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Contracts of Individuals Who are Incompetent Without Guardianship and the Interpretation of Article 428 of the Italian Civil Code: Is the Court of Cassation Wrong?

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CONTRACTS OF INDIVIDUALS WHO ARE INCOMPETENT
WITHOUT GUARDIANSHIP
AND THE INTERPRETATION OF ARTICLE 428 OF THE ITALIAN CIVIL CODE:

IS THE COURT OF CASSATION WRONG?

A comparison with the U.S. system

by

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1. Introduction

Article 428\(^1\) of the Italian Civil Code, regarding the validity of acts executed by incapacitated subjects, introduced noteworthy debates in the science of law\(^2\) and jurisprudence\(^3\) due to the delicacy of the subject. Indeed, the article extensively embraces the new discoveries of science and developments of society. The identification of new mental illnesses by psychiatrists, the study of particular phenomena such as senile dementia, and the development of a multicultural society in which foreigners require particular protection lead the scholar to constantly adapt the interpretation of this article in order to protect subjects who are not capable of evaluating their interests and controlling their own will. One of the exegetic problems posed repeatedly by this article consists of the reference to the “serious prejudice” set

\(^1\) Article 428, Italian Civil Code: “Acts performed by a person who lacks legal capacity”
Acts performed by a person who though not legally prohibited, lacks, on any grounds whatsoever, including temporarily, legal capacity when the act is performed, may be found null and void at the request of the person concerned or at the request of his or her heirs or successors and assignees, if serious harm is done to the person performing the act.
Contracts can only be found null and void when, on account of the harm deriving therefrom or which may derive therefrom to the person who lacks legal capacity or when on the grounds of the quality of the contract or otherwise, there has been bad faith on the part of the other contracting party.
The action becomes time-barred five years after the date on which the act or the contract is performed. This is without prejudice to any other legal provisions”.

\(^2\)The bibliography review elaborated by QUERCI, L’incapacità naturale all’esame della giurisprudenza: un contrasto tra massime, in Contratto e impresa, V. 28, A. 2012, n. 6, 1466-1489 p., to which reference is made, is extremely exhaustive.

\(^3\)See Footnotes 4 and 5.
forth by Art. 428, paragraph 1, which definitively represents an essential requirement
to eradicate unilateral acts executed by a person who is incompetent but without
guardianship. However, doubts remain as to whether contracts, that is agreements,
also fall under this jurisdiction. The first paragraph of Article 428 of the Italian Civil
Code explicitly refers to unilateral acts, but reference to “serious prejudice” may be
interpreted as also including agreements, which are addressed in paragraph 2 of this
article. In this regard, a difference arose between the science of law and jurisprudence.
In particular, it can be noted that while the science of law deems that
the assumption of serious prejudice also refers to agreements,\(^4\) said interpretation has
been constantly rejected by the Supreme Court\(^5\) which deems that the counterparty’s
bad faith is sufficient to make an agreement voidable.

This work intends to sustain that the interpretation set forth by Art. 428, paragraph 2
of the Italian Civil Code by the Court of Cassation, determines an excess of the
protection reserved to the incapacitated subject, which ultimately translates into un
intended bad consequences. In other words, it can be stated that this excess of
protection is occasionally detrimental to subjects who require protection because
these individuals are naturally incapacitated. It will be shown that the same is true for
the American common law.

\(^4\)P. RESCIGNO, INCAPCITA’ NATURALE E ADEMPIMENTO, Naples, 1950, p. 38; FORCHIELLI, Dell’infermità di
mente, dell’interdizione e dell’inabilitazione, in Comm. c.c.Scialoja e Branca, sub Art. 414-432, p. 63; PIETROBON,
item Incapacità naturale, in Enc. Giur. Treccani, XVI, Rome, 1990 p.5; ALPA and RESTA, LE PERSONE FISICHE ED
I DIRITTI DELLA PERSONALITÀ. LE PERSONE E LA FAMIGLIA, Turin, 2006, l, p. 6. A particular position is taken
by CENDON (by), Infermi di mente e altri disabili in una proposta di riforma del codice civile. Relazione introduttiva
e bozza di riforma, in Giur. It., it., 1988, IV, pp. 117-138, which proposes an amending draft of some paragraphs of
the Italian Civil Code concerning people with mental and psychic illnesses and necessary measures to adopt.
In the discussed article, the risk posed by the provisions set forth by Art. 428 of the Italian Civil Code to produce a
“limiting effect” of a naturally incapacitated individual is obvious. This “limiting effect” is defined by Cendon as
"the risk (...) that the excessive extent according to which acts are annulled, translates—whether to a greater or
smaller degree—to a further source of social discrimination for the "protected" person (if it is true that many
potential contracting parties of a psychically ill subject would refuse beforehand to enter into agreements with a
subject who, afterwards, could simply obtain the invalidation of the act)". Cendon’s thesis is shared in this work
even if, as seen afterwards, the problem, according to the writer, is dealt with in different ways, for legally
incapacitated or disabled individuals, subjects requiring court-appointed guardians, minors, and naturally
incapacitated individuals. The presence of a legal representative allows for the stipulation of a valid agreement
that would not be valid in the case of natural incapacity, since a naturally incapacitated individual does not rely
on a representative. These different cases require different solutions.

\(^5\)See Footnotes 5 and 6.
2. The jurisprudence of the Court of Cassation

The Court of Cassation has embraced an interpretation of Art. 428 of the Italian Civil Code, paragraph 2 for many years. This interpretation appears to go against the reasons for this provision, which consist first of all in protecting an incompetent contracting party. With regard to agreements, the Court has firmly stated a principle according to which the bad faith of a contracting party in full possession of his faculties is sufficient to void the agreement. The serious prejudice, recalled by paragraph 1 of the article, only concerns unilateral acts (for example, wills, or unilateral revocation of a contractual proposal) and not contracts (agreements). This interpretation, far from protecting incompetent individuals, results in serious prejudice, since said subjects are barred from stipulating agreements, simply because the counterparty is in bad faith. Such an agreement would have also been stipulated under normal conditions, meaning by individuals of natural capacity (because it is advantageous for them). In particular, with regard to agreements that re-allocate risks, if the contracting party in bad faith nonetheless risks the annulment of the agreements stipulated with an incompetent subject, it will not stipulate ex ante any agreement with the incompetent subject, since the agreement would be annulled in the case that it appears to be prejudiced against the incapacitated party afterward, but not before stipulation. Instead, if these agreements appear ex post to be advantageous to the incapacitated contracting party but unfavourable to the party in bad faith, the agreement would not be annulled, and, therefore, the party in bad faith would experience a loss. In view of the fact that no profit can be gained from an agreement, this party would not even stipulate an agreement that would be favourable only for the mentally incapacitated.

Decision No. 21050 of the Court of Cassation of 2 November 2004 is particularly significant in these terms. The decree states, “Once ascertained that the third party was aware of the mental incompetence of the other party, there is no reason for the legal system not to allow the annulment of the agreement, despite the fact that the third party may gain benefits or whether he thought to gain advantages.”

This decision seems to be completely lacking an awareness that by depriving the incapacitated party the possibility to stipulate favourable agreements with subjects in

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6 Cassation, 2 November 2004, No. 21050, in Riv. del notariato, LIX, 2005 p. 587, with note by SICILI.
bad faith, prejudice implicitly results. Such a situation is a case of unintended consequences.\textsuperscript{7}

3. Agreements that allocate risks

At this point, it is necessary to discuss a few aspects of agreements in general, since the above considerations do not apply to just any type of agreement. Many agreements have the goal of differently allocating risks, compared with the way these risks would be distributed in the case that a contract is lacking. To provide a simple example of a type of nonconventional agreement, imagine that the owner of a coach pulled by horses used in the city of New York decides to stipulate a weather derivative to decrease the volatility of his profits. He is aware that his profits will decrease with increasing snowfall on the streets of New York. Therefore, there is a negative correlation between quantity of snow and profits. Thus, the subject decides to stipulate an agreement with another party, according to which the counterparty shall pay the owner of the coach pulled by horses a sum of $1000 in case more than 30 inches of snow falls in year X. If instead the quantity of snow is less than 30 inches, and the owner stands to garner significant profits, the owner will pay $1000 to the counterparty. Pursuant to this agreement, the owner of the coach decreases the volatility of his profits, the so-called “variance,” since he will obtain $1000 from the counterparty in case the activity is not profitable. Thus, the volatility of profits is decreased.\textsuperscript{8} Since risk has a particular cost for risk-averse subjects, such an agreement is perfectly reasonable and advantageous for the owner of the coach. The agreement will also be favourable for the counterparty, because she can better bear the risk or even more so because she can stipulate an opposite agreement with another subject boasting different needs and cashing brokerage fees (e.g., an opposite agreement with the manager of a ski facility, whose profits are positively linked to the quantity of

\textsuperscript{7}Similarly, Cassation, 12 July 1991, No. 7784, which provides that “in order to annul an agreement stipulated by a naturally incompetent subject, serious prejudice to the latter is not required, as set forth for unilateral acts, thus the aforementioned element represents in this case, only one of the possible elements that prove bad faith.” The orientation assumed by the jurisprudence is anyhow constant. For example, Cassation, 14 May 2003, No. 7403, in \textit{Gius}, 2003, XX, p.2233. See also Cassation, 11 September 1998, No. 9907 in \textit{Rep. For. It.}, 1998, item \textit{Interdiction}, which sustains that serious prejudice is not a necessary condition to annul agreements stipulated with a naturally incapacitated subject, “thus the aforementioned element represents in this case, only one of the possible elements that prove bad faith.”

\textsuperscript{8}With regard to the concept of hedging, see BODIE and MERTON, \textit{FINANCE}, Upper Saddle River, 2000, p. 285.
fallen snow). As a result, the owner has the opposite interest to receive a sum of money if a small quantity of snow falls during the year.

As a consequence, an agreement of this type, following the mainstream of the Court of Cassation on incompetency, could not be stipulated by an incompetent without a guardianship person—even if the agreement is advantageous to the latter—if the counterparty is in bad faith, even without any prejudice to the incompetent person. Let us assume that the counterparty is in bad faith but intends to propose a fair agreement. All of the incentives of the legal system as interpreted by the Court of Cassation prevent said subject from proposing such an offer. Indeed, if the quantity of snow that falls on the streets of New York in year X exceeds 20 inches, the incompetent subject will not request the annulment of the agreement to cash $1000. If the quantity of snow is less than 30 inches, the incompetent will request the annulment of the agreement to avoid paying $1000. The agreement translates into a certain negative result for the counterparty who is simply in bad faith (meaning that he is aware of the natural incapacity of the counterparty) without taking advantage of this condition. As a result, he will not sign the agreement. The naturally incompetent subject is also prejudiced, because he will not be able to stipulate an agreement that he would have also signed if he were in full possession of his faculties.

Neo-classical economic analysis and economic analysis of law deem that the utility shall be measured before the stipulation, not after. This position is adopted by all state legal systems, like the Italian one, which asserts that pursuant to Art. 1372 Civil Code, “the agreement has legal effects for the parties.” It can be assumed that the same subjects of a legal system would prefer their utility to be evaluated before and not after the stipulation, thus making the agreements binding, and not preventing them from stipulating agreements.

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9 In general, a weather derivative will be more complex compared with the situation described in the text. For example, it will be possible to establish that if 71 cm of snow falls on the streets of New York, then the owner of the coach shall receive $20. If 72 cm of snow falls, the subject will receive $40. In case of 73 cm, the subject will receive $60, and so on. On the other hand, the same would apply even if the quantity of snow is less than 70 cm.

10 Cassation, 6 August 1989, No. 7914; Cassation, 11 September 1998, No. 9007, in Nuova Giur. civ. comm., 1998, I, p.339 with note by D’ANTONIO: according to Cassation, 2 December 1998, No. 6402 bad faith also consists of the intent of the other party to take advantage of the situation to gain benefits in the negotiation. However, recall once again Cassation, 2 November 2004, No. 21050, in Riv. del notariato, LIX, with note by SICILIA, which clearly states that “the bad faith requested by Art. 428 Italian Civil Code, consists in the awareness of a contracting party about the interdiction of the other party, in intellective or volitive terms.”
Another agreement causally aimed at re-allocating risks is the insurance agreement. Pursuant to this agreement, a party pays a fixed sum, called a premium, in order to obtain a higher sum in case of an event that causes damage. Imagine, therefore, that an incompetent (without guardianship) must transport some goods from one riverbank to the other. An insurer offers a competitive insurance agreement to the mentally incapacitated person (assuming competitive insurance companies market), meaning that the premium will be equal to \( pD+C \), where \( p \) is the probability of a detrimental event, \( D \) is the damage that may occur and \( C \) is the minimum administrative cost to manage an agreement. This economic transaction is generally advantageous for a subject, since many individuals are risk-averse and consider the cost to sustain a negative risk higher than \( pD+C \) (the existence of insurance markets proves that individual are often averse to risk). The incompetent would, therefore, benefit from stipulating this type of agreement, since he would eliminate a risk whose cost is higher than the premium paid. However, the insurer who is simply in bad faith, meaning that he is aware of the mental illness or defect of the counterparty, will never propose said agreement. In fact, if the agreement can be annulled simply in force of the bad faith of the insurer, the incompetent subject will request an annulment if the negative event does not occur and thus be refunded the premiums. Conversely, the incompetent will maintain the agreement in effect in case the negative event occurs. According to these conditions, the agreement for the insurer only represents a potential loss; therefore, he will never sign it. An agreement that has no positive payoff in any state of the world could never be favourable for a party. As a consequence, a favourable agreement for a naturally incompetent person will not be stipulated. The fact that the Court of Cassation requires only bad faith and not prejudice in order to nullify an agreement, results in the unintended consequence of damaging a mentally incapacitated person.

The approach would be different in the case of legal incapacity rather than natural incapacity. A legally incapacitated individual relies on a representative with whom a potential counterparty can negotiate in order to stipulate an agreement that is also favourable for the incompetent person. The costs required to obtain “proper

\[11\] Instead, a “fair” insurance agreement is an agreement that requests a premium equal to \( pD \). In this work, the administration cost of the agreement is discussed in order to further clarify the matter. I state in the text that an insurance market must be competitive to have a contract that is good for an incapacitated person, imagining that the contracts are of a standard form and are not tailored to a client. Therefore, a competitive market insures that the contract is fair. I do not imagine that the incapacitated person is able to find the best offer in a competitive market where offers are different.
consent”\textsuperscript{12} are not high. However, incompetents without guardianship do not rely on a legal representative; therefore, obtaining proper consent is expensive (mainly, the subject would need to wait until the condition of natural incapacity ends, at the risk of losing the convenience of the agreement. Otherwise, the subject would need to execute expensive actions in order to eliminate the condition of incompetency). In conclusion, the tendency of the Court of Cassation to make voidable agreements stipulated by an incompetent simply based on bad faith determines damage to the same incompetent subject in some instances.

4. Disappointment and regret

The state of mind of a subject who transferred a risk without damage occurring can be defined as being in a state of disappointment.” As previously mentioned, an example could be the case of a subject who purchased a derivative without later experiencing a negative result, or a subject who stipulated an insurance agreement without suffering any damage afterward.

There is another state of mind to consider, which indicates a previous advantageous condition followed by an unfavourable situation. In fact, a subject may stipulate an agreement and regret it afterward, because his preferences have changed in the meantime. For example, the case may be that a subject who purchases a real estate unit develops preferences later that result in his no longer being happy with the purchase. For example, the location of the building is no longer ideal. In this case, it is possible to talk about “regret.” While regret can be foreseen in an agreement without necessarily making the agreement unfavourable for a party (in the above example, the seller may request a price increase to sustain the risk of revoking a contract and be insured or self-insured\textsuperscript{13}), disappointment, if linked to the possibility of nullifying agreements as in the case of agreements stipulated with incompetents, renders the contract necessarily detrimental for the other party. In fact, an agreement that does not provide any positive result for a contracting party in any state of the

\textsuperscript{12}The concept of “proper consent” was introduced by CRASWELL, Property Rules and Liability Rules in Unconscionability and Related Doctrines, 60 U. Chicago. L. Rev. 1 (1993).

\textsuperscript{13}The concept of self-insurance is well clarified by POSNER and ROSENFIELD, Impossibility and Related Doctrines in Contract Law: An Economic Analysis, 6J. Legal Stud.83, 1977, p.91 and subsequent pages.
world cannot be deemed convenient. This is the reason for which a subject in bad faith will not stipulate an agreement to transfer a risk with an incompetent, even at favourable conditions for the latter. The incompetent is not able to stipulate an objectively profitable (advantageous) agreement for himself.

5. **Serious prejudice, bad faith and the possibility of nullifying an agreement with an incapacitated individual**

The main legal interpretation, contrary to the tendency of the Court of Cassation, deems that a contract (an agreement) stipulated by an incompetent can be annulled in case of serious prejudice and bad faith of the counterparty. The main argument of this theory lies in the idea that Art. 428, paragraph 2 of the Italian Civil Code implies the need to protect certainty regarding the circulation of assets.

An economic analysis of the case set forth by Art. 428 of the Italian Civil Code, paragraph 2, requires one to elaborate on considerations that further clarify the content of this article.

The following hypotheses can be assumed.

1. The agreement causes a serious prejudice, the counterparty is in bad faith and the agreement is valid;

2. The agreement causes a minor prejudice, the counterparty is in bad faith and the agreement is valid;

3. The agreement causes a prejudice, the counterparty is in good faith and the agreement is valid;

4. The agreement does not cause any prejudice, the counterparty is in bad faith and the agreement is valid;

5. The agreement does not cause any prejudice, the counterparty is in good faith and the agreement is valid.

According to the jurisprudence, the agreement is valid only in the last hypothesis, as set forth by Art. 428, paragraph 2 of the Italian Civil Code, while for the science of law, the first two hypotheses are not foreseen by Art. 428 of the Italian Civil Code; therefore, the agreement should be deemed invalid.
Let us now consider the first hypothesis. First of all, it must be pointed out that any consensual agreement, from an economic point of view, is a socially desirable transaction, because it can attain two different purposes alternatively or jointly. When the agreement is not affected by undue influence, fraud or mistake (and the traditional market failures are not present), it is considered valid and attains Pareto efficiency, meaning a change in which nobody loses and someone gains. In this case, social welfare is promoted according to Pareto’s criterion. Scholars of welfare economics underscore how such a change should be socially desirable, because it would be unanimously approved by a citizens’ meeting, since no party would be prejudiced (assuming that there is no social envy or an issue in allocating positional goods). However, the concept most often implemented to establish whether a change is socially desirable is that of efficiency according to Kaldor-Hicks’ criterion, pursuant to which a change is desirable if the sum of all the partners’ benefits, monetized, is higher than the sum of all people’s sacrifices, also monetized. It can be stated that the concept is sometimes desirable according to both criteria, while in some cases it is desirable only according to one of the criteria. For example, an agreement stipulated in a dangerous situation is Pareto efficient because both parties gain more benefits but it cannot be approved according to Kaldor-Hicks’ criterion, since it drives people who are in a potentially dangerous situation to take excessive precautions. The agreement stipulated with a party who is mistaken, but this mistake cannot be recognized, does not satisfy the Pareto criterion, because the mistaken contracting party suffers a loss. However, the agreement satisfies Kaldor-Hicks’ criterion because it ensures the certainty of legal transactions. Therefore, it is correct to state that an agreement can be generally approved because it exclusively satisfies Kaldor-Hicks’ efficiency criterion.

Scholars of welfare economics and economic analysis of law tend to mainly use Kaldor-Hicks’ efficiency criterion. However, as a particular hypothesis, we can consider an agreement stipulated in a perfectly competitive market that does not influence the price of the goods in any way. In this case, the agreement satisfies Pareto’s criterion because the parties’ welfare is improved and also Kaldor-Hicks’ criterion because social wealth increases.

The agreement stipulated by an incompetent that causes serious prejudice to him or herself, upon a preliminary analysis, is an agreement that does not satisfy Kaldor-Hicks’ efficiency criterion in view of the considerations discussed above (meaning due to the possibility of offering an advantageous agreement) and also due to the fact that the serious prejudice makes it probable that the goods are transferred from a subject who evaluates it as more to a subject who evaluates it less, thus decreasing
social wealth. According to this point of view, this movement should not be approved according to a criterion of welfare economics (or economic analysis of law). However, let us also assume that an agreement produces a serious prejudice for the incompetent party. Based upon a slightly more detailed analysis, arguments can be found that can justify the validity of the agreement for this hypothesis. Indeed, despite there being a risk that the asset will go from one subject who values it more to a subject who attributes less value to it, the counterparty can increase the value of the asset by making investments that an incompetent would not make. Let us imagine a real estate unit that is purchased at a very low price and is fully restructured afterward. In this case, the transfer of the asset from an incompetent to another party could be justified in terms of efficiency. The hypothesis is well-known in the legal system. Anthony Kronman\(^\text{14}\) was the first to underscore how a subject who acquires priy information about the value of an asset can hide it from the seller. He can be said to be “in bad faith”. If the bad faith recalled by Art. 428 of the Italian Civil Codeis the awareness that a subject has about the mental illness or defect of the counterparty, we can also talk about bad faith in the case of incompetency, since there is a lack of information similar to the intellectual or volitive lack of an incompetent individual. With regard to the United States, where oilfields are the property of the landowner, Kronman’s\(^\text{15}\) thesis is clearly understood. If the subject who makes significant investments to discover the location of these oilfields notifies the relevant land owner, all of the incentives to search for oil would be lost, with the consequence that the assets producing a value for the community would not be utilized. Therefore, the need to boost investments that increase the assets’ value could justify, in some single cases, the validity of the agreements considered in the first hypothesis.

However, upon a more in-depth analysis, it stands out that such a possibility (considering valid agreements that cause serious prejudice to an incompetent person) could result in many distortions of a vast entity, such as disapproving this option in terms of social welfare.

Incompetency may involve many categories of people, such as individuals suffering from personality disorders, blindness, senility and even the condition of being a foreigner. Should agreements that cause serious prejudice to an incapacitated person be considered valid, the behavior of the latter would most definitely be distorted. A possible hypothesis could be the distortion consisting of avoiding contact with other

\(^{14}\text{KRONMAN, Mistake, Disclosure, Information and the Law of Contracts, 7 J. Legal Stud.1 (1978)}\)

\(^{15}\text{KRONMAN, Mistake, Disclosure, Information..., supra note 13, p.19}\)
individuals, in order to prevent the risk of stipulating prejudicing agreements. Such behaviour would produce a deadweight loss for society, since naturally incompetents would suffer damage without anybody else obtaining a profit (no agreements would be stipulated). Therefore, in view of the distortions caused by a rule that would declare valid any agreements stipulated by an incompetent party and cause serious prejudice to the latter, and also in presence of bad faith of the counterparty, the conclusion must be drawn that such a rule should be considered inefficient in any case. Similar argumentations apply in the case of agreements that cause minor prejudice to the incapacitated party and bad faith.

Kaldor-Hicks’ efficiency criterion is the only criterion that justifies the validity of a seriously or slightly prejudicing agreement for an incompetent party in the presence of good faith. In this case, there is a damaged party, the incompetent. However, a rule of this type is justified in considering the importance of the agreements’ stability in order to make investments that increase the value of the assets purchased from a party in full possession of his faculties. The legal system could foresee the duty of the party in full possession of his faculties to exercise reasonable care. Therefore, in order to deem an agreement valid, the party should sustain certain expenses to verify the incompetency of the counterparty. The Court of Cassation has sometimes referred to this requirement as duty. It can be stated that this duty will be inefficient if it is extremely expensive or if it is too inexpensive, at the same time. The Italian Code already acknowledges intermediate solutions such as the one foreseen for the recognizable mistake in agreements.

6. The concept of prejudice

The concept of prejudice recalled by paragraph 1, Art. 428 of the Italian Civil Code may have two different meanings according to the main legal interpretation.

The term “prejudice” (for example, let us think about a sales contract) may mean the price difference obtained by the incompetent seller compared with the price that he

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16 Cassation, 2 June 1998, No. 5402: “The financial prejudice of a contractual party does not constitute sufficient evidence to prove the counterparty’s bad faith – essential requirement to void it – since it is not unequivocally and indistinguishably inductive of the upsetting and impairment of the volitive or intellective sphere of a party and the intent of the other party to take advantage of the condition, based on the fact that there may be multiple reasons for which a subject wishes to dispose of his assets in a disadvantageous fashion, therefore, the prove based on assumptions of a party’s awareness, according to ordinary due diligence, of the natural incapacity of the other party, requires different serious, precise and consistent proofs, if based on assumptions.”
would obtain in a perfect competitive market. In this case, we assume that the mentally incompetent person would obtain a lower price compared with the price that he would obtain in a perfect competition market.

The term “prejudice” may also mean sacrifice, due to an excessively expensive agreement. In this hypothesis, the incompetent party would pay a higher price (assuming he is the buyer) compared with the price determined in a competitive market. With regard to the second hypothesis, based on the teachings of economic analysis, it cannot be stated that an excessively expensive agreement, as previously indicated, is necessarily inefficient, and, therefore, it must be invalidated or amended. The incompetent subject can be further protected if the legal system creates incentives to individuals with mental illnesses or defects. Let us imagine that an incompetent is released from a particular place in a condition that jeopardises his assets or health. In this case, rules should stimulate entrepreneurs to wait outside the place where the incompetent is located to offer a transport service to a safe place (for example, the home of the incompetent). If social welfare depends on subjects to remain in stand-by mode to offer services to incompetents, then the fee should reflect the stand-by costs—meaning these costs must be reimbursed—and be higher than a fee generated in a perfect competitive market. If the fee is the same as the one proposed in a perfectly competitive market, the individuals would not be able to recover the stand-by costs and would cease the activity. Prejudice would result in regard to incompetent subjects.

By contrast, if there is no need to conceive incentives to maintain subjects in stand-by mode, prejudice would be caused that would be eliminated when the fee paid by the mentally incapable subject was higher than the fee requested in a perfectly competitive market.

7. A comparison with American common law

In the United States, the idea that common law is efficient, meaning that it promotes the overall wealth of society, is fairly widespread. The idea, originally elaborated by the School of Chicago and in particular by Ronald Coase and Richard Posner, was developed by various authors. A comparison with the American common law could, therefore, enlighten scholars of Italian law in regard to the efficiency of the

interpretation of Art. 428, paragraph 2 of the Italian Civil Code provided by the Court of Cassation. Common law is fairly surprising. By examining the Second Restatement of the Law, Contracts 2d, a distinction is found among at least four cases. The first hypothesis is represented by the agreement stipulated by a person who is unable to understand in a reasonable manner the nature and consequences of the transaction (§ 15, No. 1, letter a). In this case, the agreement can be voided regardless of the good or bad faith of the counterparty. Only if the agreement has been partially or totally executed and contains “fair terms” and the counterparty is in good faith can the annulment be partially or totally excluded. This hypothesis is the second made in the Restatement of the Law. However, any contract in the agreement is voidable if the counterparty is in bad faith.

The third hypothesis to examine consists of the agreement stipulated by a person who is unable to act in a reasonable manner in relation to the transaction (§ 15, No. 1, letter b): the agreement can be voided only in case of the counterparty’s bad faith, while prejudice to the incapacitated subject is not required.

These hypotheses concern incompetency unrelated to intoxication from substances. Indeed, in the presence of intoxication from substances (§ 16), the counterparty’s bad faith is always requested, while prejudice to the incompetent is not required.

Therefore, it is possible to conclude that, in line with the legal interpretation of the Italian Court of Cassation, the common law set forth by the Second Restatement of the Law, Contract 2d does not require prejudice to the incompetent individual in order to void the contract, if the counterparty is in bad faith. Incompetence is not required. Only if the counterparty acts in good faith but has reason to know of the incompetency must the contract terms be verified, and if they benefit, the incompetent avoidance is excluded. The general rule without exception set forth by the Second Restatement of the Law would be to always void the contract in the presence of bad faith.

Therefore, in line with the efficient theory of common law, we could conclude that the Court of Cassation follows an approvable orientation in terms of economic analysis of the law. However, it should be noted that the efficient theory of common law has not developed to the point of excluding many uncertainties. Many subjects who contributed in elaborating on the basis of this theory are often in disagreement
with one another.\textsuperscript{18} For this reason, I deem it inappropriate to accept this theory to such an extent that it justifies any rule in economic terms.\textsuperscript{19}

8. Conclusions

The analysis carried out herein appears to highlight how the Court of Cassation chose an interpretation of Art. 428, paragraph 2 of the Italian Civil Code against the ratio of the same provision. Perhaps excessive worries or a moralistic effort led the Court to grant extensive protection to incompetent individuals that in many instances causes damage to said subjects, because it prevents them from stipulating favourable agreements. As noted by Richard Craswell,\textsuperscript{20} if the cost of obtaining “proper consent” is high and the agreement is not favourable for both parties, a sanction can be inflicted to stimulate the counterparty to stipulate mutually advantageous agreements or imperative amendments can be applied to the same agreement. However, the existence of an efficient and mutually favourable agreement does not justify any intervention, even if proper consent\textsuperscript{21} is lacking. This tendency to also sanction mutually favourable and efficient agreements is instead implemented by the Court of Cassation, but fortunately the science of law does not provide for it.

However, the similarity between the interpretation of Art. 428, paragraph 2 of the Italian Civil Code given by the Court of Cassation and the American discipline summarised by the Second Restatement of the Law, Contract 2d is surprising. This element, in fact, leaves more than one doubt.

Nonetheless, in view of the above considerations, we hope that a more careful analysis of the consequences and evaluation of the effects caused by the provisions according to economic logic will lead the Court of Cassation to modify its consolidated legal orientation regarding the meaning assigned to Art. 428, paragraph 2 of the Italian Civil Code.


\textsuperscript{19}\textsuperscript{19}FON and PARISI, Reciprocity-Induced Cooperation, 159 J. Institutional and Theoretical Economics 43 (2003).

\textsuperscript{20}\textsuperscript{20}CRASWELL, Property Rules and Liability Rules ..., supra note 11, pp.6,16.

\textsuperscript{21}\textsuperscript{21}CRASWELL, Property Rules and Liability Rules..., quotation, p. 6.