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Regulation of the Risk of Negative Occurrences at the Stage of Contract Performance –Reference to Economic Analysis of Law

This paper focuses on the determination of regulation of potential risks at the stage of contract performance during the development of law-of-obligations relations. It examines the allocation of risks related to the performance of obligation. The paper discusses approaches of Anglo-American (common law) and German legal systems; however, the leading role is accorded to economic analysis of law-of-obligations relations, which mainly concerns the determination of practical importance of legal regulation. Within the scope of this area of research, the paper offers an analysis of respective articles of the Civil Code of Georgia in conjunction with comparable or similar solutions of common law or German law systems.

Key words: *Performance of a Contract, Economic Analysis, Behavioural Standard, Risk Allocation, Substantial Performance, Impossibility of Performance, Interpretation of a Contract.*

1. Introduction

Contemporary civil transactions give rise to different interests of persons and it becomes necessary to create various legal, political and economic mechanisms to balance them. The instrumentality function of law is accomplished through its legal mechanisms of regulation, which create the single concept of risk allocation. Presently, the foregoing has become the focus of economic analysis of law, the current methodology of the study of law. Economic thinking was brought into the field of legal studies during the 1910s and 1920s. In 1970s, it was established as a separate trend, when legal community addressed the question of efficiency of legal rules. This methodology investigates practical importance of legal rules and employs economic categories to this end.¹

The paper aims at discussing the aspects of risk allocation and thus enhancing the systemic vision of legal challenges, elucidating the practical importance of balancing the interests of the parties and interdisciplinary nature of the problem through comparison of traditional and modern opinions, and relevant comparative analysis. Identification of the risk of occurrence of a negative event at the stage of performance of obligation and efficient regulation of this risk are of particular importance for the whole system of private law relations as the allocation of risk between the parties to a civil transaction is the precondition of balancing their different interests. Based on this, the paper focuses on regu-

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¹ Kornhauser L., The Economic Analysis of Law, Stanford Encyclopedia of Philosophy, 2001, 2, <<https://plato.stanford.edu/entries/legal-econanalysis/>>, [17.07.2017].

lations concerning law-of-obligations relations in close connection with economic analysis of law. Furthermore, it will also discuss various cases of allocation of risk envisaged by Georgian civil law.

The process of performance of a contract and the problem of regulation of potential negative consequences are discussed in the paper on a step-by-step basis. Initially, attention is paid to economic categories of a contract, practical importance of the terms and conditions of a contract for its classification and the principle of risk allocation. At the next stage, the concept of an average reasonable person is described, which in fact is the manifestation of the duty of bona fide behaviour. This concept is unconditionally meaningful for every case of development of contractual relationships, amongst them, for the assessment of performance of an obligation. Consequently, the paper discusses the question of exercise of its civil law right by the party in the course of performance of a contract, within the framework of this very concept. A separate chapter is dedicated to the concept of impossibility of performance or frustration, as it can be said that this concept is the most topical performance-related risk factor. The same chapter discusses the standard of allocation of the risk of accidental loss/damage of a property. Incomplete nature of modern contracts or high level of their dependence on external factors obviously complicates the process of performance, which, in its turn, provides for the necessity of interpretation of the will of the parties. The scope and alternatives of interpretation of the will are regarded as one of the most important challenges of modern reality and can even be presumed as a risk-factor, distinctive to performance phase. Hence, these issues are discussed in a separate chapter of the paper allowing for clear visualisation of different complications arising during the performance of an obligation. The last part of the paper focuses on the specific nature of contractual relationship in a non-routine situation, upon the participation of a third person in the course of performance, which makes evident the practical implication of this external factor and specific nature of general standard of behaviour for the purpose of performance of a contract.

2. Process of Performance of a Contract

Performance of a contract covers three components, viz., time of performance, place of performance and quality of performance. Each of these components is provided for by the Civil Code of Georgia (CCG). However, the issues that are of major importance for the purpose of ensuring contractual equilibrium and fair allocation of contractual risk should be regulated in detail. Hence, the chapter below aims at identifying legal and economic benchmarks crucial for the process of performance of an obligation.

2.1. Contract and its Constituent Terms and Conditions

The main function of a contract is to ensure the performance of a promise/assumed obligation. As a general rule, a contract provides for the standard of performance and responsibilities of the parties. At the same time a contract serves the purpose of advance allocation of potential risks and selection of legal remedies for default cases. And lastly, a contract is the instrument for the reconciliation of potentially conflicting individual interests.²

² *Beatson J., Anson's Law of Contract, 28th ed., US, 2002, 3.*

2.1.1. Types of Contracts according to Economic Analysis

For the purpose of economic analysis of law³ (hereinafter – the economic analysis), a contract is a transaction for the exchange of resources and its main function is efficient allocation of these resources. Consequently, the key aspect of a contract is securing the efficient behaviour of the subjects, participating in the process of exchange. When searching for efficient behaviour, the set of circumstances is evaluated from two perspectives, viz., from that of an individual, who is the maximiser of personal proprietary interest, and from the viewpoint of contracting parties with common interest. Common will of the parties is the key standpoint of legal protection for traditional doctrines of law – both common-law and European. As per the definition of economic analysis,⁴ without legally protected and enforceable rights, the persons face the risk of making inefficient decisions as it is possible for this preference to be given to obligations, subject to immediate or concurrent performance.⁵ Legal protection of a contract aims at excluding mala fide behaviour of a person against a counter party, provision for efficient terms and conditions, identification of the party bearing the highest risk and oversight of contractual negotiations or further judicial proceedings. From the perspective of neoclassical economics,⁶ a contract is an autonomous agreement and essentially is the risk allocation mechanism.⁷ Specifically, when agreeing upon mutual rights and obligations and their validity period, the parties also create the system of allocation of risks associated with the performance of obligations.

In economic analysis, where the notions of a consumer and a manufacturer are dominating, a distinction is made between discretionary and relative contracts. A contract is discretionary when its content is isolated and does not depend on circumstances. It is relative when its content and further development depends on created circumstances or external factors. Furthermore, most of the contracts executed in modern civil relations are of relative nature.⁸ This differentiation is based on various criteria: 1) Commencement, duration and accomplishment; 2) Measurability and predictability; 3) Planning; 4) Allocation of resources vs. Distribution of gain/burden; 5) Mutual dependence, future cooperation and solidarity; 6) Number of participants and their personal relationship; and 7) Power.⁹ For example, a contract is discretionary when the beginning and the end thereof are easily definable. Also, discretionary is the contract in the case of sales between two persons when immediate performance is required from each party. Furthermore, as already mentioned, mostly the relative contracts are distinctive of modern civil transaction, when it becomes necessary to separately assess each of the above components. However, overall, a relative contract has three main components: certainty of the content, validity period and type of investment.

³ Posner R. A., *Economic Analysis of Law*, 7th ed., US, 2007, xxi.

⁴ Ibid.

⁵ Posner R. A., *Economic Analysis of Law*, 7th ed., US, 2007, 93.

⁶ For the analysis of neoclassical economics, see *Arnsperger C., Varoufakis Y.*, What is Neoclassical Economics? The Three Axioms Responsible for its Theoretical Oeuvre, Practical Irrelevance and, thus, Discursive Power, *Savez ekonomista Vojvodine*, Vol. 53(1), 2005, 6.

⁷ *Macneil I. R.*, *Economic Analysis of Contractual Relations: Its Shortfalls and the Need for a Rich Classificatory Apparatus*, *Northwestern University Law Review*, Vol. 75, № 6, 1980-1981, 1020.

⁸ Ibid.

⁹ Ibid, 1025.

Some authors¹⁰ differentiate between classical, neoclassical and relative contracts. Specifically, if in classical system, a contract is being assessed for a specific moment, the identity and status of a party are of less importance, the list of remedies is limited and the focus is shifted to formal documentary part. In neoclassical system, it is already possible to speak about predictability. In this case, a contract is being assessed with its full development. Owing to the duration and complexity of a contract, the classical and neoclassical models were gradually substituted by the above model of relative contract, where the analysis of contract-related costs and specificity of governance of contractual relationships are of importance.

2.1.2. Practical Importance of Contract Terms and Conditions

Of the criteria mentioned above, attention should be paid to allocation of gain and burden, which is quite different in each case. Allocation of risk, related to the object of performance, is the case of distribution of burden, which is apparent in terms and conditions of a discretionary contract, as each party is accorded the ordinary risk, inherent to his/her share of performance. Specifically, market risk associated with the ownership of a property (e.g., change of market price of a property) passes to the buyer upon execution of a contract and the one associated with physical condition of a property – after handing over thereof. In its turn, the risk associated with delivery/handing over/shipment of a property is associated with a seller. However, such allocation of burden may change when, for example, the performance is deferred. This means that there are circumstances which affect the ordinary process of allocation of contractual risk. E.g., the absence or ambiguity of consideration¹¹ makes due performance by the respective party less guaranteed and hence the deterioration of financial standing gives rise to a legitimate claim for the allocation of risk for the counterparty. A separate mention can be made of contracts that depend on customer-demand, when production expenses of goods (if there are any) also become subject to allocation as a result of the decrease in market demand, unlike large production relations when the conveyer principle is mostly employed for the process of distribution of gain/burden.

The cost of contract execution or transaction is the component which plays an important role at the stage of formation of a contract. Transaction costs also include the costs of governance of contractual relationships,¹² which is important from the point of view of practical organisation. Transaction costs differ according to the contract to be executed. Also, important components are the identity of the counterparty, existence of demand and alternative means of supply, risk related neutrality and intensity of negotiations. E.g., in commercial contracts, one of the leading contracting factors is the economy of production costs.¹³

¹⁰ *Willimason O. E.*, Transaction-Cost Economics: The Governance of Contractual Relations, *The Journal of Law and Economics*, Vol. 22, № 2, 1979, 236.

¹¹ *Quid pro quo* (something for something) — for more details about the doctrine of consideration, see *McGovern W. M.*, Contract in Medieval England: The Necessity for Quid pro Quo and a Sum Certain, *The American Journal Legal History*, Vol. XIII, 1969, 5.

¹² *Coase R. H.*, The Nature of the Firm, *Economica*, New Series, Vol. 4, № 16, 1937, 394.

¹³ *Willimason O. E.*, Transaction-Cost Economics: The Governance of Contractual Relations, *The Journal of Law and Economics*, Vol. 22, № 2, 1979, 237.

Based on the complexity of performance, i.e., action(s) to be performed, contracts can be differentiated as follows according to their content: 1. complex or mixed contract, which includes several actions independent from each other; 2. contract, the performance of which requires the performance of several, interrelated actions aiming at a single purpose; and 3. contract, for the performance of which only a single action is to be performed.¹⁴ The nature and complexity of the action to be performed affects the allocation of contract risk. Specifically, if the obligation is undividable, in this case, as a general rule, it is the obligor who assumes the risk of negative consequence of faulty/undue performance, including the obligation to bear the expenses of correcting the fault. This is particularly topical in the case of the contractor's agreement, when the motive of due performance of work should be ensured. However, it should as well be taken into consideration that, in the case of partial performance, allowing for refusing the compensation of performed work definitely generates unfair contractual consequence as neither of the aggrieved party can be enriched unjustly.¹⁵ Consequently, if the contract was not essentially violated, the obligation of acceptance of performed share arises. Concurrent with this reasoning is the stipulation of Article 405 of the CCG, under which if obligation was breached only partially the obligee may refuse the performance of the contract only when the performance of the remaining share of the obligation became meaningless for him/her. However, it is not clear whether this stipulation implies the obligation to accept performed share, provided that the action to be performed is dividable. Furthermore, it is a separate issue whether this obligation can arise only in the case of short-term scheduled performance or long-term recurrent performance as well. Furthermore, no matter whether the obligation is dividable or not, the implied obligation to perform it duly and in good faith remains unchanged.

The contract period is one of the key components of the content of contractual relationships. The contracts are divided into term contracts, viz., made for a certain period and contracts made for an indefinite period. Furthermore, term contracts can be further subdivided into short-term and long-term contracts. In economic analysis, contracts made for an indefinite period are called contracts with indefinite future. It is worth mentioning that pre-contractual relationships that are traditionally regarded as independent legal relations constitute the beginning of a contract as per economic analysis. Here, the commencement, flow or termination of contractual relationships is not strictly delimited, accounting for the complicated process of contract planning. Hence, from economic point of view, the moment of execution of a contract and the expiry of contract term are of a formal nature. This formality is noticeable in certain provisions of the effective Georgian civil law. E.g., Article 605 of the CCG,¹⁶ under which a contract made for three years can be extended for an indefinite period; or the existing practice of contracts revolving on a yearly basis. In certain cases, ambiguity in a contract term can be explained through placing the contract within the framework of the legal regime of a conditional transaction, provided that contract termination/extension is associated with occurrence or non-occurrence of a certain condition (for example, change in market price). The provisions of the CCG which provide for the right to claim the extension of contractual relationships is also worth mentioning. Mention should be

¹⁴ *Beatson J., Anson's Law of Contract, 28th ed., US, 2002, 510.*

¹⁵ *Ibid, 514.*

¹⁶ *Civil Code of Georgia, Parliament of Georgia, Parliamentary Gazette, № 31, 24/07/1997.*

made of Articles 559, 560, 569 and 593 of the CCG about long-term rent and contractual lease. The analysis of these articles demonstrates that in the case of existence of a bilateral will – acceptance of an offer – contractual relationships are extended. Furthermore, also admissible is the presumption on the extension of a contract for an indefinite period, which evidences the will of the legislature to maintain contractual relationships even in the case of ambiguity of the will of the parties. In conclusion, it should be said that all the above-mentioned points demonstrate how practically important and essential a certain term or condition of a contract can be for the outcomes of a contract. Furthermore, unlike the traditional approach, quite often the essentiality of the term or condition is defined by a set of internal or external factors, for which only the law and will of the parties are decisive sources.

2.2. The Concept of an Average Reasonable Person

Performance of an obligation is the key standard of performance of an obligation with due care and diligence both in continental and common law systems. This chapter discusses an objective standard of behaviour regarding each component of performance and describes respective consequences in the context of risk allocation.

2.2.1. Notion of an Average Reasonable Man

The notion of reasonability or rationality of a person is worthy of note to the extent that it depends on a set of circumstances and does not constitute an abstract category. It is somewhat delimited from the concepts of good faith and contractual equity.¹⁷ The concept of a reasonable, commonsensical person serves practical purposes of an action in the course of performance. Modern philosophy sometimes refuses to admit the direct connection between reasonable and rational.¹⁸ Specifically, the choice of behaviour, which is logical and rational, can at the same time be reasonable for a specific case and vice versa. The possibility of convergence of these categories is mostly visible in contract law. Some believe that reasonability is morally motivated rationality.¹⁹ It should be mentioned that this notion goes back to sixteenth and seventeenth century England, where the phrase "beyond reasonable doubt" first originated.²⁰ As per modern understanding, reasonability implies indefinite future, alternatives of human behaviour and potential mistakes as well. Reasonability means *recta ratio*²¹ of an action. It can be said that the notion of an average reasonable person is a fiction of law. In economic analysis this notion is equalled with socially desirable behaviour as reasonable means averaged and balanced at the same time. However, if a rationally acting person is the maximiser of own interest and

¹⁷ Zorzetto S., Reasonableness, The Italian Law Journal, Vol. 01, № 01, 2015, 107.

¹⁸ Ibid, 110.

¹⁹ Ibid, 117.

²⁰ Ibid, 119.

²¹ It should be mentioned that Dutch scholar of the sixteenth century, Hugo Grotius, who first voiced the idea of rational *ius naturale*, would explain, that *ius naturale* dictates *recta ratio*, when an action, be it rational or not, has moral basis; see Rommen H. A., Natural Law: A Study in Legal and Social History and Philosophy, Hanley Th. R. (trans.), US, 1998, 71.

is oriented towards balancing the allocation of burden/gain, an average reasonable person cooperates with others and is also interested in attaining fair terms and conditions. Consequently, as far as the consequences of human behaviour for others are concerned, the notion of an average reasonable person can easily be added to the obligation of good faith.²² To sum up, it can be said that the notion of an average reasonable person constitutes a category reflecting objective values in one case and subjective equity in the other. In this light, two main categories of contract risk are identified: a) risk associated with an event and/or situation being independent from human behaviour; and 2) risk associated with human behaviour, capabilities or mental or other condition of a person.

2.2.2. Behavioural Standard in the Performance of Obligation

In certain cases, the standard of human behaviour is embodied in the respective rules of the CCG. At the same time, it is natural for optional rules of the law of obligation,²³ providing for exemplary behaviour, to contain a stipulation that something else may follow from the content of the contract or essence of the obligation/circumstances. Respectively, during the performance of an obligation, the law, party agreement and essence of the obligation/contract related circumstances are the alternative sources for determination of human behaviour. E.g., a condition related to the time of performance can be presumed to be essentially based on contract related circumstances, irrespective of whether the parties made a stipulation in this regard. Also, if the parties have not agreed about the priority order of performance, it depends on the content of the obligation, whether it should be performed first or not. Specifically, in this case, the content of the obligation concerned is considered, i.e., conditioning or conditioned. Unless otherwise agreed, the obligations covered by a sales contract, as a general rule, are concurrent and competitive. In the case of, a labour contract, for example, performance of work is a precondition for the payment of remuneration.²⁴ Determination of the foregoing is also important for the identification of the breach of obligation.

As regards the place of performance, Georgian legislature decided that preference is to be given to the obligor's place of business or habitual residence. However, the contrary is admissible if the foregoing is not directly envisaged by a contract. Respectively, an obligee is required to take a property away from the obligor and the former becomes the bearer of the risk of performance from the moment of transfer of the property. This mode of risk allocation changes when the obligor is ready to hand over the property, but the obligee delays its acceptance.²⁵ The approach is different with the performance of a money obligation as in this case the obligor is responsible for the performance at his/her own risk and expense.²⁶

²² For further details, see: good faith — *Kereselidze D.*, Most General Systemic Notions of Private Law, Tbilisi, 2009, 83 (in Georgian).

²³ See CCG, Articles 362 and 365.

²⁴ *Anson W. R., Corbin A., Arthur L.*, Principles of the Law of Contract with a Chapter on the Law of Agency, NY, 1924, 3.

²⁵ See CCG, Article 393.

²⁶ *Pieck M.*, A Study of the Significant Aspects of German Contract Law, Annual Survey of International & Comparative Law, Vol. 3, 1996, 118.

When there is no expressed agreement of the parties, the content of the contractual relationship becomes the source for determination of contract terms and conditions. Hence, the legislature obliges an average reasonable observer and judicial practice to generalise the performance distinctive to the contract and relevant risks. E.g., in English legal system, it is characteristic for a sales contract that it is the buyer's obligation to organise the acceptance of a property.²⁷ In Georgian civil law, the criterion for the determination of the place of performance is said to be the type of the property subject to transfer/acceptance – whether it is individual or generic. In the case of an individual property, the place of performance is the location of the property, which guarantees the safety of the object of performance and passing of the risk from the obligor to the obligee upon its transfer/acceptance.

The behavioural standard regarding the quality of the object of performance is mainly determined by party agreement. Otherwise, the focus is made on the fitness of a property for the purpose of the contract or average consumption fitness. It should be mentioned here that Section 434.1(2) of the German Civil Code²⁸ (BGB) stipulates that it is the direct obligation of the seller (producer/a person involved in selling process) to communicate the objectively available information about the specific characteristics or condition of the property to the buyer. This stipulation is absent in the relevant article of the CCG.²⁹ Faulty performance, including the delivery of a different property or lesser amount thereof, is present when there is no agreement on accepting other performances. Furthermore, such an agreement can be reached either before or after the performance. In the case of delivery of the other property, practical connotation of the autonomy of the will of the parties for legal consequence is apparent as one and the same action may constitute both the breach of obligation and termination of obligation through acceptance of another performance.

Contractual circumstances may also provide whether it is possible for a third person to execute the performance and stipulate the legal status of the latter. According to general behavioural standards, when business and professional characteristics of a person constitute grounds for the execution of a contract with him/her, this person cannot enjoy the right to delegate performance. This is evidenced by Article 371.1 of the CCG, according to which when it does not follow from a law, a contract or nature of the contract that the obligor is supposed to personally perform the obligation, this obligation may also be performed by a third person. Regulation of the risk associated with the performance under the involvement of a third person is contained in Article 398 of the CCG, under which article an obligor should be liable for the actions of his/her lawful agent and those other persons he/she employed for the performance of his/her obligation, to the same extent /she would have been liable in the case of own faulty actions.

²⁷ *Anson W. R., Corbin A., Arthur L., Principles of the Law of Contract with a Chapter on the Law of Agency*, NY, 1924, 8.

²⁸ German Civil Code BGB, Federal Ministry of Justice and Consumer Protection in cooperation with juris GmbH, 18/08/1896, <<http://www.fd.ulisboa.pt/wp-content/uploads/2014/12/Codigo-Civil-Alemao-BGB-German-Civil-Code-BGB-english-version.pdf>>, [01.01.2018].

²⁹ Comp. Article 488, part 1 of the CCG: "A thing is flawless in title if it is of the agreed quality. If the quality is not agreed in advance, the thing shall be deemed flawless if it is suitable for the use stipulated in the contract or for ordinary use".

Therefore, as far as the assessment of behaviour in the course of performance of an obligation is subject to discussion of a specific case, provision for the duty of due care and due diligence of a party in the course of exercising the right is of paramount importance.

2.2.3. Unilateral Discretionary Power of a Party

Exercise of civil power by a party is one of the pressing questions of modern contract law. Unilateral power can be understood as a lawful option of a party to influence the counterparty or the outcome of contracts. Economic analysis identifies unilateral and bilateral power of a party.³⁰ The source of unilateral power is absolute ownership (fee simple absolute), whilst the source of bilateral discretionary power is a contract as this power is realised during the exchange of wealth. In this case, the term "discretion" is used to express potential unilateral will. The factors conditioning this will partially constitute the contract terms and conditions concerning time, place and quality. In effect, the unilateral power of a party is created by default and/or undue performance of an obligation. Economic analysis calls the secondary right to claim, originating after the execution of a contract, unilateral power of the party. Finally, there is an opinion about the fluctuation of the equilibrium of interests of the parties as it is presumed that contractual positions exist only for a given moment.

Provision for the right to alternative performance or alternative obligation can be regarded as a manifestation of discretionary power of a party during the performance of an obligation. The first case, as a general rule, concerns the object of contractual obligation and the other concerns some term or condition of performance. The right to alternative performance is in play when, even if the agreed performance is predominant, a stipulation about the option of substitution of the object of obligation or its essential characteristic within a reasonable period (performance option) is provided for at the same time. Furthermore, a party enjoying performance option is not required to take account of the interests of the counterparty about the enjoyment of the option. However, if it is deemed impossible to perform the priority action, the obligor is not liable to refer to an alternative performance to maintain contract and not have it terminated on the basis of impossibility of performance.³¹ In the case of enjoyment of performance option, the object of performance is being substituted and in this case the obligation is exhausted through acceptance of the other performance.³² The content of performance option is included in Article 428 of the CCG, according to which the obligation relationship terminates when an obligee accepts some other performance in lieu of performance envisaged by the obligation. Acceptance of other performance is interpreted in Georgian legal literature as innovation,³³ when an obligor is entitled to carry out and the obligee, on his/her part, is entitled to accept the other performance. It is noteworthy that the above article does not contain any reference to the necessity of provision for

³⁰ *Macneil I. R.*, Economic Analysis of Contractual Relations: Its Shortfalls and the Need for a Rich Classificatory Apparatus, *Northwestern University Law Review*, Vol. 75, № 6, 1980-1981, 1032.

³¹ *Beatson J.*, *Anson's Law of Contract*, 28th ed., US, 2002, 507.

³² *Martin S.*, *Randall L. A. E.*, *Law of Contracts*, NY, 1912, 602.

³³ *Chanturia L.*, *Zoidze B.*, *Commentary on the Civil Code of Georgia*, Third Book, Tbilisi, 2001, 517 (in Georgian). Comp.: *Dzlierishvili Z.*, *Tsertsvadze G.*, *Robakidze I.*, *Svanadze G.*, *Tsertsvadze L.*, *Janashia L.*, *Contract Law*, Tbilisi, 2014, 351 (in Georgian).

such a possibility/option from the very outset as well as its connection with any objective circumstance. The analysis of the provision evidences that the case concerns the change of basic feature of the object of performance, which was not agreed upon from the very outset and, hence, it is possible for the foregoing to be done even in the course of performance. Under similar Section 364 of the BGB, acceptance of another performance and termination of performance claim may be conditioned by the circumstances of the case. Furthermore, it is possible to provide for the right to do some other performance in lieu of assumed obligation at the very beginning of contractual relationships. In the commentary of the German Civil Code, the foregoing is nominated as the right to substitute performance.³⁴ Part 2 of the above article³⁵ regulated the obligor's right to offer alternative performance to the obligee to cover the assumed obligation. At the same time, attention is paid to the obligee's obligation to exercise due diligence for the satisfaction of his/her claim through alternative performance. The above legal option is an apparent example of identification of the priority of the purpose of obligation and clarifies to what extent the necessity of legitimating reliable behaviour of the parties is upheld by Georgian or German legislature.

The situation is different with alternative obligation. In this case, several performances are allowed, when each of them constitutes due performance of obligation. The obligor is given the option to choose among alternative actions from the very outset. Alternative obligation is regulated by Article 376 of the CCG, under which the selected obligation is regarded as an obligation to be performed from the very outset. Furthermore, all prescribed alternatives of the performance should be exhausted as the impossibility of performance of any of the actions does not constitute the right to leave the contract. This stipulation is further reinforced by Article 375 of the CCG, under which, if it turns out that the obligor can refuse one of two obligations, the obligation to perform the other action remains. It is important that the right to choose one from two potential actions is vested with the obligor as the provision for performance related risk, viz., performance costs, shipment/delivery of goods and deterioration of the quality of performance, falls within his/her terms of reference. However, it is worth mentioning that Georgian legislature stipulates that this option exists unless something else stems from the contract itself, the law or essence of the obligation. Hence, the viewpoint of an average reasonable person remains pressing with regard to the choice of the action to be performed, which naturally aims at ensuring contractual equilibrium.

2.2.4. Substantial Performance of Contract

Substantial performance of a contract does not exclude the legal regime of walking out of the contract and assignment of respective negative consequences to any of the parties. Hence, it is important to assess whether what criteria is employed for the determination of the substantiality of performance. In common law space, the question is resolved through the option of enforcement of specific statement of claim. Respectively, here an obligee is taken as an aggrieved party, who has the obliga-

³⁴ *Kropholler J.*, German Civil Code, Study Comments, *Darjania T., Tchetchelashvili Z.* (trans.), *Chachanidze E., Darjania T., Totladze L.* (eds.), Tbilisi, 2014, 664 (in Georgian).

³⁵ Comp. Article 379 of the CCG: "An obligee is not obliged to accept the other performance other than the one, prescribed by contract. The same rule applies when performance is of great value."

tion to pay for a substantially performed part on the one hand and on the other the right to counter claim for compensation of damages incurred as a result of deficient performance. Determination of substantial performance is largely associated with economic category. Specifically, in the case of deficient performance, the obligation is substantially performed unless the costs and expenses of making good the flaw(s)/deficiencies are disproportionately higher than contract price. This principle is embodied in Article 490.3 of the CCG, under which a seller is entitled to refuse the elimination of a defect as well as substitution of the object, if these actions involve disproportionately high expenses. It can be said that, in this case, the obligor is granted with certain contractual discretion at the stage of breach of obligation. This stipulation is directly linked with the economic analysis of consequences of the breach of an obligation. In fact, the above article declares the principle of efficient breach, known to economic analysis, under which principle an obligor may prefer not to perform the obligation and not to compensate damages incurred to the counterparty through non-performance.³⁶

In common law, the concept of substantial performance is mainly applied with regard to contract for work. In common law space, since early 1920s, 'performance against consideration' was the name of the case, when a defect/unfitness of a transferred property is determinable and of minor importance, because of which it is still possible to efficiently use transferred property. In this case, English courts regard contract as a contract enforceable on condition of payment of respective compensation. Substantial performance is established by the fact that buyer's expectation is satisfied to a substantial extent. Respectively, a buyer, as an average reasonable person, is free in his/her choice to accept deficient performance and respective compensation or walk out of the contract. It is worth mentioning that English courts do not extend this reasoning to a flaw in title.³⁷

Within the framework of economic analysis, the main question is who is to be assigned the trivial risks of incompatibility of performance with the agreed one – to the promisor or the promisee. In this case, the following legal circumstances are of decisive importance: whether the obligation is divisible or not, or to what extent is the consideration related to the condition of due performance of obligation. In this context, an example of the balance of interests of the parties is Section 323 of the BGB, which concerns the performance not in conformity with the contract. Specifically, Section 323.5 differentiates between performance in part and non-performance in conformity with the contract. In each of these cases, the German legislature makes assessments from the standpoint of an average reasonable person because it allows the revocation of a contract only when the obligee has no interest in a part of performance or the breach of obligation is trivial. Both these preconditions are the bearers of the concept of substantial performance. It should as well be mentioned that delimitation between performance in part and deficient performance becomes particularly pressing for a long-term contract. It is also noteworthy that stipulation about trivial nature of a breach of contract shifts focus to the position of the obligor, when, upon assessment of the interest towards the remaining part of the contract, the obligee's position prevails. In any case, the concept of substantial performance conveys mainly the economic interests of the parties and aims at comparison of the costs borne by the obligor for due per-

³⁶ For details, see: *Macneil I. R.*, Efficient Breach of Contract: Circles in the Sky, *Virginia Law Review*, Vol. 68, № 5, 1982, 947.

³⁷ *Martin S., Randall L. A. E.*, *Law of Contracts*, NY, 1912, 612.

formance on the one hand and the costs to be borne by the obligee for obtaining the object of performance from an alternative source on the other hand. According to economic analysis, the reasonability of performance is assessed from the perspective of both parties with due consideration of performance related costs and expenses for a seller and value of performance for a buyer.³⁸ It should be mentioned that the above differentiation is stressed in parts 1 and 3 of Article 405 of the CCG and the preconditions of substantiality of the breach of obligation are not presented within the single system. Furthermore, in the case of deficient performance, the standard of obligor's behaviour is defined under the provisions regulating a sales contract. Therefore, in the case of in-part/deficient performance, the question of balancing the legitimate interests of the parties becomes particularly pressing. It is important for the respective legal regime to be adequately presented in general provisions of the law of obligation.

3. Economic Analysis of Impossibility of Performance/Frustration

Upon negotiation of contractual terms and conditions, the parties take account of circumstances that may affect the value of performance. In most cases, the parties agree on the risk of accidental damage/loss of a property or excusable cases when parties can be exempted from liability. When setting certain terms and conditions, the parties aim at offsetting contractual imbalance or informational asymmetry. Economic analysis is oriented on promoting search for optimal outcome for the parties. The chapter below aims at the analysis of the doctrine of impossibility of performance/frustration for securing the best economic interests. Also, it should be mentioned that the main subject of analysis is non-faulty impossibility of performance.

3.1. Doctrinal Thesis about the Impossibility of Performance

Common law system differentiated between subjective impossibility created by a party and impossibility occurring because of external factors/objective circumstances. In the first case, the breach of obligation is in play and impossibility to attain the purpose of the contract in the other. Culpability implies the actions of both the obligor and the obligee, if the latter is not cooperating with the obligor. Under common law doctrine on frustration, quite frequently a faulty action is negligent or inconsequential. Impossibility of performance may arise both before and after maturation of performance. Impossibility occurring before the maturation of performance is the case of potential breach of obligation. In German civil law,³⁹ impossibility of performance means the breach of obligation in any case; however, it differs from the other cases of the breach of obligation according to its consequences as this is the only case which exempts a party from the obligation to perform.

Some practical cases fall within the framework of the impossibility of performance. Hence legal regulations that were developed within the framework of common law about absolute impossibility of

³⁸ *Posner E. A.*, *Economic Analysis of Contract Law After Three Decades: Success or Failure?*, U Chicago Law And Economics, Olin Working Paper, № 146, 2002, 9.

³⁹ *Comp. Lowisch M.*, *New Law of Obligations in Germany*, *Ritsumeikan Law Review*, № 20, 2003, 17.

performance, impracticability of performance and frustration are conditioned by different cases and individuality, despite the necessity of a common theoretical frame. Specifically:

- Impossibility of performance means when performance is no longer physically possible;
- Frustration means that performance is physically possible, but the underlying purpose of the contract is no longer attainable; and
- Impracticability of performance means that performance is physically possible, underlying purpose is achievable, but the foregoing would entail a much higher cost and efforts than originally contemplated.⁴⁰

It is distinctive of the doctrine of impossibility of performance/frustration that a negative event could occur because of objective and unforeseeable circumstances beyond the control of the parties without a fault of either of the parties. Respectively, this concept falls within the category of realisation of an objective risk-factor, independent from the behaviour of a person. Initially, in English judicial practice, cases of faultless impossibility were discussed in the field of marine shipments.⁴¹ Later, this doctrine covered cases when performance was to be carried out by a specific person and he/she died,⁴² when changes of normative framework left the obligation, subject to performance, beyond the control of the party,⁴³ the cases of non-occurrence of circumstance(s) underlying contract, etc. Furthermore, in the latter case, breach of legitimate contractual expectation should concern both parties.⁴⁴ Hence, common-law doctrine united cases of objective nature.

Maintenance of equilibrium in force-majeure circumstances is one of the key issues for a legal system. Initially, it was believed that⁴⁵ normal flow of circumstances underlying a contract should have been taken into account to maintain initial intention of the parties. The foregoing would become particularly important upon assessment of commercial/practical impossibility. By 1960s, common law gave preference to the theory of radical change⁴⁶ of obligations subject to performance. Specifically, it is excluded to demand such performance which cannot be claimed from a party based on initial terms and conditions of the contract. However, the main criterion of assessment is the change of the content of the obligation and not its complexity or related high costs.⁴⁷ It is worth mentioning that the doctrine of impossibility of performance does not cover dramatic change of performance costs and expenses (change of market price), as it is believed that this does not impair the purpose of the contract. The opinion regarding the rule of performance is similar. Respectively, the above negative events fall within the scope of the obligor's risk.

⁴⁰ *Posner R. A., Rosenfield A. M.*, Impossibility and Related Doctrines in Contract Law: An Economic Analysis, *The Journal of Legal Studies*, Vol. 6, № 1, 1977, 84.

⁴¹ *Beatson J.*, *Anson's Law of Contract*, 28th ed., US, 2002, 530.

⁴² See CCG, Article 453, part 1.

⁴³ *Anson W. R., Corbin A., Arthur L.*, *Principles of the Law of Contract with a Chapter on the Law of Agency*, NY, 1924, 530.

⁴⁴ Worth mentioning is a parallel with Articles 73 (c) and 360 of the CCG, as mutual mistake in transaction related circumstances, which is regarded as potential impossibility, constitutes grounds for voidance of the contract in German and Georgian codes.

⁴⁵ Opinion about implied term – the so-called fiction of term.

⁴⁶ Theory about the construction of a contract.

⁴⁷ *Beatson J.*, *Anson's Law of Contract*, 28th ed. US, 2002, 544.

According to economic analysis, in the case of non-faulty impossibility of performance, the question arises as to which party is to assume the risk of occurrence of an event and respective consequences? Or, is the foregoing possible? In this case, the first property to verify is whether the contract itself regulates the consequences of negative occurrences. The discussion of the question of maintenance or termination of the contract should remain within the scope of common will of the parties. The question whether the situation should be unforeseeable or it can be foreseeable for the parties is a subject of discussion. According to economic analysis, a judge is required to focus mainly on the commercial activities of a party.⁴⁸

Disputed cases are differentiated according to who is responsible for the risk of occurrence of a negative consequence. E.g., if performance becomes not cost-effective for an obligor, then should he/she bear the risk or is it possible for the latter to be exempted from the performance of assumed obligation? Exemption of an obligor from performance obligations means passing risk to the obligee, while refusal of exemption means assignment of this risk to the obligor. Performance is not cost-effective when expenses become so high because of unforeseen and unregulated cases that exceeded potential gain from the contract. A promisor/obligor should be exempted from the obligation when the addressee of the promise is the best bearer of the risk. In economic analysis, there are two main criteria for the determination of the "best risk-bearer party": 1) a person is capable of preventing risk at relatively small cost (this option does not actually exist in the case of faultless impossibility); and 2) a person is the best one to compensate risk. However, a person may meet only the second criterion as it is the case with insurance companies.⁴⁹ As already mentioned, a promisor/obligor can be exempted from performance obligation only when the addressee of the promisee/obligee is in the better position to insure the negative consequences of an event as the latter is in the better position to assess the potentiality or scope of a risk.⁵⁰ However, in common law space, there is a presumption that a promisor/obligor is more capable of prevention or insurance of an event, which makes performance not cost-effective.⁵¹ Exemption from performance obligation is allowed only when counterparty is in a better position to foresee, assess and insure the risk, which again leads us to the concept of a reasonable observer.

As a general rule, a party is ready to pay high price for performance to get rid of the burden of risk, meaning that risk is a measurable category. Performance risk consists of the probability of its occurrence and its scope. It is necessary to know these features to define compensation in lieu of risk assumed by a party. Hence the simplest and most cost-effective means of risk allocation is claiming high contract price, the so-called risk insurance premium. According to economic analysis, there are two fundamental methods of minimisation of potential damage, viz., prevention and insurance. When it is possible to prevent damage at minimal cost one faces preventable risk. However, when this is not

⁴⁸ *Beatson J.*, *Anson's Law of Contract*, 28th ed. US, 2002, 546.

⁴⁹ *Posner R. A., Rosenfield A. M.*, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, *The Journal of Legal Studies*, Vol. 6, № 1, 1977, 90.

⁵⁰ *Ibid.*, 92.

⁵¹ *Uniform Commercial Code*, 1952, <<https://www.law.cornell.edu/ucc>>, [01.01.2018]. § 2.615 of the UCC focuses on the impracticability of performance and the non-occurrence of a contingency should be basic assumption for the parties upon execution of the contract. It should be stressed that only the seller is entitled to employ this legal remedy.

the case, the risk of suffering property loss and the necessity of reduction of costs, related to its occurrence, are in play. In this case, the simplest model of risk allocation is the correction of price in accordance with the amount of expenses to be borne to compensate potential loss.⁵² In other words, the economically attainable purpose is securing the compensation of property loss that was suffered as a result of realisation of risk, which depends on who is the best bearer of the risk. In the case of economic impossibility, the main purpose of an adjudicator is to establish those contract terms and conditions the parties agreed upon to foresee the realised risk. Furthermore, it is believed that the parties are entitled to agree on the performance of impossible, what in fact means the agreement on the payment of compensation. As far as the impossibility to prevent damage is a precondition of application of the doctrine of impossibility of performance, demonstration of due care and due diligence is one of the qualifying circumstances in this case as well.

Section 275 of the BGB – exclusion of the duty of performance – regulates the concept of impossibility of performance. Here, the impossibility of performance is detailed according to types (objective-subjective, factual-legal and initial-further) both at legislative and doctrinal levels. The German code integrates the issues of exclusion from the duty of performance and refusal of performance by the obligor in this general paragraph. In the context of securing contractual equilibrium, the right of the obligor to refuse performance is of particular importance. The foregoing is equalised to the case of practical impossibility when performance becomes disproportionately complicated (unreal impossibility).⁵³ Precondition for the application of the right to refuse performance (practical impossibility) is the necessity of grossly disproportionate expenses or unreasonable efforts on the part of the obligor. One of the measurements of the disproportionality of costs and expenses/efforts is an obligee's interest in the performance of the obligation. Furthermore, a reference is made to the content of the law-of-obligations relation and good faith principle. Even in the case of impossibility for the obligor to render performance in person, part 3 of the above section provides whether the obligor should be obliged to perform the obligation, taking account of mutual weighing of the obstacle to the performance and the interests of the obligee. It is stressed in BGB commentary⁵⁴ that temporary impossibility can be taken as a permanent one when an obligee cannot be obliged to remain contractually bound until the removal

⁵² A very good example of the practice of transformation of risk into value is the activities of insurance companies. The example of delay of marine shipment due to the deterioration of weather conditions well demonstrates the problem of allocation of risk in the case of faultless delay. Specifically, the cargo shipment contractual relationships are aware of the so-called delay fee. The bearer of risk for unloading a train-car due to the deterioration of weather conditions can be the sender in one case and the recipient in the other. The foregoing is established according to who is the payer of delay fee and on what condition. If it is agreed that the fee is paid by the recipient and the latter is exempted from fee due to the deterioration of weather conditions, it turns out that the bearer of the respective risk (the case of faultless delay/temporary impossibility) is the sender of the train; and if it is agreed that there is no excusable reason for the delay and the sender received certain amount for unloading the train-car as scheduled or earlier, it turns out that in this case the bearer of the risk is the recipient and the amount received by the latter for unloading train on time is a kind of compensation for that. Consequently, essential is which of the parties is the bearer of the risk. For details see: *Posner R. A.*, *Economic Analysis of Law*, 7th ed., US, 2007, 105.

⁵³ *Kropholler J.*, *German Civil Code, Study Comments*, *Darjania T., Tchetchelashvili Z.* (trans.), *Chachanidze E., Darjania T., Totladze L.* (eds.), Tbilisi, 2014, 150 (in Georgian).

⁵⁴ *Ibid.*

of the obstacle. To sum up, it can be said that the basic principle is to guarantee the proportionality between costs and expenses to be borne by the obligor on the one hand and obligee's interest in performance on the other.⁵⁵ It should be mentioned that in this case the contractual price of performance remains unregulated, which is one of the leading criteria for economic analysis. In this respect, worth mentioning is the fact that BGB regulates the case of change of the basis of a contract (changed circumstances) by the separate Section 313, which implies economic impossibility when the legitimate interest of the obligor predominates.

The interpretation made in Georgian legal literature⁵⁶ focuses on objective absolute impossibility caused by unforeseen circumstances, the so-called force-majeure circumstances. It turns out that obstruction/complication of performance, i.e., economic impossibility falls within the scope of the concept of changed circumstances and contract adjustment,⁵⁷ unlike the above-discussed common-law doctrine, which *inter alia* also covers the cases of practical impossibility. In the CCG, Article 401 is the only one mentioning the impossibility of performance as such. Specifically, the case of non-faulty delay, discussed therein, is qualified as impossibility of performance. The main criterion for exemption of an obligor from the performance of obligation is the absence of his/her fault and less importance is accorded to allocation of risk between the parties in the case of contingencies. It should as well be mentioned that with such scarce regulation, provision for contractual equity is an ambiguous issue when the impossibility of performance is disputed, except for the cases when disputed circumstances will be placed within the framework of the institute of complication of performance and resulting from the foregoing adjustment of a contract.

3.2. Accidental Loss/Damage of an Object of Contract

The risk of accidental loss/damage of a property is particularly topical in the context of impossibility of performance. In common-law space, this case is known as destruction of goods. Furthermore, for such qualification, the object of a contract should be a special property with an individual feature, which was destructed without seller's fault and before the moment of transfer of the relevant risk to the buyer. In this case, setoff of contractual obligations is the single-option legal consequence.⁵⁸ Under the Unified Commercial Code (UCC),⁵⁹ in sales-shipment contracts, the risk of accidental loss of goods is borne by the seller until the transfer of goods to the carrier. In sales-delivery (delivery to the place of destination) contract, it is again borne by the seller, but this time until the delivery of goods to the place of destination. Hence, as a general rule, the best bearer of the risk is the seller as it is believed that the bearer of the risk is the one who ensures carriage/conveyance of goods.⁶⁰

⁵⁵ Comp. CCG, Article 490, part 3: "A seller may refuse to eliminate the defect or to replace the property if either action would require disproportionately high expenses."

⁵⁶ *Chanturia L., Zoidze B.*, Commentary of the Civil Code, Third Book, Tbilisi, 2001, 371 (In Georgian).

⁵⁷ CCG, Article 398.

⁵⁸ Sale of Goods Act, 06/12/1979, <<https://www.legislation.gov.uk/ukpga/1979/54>>, [01.01.2018].

See § 2.509., Short Uniform Commercial Code, 1952, <<http://www.casefilemethod.com/statutes/short%20ucc.pdf>>, [01.01.2018].

⁶⁰ *Posner R. A., Rosenfield A. M.*, Impossibility and Related Doctrines in Contract Law: An Economic Analysis, *The Journal of Legal Studies*, Vol. 6, № 1, 1977, 108.

In the case of damage or partial destruction of an object of contract, the key principle of the doctrine of impossibility of performance about exemption of a buyer from the duty of performance remains valid, provided that the buyer, if that is his/her will, is entitled to accept the undamaged/remaining part of goods.⁶¹ Furthermore, the scope of the duty of the latter to pay for goods will depend on the divisibility of the object of performance. The foregoing can be determined through the establishment of the intention of the parties. Specifically, it should be determined whether the partially performed share is separable and whether it is possible to accept partial performance. In any case, this option is a certain privilege of the buyer. This privilege can be proved by the fact that the destruction of goods, including partial destruction, sets off seller's any right to claim against the buyer. Despite the foregoing, in practice, it is difficult to explain the degree of damage of goods for full exemption of the buyer from the duty of performance. Widely explained, even when goods cease to exist only from a commercial point of view, when it is not of agreed quality, this is equated to physical destruction from legal viewpoint.⁶² Furthermore, this negative event should occur before the transfer of title to the buyer.

The question of refund of advance payment made by the buyer prior to destruction/damage of goods is an important issue for common-law judicial practice.⁶³ Initially, it was presumed that the set-off of a mature obligation was not possible, and parties could have been exempted only from future obligation. Therefore, the risk of a negative occurrence was vested with the party who first performed the obligation. However, later it was clarified that the amount paid by the buyer in advance was subject to refund in any case and the foregoing was to be done through filing a claim for restitution. However, a precondition for restitution was non-performance of an obligation to the full extent, which left the cases unregulated when the buyer had borne expenses for the purposes of performance or came into possession of a property that was useless for him/her or/and the buyer received remaining/undamaged share of performance.⁶⁴ Hence, the UK Frustrated Contract Act 1943⁶⁵ introduced the principle of inadmissibility of unjust enrichment. The foregoing becomes particularly pressing when the action carried out before frustration of a contract gives certain benefit to a party. Specifically, a

⁶¹ Comp., Uniform Sales Act, 01/01/1906, <<http://source.gosupra.com/docs/statute/221>>, [01.01.2018]. Worth mentioning are Sections 7 and 8 of the USA, under which sections, if at the moment of execution of a contract or after the execution thereof the object of sale does not exist or has perished without the knowledge of the seller, the contract is void. If goods have perished in part or have wholly or in a material part so deteriorated in quality as to be substantially changed in character, the voidance of the contract is the choice of the buyer, falling within the scope of the freedom of will. In other words, the buyer is entitled to regard contract as void or accept undamaged part of goods as performance and maintain law-of-obligation relations with the seller pro rata to carry out performance. The above sections contain direct reference to the moment of transfer of risk, which should stem from the contract or/and its interpretation. The foregoing again makes clear the importance of allocation of the risk of occurrence of a negative event for legal consequence. Furthermore, voidance of a contract due to non-existence of the object of fulfilment is a general legal consequence and the precondition of the foregoing can be either the impossibility of performance or mutual mistake in the basis of the transaction. See *Williston S.*, *Law Governing Sales of Goods at Common Law and Under the Uniform Sales Act*, NY, 1909, 190.

⁶² Comp. *Francis B. T.*, *Handbook of the Law of Sales*, US, 1895, 196.

⁶³ *Beatson J.*, *Anson's Law of Contract*, 28th ed., US, 2002, 541.

⁶⁴ *Ibid*, 534.

⁶⁵ The Frustrated Contracts Act, 05/08/1943, <http://www.bclaws.ca/civix/document/id/complete/statreg/96166_01>, [01.01.2018].

person liable for restitution, in his/her turn, is entitled to file a defence against compensation of expenses incurred. In this case, mature claims can be mutually set-off. The foregoing proves again that, in the case of impossibility of performance, one of the key goals is provision for the equilibrium of the interests of the parties.⁶⁶

Under Section 446 of the BGB – Passing of Risk and Charges – passing of the risk of accidental destruction and accidental deterioration is associated with the delivery of the goods sold. In other words, this is called performance hazard/risk. Transfer means handing over a property into the direct possession of a buyer and does not imply granting indirect possession. Furthermore, if an obligor can refuse performance by reason of impossibility of performance pursuant to Section 275, then under part 1 of Section 326, he/she is not entitled to claim consideration from the obligee. This means that the obligor bears the risk for a negative occurrence during performance. Furthermore, both in common-law and German civil law, impossibility of performance (frustration) is established with regard to an individually defined property and the seller is required to accomplish performance through any means if the property is a generic one. Passing of the risk of performance is quite topical in the case of conditional sale when there is a certain period between delivery of goods and full payment of the value.⁶⁷ Also, separate regulation of the question of passing the risk of shipment of goods should be accounted for time factor necessary for the delivery. Specifically, in the case of sending goods to some other place on the request of the buyer, the risk passes to the buyer from an earlier moment, i.e., from the moment of handing over the goods to a dealer by the seller. Hence, when there is no agreement on sending goods to the other place, the risk passes to the buyer only from the moment of transfer of the goods under the direct ownership thereof. Furthermore, reference to sending the goods to the other place is an exemption and supply/delivery of the goods should be subject to the common rule of passing risk at the place of performance. Also worth mentioning is the fact that, according to common opinion, a carrier will not be considered as a person assisting performance, even if the sales object is carried by a seller's employee and the object is accidentally destroyed at that moment. Even if the carrier is at fault, the seller will not be liable for the action committed by the former, as a person assisting the performance. There is an obligation to send, which means that the seller is excluded from liability from the moment of handing the property over to the carrier.⁶⁸ For the purposes of passing on the performance risk, the situation where the buyer is late with acceptance is equalised to the transfer of the goods. Articles regulating sales contracts and work contracts in the CCG contain stipulations that are similar to those of the German code.⁶⁹ In this light, Article 402 of the CCG which provides for an obligor's liability for the consequences of overdue performance is worth mentioning. Specifically, in the case of overdue performance, the obligor is responsible for any negative consequence, including for damage resulting from impossibility of performance due to delay/accidental damage. Under Article 401 of the same code, strict liability of the obligor is linked with faulty action of the latter as non-faulty non-performance of an obligation within agreed timeline is not qualified as an overdue performance of the obligor. Therefore, the risk of occurrence of every negative consequence of delay is vest-

⁶⁶ *Beatson J.*, *Anson's Law of Contract*, 28th ed., US, 2002, 558.

⁶⁷ *Kropholler J.*, *German Civil Code, Study Comments*, *Darjania T., Tchetchelashvili Z.* (trans.), *Chachanidze E., Darjania T., Totladze L.* (eds.), Tbilisi, 2014, 341 (in Georgian).

⁶⁸ *Ibid*, 343.

⁶⁹ See Articles 482 and 651 of the CCG.

ed with the obligor, except for the case when the latter successfully proves that there is no causal link between inflicted damage and overdue performance. The foregoing stems from Article 394.1 of the CCG, as in the above case the legislature focuses on the necessity of conditioning the consequences of overdue performance by overdue performance.

4. Complexity of Interpretation of a Contract through Dispositional Norms

Division of legal norms into dispositional and imperative ones is inherent both for European and case-law systems. Imperative norms, which mainly aim at ensuring contractual equilibrium, are also the norms that limit freedom to contract. However, the scrutiny of application of dispositional norms is a particular focus of economic analysis. The main criterion for the selection of these norms is said to be the will the parties should presumably have upon the execution of a contract. These norms are regarded as a variety of certain standard terms and conditions. However, the question of how stable the determination of potential common will of the parties in each case from conceptual point of view is still pressing. Drafting of a contract and its enforcement are key stages in contract law. It is practically impossible to fully predict potential challenges and provide for countervailing measures.

4.1. Economic Analysis of Contract Interpretation

A question arises within the framework of the economic analysis as to which regulation would have been preferred by the majority of negotiating parties in the case concerned. There is a discretionary rule that contains a sanction in common law, which does not imply the proposed model of behaviour. An example of the foregoing is the legal solution of the UCC,⁷⁰ under which solution a contract is not enforceable unless the parties had agreed upon the number of the object of performance. Hence, no option of correction/ interpretation of defect is envisaged. As it turns out, the case concerns the term of a contract which is decisive for the existence thereof. In this context, a parallel should be made with Article 53 of the CCG, under which a transaction does not exist when its content cannot be ascertained from its form of expression or from other circumstances. Part 3 of Article 477 of the CCG may also provide for the consequence related to non-determination of the number of the object of performance, but this provision mentions only the price. This approach is justified by a stipulation that it is difficult and expensive for the court to determine the reasonable number of the object of performance. Hence, minimal determinability of a contract appears to be the precondition for its existence.

When a term or condition is not determined *ex ante*, the contract is to be amended with due consideration of legal status existing before its execution, which excludes mala-fide behaviour. As far as the cost of *ex ante* anticipation and evaluation of potential occurrences/circumstances during the lifetime of a contract are disproportionately high, it naturally becomes necessary to interpret the contract later. Thus, the thesis – agreeing to disagree – is admissible.⁷¹ According to economic analysis, the

⁷⁰ See UCC § 2.201.

⁷¹ Posner R. A., The Law and Economics of Contract Interpretation, The Chicago Working Paper Series, Vol. 83:1581, 2004, 5.

preconditions of interpretation of a contract are as follows: risk-neutrality of the parties, symmetrical information, contractibility of all variables and absence of additional costs and expenses. It is necessary to determine the will of the parties, viz., when did they provide for specific terms and what broad norms were left and where. Therefore, the interpretation becomes necessary not only for filling gaps, but also because the parties consider it possible from the very outset, leaving room for interpretation.⁷²

There are four main methods of interpretation in common-law space,⁷³ viz., the "four corner" rule, mutual mistake rule, *contra proferentem* rule and extrinsic non evidence rule.⁷⁴ Economists offered several interpretive strategies to the courts. The first strategy is majoritarian default – the meaning that most parties to contracts would use should be considered, which will often be the same as the customary meaning or trade usage. The second strategy is penalty default (less priority interpretation) – the meaning/interpretation should be found, which most parties to a contract would not use. This strategy provides for two incentives, viz., the parties try to make their contract terms less ambiguous and the parties cooperate in a most open manner and disclose all the available information. The foregoing comes close to word-for-word or literal interpretation. The third strategy is to determine which term would be efficient in a specific case for the parties despite the possible position of the majority of the parties. In this case, the expectations of specific parties are subject to assessment. The court interprets a circumstance/situation for a specific case and not for the majority of similar contracts. It should be said that it is difficult to determine attributes that speak for the efficiency of the above strategies and rationality of the consequence.⁷⁵

When parties are reasonable and fully informed, they purposively draft contract terms and conditions to foresee every potential consequence. In economy, this situation is called equilibrium, when neither of the parties is interested in avoiding the agreement of contract terms and conditions and improve own position at the expense of the other. Furthermore, the cost of detailed drafting of a contract may exceed the expected gain, which should as well be taken into account. Non-regulation of an issue *ex ante ex post* results in a dissonance between the parties with regard to agreed rights and obligations. Here the question arises as to what contingent rights should be conferred and what contingent obligations should be imposed on the parties. The traditional answer is as follows: *ex post* a party may be imposed with only those rights and obligation, he/she would have reasonably agreed to *ex ante* had he/she predicted the potential situation. This is called the rule of "hypothetical contract theory"; this is the contract the parties would have agreed upon *ex ante*, if the cost of agreement had not made such a specification irrational.⁷⁶ According to hypothetical contracting or consent theory, the parties should be imposed with the same relevant obligations/liability as in the case of express consent as they allowed for the problem from the very outset. The problem is that contingent obligations are imposed on

⁷² Shavell S., On the Writing and the Interpretation of Contracts, *The Journal of Law, Economics and Organization*, Vol. 22, 2006, 290.

⁷³ For details, see: Posner R. A., *The Law and Economics of Contract Interpretation*, The Chicago Working Paper Series, Vol. 83:1581, 2004, 1.

⁷⁴ Smeenk B. P., *Ambiguities and Extrinsic Evidence*, *Advocates' Quarterly*, Vol. 12, 1990, 237.

⁷⁵ Posner E. A., *Economic Analysis of Contract Law After Three Decades: Success or Failure?*, U Chicago Law And Economics, Olin Working Paper, № 146, 2002, 14.

⁷⁶ Coleman J. L., Heckathorn D. D., Maser S. M., *A Bargaining Theory Approach to Default Provisions and Disclosure Rules in Contract Law*, *Harvard Journal of Law and Public Policy*, Vol. 12, № 3, 1989, 640.

the parties independently from them, after the execution of the contract. However, the economic arguments about utilisation and consensus speak for the necessity of efficiency of court decisions. Ultimately, the theory of hypothetic consent/contracting essentially reflects rational self-interest. It is believed in economic analysis that different stages of a contract require different levels of rationality and respectively the measures against ambiguity should also be different. The above strategies of contract interpretation evidence that the methodology oriented on practical consequence of interpretation of contract terms and conditions may override classical deliberations about the contradiction between the inner will of the declarer of the will and perception of the addressee of this declaration of will, when the inevitability of interaction between the declarations of will is commonly recognised.

Summing up, it can be said that according to the approach distinctive of the common-law legal system, only that contract can be interpreted which directly mentions or indirectly implies the option of interpretation of a term or condition. Otherwise, a contract does not exist or is unenforceable. Hence, the maxim of law is that only what can be defined is subject to interpretation.⁷⁷ It is worth mentioning that the thesis contained in Article 327.1 of the CCG about the necessity of agreement about essential terms and conditions coincides with the above maxim. Furthermore, all those criteria that are important for the interpretation of the declaration of will and developed in judicial practice – including the importance of the process of negotiation, existence and content of the usages of trade, general standard of reasonability, already implemented transactions, etc. – are reflected in separate provisions of the Georgian code.⁷⁸

4.2. Scope of Interpretation of a Contract — Parol/Extrinsic Evidence Rule

Upon interpreting a contract/declaration of will, a question arises about the type and scope of the rights and obligations or contractual liability that may be granted and imposed upon a party by a court of law. The latter is to determine the rights and obligations the parties would have reasonably agreed upon had relevant negotiations been conducted. Hence, when the execution of a fully detailed contract is associated with unreasonably high expenses, this burden passes to the court, which interprets the agreement through dispositional norms and creates the so-called hypothetical contract. Because of the impossibility in predicting every cost or expense related to the process of execution of a contract or every risk-bearing situation, contracts are incomplete from the perspective of economic analysis and the parties allow for their completion/interpretation on the bases of business usages or judicial practice. According to economic analysis, a Pareto-Optimal contract⁷⁹ should be made a contract, to which the parties would agree upon had there been no contingent transaction costs.

Parol evidence rule, according to which a party was not entitled to use some oral stipulation, interpretation or testimony made during the pre-contractual phase for his/her own benefit and thus challenge the terms and conditions contained in final document, is important for the purposes of interpret-

⁷⁷ *Beatson J.*, *Anson's Law of Contract*, 28th ed., US, 2002, 60.

⁷⁸ See Articles 52, 337-340 of the CCG.

⁷⁹ Pareto-Optimal situation: a state of affairs in which no person in society can have his utility increased by redistribution of resources without making someone else worse off. See *Gordon D.*, *An Introduction to Economic Reasoning*, Alabama, 2000, 183.

ing a contract.⁸⁰ This rule was later applied to written evidences as well. Hence, focus was made on the initial character of the contract and its form, i.e., the later agreement prevails over the earlier one. Of course, the limitation cannot cover the agreements reached after the execution of the contract. In other words, the question of impact of earlier interpretations/agreements of the parties on final document drafted by them became the focus of common-law legal system. The above rule, in the case of its unconditional application, became a serious barrier for the court in the course of interpretation of final contracts.⁸¹ Hence, it was presumed that a contract abandons earlier terms and conditions only when they are controversial, and the final contract directly provides for their invalidation. Hence, the application of this rule has no grounds until the contract is agreed with its detailed content. It comes to effect when a court identifies terms and conditions, subject to enforcement for the moment concerned. To sum up, it can be said that parol evidence rule should not be applied in the course of interpretation of a contract as in certain cases the precedent circumstances are particularly important. Furthermore, the purpose of interpretation is the clarification of the content of the contract and not its amendment or contradicting it. Parol evidence rule does not apply in proving an essential mistake, abuse of influence and also with regard to conditional contracts.⁸² It is a separate matter for economic analysis as to who should allow such evidence – the court or the parties. Furthermore, the existence of the possibility to control parties in the process of interpretation of a contract is a separate issue. Specifically, considering mutual interests, it may be reasonable for the parties to define which contract term or condition should be left beyond interpretation. Furthermore, discussion of an evidence of pre-contractual period is an expensive process. Therefore, efficiency of scrutiny of this stage during judicial proceedings is subject to separate assessment. It may be functional for the parties to have certain control over the process of interpretation. In this case as well in order to personally determine the reasonability of reviewing some evidence.⁸³

5. A Third Person in the Course of Performance

One of the major factors providing for performance process is the involvement of a third person in the course of performance. The chapter below focuses on the assessment of actions carried out by a third person in the course of performance. We will examine the following questions: what is the risk inherent to the employment of a third person in the course of performance and what is the duty to duly select the latter is associated with? What are the legal consequences of negative occurrences, caused by a negligent action of a third person?

The common-law doctrines of contract privacy and consideration considerably restricted the option of participation of a third person outside contractual relationships. However, Contracts Act

⁸⁰ The word ‘Parol’ means ‘spoken’ (in English — Spoken, in French — Parler), *Corbin A.*, The Parol Evidence Rule, *The Yale Law Journal*, Vol. 53(4), 1944, 610.

⁸¹ *Ibid.*

⁸² Evidence, *Outlines*, 2016, 29-30, <http://www.lexisnexis.com/documents/pdf/20160617015319_large.pdf>, [01.01.2018].

⁸³ *Shavell S.*, On the Writing and the Interpretation of Contracts, *The Journal of Law, Economics and Organization*, Vol. 22, 2006, 310.

(Rights of Third Parties⁸⁴) 1999 allowed the foregoing in cases when a contract expressly provided or indirectly implied this option. Although the extension of contractual terms and conditions to a third person are still complicated in practice, such a solution may be provided by the contract itself as mentioned above.⁸⁵

Particularly pressing is the question of participation of a third person in the case of transfer of a property. In this case, the obligor's risk is associated with the transfer of the object of performance by a third person as a negative consequence caused by the fault of the third person; this is a risk-factor associated with the actions of the obligor. The question of limitation or exclusion of the risk of contractual liability is subject to a separate discussion. Because, when providing for this stipulation, the obligor may extend it to a subject that is not a party to the contract but participates in the course of performance. It should be mentioned that when an assistant third person is not protected by such stipulation, he/she enjoys the right to certain recourse (right of contribution) against the obligor.⁸⁶

At any stage of performance of obligation, upon some negative occurrence conditioned either by a negligent action of a third person or by an objective factor, the risk-bearing subject is the obligor. In the present case, the centre of attention is only that category of third persons who share the action to be performed with the obligor. Under Section 278 of the BGB, the actions of a person assisting a debtor in the performance of an obligation is regarded as the action of the latter; however, in fact this is the case of a debtor's liability for other person's action (vicarious liability). It should be mentioned that Section 831 of the same code separately mentions the case of a performer of the assignment, an agent, and bases an obligor's liability on insufficient prudence of the latter in selecting a performer of the obligation and thus on the faulty action of the obligor. In common law, the foregoing is embodied in the concept of *Respondeat Superior*,⁸⁷ and the principle of liability without fault, underlying this concept, is proved by economic analysis as well. Specifically, it is presumed that liability should be imposed on the person who is in the position to prevent an error or negative consequence at lesser cost.

An assistant in performance is a person who is involved in the performance at the obligor's discretion. Such a person, *inter alia*, may be the railway, postal service or a similar organisation. As already mentioned, in the case of any such involvement, the bearer of non-performance risk is the obligor himself. It should be mentioned that a producer does not fall within the scope of the notion of such a person and respective regulation. Furthermore, Section 278 of the BGB considers it admissible to agree about the exemption of the obligor from the liability for a wilful action of the person assisting him/her in the performance, in advance, what is excluded by Section 276.3 in the case of fault on the part of the obligor himself/herself. To compare, the similar Article 396 of the CCG, which does not provide for the option of prior agreement of the obligor's exemption from the liability in the case of wilful action of a third person should be mentioned here.

⁸⁴ Contracts (Rights of Third Parties) Act, 11/11/1999, <http://www.legislation.gov.uk/ukpga/1999/31/pdfs/ukpga_19990031_en.pdf>, [01.01.2018].

⁸⁵ *Beatson J.*, *Anson's Law of Contract*, 28th ed., US, 2002, 182.

⁸⁶ *Ibid.*

⁸⁷ *Respondeat Superior* – Let the Master Answer. See *Thompson S. D.*, *Respondeat Superior*, 1879, 238, <<http://heinonline.org>>, [14.08.2018].

To demonstrate the difference, part 2 of Article 371 of the CCG can be mentioned, which, according to opinions expressed in Georgian legal literature,⁸⁸ should include the assisting third person involved in the performance. This part mainly regulates the performance of another person's obligation at the discretion of the third person. Whether it is possible for a third person to act independently from the will of the obligor is evidenced by the fact that the obligee is entitled not to accept performance offered by a third person if the obligor is against it. This wording gives rise to a question, viz., what is the motive of the obligee to accept performance and that of the third person, to perform an obligation against the will of the obligor. In the interpretation of Section 257 of the BGB,⁸⁹ such a person is denominated as a person hired to render some service, an agent, deposittee and a partner doing business. These persons may be performing the so-called alien obligation at their own free will. In the case of absence of the component of will or making a mistake, an option of claiming the restitution of initial condition from the third person based on unjust enrichment provisions is provided.

The answer with regard to the motive of the action is relatively clear upon analysis of the case, envisaged by Article 374, when a third person is driven by a legitimate right/interest in a property, which is facing enforcement on the part of the obligee. There should be a property under the possession of the obligor, encumbered by a third person's right. The legal consequence of satisfaction of the obligee by a third person is also logical, as, according to subrogation rule, the obligee's claim against the obligor passes to the former, which cannot be said when analysing the case envisaged by Article 371. Exemption of the obligor from specific performance obligation may constitute the subject of legal relationship existing between the latter and the third person. To sum up, it can be said that in cases envisaged by Articles 371 and 372 of the CCG, the third person is the subject acting with specific legal interest and is not just a subject involved in the performance, who is used by the obligor for the performance of his/her obligation. Consequently, the principle of debtor's liability without fault, envisaged by Article 396 of the CCG, should not apply to these cases. This means that the third person should be the subject bearing the risk of negative occurrence in the course of performance, independently from the obligor.

6. Conclusion

The paper focused on the vision of current and concurrent processes of performance of obligation from the position of economic analysis, which allows for comparison with traditional legal visions. In conclusion, the following issues could be identified:

1. Economic analysis regards the behaviour of a subject, party to a contract, as the action of the maximiser of individual gain, whilst legal protection of wealth is common legitimate contractual expectation of the parties for traditional legal doctrines – both common-law and German ones;

2. Economic analysis delimits between discretionary and relative contracts. In a relative contract all the values are variable and are evaluated on a case-by-case basis. Furthermore, unlike traditional

⁸⁸ *Chanturia L., Zoidze B.*, Commentary on the Civil Code of Georgia, Third Book, Tbilisi, 2001, 302 (in Georgian).

⁸⁹ *Kropholler J.*, German Civil Code, Study Comments, *Darjania T., Tchetchelashvili Z.* (trans.), *Chachanidze E., Darjania T., Totladze L.* (eds.), Tbilisi, 2014, 142 (in Georgian).

vision, where a party is accorded ordinary risk inherent to his/her share of performance, economic analysis identifies circumstances, which changes the risk allocation standard in principle. These circumstances can be: time scheduling of performance, disproportionality, ambiguity or absence of consideration, change of customer's demand, complexity of production of goods, large cost of execution or renegotiation of a contract, identity and legal/economic status of the party, difficulty of contract administration and a party's attitude towards the risk;

3. Concept of an average reasonable person, which is topical for traditional legal doctrines and is the leading concept both for the legislature and judiciary for the identification of correct behaviour, acquires different practical connotation in economic analysis. Here, it is attempted to delimit the concept of average reasonable person from general duty of good-faith behaviour and to incorporate the element of economic rationality to a greater extent;

4. Economic analysis creates the concept of unilateral discretionary contracting power of a party in civil-law relations, which is well demonstrated in the course of performance of an obligation. The source of this power is both initial terms and conditions of the contract and consequences of default. Furthermore, economic analysis allows for the existence of changing equilibrium between the interests of the parties, as according to elaborated opinion, contractual positions can exist only for a specific moment;

5. The concept of substantial performance is the manifestation of the judgements of economic analysis. E.g., in the case of faulty performance, the obligation is substantially performed if the cost of removals of the defect is not disproportionately higher than contractual price of performance. Hence, due performance of obligation is regarded as a situation which influences initial value of performance and exempts the obligor from performance obligation. This concept responds to well-known economic analysis principle of efficient breach, according to which principle an obligor should have the right not to perform an obligation and compensate damages incurred to the counterparty through non-performance;

6. In the case of impossibility of performance, a result of a risk-bearing event, it is important to maintain contractual equilibrium. Here the question arises as to who is to bear the risk of occurrence of the event and whether proprietary liability should be borne by either party. Impossibility of performance is one of the concepts associated with the allocation of risk. Exemption of a promisor/obligor from performance obligation means passing the risk to the addressee of the promise and refusal of exemption and allocation of this risk to the promisor/obligor. An economically attainable purpose is to secure the compensation of property loss caused by the realisation of risk, which depends on who is the best bearer of the risk. Furthermore, traditional common-law doctrine of impossibility of performance/frustration of purpose of the contract coincides with the purpose of economic efficiency of a contract, which is proved by economic analysis;

7. Within the framework of economic analysis, the preconditions of interpretation of a contract are as follows: risk-neutrality of the parties, symmetrical information, contractibility of all variables and absence of additional costs and expenses. When parties are reasonable and fully informed, they purposively draft contract terms and conditions to foresee every potential consequence. In economy this situation is called equilibrium. However, the cost of detailed drafting of a contract may exceed the expected gain, which generates a necessity for the parties to leave some gaps. It should be stressed that

classical theory of hypothetical consent/contracting essentially coincides with the idea of protection of rational idea, which is widely discussed in economic analysis;

8. Economic analysis gives autonomous importance to certain factors conditioning performance process. One such factor is the participation of a third person in the course of performance. The negative consequence caused by the fault of a third person, involved in performance, is a risk factor related to the actions of the obligor; and

9. When some negative occurrence is conditioned either by a negligent action of a third person or by an objective factor, the risk-bearer subject is the principal/obligor. In the first case, the action of an assistant/agent performing obligation is regarded as the action of the obligor himself/herself and in the second case, it is presumed that the third person cannot be liable for an objective obstacle to performance. According to economic analysis as well, liability may be imposed on the person who can prevent the mistake or negative consequence with relatively less expenses.

Based on the foregoing, it becomes apparent that, as of to date, complicated contract-law relations are viewed in different light according to different economic concepts and categories. This, in turn, promotes the determination of the efficiency and social importance of current concepts of law and identification of new solutions for the assessment at legislative and judicial levels.

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