

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

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

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

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

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

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

5/11/2009 © The University of Sheffield
