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Economic analysis of contractual breach sanctions

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Abstract
The conclusion of any contract aims at implementation of the obligations arising from it. Morality dictates that people adhere to what they assumed regarding others. The law also supported the moral judgment and in case of breach of obligations to oblige, compensation as a sanction is imposed on obligor. In view of the economic analysis, he also committed to respect his contract and the Contract shall be performed contrary to the intention of breaching party, and on both sides the effectiveness is motivated to build trust and to maximize contract efficiency. Typically there are two basic solutions in compensation for breach of contract. First, the obligation of obligator to perform obligation, secondly, payment of damages for non-performance, either by the parties in the form of penalty clause or by the court to refer the matter to the expert identified and they are required to pay it. In choosing one of these, economic perspective considers the economic benefits of each of these two solutions. If so economic benefit in cases where subjective commitment and intellectual damage on the implementation of the commitment, as compensation for these losses not compensated correctly, and basically cannot be estimated. In second view, sentence in view of the compensation usually refers to material damages or economic damages, in such cases compensation for losses caused to the obligee can be compensated better and more efficient method is considered. Finally, it must be borne in mind that the purpose of signing the contract because is its implementation and in cases where the performance of contractual obligations under changed circumstances faced hardships, the elimination of obstacles to the implementation of the contract will be resolved, it seems to modify the contract as a mechanism for the implementation of the contract must be considered unless they agreed to be imposed on them by law or judicial authority. In this case, unless the modification is done by mutual consent, it is modification by legal and judicial means economically, we'll see how the parties to the agreement have wanted to do risk allocation or choose the more efficient ones, that is, which party can a lower cost can bear the risk of changing circumstances and consider same party responsible for it.

Key words: *contractual breach, obligation, compensation, implementing the commitment, contract modification.*

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Introduction

The incentive of contract parties is implementation of the obligations arising from it. But sometimes, for reasons such as treason or negligence of obligor, as well as the loss of a commitment issue, or delay, its implementation becomes impossible so that the other party (obligee) makes losses. In this case, the legislative remedies to compensate the obligee can be predicted, which is conceivable in three ways: (1) the obligation to perform the contract or specific performance (2) compensation (3) contractual modification. Each of these three methods can be useful in their specific situation. In view of the economy, the use of any of these practices with the economic basis under certain conditions and considering the performance and value of that method receive much attention so that at the time of breach of contract, according to the conditions and circumstances that have changed, one of these methods that has most economic efficiency (in terms of contractual justice, such as the assumption that the obligor is intended to perfidy, here economic efficiency for the benefit of the obligee is considered) is chosen. The economic basis for sanctions of violations can be expressed as follows: 1. Pareto efficiency, the measure of this issue deals with the fact that if in determining the sanction, choosing the manner in which one of the parties increase economic prosperity, in such a way that does not damage the other party's welfare, we consider that way. 2. Kaldor-Hicks efficiency; according to this standard, sanction is selected that in addition to the compensation of the obligee, place obligor, despite the lack of performing of commitment, in a better position. According to the description given, in this study, we are going to study carefully the types of sanctions for violation of the obligations, and the economic fundamentals of each of the sanctions are reviewed and then they are studied and explored in our economic analysis. But before addressing the major issues, firstly, we refer to the economic analysis of law.

1. Economic analysis of law

According to the definition of economics: "Economic is allocation of scarce resources of production." According to this definition, since resources are limited, and there are unlimited human needs and desires, therefore, it gives a rational economic choice, so, when rationality is analyzed from an economic perspective, meaning that it is considered, that any person have various occasions to make a choice that is more efficient, in fact, the best option is one that is most profitable. (Badini, 2003, 99); also in the economic analysis of law, to establish the connection between human behavior and legal norms, legal rules are considered as price in the market. And accordingly, analysis of consumer behavior and price is used to analyze the behavior of individuals in legal rules. So the people react to the price of goods and services, and the price is higher (in the same utility), tendency to use the goods or services is reduced and vice versa. For the laws also, if a behavior is subject to civil or criminal sanctions, it is an avoided behavior, and the fines and the costs of it higher, people are less inclined to commit it and vice versa, where the behavior or inserted clause in a contract has higher guarantee and legal protection, naturally, the more likely they are treated (Kotter, 2010, 4).

2. The types of sanctions

2-1. Specific performance

Requiring obligor to perform the obligation in case of violation of contractual obligations is possible when: first, the contract remains valid and commitment to the cause has not been dissolved. Second, when there is the possibility of implementation of commitment, because the obligation and personal responsibility to do impossible is impossible and create pressure on the obligor in this way is futile and irrational. The rules of impossibility of performance of the obligation are custom and habit, thus, any obligation to implement the impossible is void and contract related to this obligation is void, although performance commitment is

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rationally not impossible. If the impossibility of performance results in nullity of the contract only when it is absolute, when it can be neither done by obligor nor another person, otherwise according to articles 222 and 238 of the Civil Code, if the obligor is not able to perform obligation, but the other person could do such a commitment, the commitment by the party obligor will be implemented at a cost by the person obligor indicating as steward of commitment the obligor is not able to implement. Third, the commitment in terms of time for the desired number of frequency (with the time limit), and when it was reached, because as per assumption of that the desired time, after the desired time, doing commitment will be useless; Fourth, the more difficult conditions for commitment due to transformation, when predicating the changes is possible for the obligor; because otherwise in accordance with the principle of autonomy of legal acts and legal rules to comply with the intent of contract (contracts are subject to intent), no one will be forced to do more than what is intended. Fifth, existence of the right of the requirement of obligor to perform a contractual obligation. In case of refusal of commitment required to fulfill the obligation, there is right for the oblige to require its performance, but sometimes due to the exercise of the right of obligor to of commitment, it is not possible in absolute manner and the dependence of the two contract matters, each of the parties has the right to the delay implementation of its commitment until implementation of another party's commitment. The right is among obstacles of specific performance (Shahidi, 2012, 31-41).

2-2. Compensation

Another guarantee of performance of the obligation can be "compensation" and it is conceivable in two ways: 1. the penalty clause, which by agreement of the parties in implementing the provisions of the contract in case of violation by obligor, is mentioned in the contract. 2. Determination of damages by the court, which can be done by referring the matter to an expert. Compensation is usually considered in the hypothetical case where there is no possibility of implementing the principle of commitment; however, in some cases, damage for oblige in obtaining enforcement of the obligation may be the choice offered. When obligor's right to claim damages for non-performance will meet the following four conditions: First, the deadline for the implementation of commitments has expired; second, non-performance resulted in the obliges damage and damage caused by it is not fixed. Third, non-performance is not due to external causes (Force majeure or fault of the oblige or third party); in accordance with Article 227 of the Civil Code, the cause of hindrance should not external be causes and there should be no proof to contrary to the obligor. Fourth, compensation is required by contract or custom or law (Safai, 2013, 206-219). However, if the subject is cash commitment, lack of implementation is subject to special regulations .

2-3. Modification of contract

Modification of contract is method that is neither unduly hard on obligor like original obligation no force absolute performance irrespective of conditions and is also not like method of giving right to terminate contract. Modification is a midway method, which is one of the exceptions to the rule of necessity of contracts (Dorahaki, 2003, 91); binding of contracts is currently not very favorable in view of lawyers and earlier validity of it has been lost and lawyers began to think gradually that, when due to the accident that is unforeseen, value of money degrade or have sharp rise, the court can, by modifying the terms of the contract, change the obligation to fit the economic situation. Also, it was suggested that, if a specific penalty clause in the contract with the real damage caused by the violation of proportionality is not reasonable, the court can change it (Katuzian, 20163, 148).

The second type of is legal one. Modification occurs where it made by law directly or carried out by either party with the right to give it

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(ibid., 71) The contract and Judicial modification take their validity from the law, and it is not the judge could do it directly without the parties explicitly or implicitly asking it. In fact, in judicial modification, the judge interpret the will of the parties within the law (Shams, 2011, 25).

The third type of modification is judicial modification. "Judicial modification in which there is high possibility of dialogue and uncertainty is the case where the judge, citing the implied term of the contract or stopping the injustice and the loss of one of the parties, modifies the terms of the contract appropriate to the circumstances (Katuzian, 2008, 71); in any case, the judge in case of dispute and the proceedings have to interpret and comment on it (Safai, 2013, 157).

Therefore, it can be said that "If the legislator under a general warrant and as a rule, allows the judge to revise the contract, whose balance is disturbed by an unforeseen accident, it is judicial modification" (Hosseinabadi, 1998, 207).

3.Economic fundamentals of contractual sanctions

3-1. Pareto efficiency

Under this criterion, efficient economic operation occurs when at least one person has better conditions than before, without making someone have else worse conditions. (Christopher T.Wonnell, 2000-2001, 6). Pareto criterion is divided into "Pareto optimality" and "Pareto superiority". In this definition, there levels between state of affairs. The "A" is Pareto superiority compared to b only if nobody become worse in shift from A to Band yet at least one due this movement becomes better than before. In other words, "A" has Pareto superiority over "B" if no one prerfer "B" to "A" and at least one person prefer "A" to "B". Pareto optimality of state of affairs occurs when no conditions comparedto that status have Pareto superiority conditions. That is, no movement from Pareto superiority situation causes at least one person have worse conditions (Jules, 1982, 1106-7). In other words Pareto optimality refers to situation concerning where the status of a person doesn't improve unless by worsening the situation of another. So, Pareto optimality refers to a situation in which there is no other possible changes of Pareto superiority type (Klaus, 2009, 32).

Often the parties provide concerning the sanction of penalty clause in the terms mentioned in the contract. So when the parties stipulate the penalty clause, they stipulate their intended sanctions, primarily their economic efficiency should be deemed valid. At the time of signing, the parties are free to enter into contract, so the heavier penalty clause proposed, the more exorbitant prices are charged. So towards the cost of additional prevention (violations), as well as additional risks that should be undertaken (the risk that is due to the heavy duty sanctions of a stronger commitment),the obligor asked for a higher amount (DeGeest, 2000, 742).

3.2- Kaldor and Hicks efficiency

Based on the criteria of Kaldor - Hicks, the economic effieicny of an act realizes when as a result of new efficiencies, some (winners) improve in such a way that even after compensating losers, they also have better conditions. The benchmark utility compared between individuals. In other words, benefits for a person, even if it is harmful to another, cause social welfare increase, so that the benefit can compensate for the harm suffered and his situation remains better than before. The benchmark compares utility between individuals. Nicholas Kaldor and John Hicks saypolicy changes are an improvement when winners of this change could compensate losers and yet remain in better condition (Chridtoper, 2000-2001, 8).

The use of this measure as an economic basis in determining sanctions for violation of obligations so will be as follows: as per case, sanction applied that in addition to compensation for losses incurred by the obligee, obligor also remain in a better position. In other words, this measure can be a measure of "win-win"

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for both sides.

Importantly, problems stem from the economic analysis of law on the criterion of Pareto and Kaldor - Hicks is conflict with the principles of fairness and morality. While these principles in the world of law are valuable and highly regarded.

4. Economic analysis of contractual sanctions

4-1. Specific performance

As previously stated, the specific performance is considered as one of the contractual breach sanctions. This type of sanction is placed against the sanction of compensation of loss due to the breach of contract. One of the problems in the courts in order to determine their losses is that sometimes it is not possible to estimate the extent of damage. But when the Obligor is subject to perform original obligation, the courts has not no problem of determining the exact amount of damages. Because the obligation to do the original commitment, party has to perform commitment required in contract. In terms of economic analysis, in cases where the value of a commitment is highly subjective and personal, commitment to fulfilling the promise is better than compensation for the damage. For example, to deliver a manuscript, to determine the exact amount of damages is not possible for the court, but parable about goods, that are generally of typical value, to determine the amount of damages is more convenient (Kotter, 1389, 348-335). In fact, one of the differences between performing original commitment and order to pay damages is that in performing original commitment, intellectual losses are also compensated. In addition, non-economic damages are not quantifiable by court and the remote damage is not considered as well, but with implementing the original commitment, all these are considered (Ansari, 2011, 502-503).

Of course, type of contract also affect whether or not compensation for breach is efficient. In fact, performing of original commitment is desirable in fully defined contracts (Shavell, 2004, 312)

Run the same commitment, is not always economically desirable. Because the real value of the play is to play efficient, obligor will have an incentive to behave efficiently. (Kotter, 1389, 270), but if not we will be faced with the implementation of contracts that are inefficient.Because in this case the contract are performed only if the running costs is higher than its value, costs are higher than the value of the contract, as foreseen by the parties and considered (Shavell, 2004, 312).

Performing original commitment is not always economically desirable. Because the real value of the performance is equal to efficient performance, obligor will have an incentive to behave efficiently (Kotter, 2010, 270) but if it is not, we'll be faced with the implementation of the contracts that are inefficient.

It is also undesirable to fulfill commitment in incomplete contracts. Because in this case the obligor even if its costs exceed the value of the contract, will be required to execute the contract. For example, if the obligor is to make the table that is worth 1,000 points. But the cost of building is more than 1000 units. Value and utility of contracts for both sides will come down, because the obligee's desk is not worth more than 1000 units, but because of breach of contract, and lack of foresight conditions, obligor will still have to perform the same commitment (Shavell, 2004, 313)

4-2. Compensation

Overall for the compensation to lead to economic efficiency, there would be required to have two features: firstly, the increasing prosperity in the sense that the rules of the compensation so designed that direct the obligation to perform the contract if its efficacy is established and stop it if it is inefficient (Zamir, 2007, 116). Second, the good incentives for parties be create. These occur in obligor and obligee by actions to reduce costs. Compensation rules affect these. For example, if the compensation under contract is high, the obligor makes more caution, but the obligee

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trust contract more, or may not attempt to cut costs. The converse is also true.

4-3. Modificationof contract

The modification of contract means obligor violates one part while performing other part of contract. In other words, modification will be possible when the contract can be implemented, otherwise there will be no possibility of modification.

When value of execution of the contract will result in reduced performance. Here, economic analysis does not recommend performing of contract, but also violations or changes in its provisions, in the form of modifications, they can make an effective contract. (Aalipour Harris, 2013, 103-104): devaluation of contract is imaginablein two ways:

First, the unfortunate event that makes cost of commitment increase in terms of implementation. Such as strikes or increased cost of raw materials (Kotter, 2010, 341), in fact, an occurrence that is considered to be bad in terms of economic analysis, or obligor accident make cost more than the cost of the contract or execution of the contract value is less than the amount of contracts for the obligee (Ansari, 1390, 516).

The second event is pleasant, typically referring to another contract whose profit for the obligor is more than the basic contract, i.e. the obligor offer another contract, which is worth to him more and given that economic efficiency requires that resources the position to shift to most valuable activity, economic analysis, if the obligee damages in the first contract can be compensated, suggests the second contract (Cotter, 2010, 345-347). In fact, when the obligor always have to perform commitment, even if the contract value is law for the two sides and at the same time costs are high, again, he is required to perform and may not direct resources to where efficiency is higher.But if there is a possibility of compensation,obligor chooses between the compensation and the same commitment, and selects the cheapest way, if the damage is fully determined, obligee remains indifferent between compensation and performance of the same commitment. So if it is deemed appropriate criterion for determining the compensation and modification of obligations of the parties, a contract that is ineffective will become a mutually beneficial agreement (Aalipour Harris, 2013, 105)

Conclusion

According to the above expressed, allocation of sanctions for violation of obligations with regard to economic efficiency (taking into account the economic basis) and in certain situations is focus of attention; and not a specific sanction being effective economically all the circumstances. Sanction of "obligation to fulfill the obligation (specific performance)" can only be of the economic efficiency if an obligation is subjective and personal in a way that is not possible for the court to determine the exact amount of damages. When there also intellectual damages are cases where the application of the sanction is the best way of compensation. Use of this method is useful in two cases: first, when efficient breach of contract is faced so that cost of performance is more than benefit for parties, and breach is thus more valuable. The second is where accurately assessing damage is possible like where there is a penalty clause in the contract stipulated by the parties or determined by the court. In the "modification of agreement" by the condition that the contract has been incomplete, the use of modulators (contractual, legislative and judicial) can be economically effective. But what is important in the use of modified contract is how to allocate risks to the parties to the contract. Which party should bear the risk of medication? We allocate risk in two ways: First, the party that has the lowest cost can take precautions so that there is the ability to predict risk for him. For example, in anticipation of a possible breach, the insurance of contract is provided. Second, the responsibility of the party that he may be left with the lowest cost of risk. This assumption is where there is no possibility of predicting risk.

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According to the description of the types of sanctions for violation of obligations, it seems that the economic sanctions of "obligation to fulfill the obligation" and "modification of contracts" are Pareto efficiency while in efficient violation of contract, Kaldor - Hicks basis is more considered.

General economic perspective holds that justice is synonymous with economic efficiency and this point approach with interference of economics and law creates a radically economic view in law in such a way that the sanction of violations from an economic standpoint is concerned that has economic efficiency even if it is outside of morality and fairness. With this approach of applying sanctions, requirement to fulfill the obligation or compensation in domestic law are faced with the challenge of dealing with ethics and fairness and accepting it is a bit difficult, but guarantee for the implementation in form of modification of contract from an economic standpoint is more compatible with the ethics and fairness (as values that are considered in contract law). Therefore, from this perspective receives more attention. Finally, if economic discussions are introduced in sanctions for contractual breaches, although the specific situation of each contract should be considered separately; sanction of modification of contract should be more considered by the courts.

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