



Economic Analysis of the Remedy of Rescission

Dr. Qi Zhou, Lecturer in Law
University of Sheffield



Outline

- Legal background
- Deterrence features of rescission
- Impacts on the incentive structure
- Why using rescission
- Questions for future research



The Remedy of Rescission

- Voidable contract = rescission v. void contract
- The legal consequence: restitution
- Rescission is a remedy for
 - Misrepresentation
 - Duress
 - Undue influence



The effective deterrence

$$Dq \geq G - C$$



$$Dq + C \geq G$$



$$q \geq 1 - \frac{C}{G}$$



Economic features of rescission

- $D =$ the party's expectation interest
- Only q can be increased
- So, the deterrence of rescission is effective, if $q \geq 1 - \frac{C}{G}$
- The higher C , the more effective the deterrence

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Why $q < 1$ in reality: (1)

- Legal restriction
- impossibility
- lapse of time
- affirmation
- the good-faith third party

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Why $q < 1$ in reality: (2)

- Costs of litigation
- The loss of expectation interest
- Uncertainty
- Two type of Legal errors:
 $q < 1$; $q > 1$

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Other incentives

- The victim party's incentive for precaution
- The victim party's incentive for opportunism
- Chilling effect



Why to use rescission

- The high cost of making the contract
- Corrective justice
- An appropriate remedy in consumer transactions
- A policy maker may be more concerned with the chilling effect of the law



Further research questions

- Validity of contract in general
Voidable contract, void contract, void clause
- Combination of private remedies
Damages and rescission
- Combination of public law sanction and rescission



THANKS