach. Under this rule, a breaching party is at fault not only if he could have done better or did not meet the market standard, but also if he could have foreseen an extrinsic obstacle.\(^3\) While the scope of this rule's application is a bit disputed,\(^4\) it is clearly very similar to that of article 79 of the CISG.

Nonetheless, in one, perhaps two, highly important respects, the fault principle is still paramount in German law. The first concerns sales of prefabricated products in mass transactions. Under German law, as well as Italian law, the seller is not responsible for the fault of a third-party producer—although there is vicarious liability in principle.\(^5\) Instead, the seller becomes responsible and owes damages only if—after having been informed by the third-party producer and given an opportunity to make alternate arrangements—he does not act. Moreover, this implies that the seller owes the purchaser damages only to the extent that the damages are due to the seller's negligence after breach by the third party. A second aspect is not strictly about fault but has a similar effect. Article 3, paragraph 5 of the EU Sales Directive,\(^6\) which is pan-European, states that the nonbreaching party can rescind a contract only after having given the breaching party a second chance. Therefore, it is possible the breaching party faces rescission only under conditions that often may be even more protective than those associated with fault liability. This regime also applies to damages that stem from the rejection of performance by the breaching party, for instance the return of the good delivered. In fact, remedies that result from the rejection of performance in kind by the breaching party typically require willful

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23. In these cases, a guarantee to supply a good of the standard owed—at least on the second try—is implied in section 276. See BTDrucks 14/6040 at 132; Grundmann, supra note 16, paras. 177-80; Hansjörg Otto, *Die Grundstrukturen des neuen Leistungsschädigungsrechts*, 24 JURISTISCHE AUSBILDUNG [JURA] 1, 1-11 (2002); supra note 17.

24. BGB § 311a(2) translated at Bundesministerium der Justiz, supra note 17 ("The obligee may, at his option, demand damages in lieu of performance or reimbursement of his expenses in the extent specified in section 284. This does not apply if the obligor was not aware of the obstacle to performance when entering into the contract and is also not responsible for his lack of awareness.").

25. For an argument advocating the application of this rule to all contracts and in all phases of formation, see Stefan Grundmann, *Der Schadensersatzanspruch aus Vertrag*, 204 ARCHIV FÜR DIE CIVILISTISCHE PRAXIS 569, 580-82 (2004). Other authors argue that the wording of the rule captures only complete ex ante impossibility, and they restrict its scope of application accordingly—even though the 2002 reforms were designed to end the splitting up of breach into many different regimes. See, e.g., Christian Grüneberg, in PALANDT, BÜRGERLICHES GESETZBUCH § 311a(4) (Petere Bassange et al. eds., 66th ed. 2007).

26. Helmut Heinrichs, in PALANDT, BÜRGERLICHES GESETZBUCH, supra note 25, § 278(13); Grundmann, supra note 25, at 580 (sharply criticizing this result). The rule is already different under French law. See CASES, MATERIALS AND TEXT ON CONTRACT LAW, supra note 16, at 663–65.

27. See supra note 13.
omission on the side of the breaching party. Thus, considering fault or strict liability without the mechanism of a second chance may be questionable.

French civil law is very similar to German law (although perhaps less explicit) in the most important respects named above. Namely, liability for fault serves as the underlying principle, but there is a presumption that the breaching party was negligent if the contracted-for result is not reached. In French law, the market standard approach is less explicit than in German law, but as a practical matter, the situation is similar to that in Germany; therefore, the French objective standard also comes very close to a strict liability regime.

French law is interesting—and even outstanding—in a different respect. In France, there is a long-standing tradition, developed by René Demogue early in the twentieth century, of distinguishing between “obligations de moyens” (promises of best efforts) and “obligations de résultat” (promises of result). The difference between article 1137 and article 1147 of the French Civil Code served as the basis for Demogue’s distinction. In the “obligations de resultant,” a specified result must be reached—for instance, construction must be finished—and there is an excuse only in case of force majeure, while in “obligations de moyens,” only best efforts are required—for instance, in cases where medical treatment is offered.

B. Some Striking Nuances in Common Law Systems

There is a wide swath of literature explaining fault and strict liability in common law systems—although perhaps less so devoted solely to British law—and this Article will not attempt duplicate this effort at great length. Nonetheless, a few aspects of the common law norms—elements of fault within traditional strict liability systems—are important here.

First, in stark contrast to the civil law convention whereby liability is not accorded for the acts of third parties, the common law makes breaching parties strictly liable for their own defects and for those caused by third parties. The core argument for this regime is that without it, the splitting of performance between all contributing parties (e.g., producer...

28. The law (and more) can be found in English. See CASES, MATERIALS AND TEXT ON CONTRACT LAW, supra note 16, at 663–65, 667–69; Anthony Ogus & Denis Tallon, Remedies, in CONTRACT LAW TODAY: ANGLO-FRENCH COMPARISONS (Donald Harris & Denis Tallon eds., 1989).

29. See PHILIPPE MALAURIE ET AL., LES OBLIGATIONS para. 945 (2d ed. 2005) (citing the exceptions in section 1927 Code Civil which serve as basis for an e contrario argument in the other cases).

30. See, e.g., MURIEL FABRE-MAGNAN, LES OBLIGATIONS 418, 439–48 (2004) (specifying that the burden of proving fault is on the nonbreaching party unless the case falls into an intermediate category called “obligation de moyens renforcée,” in which case the burden of proof is reversed); André Planqueuel, Obligations de moyens, obligations de résultat, 71 REVUE TRIMESTRIELLE DE DROIT CIVIL 334, 336 (1972).

31. Daniels v. White & Sons, Ltd., (1938) 4 All E.R. 258 (K.B.); see also Raineri v. Miles, [1981] A.C. 1050, 1086 (H.L.) (“[F]or damages for breach of contract, it is, in general, immaterial why the defendant failed to fulfil his obligation, and certainly no defence to plead that he had done his best.”).
and retailer) would lead to a situation without liability because the purchaser typically does not have a contractual relationship with the producer.  

The second point worth highlighting in this context is that some common law countries—but far from all—have a particular regime for particular service contracts that, in many cases, subjects particular service providers to liability only in cases of negligence or fault. In these countries, the traditional common law strict liability regime is superseded by statutory law for particular situations, namely, for service contracts such as those for medical treatment. This is similar to the already-mentioned and long-standing practice in France of distinguishing between “obligations de moyens” and “obligations de résultat” because, like with obligations de résultat, success is not guaranteed when particular service contracts are breached. French law is, however, still more to the point in that it names the core criterion directly: from a policy perspective, it is by no means correct to assume that we should allow for a fault exception for all supply-of-services contracts. To the contrary, it is necessary to ask separately for each type of (service) contract whether success has been promised, albeit implicitly, or not.

A third point worth highlighting is that the common law limits damages to those consequences that were foreseeable, or as English law puts it, were not too remote. This is also the rule in the CISG. Some civil law countries, namely Germany, have been reluctant to place such general limits on damages; others, such as France, have not. The German solution, according to some authors, is based on the fact that the fault principle is enough of a limit “at the entry” to liability. Yet, this would imply that foreseeability should still be utilized as an “exit” limit in situations of strict liability when in practice it is not. One point on the melding of fault and strict liability is striking, although not often highlighted in English or American literature: foreseeability (of a certain danger) is a classic criterion for fault in civil law, albeit in another context, for establishing


35. CISG, supra note 5, art. 74(2). On this rule see the standard commentaries cited supra note 5.

36. FABRE-MAGNAN, supra note 30, at 576, 583.

37. See, e.g., Riesenhuber, supra note 21, at 132, 148.
whether precautions were necessary. Thus a fault element slips in, i.e., the strict liability regime is not "pure" even in its core scope of application. The reasons for this will be taken up after discussing strict liability from a policy point of view.

C. Particular Refinement in European Investment Services Law

The European Parliament's 2004 directive on investment services law provides another approach to the combination of fault and strict liability. The new directive replaces an older one from 1993 and since the rules are so detailed on the European level, a fairly uniform standard remains even after transposition into different national laws. One core issue motivating this directive was the way in which investment service providers should best execute their clients' orders. Investment service providers typically have many alternative markets where they can execute a client's order; also, they can bundle orders or execute them individually, and best execution typically differs from bonds to shares and other securities. The EC legislature did not feel capable of prescribing specific guidelines as a result of the wide variety of cases. On the other hand, the legislature in the new regime did not want to use a general clause—like "best efforts"—either. Instead, the legislature opted for the following scheme: Each service provider has the discretion to shape its own procedure for how it would handle clients' orders. This procedure, however, has to be made public, and the provider has to periodically assess its performance under the procedure chosen as compared with others and publish the results. There is no liability as long as the provider observed the procedure and it did not have obvious flaws (which would be an extraordinary case, as one would not expect clients to choose providers with highly flawed procedures).

The EC legislature's approach to investment services is interesting in that it tries to tackle the problem of service contracts. In many service contracts, the result reached through performance of the contract does not indicate with sufficient certainty the quality of the provider's efforts toward execution. The EC directive aims to make the quality of providers' efforts

38. For a collection of the extensive case law, see Grundmann, supra note 16, paras. 52, 70, 142, 148.


measurable nevertheless. On the other hand, there is less need for liability as long as clients can diversify (and thus have a sample of the market) and the incentive for providers to supply good performance is particularly high. High incentives exist here: their performance will become highly visible, and the future success of their business will therefore depend on these figures.

II. A MARKET FUNCTION APPROACH

A. Ethics or Economics—The Wrong Question

The majority of civil law scholars endorse the idea that the fault principle is ethically well-founded, and some scholars clearly see it as ethically superior to strict liability. The core argument is the following: A system that grounds damages in fault gives the breaching party more freedom, since he does not have to answer for developments that he could not control. In a Kantian tradition, it is seen as an act of freedom to choose between breach or conformity with a contract. Others, however, argue that a regime of strict liability may also foster some level of freedom by furthering the principle of *pacta sunt servanda*, that agreements must be kept—a principle of equal importance with freedom of will. Therefore, balancing of both principles seems necessary. In fact, this reasoning is used to explain why most systems include both fault and strict liability elements.

While it is true that most systems follow a nuanced approach, the above explanation is misguided. First, freedom and *pacta sunt servanda* are not of equal importance, at least not in the context discussed here. There is actually a clear hierarchy between them, and *pacta sunt servanda* is clearly more important because of the following reason. Those who advocate the ethical superiority of the fault principle because it gives the breaching party the freedom to answer only for those acts and events for which he is responsible forget one rather simple fact: there is an earlier type of freedom that allows each party to decide what offers he makes and to which standards he wants to bind himself, i.e., the freedom of contract. In fact, fundamental concepts such as normative individualism or Böhms concept of a private law society are significant because they clarify one thing: the most vital tenet of


43. Riesenhuber, supra note 21, at 145.

44. See id. at 148.

freedom in modern times (and Böhm sees this time as starting with the French Revolution and the “private law society” it installed) is the right of each person to decide, to the greatest extent possible, which obligations to assume. This freedom—which comes first—is disregarded if the question of whether fault or strict liability should govern is decided, not on the basis of the parties’ expressed or implicit intentions, but rather on the basis of an “ethical credo” about the superiority of fault or of strict liability. If the freedom of the parties is taken seriously, the question is how to interpret their intentions, not to impose on them a regime judged by scholars, legislatures, or any other third party to foster their freedom and therefore be ethically superior. Replacing the choice made by the parties—even if justified as fostering freedom—is paternalistic. Normative individualism, on which the economic analysis of contract law rests, has mainly ethical foundations too, including the assumption that each individual is given the freedom of choice as far and as early as possible.

The core question is therefore which regime best fosters the intentions the parties had in mind when entering the contract. Does strict liability better mirror their expectations or does fault liability? Is the answer the same for all contracts? Does a requirement of foreseeability mirror parties’ expectations? The next Section uses party and market expectation as a guideline for answering these questions.

B. Party and Market Expectation as Guidelines

Liability in contract law is not really an issue when it comes to the recipient of goods or services. Payment is generally owed under a strict liability rule. (Some exceptions are discussed below in Section II.C.) Liability of the provider of goods or services, therefore, is the real issue. It is helpful to keep in mind that liability results in compensation. Damages account for what the recipient has bargained for but has not fully received. Thus liability in all its forms helps to make the recipient whole if the performance he receives is not in conformity with the contract.

However, if liability requires more than mere nonconformity, the recipient’s expectation of receiving the benefit of the contract for which he bargained is not fulfilled in those cases where the additional requirement—for instance, fault—is not satisfied. Therefore liability that is based exclusively on nonconformity with the contract—that is, strict liability—has the advantage of making different offers easier to compare. All costs resulting from a certain behavior, for instance the production of the good sold in conformity with the contract—and the production of the good sold in nonconformity—are calculated into the prices if liability is strict.46 This is so because the buyer either receives the benefit of the contract for which he


46. See ROBERT COOTER & THOMAS ULEN, LAW & ECONOMICS 208–12 (5th ed. 2008); Steven Shavell, Strict Liability versus Negligence, 9 J. LEGAL STUD. 1, 4–8 (1980).
bargained or he receives full compensation without any additional require-
ment. The benefit bargained for will be received irrespective of whether
performance is in conformity with the contract (or at least something close
to the benefit when potential litigation costs are factored in).

It would seem to be a cornerstone in a model of competitive markets that
clients be put in a situation where comparability is best guaranteed. But any
requirement of fault reduces comparability: A party that bargains for a spe-
cific benefit receives the full benefit only where the other party fulfills his
contractual obligations, but a fault regime obligates him to fulfill an addi-
tional requirement before receiving the full benefit where the other party
breaches. Under strict liability (if one ignores litigation costs), nonconform-
ity does not matter. The buyer who receives performance in conformity with
the contract is just as well off as the one who does not receive performance
in conformity with the contract. Thus, strict liability reduces the influence of
nonconformity on whether the full benefit of the bargain is received, and it
increases comparability because developments in the future that the buyer
cannot foresee (namely, breach) become irrelevant for the (value of the)
benefit he derives from the contract.

An additional advantage of strict liability is related to governance. In
strict liability, the person who can best influence and assess the quality of
the performance, i.e., the provider of goods or services, carries all costs of
conformity. Therefore, no external person, for instance a judge applying the
Hand formula, has to make this assessment. 47

Comparability should again be the core criterion in the parallel question
of whether there should at least be a force majeure excuse. Common law
scholars tend to exclude such an excuse rather categorically unless there is a
contract term to the contrary, but many civil law scholars (in cases where
there is strict liability in civil law) find the contrary. 48

C. Promise of Results or Promise of Best
Efforts—The Core Criteria

If strict liability better fosters freedom of contract, or freedom to bind
oneself to a standard that the other party expects, and it also fosters compa-
rability of offers, the core question is how to justify exceptions to strict
liability. As a starting point, the distinction between contracts for results or
best efforts, which is so fundamental in French law, would seem to be
highly sensible. There are promises where no result has been promised or no
such promise can be inferred from the parties' typical interests because there
are cases in which too many other factors can obstruct a certain result. In
other words, where an obligation is such that the result can be promised

47. See Shavell, supra note 46. In the German context, see also Michael Adams,
Ökonomische Analyse der Gefährdungs- und Verschuldenshaftung 137-40 (1985);
Andreas Blaschczok, Gefährdungschaftung und Risikozuweisung (1993).

48. Compare Treitel, supra note 32 (common law), at 838, with Fabre-Magnan, supra
note 30, at 573-74 (civil law).
because it is within the party's control, strict liability is acceptable (and indeed fosters comparability and thus market and party expectations). But where this is not the case, strict liability is just not appropriate because parties would not expect a guarantee of result.

The first category, where strict liability is appropriate, includes virtually all sales of goods and some sales of services. For example, strict liability should typically apply to mass-production contracts. The German rule, which would hold that the seller is not accountable for the defects caused by the third-party producer, is clearly suboptimal in this context. This rule is not suboptimal (only) because of the shortcomings of the fault principle. In fact, it goes beyond fault and excludes liability if there clearly was fault on the side of the third-party producer. One way around this result would be to design vicarious liability differently, i.e., to make the seller responsible at least for the fault of other members of the distribution chain (including the producer). But strict liability provides a much easier solution: the seller's liability would be beyond doubt (vicarious liability would not matter) and as a result the producer's recourse from the seller would also be known. The effect is that ultimately the person who caused the nonconformity is subject to liability and not exempt for reasons such as privity of contract. Uniform international law and its development confirm the correctness of applying strict liability to these contracts: article 79 of the CISG, which covers sales, is the most prominent rule in which strict liability is carried through consistently.49

The second category—where strict liability is inappropriate—is comprised of some, but by no means all, services. This is the really difficult category. The distinctive feature should not be the type of contract, but rather the question of whether reaching a certain result is within the party's control or more precisely, within a typical party's control. In cases where the answer is negative, no promise of result can be inferred from the parties' typical interests. In these cases, a guarantee is the exception, rather than the default, and must be proved by the nonbreaching party. The parties could agree to a guarantee, but the law should not infer it from the typical interests of the parties in such a case. If, however, the result is within a typical party's control, a promise of result can be inferred from the parties' typical interests, because such a promise is reasonable and it fosters comparability and thus market and party expectations. Therefore, in a contract for services, one has to ask whether the result intended is within the control of the seller (or within the control of the network he gathers around him). This explains why, for instance, in the case of credit transfers there should indeed be strict liability. Credit transfers constitute one of the few classes of cases on liability—fault or strict—that the EC has decided, and indeed the legislature decided in favor of strict liability.50 The payment chain has control over

49. On the strict liability concept and the exact shape of the exceptions in this case, see, for example, Hans Stoll & Georg Gruber, Exemptions, in Commentary on the CISG, supra note 5, art. 79, paras. 10–13, 30–32, rdnr. 6–9. For its importance in the German legislative process, see Abschlussbericht der Kommission zur Überarbeitung des Schuldrechts 123 (Bundesminister der Justiz ed., 1992).

whether the credit arrives at the beneficiary’s account—within a fixed period of time and without getting lost in the chain. Because of all this, a guarantee can easily be given; and the EC Directive interprets the parties’ understanding as implying such a guarantee. It is worth noting that this is not even a very exceptional case in the area of services. Contracts that specifically provide for success or a particular result (so-called works’ contracts in European terminology)—and this is a large number of cases—fall into this category.

Deciding whether strict liability should apply based on whether the contract is within the party’s control would seem to be convincing on the side of the recipient as well. The recipient typically just owes payment. While this duty is a strict one and the recipient cannot simply claim he was not at fault for a lack of money, many legal systems nevertheless accept excuses for late payment, such as illness. This result is justified by the fact that comparability is not an issue. As recipients do not make offers on the market, there are few factors that suppliers of goods or services use to compare potential recipients. While solvency is certainly one, temporary illness is not. And while a suitable contingency for coping with such “unexpected” obstacles is a factor for which a “guarantee” is expected on the side of the supplier, it is probably not on the side of the purchaser (client). This is because illness is not seen as being within the purchaser’s control, while the capacity to cope with illness is seen to be within the control of a supplier enterprise, i.e., the supplier enterprise can more easily organize his affairs to deal with illness.

Similar criteria can be applied to long-term contracts. This would imply that one can consider a party to be able to “control” procedures which he has to apply and therefore be held liable for gross negligence if he does not apply these procedures. On the other hand such a party could not be considered to “control” the outcome. The business-judgment rule in corporate law—which certainly is as well grounded in the policy aspect that risk taking by managers should be encouraged—may also be explained by this idea. In contracts, this idea has been developed only in the context of labor law,

paras. 21–26 (1999). This directive has been repealed by Parliament and Council Directive 2007/64/EC, 2007 O.J. (L 319) 1, 8; the rule discussed here has, however, not been changed. See, e.g., DESPINA MAVROMATI, THE LAW OF PAYMENT SERVICES IN THE EU (2008); Johannes Priese- mann, Proposal for a Directive on payment services in the internal market: Overview and initial comments, 1 EUREDIA 15 (2006).

51. In the German context, see BGB § 631 and standard commentaries on this section. In the French context, see, for example, FABRE-MAGNAN, supra note 30, at 418.

52. For German Law, see Heinrichs, supra note 26, § 276, para. 28.

53. At least if it is a long-term relational contract that takes up most or all of the breaching party’s working power for a considerable time.

where it is obvious that employers should diversify or insure the risk of breach because employees cannot do so as easily in most cases. But it could readily be developed in other areas, and a market expectations approach would be helpful in a discussion of how exactly the duties should be shaped in these areas.

In summary, strict liability best fosters comparability as the core criterion for party expectations by determining the parties' will at the moment of formation of contract. Exceptions to the strict liability regime have to be justified by the fact that a contract involves a type of performance wherein the result is not within the (typical) party's control. If the contract is a long-term one, an additional allowance, embodied by a negligence standard, for instance, could be made for the fact that breach is likely to occur at some point.

D. Fault, Foreseeability, and Other "Softeners" of Strict Liability

Fault is one alternative to strict liability. As discussed in the previous section, a fault regime can be justified where a result is not within the control of the breaching party (or his partners in the chain). This control-oriented divide works quite well where the intention of the parties is the criterion that decides the case. In some cases, however, we look beyond the intention of the parties and consider public policy motives. One such case is antidiscrimination rules. There, public policy concerns justify a strict liability regime even where the party in violation cannot be seen as being in control of the result. But there are other ways to deviate from strict liability as well.

The first is foreseeability. The rationale for a foreseeability requirement is that the purchaser (client) is in the best position to anticipate exceptional circumstances that may give rise to a loss. Therefore he should carry the risk of not being compensated when he does not disclose this risk when the contract is being formed. Why this reasoning—itself a pocket of fault—should be restricted only to strict liability regimes and not apply to fault regimes is not evident at all. Thus the German regime would need correction not only with respect to the principle (strict liability), but also with respect to the excuse. In many cases, German law will compensate more extensively than common law systems because, under German law, fault does not impose a high hurdle (and therefore German law will provide for compensation in most cases), while the foreseeability requirement used in

55. The European Court of Justice also decided that the duty not to discriminate on the basis of gender was subject to strict liability. E.g., Case C-177/88, Dekker v. Stichting Vormingscentrum voor Jong Volwassenen (VJV-Centrum) Plus, 1990 E.C.R. I-3941, 3975. It is not just cases involving willful and particularly offensive discrimination that are subjected to liability. Given that "indirect" discrimination can be quite tricky, the result reached by the ECJ is not easily explained by an argument that it is "in the hands" of the employer not to discriminate; it seems more like a decision of public policy.

56. See supra note 31.

57. COOTER & ULEN, supra note 46, at 274.
common law systems does restrain remedies. It must, however, be noted that German law contains some limits as well that, in some cases, function similarly to the foreseeability excuse: it opts for an approach in which comparative negligence reduces the amount of damages owed. Thus, if the nonbreaching party could have mitigated the damages—for instance, because disclosure of a special risk would have induced the breaching party to apply more care—damages might be limited, albeit less stringently. The question of foreseeability is, however, more complex than the German approach. Because it is not always easy to prove damages, compensation for breach is typically suboptimal as a general rule. Therefore, it may well be that the risk of incurring liability that is not foreseeable to the breaching party reduces his inclination to breach the contract where performance avoids the problem of proof of damages. Therefore, when assessing the well-foundedness of a foreseeability rule the following alternative must be kept in mind: the criterion may well place the onus of disclosing on the party who has better information, but it may also reduce the already suboptimal deterrence value of damage remedies.

A second way to deviate from strict liability is the "second chance" principle. If a breaching party faces certain remedies only after having a chance to cure its nonconformity, then remedies are not immediately available in all cases of breach. Under European and German Law, the second-chance principle applies not only to the nonbreaching party's restitutory remedies, but also to his damages, insofar as the damages consist of the return of the defective performance and a claim for money to buy a substitute. The requirement of a "second chance" may deviate from strict liability even more than a mere fault requirement, because breaching parties may have a right to a second try even if they acted in a grossly negligent—not just a negligent—way. From a policy perspective, this deviation from strict liability can be justified by the fact that the "second chance" postpones more invasive remedies only if the chance is used promptly and without considerable hassle. Thus this justification for deviation does not reduce the amount of compensation, but affects only the form of compensation.

CONCLUSION

Fault or strict liability? This is too simplistic a question. Strict liability and some fault liability is more or less the reality in all countries—with larger exceptions in the area of services. Furthermore, if the aim of the fault

58. BGB § 254. This is a rule that most authors in the American law and economics literature accept as well. See, e.g., COOTER & ULEN, supra note 46, at 346, 366, 383–86; RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 172–77 (7th ed. 2007).

requirement is to not excessively restrict the freedom of the breaching party, there are other—probably more appropriate—governance devices in contract law to be taken into account. These include the "second chance" and the foreseeability principles. Thus, this Article highlights two trends with respect to the fault principle. The first trend is that there are nuances to both general approaches. The second is the use of functionally related instruments, which traditionally have not been seen in conjunction with the fault principle but have a similar effect.