A contract is typically constituted by an exchange of promises. When the promisor does not deliver the agreed goods or services, contract law protects the promisee’s “expectation interest” by putting the promisee in the position he would have occupied had the promisor delivered. Promisees make contracts because they expect to value the goods or services, but promisees also expect to pay the price. Hence, a disappointed promisee’s expectation interest is the net value of what he expected to get.

Some contract theorists argue that the promisee should get more. These philosophical theorists claim, variously, that the legal or moral structure of contractual obligation requires that contractual promises be specifically performed. According to these critics of the expectation remedy, it is incoherent to hold both that a promisor can bind herself (legally or morally) to perform and that the promisor may breach if she pays the legally set price. Rights may be waived, of course, but waiver requires actual assent by the rights holder, not the compelled acceptance of a legally set and inadequate price.

The literature is imprecise regarding the actual implications of this criticism, so an initial task is to clarify those implications. A right to performance should entitle the promisee to either

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1 Part III below reviews the work of many of these theorists in detail. Their views are briefly summarized here.
Economic theory distinguishes between "contract" and "trade". As an example, parties contract when they agree to sell goods for a price. Parties trade when the seller delivers the goods and the buyer pays.

The promisor's cost either is an opportunity cost or a historical cost. To see the difference, when a third party bids for goods the promisor agreed to sell to the promisee, the opportunity cost of trade is the third party bid that the promisor rejects. When there is no third party, the (historical) cost of trade is the production expense the promisor incurs by delivering the goods. A trade is inefficient when either cost exceeds the value the promisee attaches to the goods.

Proponents of current law and its philosophical critics both agree that the promisee is entitled to the trading gain but they divide over whether the promisee has an entitlement to the nontrading gain as well.

The promisee’s entitlement to the nontrading gain might be protected either by a specific performance award, a punitive damages award, or an award requiring the promisor to disgorge her gain from exit. These "property rights" remedies permit a promisee to share in the nontrading gain because a promisor subject to a legally enforceable duty to trade, or who faces sanctions for not trading, must purchase the promisee’s consent to exit. In fact, however, contract law takes a very different approach. The property rights remedies are either

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4It is important to stress that were the critics’ position accepted, the promisee would only receive a portion of the nontrading gain. As we show below, the promisor always can deprive the promisee of the nontrading gain by trading. Thus, while the promisor must pay a portion of the nontrading gain in order to exit, the promisor also can extract a portion of the nontrading gain by threatening to perform. Thus, when the promisee has a right to performance the parties will renegotiate to share the nontrading gain.
discretionary with the court – specific performance – or seldom awarded – punitive damages and disgorgement. Instead, the law authorizes a promisor to exit from the contract without the promisee’s consent if the promisor pays to the promisee his net lost value; that is, the trading gain. Accordingly, the promisor today appears to captures the entire surplus that the failure to trade creates: the full nontrading gain. The practical implication of the critics’ position thus comes to this: contract law should change such that promisees can share in (get all of?) the nontrading gain.

Even economic contract theorists – who reject the critical attitude of philosophers on this point – accept the characterization of contract law that leads philosophers to be critical – namely that the law permits, and indeed encourages, promisors to capture the full gain from not trading. On the economic view, a promisor should reject trade when the cost of trading would exceed its value to the promisee. Contract law causes this condition to be satisfied by requiring the promisor to pay the promisee’s foregone value. This has been sufficient in the law and economics literature. Scholars there care about the size of the pie, not how it is divided up, and they therefore have been indifferent to the distributional implication of the rights argument that the philosophical critics make.

The moral and the economic theorists are united, therefore, in their rejection of what we call “the dual performance hypothesis”. On both types of contract theory, the promisor, in effect, makes a simple promise: to trade goods or services in return for a price. The failure to deliver, in both theories, thus is a “breach”. The theories disagree normatively. On the economic view, it is enough that the law protects the promisee’s trading gain because this degree of protection causes the promisor to breach only when breach is efficient. On the moral view, restricting the
promisee to his trading gain violates his rights because he also is entitled to the nontrading gain.

The dual performance hypothesis holds that the typical promisor makes a promise in the alternative: either to deliver goods or services in return for a price or to make a monetary transfer to the promisee in place of delivery. The alternative mode of performance, making the transfer, can be explicit, as when the contract contains a liquidated damage clause, or can be implicit, as when the parties accept the legally required default transfer: under it, the promisor must pay the promisee’s trading gain. In both cases, the promisor “breaches” only when she fails to comply with either aspect of her promise: that is, she fails to deliver and she refuses to pay. Put another way, a promisee’s right to performance is a right either to the delivery of the promised goods or services or to the delivery of money. The failure to deliver the goods or services simpliciter thus is not a breach. Contract theorists of both the economic and philosophical bent tend to reject the dual performance hypothesis on the ground that it is at least psychologically and perhaps also ethically implausible: parties, it is said, contract to receive the goods or services associated with trade. We accept this premise but nevertheless argue here that the dual performance hypothesis is well supported.

Our argument in favor of the dual performance hypothesis proceeds along two, intertwined, paths. One path, which is developed in Parts II, elaborates a model of contractual behavior designed to reveal not just that the dual performance hypothesis reflects efficient contracting behavior but also how dual performance generates efficiency and to whom the efficiency gains that are generated inure. Our model produces three results.

First, we recreate the standard result that a transfer term which requires the promisor to pay the promisee’s net gain from trade induces the promisor to trade only when trade is efficient.
We go on briefly to show that parties will accept this transfer term in their contract.

Second, we make the novel claim that promisees share in both the trading gain and the nontrading gain under current contract law. Sharing is effected through the vehicle of a lower contract price. To see how, suppose that the promisee can recover only his expectation (i.e., the trading gain), either through trade or through damages, and recall that the trading gain is the difference between the promisee’s value and the price. Holding the promisee’s value fixed, the lower is the price, the greater is the trading gain. Sophisticated parties recognize that a contract creates the possibility of two categories of gain. Competitive pressure, we show, then compels promisors to reduce the price by the expected share of the nontrading gain that promisee bargaining power permits promisees to command.

This analysis shows that current contract law is more responsive to the claims of its philosophical critics than is commonly realized. Promisees, it turns out, can share in the nontrading gain in two ways. A promisee without a legally enforceable property right to the promisor’s performance (i.e., a promisee under current law) shares in the nontrading gain ex ante, through the price mechanism. A promisee with an enforceable property right shares ex post, through the mechanism of the “exit price” that a promisee with a property right can exact. Thus, the view that current contract law permits promisors to capture the entire nontrading gain is incorrect. The choice between current law and its critics reduces to a second order question: whether it is better for promisees to share ex ante through the price mechanism or to share ex post through the renegotiation mechanism.

Third, we make the additional novel claim that promisees usually prefer sharing ex ante, through the price, to sharing ex post, through renegotiation, because ex ante sharing generates a
higher expected return. This claim implies that ex ante sharing – i.e., current law -- should be the default; parties should be taken to accept contracts that restrict them to their expectation unless they write contracts that give the promisee a right to performance.\(^5\) Another way to put this third claim is that the alternative performance hypothesis is psychologically plausible because the alternative performance contract it postulates often is the maximizing contract. Parties plausibly prefer more to less.

The other path along which our argument travels, which is developed in Part III, seeks to connect the structure of ex ante surplus sharing that our model identifies to the doctrinal rules of the positive law, the immanent normative structure of contractual obligation, and the principles of promissory morality that are implicated by contract law. Here again our argument produces three conclusions.

Fourth, we argue that although the legal sources sometimes express themselves in ways that have misled both economists and philosophers into rejecting the dual performance hypothesis, both the more detailed rules that govern contracts remedies and the outcomes that courts impose under these rules are best interpreted as affirming that hypothesis. Put briefly and a little provocatively, the best interpretation of the positive law casts the expectation remedy as direct rather than substitutionary relief and therefore makes specific performance (properly reinterpreted) the standard remedy for breach of contract.

Fifth, we argue that this interpretation of the doctrine renders the dual performance

\(^5\)In most jurisdictions, current law is mandatory: courts do not enforce contracts for specific performance or enforce penalty terms. The new UCC Article 2 recommends that courts should enforce contracts for specific performance but few states have adopted this reform. The proposed new Restatement of Restitution, in §39, permits courts to order disgorgement as a remedy when justice so requires and when the expectation remedy is inadequate. We argue below that parties should be permitted to contract for specific performance or disgorgement, but that these should not be defaults.
hypothesis consistent with the immanent normative structure of contractual obligation. We reject the familiar suggestions that the expectation remedy merely prices rather than sanctions breach and that contract law, by encouraging efficient breach, betrays its own normative commitments.

And sixth, we argue that the type of ex ante sharing associated with the dual performance hypothesis is morally appropriate for promisors and promisees who interact, as they do in contract, at arm’s length. In making this argument, we take on the core moral objection to the dual performance hypothesis, which is (roughly) that the expectation remedy encourages promisors to behave, within the promise relation, in a self-interested way that betrays the solidarity that this relation should properly involve. We argue, to the contrary, that the thinner form of promissory solidarity associated with the dual performance hypothesis, in which the terms of contractual sharing are cabined by the parties’ ex ante agreement, is appropriate for commercial promises in open, cosmopolitan economies.

We conclude this Introduction with two caveats and a methodological observation. Initially, we analyze commercial transactions. Our paradigm case is an agreement to produce a widget, not an agreement to cook dinner together on Thursday nights. This focus has two consequences. First, it permits us to abstract from the familial and affective claims to which contracts in private circumstances may give rise. It would be a category mistake, for example, to offer $50 to the friend with whom circumstances caused you to miss dinner. It is not a category mistake for the promisors in our analysis to offer money to promisees when the promisors fail to deliver goods.

The second consequence of assuming a commercial transaction is that the assumption
permits us plausibly to assume that the parties in our analyses understand the deals they make and are competent to conclude them. We make this assumption not only for its realism but also for heuristic reasons. To see what is meant, realize that current critiques of contract law implicitly assume full rationality. The concern is that rational promisors use the law to deprive rational promisees of the full nontrading gain. We analyze this core contracting case to show that the concern is misplaced. We have not – noone has – analyzed cases in which promisees subject to current law make systematic cognitive errors, and compared the results in those cases to the requirements of morality.

Our second caveat is that we take the problem from the literature, not from life. Analyses of the expectation interest commonly assume, or more commonly presuppose, that (a) the parties know the values of the relevant economic parameters; (b) the parties know the law; and (c) courts can acquire enough information about deals to protect the promisee’s expectation. We also make these assumptions. Further, analyses of the morality of contract remedies assume, often implicitly, that the parties do not make relation specific investments in the subject matter of the contract, and neither do our parties. We accept the problem as previously set out because life is sometimes like that, and again for heuristic purposes. Our goal is to refute the claim that contract law performs badly even in ideal circumstances. Whether, and if so how, contract law yields results that are inconsistent with morality in less than ideal circumstances is now the task of analysts to show.

Finally, our formal model and our more discursive analysis are each constructed with the other in mind (this is why we say that the two paths of our argument are intertwined). Our model’s account of the structure of contractual sharing is developed to answer to conceptual
concerns about the relationship between contract remedies and contractual solidarity. And our interpretive engagement with the doctrinal, normative, and moral structure of contract aims to elaborate this structure in light of the instrumental interactions between contracting parties that our model highlights. We return to comment on this marriage between economics and philosophy in our conclusion.

Part II models the parties’ contracting problem. Part III interprets the model to show how the positive results that Part II develop clarify the normative issues that occupy the literature. Part IV is a conclusion.

II. A Model of Contracting

1. The Basic Setup

A risk neutral seller and a risk neutral buyer, functioning in an ex ante competitive market, agree to trade an item of personal property. The parties’ contract does not create a property right. Rather, the contract contains two term types and a price. The “action terms” describe the item that the parties expect to trade and set out the delivery steps the seller is to take. These terms determine the cost of a trade. The “transfer term” specifies what the seller must pay to the buyer if the seller does not deliver the item. This term determines whether the parties trade the item or not. The action and transfer terms may be legal defaults or may be explicitly negotiated. As examples of the former, if the contract is silent with respect to the time of delivery, the legal action term requires the seller to deliver in a reasonable time. If the contract is silent with respect to the transfer the seller is to make to the buyer if the seller does not deliver the item, the legal transfer term requires the seller to compensate the buyer in a reasonable manner.
not deliver the item, the legal transfer term is the relevant section of the Restatement of Contracts or the Uniform Commercial Code. The price is a transfer that the buyer must pay to the seller if the parties trade the item. The price divides the total expected gain from contracting.

The parties later observe the realization of two random variables: the seller’s cost to produce (or acquire) the item, and the value the buyer attaches to the item. If the seller chooses to trade, she tenders the item and the buyer pays the price. If the seller rejects trade, she pays the sum the contract’s transfer term specifies. A discussion of the expectation interest cannot get off the ground unless there is an expectation to protect. Hence, we assume that the buyer’s value exceeds the price in at least some states of the world in which the seller prefers not to trade.

The timing of the model is as follows:

$t^1$: The state moves by choosing a default transfer term. The state’s goal is to enact the term that maximizes parties’ gains from trade.

$t^0$: The parties contract. At this time, they decide whether to accept the default transfer term or create their own term.

$t^1$: The parties observe the seller’s cost of complying with the contract’s action terms and the value the buyer would derive from performance of those terms.

$t^2$: The seller chooses whether to trade or to transfer.7

We necessarily analyze contracts that are obligationally but not fully complete. To see what is meant, let $\Theta$ denote the set of possible states of the world that may obtain at $t^1$. Partition these states into two subsets: $\theta_A$ and $\theta_T$. Trade is assumed to be efficient if the actual state $\theta$ that

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7 Under a contract that grants the promisee a right to performance – e.g. a specific performance contract – if the seller rejects trade at $t^2$, there will be a $t^3$, at which the parties will renegotiate to share the nontrading gain.
To clarify this point, we assume that the seller’s realized cost exceeds the price in some states of the world that fall within the descriptor $\theta_A$. A complete contract would set a price for every possible $\theta_A$ state. Since price would then exceed cost in every one of these states, the seller would prefer to trade in all of them. Contracts are incomplete – i.e., some states are left unpriced– because there are an infinite number of possible future states but a finite amount of money to devote to contracting about them.

The seller’s expected cost of producing the item is distributed on $F$ with a mean of $C$. There are two cost categories. If the parties expect that a third party may appear to bid for the item, then $F$ is the distribution of possible bids; if instead the parties expect that the seller’s production cost may vary, then $F$ is the distribution of possible production costs. The buyer’s expected value for the item is distributed on $G$ with a mean of $V$. Since it would be inefficient to contract if the buyer’s expected value is below the seller’s expected cost, we assume that $V$ exceeds $C$.

As of $t^0$, parties expect realized values to equal expected values, so the expected gain from trade is $V - C$. We refer to this expected gain as a “surplus” and denote it $S_a$. Trade is inefficient if the ex post state $\theta$ is in $\theta_T$. Then the seller’s realized cost exceeds the buyer’s realized value. The mean of the cost distribution conditional on the realized state being in $\theta_T$ is denoted $C_H$; and the mean of the value distribution conditional on the realized state being in $\theta_T$ is

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Formally, $S_a > S_t$ and $\beta_a \in [\frac{1}{2}, 1]$. We assume that the state probabilities are exogenous. These assumptions about $S$ and $\beta_a$ importantly differ from the assumptions that underlie the regnant suspicion of the dual performance hypothesis. That suspicion, recall, follows from the view that parties contract in order to receive a performance, not to make a bet. This view is correct, but theorists who reject the hypothesis go on implicitly to suppose that parties at the contracting stage naively assume that the trade they prefer occurs with probability one. On this assumption, a contract need not be in the alternative. In contrast, the sophisticated parties in our model believe that trade is more likely than not, but they also know that trade may turn out to be inefficient. On this view, a promise in the alternative – to perform or to pay – may maximize the parties’ expected return.

Parties make contracts in order to trade, not to speculate on future states of the world. Therefore, we assume that parties expect the trading surplus to exceed the “nontrading” surplus and expect the probability of trade to exceed the probability of not trading.9 Parties behave efficiently if they trade when they are in $\Theta_A$ and reject trade when they are in $\Theta_T$. On these assumptions, the maximum expected surplus from contracting is $S_k = \beta_a S_a + \beta_t S_t$. This is positive because both surpluses are positive.

To complete the model, the parties observe the distributions $F$ and $G$ when they contract, and they observe the realizations of the cost and value variables at $t^1$. If the parties litigate, the court observes whether they have traded, the contract and the buyer’s realized value. Hence, the court can protect the buyer’s expectation: that is, if the seller fails both to trade and to pay the transfer for not trading, and the contract is silent regarding transfers, the court can award the buyer the difference between the value he would have realized from trade and the price.

2. The transfer term

Part 2 first recreates the result that protecting the promisee’s expectation is efficient with

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This point has been made frequently. See, e.g., Richard Craswell. 

Part 3, which is largely new, then exhibits the sharing properties of these contracts.

2.1 An efficient transfer term: Under the contracts we initially model, the promisor can refuse trade if she makes a transfer to the promisee. An efficient transfer term would ensure in expectation that the parties trade if and only if the realized trading surplus exceeds the nontrading surplus. Let the contract price be $p_k$ and the realized cost and value variables be $c$ and $v$. Suppose that the state, which moves first, chooses a default transfer term, denoted $t$, that requires the seller to pay the buyer’s realized expectation if the seller rejects trade: $t = v - p_k$. The seller at $t^1$ would like to reject trade when $c > p_k$, but she must pay $t$ if she does. The seller thus trades if $c - p_k < t = v - p_k$, or if $c < v$, and she rejects trade if $c > v$. Therefore, the default transfer term $t$ induces the parties to capture the greater of the realized trading or the realized nontrading surplus. Since the expected values of $c$ and $v$, as of $t^0$, are $C$ and $V$, parties know that if they accept the legal default, they will realize the maximum expected contracting surplus $S_k$.

If renegotiation is costless, however, then on the information assumptions made here any transfer term that equals or exceeds $t$ is efficient.\(^\text{10}\) For example, consider a transfer term that requires the seller to pay $t = \infty$ if she fails to trade. The buyer’s gain from trade is $v - p_k$. The seller can restrict the buyer to this payoff by trading, at a loss of $c - p_k$. Therefore, the parties will renegotiate to excuse the seller from trading, even when $t$ is very large, if the seller can make a transfer to the buyer that gives the buyer a payoff that exceeds his trading payoff, and gives the seller a payoff that is less than her (negative) trading payoff. Denote the set of such payoffs $X$.

\(^{10}\)This point has been made frequently. See, e.g., Richard Craswell ....
Hence, any \( x \in X \) must satisfy \( v - p_k < x < c - p_k \). The set \( X \) from which any \( x \) is to be drawn satisfies these inequalities if and only if \( v < c \). Hence, even when \( t \) equals infinity, parties renegotiate such that they only trade if trade is efficient.

It is unrealistic to assume that renegotiation is costless, however. The transfer term \( t \) maximizes ex post surplus without requiring the parties to renegotiate. Parties thus prefer \( t \) in a wider range of circumstances than any other transfer term. Therefore, we sometimes refer to \( t \) as the efficient transfer term.\(^{11}\)

2.2 The contract: Parties will accept the legal default transfer term. The contracts we model are the product of bargaining, and we assume the bargaining is Nash: that is, each party’s relative bargaining power is a function of the parties’ disagreement points and their discount rates. The party who can do better outside of the deal commonly does better in it because the other party cannot persuade her to deal unless he accepts a contract that permits her to beat her outside offer. The more patient party also does better because she can wait longer for a favorable offer. For convenience, it is common to normalize the parties’ outside options to zero. It also is common to assume that the parties’ discount rates are equal because commercial parties usually can lend and borrow at the same rates. On these assumptions, the parties will split the expected gain from contracting equally. Importantly, this split is exogenously determined, in the sense that neither party can affect the size of her counter party’s outside option, nor the rate at which the counter

\(^{11}\)Neither party in our model makes a relation specific investment, but the model is sufficiently general to apply to the investment case. When the buyer’s value is verifiable, as we assume, the expectation interest remedy – i.e., the transfer term \( t \) – induces the parties to invest optimally. For a review and analysis, see Alexander Stremitzer, “Standard Breach Remedies, Quality Thresholds, and Cooperative Investments”, Mimeo (2008). There is a question why parties contract, rather than make spot purchases, when markets are thick. Our parties may contract to protect investment, or to insure themselves against any disruption costs that the failure to trade could cause. This latter motivation is analyzed in Alan Schwartz and Robert E. Scott, “Market Damages, Efficient Contracting and the Economic Waste Fallacy”, Forthcoming Columbia Law Review (2008).
party discounts returns to present value.\textsuperscript{12}

Turning directly to the contract, the seller will not sell the item unless the price at least equals her expected cost, and the buyer will not pay more for the item than his expected value. Denote the largest possible gain under the contract as $Z$. Since bargaining power is exogenously set, and implies an equal split, neither party can do better than capture one half $Z$, so the parties want $Z$ to be as large as possible. We have just shown that the parties realize the maximum expected surplus, $S_k$, with the transfer term $t$. Hence, the parties accept the legal default; $Z = S_k$; and the price is $p_k = C + \frac{1}{2}S_k$. The seller receives her expected cost plus one half the expected surplus, and the buyer pays the price and nets one half the surplus.\textsuperscript{13}

3. Surplus sharing

3.1 Surplus sharing and the price:\textsuperscript{14} The entire expected nontrading surplus is positive from a social point of view (no unproductive costs are incurred), but only a portion of this surplus is positive from the seller’s point of view. To see why, recall the renegotiation example above, in which the nontrading surplus exceeded the trading surplus but the transfer term was so large that the seller had to buy her way out of trading by paying the sum $x > v - p_k$ to the buyer. The difference between the payment $x$ and the gain the buyer would have made from trade ($v - p_k$) reflected the portion of the nontrading surplus that the seller had to share, and thus reduced the

\textsuperscript{12}The equal split does not come from outer space, but is the Rubenstein solution to the parties’ complete information bargaining game on the text’s assumptions. The important point is that the split, whether equal or not, is exogenous. This induces the parties to behave cooperatively at the contracting stage: parties who cannot affect how the pie is divided up will cooperate to increase the pie’s size. That the surplus is exogenously determined is a standard contract theory assumption.

\textsuperscript{13}The buyer receives half the expected surplus if $V - p_k = \frac{1}{2}S_k$. Substituting for $p_k$, the buyer receives half the expected surplus if $V - (C + \frac{1}{2}S_k) = \frac{1}{2}S_k$, or if $V - C = S_k$, which must hold because the parties cannot expect to share more than the difference between the promisee’s value and the promisor’s cost.

\textsuperscript{14}The analysis in Part 3.1 assumes that current contract law applies; that is, the buyer is restricted to his expectation when the seller rejects trade.
A competitive market performs the same function ex ante as a very large transfer term does ex post. The market, that is, compels sellers to share because sellers must make competitive offers. Buyers know that a contract creates two possible surpluses: one from trade and one from no trade. A seller who does not offer buyers a share in both surpluses will lose business to sellers who do. This analysis allows us to describe the price more precisely.

\[ p_k = C + \left[ \beta_s \left( \frac{S_t}{2} \right) + \beta_t \left( -\frac{S_t}{2} \right) \right] \]

The first term on the right hand side is the seller’s expected cost, which any price will permit her to recover. The positive first term in brackets is the seller’s share of the expected gain from trade: one half the expected trading surplus times the probability that the parties trade. The negative second term is the price reduction that is necessary in order to grant the buyer a share of the expected nontrading surplus. The value of this term is one half the expected nontrading surplus times the probability that the parties do not trade.

To see how parties share surplus through the price, fix the buyer’s realized value at \( v \) and compare the buyer’s payoffs under two prices: the price \( p_k \) that permits sharing and a price \( p \) that does not. The price \( p \) has the first two terms in \( p_k \) but not the negative last term. Consequently, \( p > p_k \). The transfer term \( t \) requires the seller to pay to the buyer his value less the price if the seller rejects trade. Now consider the buyer’s payoffs under the two prices. If the seller delivers the contract item, the buyer gets his value less the price. The surplus sharing price is lower than the nonsurplus sharing price; hence, when the parties trade the buyer does better under the surplus sharing price than under the nonsurplus sharing price. If the seller fails to deliver the item but
We motivate this assumption in two ways. First, it is commonly said that parties think of performance but
do not think of breach. A buyer with this mind set believes that his seller always performs. Second, the law
defends the buyer's expectation interest. Thus, our candidate buyer expects to realize his trading profit
either because the seller delivers the item or because the seller pays expectation interest damages. As a
result, this buyer believes that he will capture his share of the trading profit with certainty. His mistake is
that a buyer's expectation is his realized value less the price, and the realized value is low in states of the
world in which trade is inefficient.

Regarding the intuition, the efficient transfer term awards to the buyer his value less the
contract price. The lower is the price, the greater is the transfer. Recognizing this, competitive
sellers, who must offer buyers a share in both contractual surpluses, charge a lower price than they
would charge if they had only to give buyers a share of the trading surplus. The price is lower by
the buyer's share of the expected nontrading surplus, which is the negative second term in the
complete expression for $p_k$. Put another way, the seller pays the buyer his share of the nontrading
surplus in the form of a price reduction.

We set out an example to make this analysis concrete. In the example, the expected values
of the relevant variables are $C = 100$ and $V = 150$. Therefore, $S_a = 50$. The mean value of the
seller's expected cost, conditional on cost exceeding value, is 160, and the mean value of the
buyer's valuation, conditional on cost exceeding value, is 130. Therefore, $S_t = C_t - V_L = 30$. We
let the probability that trade is efficient be $\beta_a = .7$, so the probability that the parties do not trade is
$\beta_t = .3$. Using the expression for $p_k$, the surplus sharing price is $100 + .7(50/2) - .3(30/2) = 113$. A
buyer who does not bargain for a share of the nontrading surplus, we now assume, believes that
trade is certain (i.e, $\beta_a = 1; \beta_t = 0$). The no surplus sharing price thus is $p_n = 100 + (50/2) = 125$.

Suppose now that trade turns out to be inefficient and actual values equal expected values.
When the contract price reflects surplus sharing, the transfer term $t$ requires the exiting seller to

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he will capture his share of the trading profit with certainty. His mistake is that a buyer's expectation is his realized
value less the price, and the realized value is low in states of the world in which trade is inefficient.
pay the buyer $v - p_k = 130 - 113 = 17$. Hence, the buyer captures 57% of the nontrading surplus of 30. Now let the contract price be $p_n$, the price that does not reflect surplus sharing. Under the transfer term $t$, the seller exits by paying the buyer his realized value less this high price. The buyer thus gets $130 - 125 = 5$ and captures only 17% of $S_r$. To summarize, competitive pricing permits sophisticated buyers to share surplus materially in states of the world in which trading is efficient and in states of the world in which it is not.

3.2. Moral critiques of contract law and surplus sharing

The view that contract law precludes surplus sharing either is inconsistent with rationality or rests on an undefended premise. Regarding the former defect, rational, informed buyers know that contracting creates two possible surpluses. As a consequence, competitive sellers must offer contracts to these buyers that have the efficient transfer term $t$ and the price $p_k$ that permits a buyer to share materially in the nontrading surplus. Suppose that, as in the surplus sharing example above, a buyer believes that he always realizes his expected gain from trade. We call such buyers naive. A seller who faces naive buyers offers them the higher price $p_n$ and then, in nontrading states, pays to these buyers the relatively low sum that the price $p_n$ together with the transfer term $t$ implies. Thus, the claim that contract law excludes promisees from sharing in the nontrading surplus, because the law protects only the promisee’s expectation, holds only if enough promisees are naive so that sellers can charge noncompetitive prices.

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16 Part III presents a more complete analysis of the moral critiques. We focus here on the positive errors that underlie these critiques.

17 See note 15, supra, for an explanation.

18 The text uses the phrase “enough” because if some buyers are naive while others are not, competition among sellers for the sophisticated buyers could cause noncompetitive naive prices to disappear. See Alan Schwartz. “How Much Irrationality Does the Market Permit?”, 37 J. Legal Studies 131 (2008). Thus a full analysis of expectation interest remedies will sometimes require a market inquiry.
That many naive commercial buyers exist should be established, not assumed. Moral contract theories assume that promisees have the ability to choose action terms that are in a promisee’s best interest; for if promisees make irrational choices regarding the contract’s substance, there seem not to be well grounded property rights to protect. Choosing the action terms, however, requires forward looking thinking. This raises the question why a promisee who is looking ahead will fail to realize that trade under a contract is uncertain, and thus ask how the contract regulates the no trade possibility.

Regarding the undefended premise, contract law’s protection of the expectation interest permits rational promisees to share in the nontrading surplus through the vehicle of a lower contract price. A property right would permit rational promisees to share in the nontrading surplus through the vehicle of an ex post renegotiation. Hence, the alternative performance hypothesis is implausible if parties prefer the sharing game to be played ex post rather than ex ante. We argue below that parties commonly prefer ex ante sharing.

4. The maximizing contract

In this subpart, we compare the promisee’s expected gain under the ex ante sharing contract to his expected gain under the ex post sharing contract, which is denoted a “property rights contract”. We first show that all property rights contracts are the same: the promisee’s share of the nontrading gain is invariant to the type of property rights protection the law or a contract accords him. Then we argue that promisees often prefer contracts that yield sharing through the price to property rights contracts that yield sharing through an ex post renegotiation. Beginning

\[19\text{Under the competitive market assumption, sellers make zero profits in any equilibrium and so will accept any contract that buyers prefer. Since buyers realize the entire surplus from contracting, the contract that maximizes the buyer/promis}ee’s expected payoff maximizes expected surplus, and so is the efficient contract.\]
with our initial claim, a very large penalty is equivalent to the specific performance remedy. Neither remedy causes the promisor to perform inefficiently, and under both she exits by paying to the promisee a sum that is between the promisee’s gain from trade and the promisor’s loss from trading. Similarly, a promisor would trade inefficiently if the promisee’s disgorgement remedy transferred the full gain from not trading to the promisee; but again the promisor escapes inefficient trade by paying to the promisee a sum that is between the promisee’s trading payoff and below the promisor’s disgorgement loss. The bargaining sum the promisee exacts under each of these remedies is a function of (a) the nontrading gain; (b) the trading gain; and (c) the promisee’s (exogenously determined) bargaining power. These three variables do not vary with the particular remedy the promisee invokes to trigger a renegotiation. Hence, the promisee’s payoff is the same under every property rights contract. This result permits the analyst to compare the parties’ expected returns under two contract types: the price sharing contract and any property rights sharing contract.

A promisee/buyer usually has a greater expected return under the price sharing contract. The expected gain from trade exceeds the expected gain from not trading and the probability of trade exceeds the probability of not trading. Therefore, the expected trading surplus exceeds the expected nontrading surplus. The buyer thus has a larger expected gain under the ex ante sharing contract in trading states because he buys his share of the trading surplus with a lower price than the property rights price. In states in which the parties do not trade, the buyer expects to receive his value less the price as damages under either contract type, and the additional share of the nontrading surplus under a property rights contract. The damages part of his return is larger under

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See text at note 9 and note 9, supra, for a justification of these assumptions.
ex ante sharing because the price is lower. The buyer thus does better under ex ante sharing when he believes that the larger gain he makes in trading states plus the larger damages he collects in nontrading states exceed the portion of the nontrading surplus that a property rights contract permits him to acquire. Since the nontrading surplus is lower than the trading surplus, this condition is hard to satisfy.

In the model here, the buyer’s preference shifts to the property rights contract when the share of the nontrading surplus this contract permits him to acquire is the only return he expects to get. This condition obtains when the buyer expects his value in nontrading states to be below the contract price, so there are no expectation damages to collect. To see why this condition is difficult to satisfy, realize that the seller trades when her high cost is below the high property rights price and the buyer collects expectation damages when his value is above that price. Therefore, the seller’s cost can exceed the price while the buyer’s value is below the price when there is a large wedge between the cost and value variables: that is, when the nontrading surplus is so large as to approach the trading surplus. Putting this condition more precisely, a property rights contract maximizes the buyer’s expected return when (a) the buyer’s mean low value is substantially below his mean value (i.e., $V_L << V$); (b) the seller’s mean high cost is substantially above her mean cost (i.e., $C_H >> C$); but (c) nevertheless, the difference between the seller’s high cost and the buyer’s low value is less than the difference between the buyer’s mean value and the seller’s mean cost (i.e., $C_H - V_L < C - V$). Since parties contract to realize gains from trade, not to realize gains from renegotiation, the cost and value variables will satisfy all of these requirements only in unusual cases. Therefore, buyers commonly prefer ex ante sharing to ex post sharing.\(^\text{21}\)

\(^\text{21}\)The Appendix formally demonstrates this reasoning.
To illustrate this preference, return to the example above. We assume that realized values equal expected values and begin with the price under a property rights contract. Unlike the naive promisee in the example above, a sophisticated promisee will recognize that trade is not certain, and that when the seller rejects trade the promisee will share in the nontrading surplus through bargaining. In the example, the seller’s expected cost was 100, the promisee’s expected value was 150 and the probability of trade was .7. The property rights contract permits the seller to recover her cost and her expected share of the trading surplus through the price. The price does not reflect the nontrading surplus because that surplus is shared through bargaining. Hence, the property rights price is \( p = 100 + .7 \left( \frac{1}{2}(50) \right) = 117.50 \).

The buyer’s expected return under a property rights contract is the sum of the expected payoffs when the parties trade and when they do not. The expected trading payoff is value less the price times the probability of trade, or \(.7(150 - 117.50) = 22.75\). When the parties do not trade, the buyer’s mean expected value is 130, so his expectation is this value less the price, which is 12.50. As expected values are assumed to equal actual values, the seller’s cost is 160 so the total expected bargaining zone in nontrading states is 160 - 130 = 30. The buyer must get at least his expectation of 12.50 and the parties expect to split the remaining 17.50 equally. The buyer’s total expected payoff in nontrading states thus is 12.50 + 8.75 = 21.25. The probability that the parties do not trade is .3, so the expected value of the buyer’s renegotiation share is .3(21.25) = 6.38. Therefore, the buyer’s total expected payoff under the property rights contract is 29.13.

The buyer’s expected payoff under the price sharing contract is larger. Recalling that the price under this contract was 113, when the parties trade, with .7 probability, the buyer realizes 150 - 113, so his expected trading payoff is 25.9. When the parties do not trade, the buyer receives 130 - 113 = 17. The probability of receiving this is .3 so the buyer’s nontrading payoff is 5.1. The
buyer’s total expected payoff thus is 31. To be sure, the expected value to the buyer of not trading is 5.1 under a price sharing contract and 6.38 under a property rights contract. But since the probability of realizing the nontrading gain is relatively low, and the probability of receiving the larger trading gain is relatively high, the buyer’s total expected payoff under the price sharing contract exceeds his total expected payoff under the property rights contract.

We summarize this analysis with two Propositions:

Proposition 1: Current contract law permits promisees to share materially in the surplus that the parties’ failure to trade creates.

Proposition 2: If contract law enforced property rights contracts, which also permit promisees to share in the nontrading surplus, promisees would commonly reject these contracts whenever they have an expectation to protect.

We make three further comments. First, these Propositions support the dual performance hypothesis. It is plausible for promisees to permit promisors to perform either the contract’s action terms or the contract’s transfer term when, as is often the case, conferring this discretion on the promisor maximizes the promisee’s expected return. Analysts who reject the dual performance hypothesis commonly say that promisees contract for performance, not for damages. To the contrary, we show that, when values are verifiable, a promisee would prefer a property rights contract only to realize gains from the promisor’s refusal to trade. Second, nothing in our analysis suggests that property rights contracts should be unenforceable. We argue only that they should not be default agreements. Third, promisees commonly prefer property rights contracts when asymmetric information makes enforcing the ex ante price sharing contract difficult. We initially assumed that the parties observe the expected values of the relevant variables (V and C) and the realized values of these variables (v and c). Importantly, the court also observes v. The court thus
can award the buyer $v - p_k$ if the seller refuses to comply with the contract’s transfer term. Now suppose instead that while the parties continue to observe $v$ and $c$, $v$ is unverifiable. Then, the court cannot protect the buyer’s expectation, and the seller has an incentive to reject both trade and transfer. In this case, competition would compel sellers to offer the property rights contract because this contract permits buyers to exact a share of the nontrading surplus through renegotiation.

5. Summary

Contract law’s protection of the expectation interest has different implications than both the economic and the moral theories of contract suppose. Both sets of theories agree that (a) contract law’s protection of the expectation interest induces the promisor to trade only when trade is efficient; (b) contract law’s restriction of the promisee’s return to the trading gain implies that the entire nontrading gain goes to the promisor; and therefore (c) the promisee can share in the nontrading gain only through a renegotiation that the possession of a property right permits him to force. The theories disagree on the morality of excluding promisees from sharing in the surplus that the promisor’s rejection of trade creates. As we show in Part III, economic contract theorists seem indifferent to the distribution of the nontrading gain. Philosophical critics of contract law argue that the promisee is entitled to the nontrading gain. An apparent implication of this view, though not expressed in the literature, is that promisees would contract for property rights protection if they could.

We agree with claim (a) but reject claims (b) and (c). Our contribution is to show that (a’) any property rights contract only permits the promisee to realize a share of the nontrading gain; (b’) the promisee also can share in the nontrading gain under current law because prices are lower when the promisee does not have property rights protection; and (c’) the promisee commonly prefers a
contract that yields surplus sharing through the price rather than through renegotiation because  
price sharing maximizes a promisee’s expected return. These three results support the dual 
performance hypothesis: typical promisors make a promise in the alternative -- either to trade or to 
make a monetary transfer to the promisee in place of trading. The failure to trade thus is not a  
breach.
III. Interpreting the Model: The Doctrinal, Normative, and Moral Structure of the Expectation Remedy

The model in Part II argues that the alternative performance hypothesis best explains how parties contract. A seller/promisor makes a promise in the alternative, broadly speaking: to provide goods or services to the buyer in return for a price, or to make a monetary transfer to the buyer in lieu of performance. We show here that contract doctrine regarding damages and contract law generally are consistent with the validity of the dual performance hypothesis but that contract scholarship by and large incorrectly rejects it.22 We make this argument by interpreting out model – which reveals that the expectation remedy increases the surplus form both trade and non-trade, and that the increases surplus that the remedy enables inures to the benefit of both sellers and buyers. Our argument promotes our broader project, which is to construct not just an economic but a general defense of the expectation remedy. Our justification of the dual performance hypothesis enables us not only to reestablish the result that the expectation remedy is ex post efficient, but more importantly to re-interpret the law’s doctrinal preference for the expectation remedy in a way that renders the doctrinal structure of the law consistent with the normative structure of contractual obligation and the core moral values that connect contract to promise.

Along the path of our argument, we identify several misunderstandings in the existing literature. These misunderstandings are not comprehensive; not every commentator makes every mistake, and some of what others have written is consistent with the main lines of the

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1. The seminal article concerning the perform-or-breach decision, at least for lawyers, is Robert Birmingham, “Breach of Contract, Damage Measures, and Economic Efficiency”, 24 Rutgers L. Rev. 273, 284 (1970). Birmingham argued that a promisor should be permitted to breach the contract and pay expectation damages because such breaches yielded ex post efficiency. An early argument for the efficiency of the expectation remedy concerning other aspects of the contract relation (in particular, the selection of contracting partners and the degree of promisor precaution against involuntary breach) is Richard Craswell, “Contract Remedies, Renegotiation, and the Theory of Efficient Breach”, 61 S. Cal. L. Rev. 629 (1988). These arguments do not show that the expectation remedy is efficient with respect to all aspects of contract behavior, such as investment. Recently, Stremitzer showed that protecting the expectation interest, when contract quality is verifiable, yields efficient investment. See Alexander Stremitzer, “Standard Breach Remedies, Quality Thresholds, and Cooperative Investments”, Mem. (2008).
argument that we develop here. But the core misunderstanding remains and exercises a hold over intuitions concerning contractual obligation that is hard to shake loose, even for those who try. This is the idea that contracts give promisees an entitlement only to what we have called their action terms, rather than to *either* their action *or* their transfer terms. This mistake produces confusions on three levels. On the level of legal doctrine, it promotes the view that promisors who voluntarily perform transfer terms instead of performing action terms breach their contracts and, relatedly, that courts who order promisors to make transfers provide only substitutionary rather than direct vindication of contractual rights. On an analytic level, which considers the law’s immanent normative structure, the mistake promotes the view that the expectation remedy, by encouraging promisors to violate their contractual obligations, prices these violations rather than sanctions them. And by so doing, the law undermines the normative force of the very legal order to which it belongs. Finally, on the level of morality, the rejection of the dual performance hypothesis promotes the view that the legal order governing contracts is hostile to the moral order governing the promises that contracts typically also involve.

We reject each of these propositions. To explain why, we return to the core ideas in our model. These core ideas are: the distinction between a contract’s action and transfer terms; the notion of surplus sharing and the distinction between sharing ex ante and sharing ex post; the result that the promisee shares in both the trading and the nontrading surplus whether he has a right to the seller’s performance of the contract’s action terms or not; and the result that promisees generally prefer not to have property rights in the action terms. Using these ideas, we reinterpret legal doctrine to show that promisors who voluntarily pay expectation damages do not breach their contracts at all and that when courts imposes expectation damages they order direct rather than substitutionary relief. Further, we argue that the expectation remedy sanctions rather than prices breaches, and that the remedy therefore is consistent with the
normative structure of contractual obligation. Finally, we give the expectation remedy an interpretation that renders it formally consistent with putting as much of the morality of promise into contract as one might reasonably want and, moreover, we argue that the form of sharing that the expectation remedy introduces into the contract relation better serves the substantive values associated with the morality of promising than its alternatives, at least for the case of exchanges of promises among self-interested parties interacting at arm’s length in an open, flexible economy.

1. Contract doctrine

The expectation remedy establishes an interpretive presumption that a contract that is silent on the matter should be construed to give the promisor the option to reject trade and instead to make a transfer equal to the net gain that trade would have yielded the promisee. The law reflects an interpretive presumption rather than a rule because, Part II showed, the maximizing contract commonly contains this option; hence, the law takes parties to have created the option unless other evidence makes the interpretation implausible.

Moreover, and critically, our model – through the structure of surplus sharing within contractual relations that it elaborates – reveals that both promises are, equally, actual rather than merely hypothetical, and in particular that the promise concerning transfer is just as real, and just as much actually made by the parties, as the more obvious promise concerning trade. The model vividly reveals the transfer promise, specifically in the fact that buyers share contractual surplus in both the trade and transfer states and that they do so through the same mechanism, namely the contract price. The price functions to fix the value to buyers not just of trade but also of transfer: The efficient transfer term, after all, mimics the gain to buyers from trade, setting the transfer that they buyers are owed according to the value that they ascribe to action minus the price. *The transfer promise is thus just as real – just as much a part of the*
overall agreement – as the trade promise; indeed, it comes into being through the very same terms, which in effect constitute a liquidated damages clause.\textsuperscript{23}

On this understanding of the typical contract, a promisor who declines to perform the contract’s action terms but instead makes a (voluntary) transfer to her promisee equal to his expectation interest does not, all-things-considered, breach the contract at all, but rather keeps it through making the transfer, which is just an alternative way of specifically honoring her promise. By paying, that is, the promisor directly vindicates her promisee’s expectation. Similarly, when a court, confronting a promisor who refuses both to act and to transfer, requires the promisor to pay damages equal to her promisee’s expectation, the court is not ordering substitutionary relief but rather is directly enforcing the contract’s transfer term. The choice between “specific performance” and “expectation damages” therefore involves only the purely interpretive question what content (at least as a default rule) the law takes contractual promises to have: what are called “expectation damages” imply (as a default) a transfer term set at the promisee’s valuation of the contract’s action term; “specific performance” implies a transfer term set at $\infty$.\textsuperscript{24}

The decisional law implicitly adopts this interpretive approach to contract remedies: that the doctrinal preference for expectation damages does not indicate a preference for substitutionary over direct relief but rather establishes an interpretive presumption that making an appropriate transfer constitutes an alternative means of performance. To be sure, this structural feature of contract doctrine is sometimes obscured by the way in which the doctrine is explained – for example, when the Restatement characterizes the expectation remedy as

\textsuperscript{23} This helps to explain the rule that when a contract identifies a particular “remedy” as an alternative to action, this alternative is exclusive only where expressly agreed. See, e.g., UCC §2-719(1)(b) (“resort to a remedy specified by a contract is optional unless the remedy is expressly agreed to be exclusive, in which case it becomes the sole remedy.”) Exclusivity must be express because the price term fixes its own transfer as an alternative to action, and if a contract does not say so expressly, there is no reason to reject one transfer in favor of the other. Of course, there exist doctrinal complexities in this area, and not all courts understand the UCC in the way that our approach recommends. See, e.g., Northern Illinois Gas Co. v. Energy Cooperative, CITE.

\textsuperscript{24} Recall here the renegotiation example in Part II (at note 8). When the transfer term is set at $\infty$, the parties share the nontrading gain through an ex post renegotiation.
“attempting to put [the promisee] in as good a position as he would have been in had the contract been performed, that is, had there been no breach.”

But this characterization is consistent with the correct view because a promisor who rejects trade in favor of making a voluntary transfer of her promisee’s expectation interest typically immunizes herself against legal claims for breach of contract. Courts thus order promisors to pay (expectation) damages only when they have refused to perform both their contract’s action and transfer terms. Using the Restatement’s language, the expectation remedy does put the promisee in the same position (and therefore in as good as a position) as he would have occupied had the promisor performed the contract when the promisor makes a voluntary transfer equal to the value that the promisee placed on action.

The courts’ acceptance of the interpretative approach to contract remedies is illustrated by what courts do in the rare contexts in which contract law (for reasons found elsewhere in its doctrinal structure) presumes that contractual promises exclude transfers as alternative forms of performance, to insist instead that only action counts as performance. Courts then abandon the general preference for “expectation damages.” When voluntary transfer does involve breach, and “expectation damages” cannot be recast as directly vindicating a contractual entitlement but are ineliminably substitutionary, then expectation damages are no longer awarded.

A typical case is Gassner v. Lockett. The defendant seller in Gassner conveyed a parcel of real property to the plaintiff (who did not record the sale) and later reconveyed the same parcel to a third party (who did record the sale) for a higher price. The plaintiff buyer sued, seeking specific performance of the original conveyance, which was unavailable in light of the third party’s good title to the land. The court did not grant the plaintiff “expectation

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25 GET CITE.
26 CAN I FIND CASES?
27 101 So. 2d 33 (Fla. 1958). One of us has discussed Gassner before, see Daniel Markovits, Contract and Collaboration, __ Yale L. J. __ (____), and the discussion here builds on and extends the earlier discussion.
damages” – that is, substitutionary relief based on the plaintiff’s valuation of the land. Instead, the court treated the seller as a trustee for the buyer in respect of the land. The seller’s involuntarily assigned fiduciary duties required him to maximize the land’s value. He could not satisfy this obligation by making a transfer equal to the smaller value that the buyer could have produced. The court thus awarded the buyer damages – now structurally a direct rather than a substitutionary remedy (they were, after all, the proceeds of the buyer’s beneficial ownership of the “trust”) – that were not limited by the buyer’s valuation of the land but instead included any profit the defendant realized from resale. The court, moreover, reached this conclusion although the defendant (an old man) had displayed no bad faith in making the second sale but was merely forgetful of the first. That is, the court granted restitution despite the tort rule that where a defendant’s interference with plaintiff’s property is justified or merely negligent, the plaintiff’s recovery is capped by her loss and that a plaintiff may recover a defendant’s larger gain only where the defendant’s conduct is consciously or intentionally tortious.28 This analysis reveals that the Gassner plaintiff’s restitutionary claim succeeded because it was also, and more fundamentally, a contract claim for specific performance of a contract that did not allow for transfer in place of action. This claim – which receives doctrinal elaboration in the court’s constructive trust – proceeds, like all contract claims, under a theory of strict liability, which is why the defendant’s blameworthiness was irrelevant to the decision.

Gassner thus illustrates that when the law, for an independent reason, rejects the default transfer term associated with the expectation remedy in favor of an interpretation that makes action the only form of performance (or, equivalently, sets the transfer term at ∞), then it abandons expectation damages, which now could only be substitutionary relief, and awards

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28 Compare, e.g., Vincent v. Lake Erie Transp. Co., 124 N.W. 221 (Minn. 1910) (defendant damages plaintiff’s dock while trespassing to save his boat in a storm; plaintiff recovers cost of repairs to dock and not larger value of defendant’s saved boat), with Olwell v. Nye & Nissen Co., 173 P. 652 (Wash. 1946) (defendant knowingly uses plaintiff’s egg-washing machine without permission; plaintiff recovers the labor costs defendant saved by using the machine). CHECK THIS ACCOUNT.
whatever direct relief is possible. The law requires literal action where it can, as in the typical
case of specific performance of land contracts. And where literal action is impossible, as in
_Gassner_, then the law requires a seller to pay money damages that function as the structural
analog to action. These damages treat conduct by the breaching promisor in respect of the
contracts’ action terms as undertaken on the promisee’s behalf. Our earlier claims that
voluntary transfer does not involve breach and that expectation damages are best understood as
the specific enforcement of a contract’s (implicit, but actual) transfer term, therefore receive
further support from the courts’ practice, when voluntary transfer is not permitted and
expectation damages cannot be so understood, to reject these damages in favor of a remedy that
is best understood as a form of direct relief.

In spite of these features of the doctrine, the view that a voluntary transfer is a breach
and that the expectation remedy, because it provides merely substitutionary relief, permits (and
even encourages) breaches whenever they are efficient have surprising staying-power, retaining
their hold even on those who appear self-consciously to try to shake it loose. We give two
examples here of prominent commentators who have recognized that a promisor’s voluntary
payment of the promisee’s trading gain might constitute an alternative form of performance,
but also, in the very same breath, characterized the payment as a remedy for breach, not an
alternative form of specific performance.

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30The modern originator of that theory, Robert Birmingham, introduced the argument for the
expectation remedy’s efficiency by writing that “[r]epudiation of obligations should be encouraged where the
promisor is able to profit from his default after placing his promisee in as good a position as he would have
occupied had the performance been rendered.” See Birmingham, supra note __, at 274. And Richard Posner,
who has perhaps been the theory of efficient breach’s most prominent promotor, cast the efficiency of the
expectation remedy as involving a similar assault on the idea that the law requires contracts to be kept: “If [a
promisor’s] profit from breach would . . . exceed the expected profit to the other party from completion of the
contract, and if damages are limited to loss of expected profit, there will be an incentive to commit a breach.
There should be.” Richard Posner, _Economic Analysis of Law_ (1st ed. 1972) at 57. The most recent edition of
Posner’s _Economic Analysis of Law_, though it reflects many changes in the characterization of the expectation
remedy’s efficiency, retains unchanged the thought that the conduct the remedy encourages, though efficient,
involves a breach of contract, and therefore that the remedy itself provides merely substitutionary rather than
direct relief.
Holmes, in his famous observation that a contract merely creates an obligation in the alternative – as he put it, that “[t]he duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it, -- and nothing else”\textsuperscript{31} – also supposed that this put contract in tension with morality, which requires, simply, that promises be kept. His remark about contract is sandwiched between claims that the suggestion that contracts must be kept represents “the confusion between legal and moral ideals,”\textsuperscript{32} propagated by “those who think it advantageous to get as much ethics into the law as they can.”\textsuperscript{33} Thus Holmes did not follow his doctrinal insight that a contract is merely a legal obligation in the alternative backwards to its source, that the contract itself contains alternative promises, so that making the transfer that the contract requires is a form of performance. As we argue in greater detail below, that a contract contains two promises permits the expectation remedy to put as much ethics into legal doctrine as any other reasonable alternative.

Much more recently, Steven Shavell has similarly identified the doctrinal confusion associated with the idea of “efficient breach” only be drawn back into it. Shavell observes that “because all contracts are incomplete, that is, do not explicitly address many contingencies, one cannot automatically say that a person has made a promise to do . . . a particular thing in a problematic contingency even though the contract in a formal sense imposes an obligation to perform.”\textsuperscript{34} Moreover, he argues, where the costs to the promisor of performing a contract in an unaddressed contingency exceed the value of performance to the promisee, the parties would not have required performance in that contingency if they had addressed it in their contract.\textsuperscript{35} Finally, Shavell observes that “we can deduce from the fact that the party in breach

\begin{footnotesize}
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was willing to pay the expectation measure of damages that [performance cost her more than its value to her promisee, so that] . . . the parties likely would not have stipulated performance had they addressed the contingency that arose.”

Because Shavell believes, plausibly, that “if a contract does not address a contingency, then the moral duty of a party if the contingency arises is determined by what the contract would have said had it provided explicitly for the contingency,” he concludes that the willingness of promisors to pay expectation damages in a particular contingency implies that they have no contractual obligation to perform in that contingency. In effect, Shavell argues that incomplete contracts should be read as limiting promisors’ obligations to perform their action terms to cases in which action is efficient, and that when the law (through the expectation remedy) implies a transfer term equal to the value that promisees place on action, it limits promisors’ action obligations in just this way. But Shavell never quite completes his thought. In particular, he does not reach our insight that the action and transfer terms have equal standing in contractual relations and therefore that an appropriate transfer, and in particular the transfer associated with the expectation remedy, is an alternative form of performance. Nor does he recognize this insight’s central normative significance for contract theory.

Thus, even as Shavell purports to argue that it is not necessarily immoral for promisors to decline to perform their contracts’ action terms and to pay expectation damages instead, Shavell consistently speaks of such conduct as quite generally involving breaches of contract, even when the promisor’s refusal to trade is efficient and so reflects the contingencies that Shavell wishes to impute. This language introduces an internal tension into Shavell’s

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38 Sometimes, the two thoughts appear immediately next to each other, as in the following passage: In other words, under the expectation measure of damages for breach, the seller will fail to perform in the same contingencies as the seller would be permitted not to perform in a complete contract. Accordingly, breach should not be characterized as immoral under our assumptions.

argument: that is, he argues that an efficient promisor refusal to trade both is consistent with the morality of promising and also constitutes a breach. If the conduct in question occurs in circumstances in which the parties (who track efficiency) would have agreed that the promisor need not act, then her failure to act cannot involve a wrong or entitle her promisee to a legal remedy. 39 Put the other way around, Shavell’s remedial views require him to condemn “efficient breach” though his goal is to show that the promisor’s refusal to trade is moral.

This tension in his analysis exists because for him the payment of expectation damages is an epistemic tool rather than a normative feature of the parties’ contractual relation. He writes that when the law makes expectation damages the remedy for breach, then “we as onlookers know that when breach occurs, it must be moral, for we can infer that the cost of performance must have been higher than the value of performance from the willingness of the seller to commit breach”. But this suggests that if courts could measure costs and values directly, then the expectation remedy might be done away with. Put another way, Shavell’s epistemic approach to the expectation remedy cannot justify the view that it is a remedy, and so in his analysis expectation damages are an epistemic tool whose use does not rest on a normatively sound foundation. 40

39 As Shavell himself says, “In committing a breach and paying damages, the promisor would be acting in exactly the way called for by a complete contract.” Steven Shavell, Specific Performance Versus Damages for Breach of Contract: An Economic Analysis, 84 Tex. L. Rev. 831, 867 (2006). But it remains unclear why, on Shavell’s view, conformity to the contract requires the damage payment at all.

40 For a similar argument, see Seana Shiffrin, Why Breach of Contract May be Immoral, ___ Mich. L. Rev. ___, SECTION IA (forthcoming 2008). GET OKAY TO CITE TO FINAL VERSION.
Our approach is preferable – to agree with Shavell that the payment of the promisee’s expectation should be required just when it would be efficient to replace action with transfer, but to see this transfer as an alternative form of performance, and therefore not as a mere epistemic tool but rather as deeply embedded in contract law’s doctrinal, and ultimately normative and moral, structure. Indeed, in this sense, our views are the exact opposite of Shavell’s: whereas Shavell assimilates “efficient breach” to the absence of a moral obligation, we assimilate “efficient breach” to a moral obligation’s performance; and whereas Shavell understands the expectation remedy as a mechanism for identifying cases in which promisors are not obligated at all, we understand the expectation remedy as a the direct enforcement of promisors’ obligations to transfer.

2. The analytic claim

The doctrinal misunderstandings associated with the theory of efficient breach have encouraged a line of criticism which claims that the expectation remedy is inconsistent with the broader normative structure of contract law. This is an analytic point rather than a moral one, referring to the norms immanent in contract rather than to contract’s connection to moral values that reside outside of the law. We take up the morality of the expectation remedy in Part III.3 below. In this Part, we show how our reconstruction of the doctrinal order associated with expectation damages refutes this criticism.

Critics of the expectation remedy argue that the theory of “efficient breach” invites promisors to abandon their obligations when this maximizes overall surplus. As a consequence, expectation damages are the price of a breach rather than the sanction for a wrongful breach.41 Melvin Eisenberg thus remarks of the law’s encouragement of refusals to trade: “if you don’t wish to take a promised action when it is due, because all things considered

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you believe that the cost to you of taking the action would exceed the gain to the promisee, you shouldn’t keep the promise.”

Indeed, Eisenberg, adds, this “is not only an effect of the theory of efficient breach, it is a purpose of the theory.” In its self-presentation, the theory of “efficient breach” encourages the thought, as Farnsworth puts it, that “a ‘mere’ breach of contract is not a ‘wrong.’” Critics (turning the theory of “efficient breach” against itself) insist that this thought is inconsistent with the idea that contracts confer on promisees a normative power to demand performance. Contract’s immanent structure, so the critics claim, commits it to the proposition that breach is objectionable and must be sanctioned, which is the formal opposite of the expectation remedy’s encouraging attitude towards “efficient breach.”

The conceptual core of this criticism lies in the idea that a contract’s action terms exhaustively characterize what performance involves, so that money damages, no matter how large, are substitutionary relief. It is common to hear critics, pursuing the thought that the phenomenon of “efficient breach” places the expectation remedy at odds with the fundamental normative structure of contract, echo approvingly the UCC’s observation that “the essential purpose of a contract between commercial [parties] is actual performance and they do not bargain merely for a promise, or for a promise plus the right to win a lawsuit.” That parties to a contract typically prefer later to trade is true but, as Part II showed, parties also recognize that

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45 UCC s. 2-609 cmt. 1 (2003). A recent example is Melvin Eisenberg, Actual and Virtual Specific Performance, the Theory of Efficient Breach, and the Indifference Principle in Contract Law 93 Cal. L. Rev. 975 1007 (2005). Eisenberg cites an influential treatise on restitution, which claims that “In most contracts, . . . [t]he expectation that deserves protection is the promised performance . . . .” 3 George Palmer, The Law of Restitution s. 15.9 at 440 (1978). This remark of course simply repeats the ambiguity in the UCC comment and, depending on how that ambiguity is resolved, may simply repeat Eisenberg’s mistake. CHECK PALMER TREATISE.
not trading sometimes will make them better off. Hence, another “essential” party “purpose” is to allocate the gain from not trading. The dual performance hypothesis shows that parties do this by permitting the promisor to make a transfer of the promisee’s trading gain in return for the right not to trade when trading would be inefficient. In light of this permission, the analytic criticism of the expectation remedy is quite generally mistaken.

If expectation damages were merely substitutionary, courts that award them would leave promisees with something other than what they have bargained for, and hence (perhaps) would undermine contract’s essential purpose. But because, as we have shown, expectation damages are in fact a species of direct relief – the specific enforcement of a contract’s (implicit) transfer term – courts that award them leave promisees with exactly one of the two possible things that they have bargained for. The expectation remedy, properly understood, therefore does recognize that promisees bargain for performance, and performance is what it delivers to them. The remedy thus is consistent with the UCC’s devotion to vindicating promises with direct relief.

46Here it is worth taking up an additional distinction in the margin. Ian Ayres and Gregory Klass rightly observe, in a context related to the current one, that “there are good reasons why promisors want to implicitly say that they intend to perform simpliciter, rather than that they intend to perform or pay damages . . .” Ian Ayres and Gregory Klass, Promissory Fraud without Breach, 2004 Wisc. L. Rev. 507, 513. Ayres and Klass marshal this observation against views, like ours, that understand contractual promises as (implicitly) promises to trade or to transfer. But although Ayres and Klass are right to observe that promisors typically intend to act, they they do not sufficiently recognize that promisors have two types of intentions: concerning what they intend to do and concerning what they intend to obligate themselves to do. And while contractual promisors may well (for the good reasons Ayers and Klass report) typically intend to act, they have equally good reasons to obligate themselves either to act or to transfer. So Ayres’s and Klass’s accurate observation is not a valid objection to the view of contractual obligation that we develop. We note, finally, that local criticisms aside, our position seems to us friendly to Ayres’s and Klass’s larger project, which, as their title suggests, is to explain how promissory fraud might arise in tort even where there are no violations of contractual obligations (in part because there might not be any contractual obligations to violate). Insofar as contract law focuses specifically on promisors’ intentions to obligate, and promisors may have quite separate intentions concerning what they will do, Ayres’s and Klass’s tort theory fits naturally into a gap that contract necessarily leaves unfilled.
Consequently, the expectation remedy is also consistent with the analytic structure of contractual obligation that this devotion reflects.\textsuperscript{47} To be sure, the expectation remedy encourages promisors to abandon \textit{trade} as efficiency requires. But it does not encourage them to abandon their contractual obligations \textit{tout court}. These obligations, after all, are properly understood to involve promises in the alternative – promises to act or to transfer – and promisors who acknowledge their contractual obligations may wish to honor them by transfer rather than action. The expectation remedy encourages them voluntarily to do so, because it provides that courts confronted with recalcitrant promisors will enforce the obligation to transfer. Rather than undermining the immanent normative structure of contractual obligation, the expectation remedy \textit{directly} vindicates that structure.

\section*{3. The morality of contract: expectation damages, the wrong of breach and contractual solidarity}

The moral criticism of the expectation remedy picks up where the analytic criticism leaves off; it assumes that the expectation remedy provides substitutionary relief to disappointed promisees (setting the substitution amount at a level that encourages breaches), and it adds to the \textit{analytic} claim that this is inconsistent with the immanent normative structure of \textit{contract law} the \textit{moral} claim that this is inconsistent with the external-to-law values.

\footnote{Jules Coleman has recently taken an approach to the expectation remedy that is opposite to ours: his view holds that understanding the expectation remedy along the lines set out by the traditional theory of efficient breach is consistent with the normative structure of contract whereas understanding the expectation remedy along the lines suggested by our view of contract, which he calls the option view, is not. See Jules L. Coleman, Some Reflections on Richard Brooks’s ‘Efficient Performance Hypothesis,’ 116 Yale L. J. Pocket Part 417 (2007). Thus Coleman argues that on the efficient breach theory the expectation remedy follows a \textit{breach} (hence the theory’s name), and therefore the remedy functions as a sanction, remedying an action that the promisor has the power but not the right to do. \textit{Id.} Coleman contrasts this with the option view which, as he understands it, gives promisors not just the power but the right to pay damages rather than perform. Coleman argues that the option view, in our language the dual performance hypothesis, is inconsistent with the basic idea that contracts transfer to promisees the power to demand performance. \textit{Id.}}

We are unpersuaded by Coleman’s rejection of the dual performance hypothesis. Promisees have the power to require promisors to do what they promised to do. If promisors make promises in the alternative, then promisees have only the power to require a promisor to pay if she refuses to trade. Since we show that the typical contract contains two promises, an order to pay expectation damages actually is an order of specific performance. As a consequence, giving promisors a right to transfer rather than to trade poses no more threat to the normative structure of contract than giving promisors a right to do either of any two acts.
involved in the morality of *promising*, which the law incorporates when it makes contractual obligation promise-based.

Thus, moralists claim that a promisor who pays (expectation) damages rather than trades in effect converts her promisee’s interest in the performance to her own benefit.\(^{48}\) Expectation damages, it is said, allow promisors unfairly to profit from something that is no longer theirs. But principles of fidelity or faithfulness require promisors to do what they say they will do. These principles support making specific performance or restitution (its cognate, as *Gassner* revealed) the appropriate remedies for breach of contract. This moral idea has been repeatedly promoted by a broad range of commentators, including economists who doubt the moral foundations of the traditional economic analysis of contract remedies,\(^{49}\) moralists who have accepted that the economic characterization of efficient breaches correctly captures the positive law,\(^{50}\) doctrinalists who emphasize that the expectation remedy renders contract law less solicitous of promisees than tort law is of owners (certainly there is no general tort doctrine of efficient conversion analogous to the contract doctrine of efficient breach),\(^{51}\) and a small but perhaps growing number of courts who have suggested that breaching promisors should be required to disgorge their gains from efficient breaches under the “principle of the law of restitution that one should not gain by one’s own wrong.”\(^{52}\)

This association between the expectation remedy and a morally permissive account of promise-breaking is mistaken. That promisors should be true to their words (and do wrong to break them) does not say what those words achieve: principles of fidelity are not principles of interpretation. The claim that the proceeds which the rejection of an inefficient trade create

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\(^{48}\) CITES: Begin with Friedmann, Laycock, and the EarthInfo court.  

See Richard R.W. Brooks, The Efficient Performance Hypothesis, ___ Yale L.J. ___ (____).  


CHECK CITE AND TEXT.
should be returned to the promisee in “restitution” of a wrongful gain is not an independent argument for restitution but rather expresses an interpretive conclusion about the content of the promisee’s expectations. We show above that the standard interpretive conclusion is incorrect.

The promisee can share in the gains from rejecting trade either through the lower price that a contract which permits the promisor to exit on payment of the promisee’s trading gain requires, or through the renegotiation that a promisee with a right to restitution can force. In the typical case, the promisee’s expected return from contracting is maximized under contracts that make alternative promises. Promisees thus should be taken to have made such contracts unless the evidence proves otherwise. As a consequence, the default contract does not commit a promisor always to trade but rather to trade or to pay damages, efficient breaches thus are not truly breaches, and promisors who profit from them do not profit from wrongs. In this light, the expectation remedy is specific performance of the promise to transfer that (as our model shows) contributes just as significantly to surplus sharing as the promise to trade. The moral critique of contract damages has yet to refute this view.

Moreover, our arguments illustrate that an expectation-based remedial regime in contract law is formally consistent with the most moralistic attitude towards breach of contract, including an attitude that treats every true breach as constituting a tort-like wrong, for which tort-like damages, including even punitive damages, might potentially be available.

There exists a qualitative difference between a promisor who refuses to trade but voluntarily transfers, on the one hand, and a promisor who declines both to trade and to transfer on the other. The first promisor keeps her contract and honors her promissory obligation; the second breaches her contract and acts immorally. And when the expectation remedy is ordered by a court (as opposed to being volunteered by the promisor), then it is not just a price but a sanction – a form of redress for this wrong. Nor need it be the only form of
The difference between ordinary and gross breaches of contract has not always been clearly appreciated by commentators, who have sometimes conflated questions of intent, efficiency, and blameworthiness in ways that our doctrinal and analytic analyses of the expectation remedy help to clear up. Richard Posner, for example, once proposed a distinction between “efficient breaches” and inefficient breaches, which he called “willful breaches,” and suggested that this might justify awarding punitive damages for the willful breaches. However, the conduct Posner called “efficient breach” is no less intentional than the conduct he calls “willful breach,” so that his call for punitive damages cannot be sustained in virtue of the promisors’ intent, and the use of the word willful is in this respect misleading. Instead, the difference between the two

redress. Nothing in our approach rules out that those who truly breach contracts – at least in appropriate cases – do not just come under a duty to remedy their wrongs, but also deserve punishment.

Indeed, our reconstruction of the doctrinal order surrounding the expectation remedy opens this order up to the possibility of punitive damages for breach of contract. Far from encouraging breaches, the expectation remedy (properly understood) re-emphasizes the seriousness with which the law treats contractual promises – it is an integral part of the law’s commitment to directly enforcing such promises (once the promises’ contents have been properly understood). Our argument therefore invites a new inquiry into the proper attitude for the law to take towards true breaches. Again, a promisor who commits a true breach – who neither acts nor transfers – commits an unambiguous wrong. That contract law takes this wrong seriously enough to remedy the wrong directly, by undoing it (by ensuring that one of the alternatives in the contractual promise to trade or to transfer is performed) makes it natural to ask whether the wrong merits legal punishment: whether punitive damages should be available for true breaches of contract, in which promisors refuse both to trade and to pay money.

The question whether punitive damages are appropriate in the case of true breaches is, on our view, therefore just the standard question which civil wrongs are sufficiently serious to warrant civil punishment. This is a difficult question even in tort (where the question of punitive damages is allowed to reach a jury only in the case of gross torts).53 It may be an

53 The difference between ordinary and gross breaches of contract has not always been clearly appreciated by commentators, who have sometimes conflated questions of intent, efficiency, and blameworthiness in ways that our doctrinal and analytic analyses of the expectation remedy help to clear up. Richard Posner, for example, once proposed a distinction between “efficient breaches” and inefficient breaches, which he called “willful breaches,” and suggested that this might justify awarding punitive damages for the willful breaches. However, the conduct Posner called “efficient breach” is no less intentional than the conduct he calls “willful breach,” so that his call for punitive damages cannot be sustained in virtue of the promisors’ intent, and the use of the word willful is in this respect misleading. Instead, the difference between the two
especially difficult question in connection with breach of contract. Where freedom of contract reigns broadly (and can even set the operational boundaries of good faith and fair dealing), it will be very difficult to distinguish gross breaches of contract (for example, bad faith breaches) from breaches – even true breaches, involving a refusals both to act and to transfer – that violate only contract itself.\textsuperscript{54} Moreover, mistakes in the direction of awarding punitive damages where none are deserved threaten both impermissibly to punish the innocent and to undermine the predictability of commercial litigation, thereby undoing many of the efficiency gains generated by expectation damages (including of course the gains associated with substituting transfers for inefficient trades that our model identifies). The concerns require courts to tread carefully. In many jurisdictions, courts have decided that they cannot tread carefully enough, and so in the end declined to venture forth at all. But if punitive damages for gross breach of contract have had a short career in American law,\textsuperscript{55} this is not because of any principled tension between their moralizing nature and the normative structure of the expectation remedy, but rather because of pragmatic difficulties that are internal to the effective articulation and administration of the punitive damages themselves. Again, the expectation remedy – at least as a formal matter – allows contract law to say all the things concerning breach that moralists about promising wish it to be able to say.

\textsuperscript{54} This problem is not nearly so difficult in special substantive contexts, for example involving insurance contracts, where the regulated character of the business entails that much less of the arrangement between the parties belongs to the contract and much more to the implied in law covenant, and where the strategic structure of the interaction makes conduct that constitutes bad faith on any terms more easily identifiable.

\textsuperscript{55} Experiments in awarding punitive damages for breach of contract, begun in the 1970s, were ended, and indeed reversed, by the 1990s. A 1999 survey reported that by then 39 American jurisdictions did not allow punitive damages in contract claims unless the plaintiff established an ordinary and independent tort and that only 12 jurisdictions allowed punitive damages in limited circumstances for tortious breach of contract. GET CITIE.
Accordingly, the moralist argument against the expectation remedy can succeed, if it succeeds at all, not on formal grounds but on substantive ones. There is not a good substantive argument to make, however, unless contracts contain one promise – to trade – rather than two promises – to trade or to transfer. An extravagant statement of the moral critique appears, for example, in Friedmann’s polemical suggestion that the theory of efficient breach is, in principle, equally applicable to property rights, where it leads to the adoption of a theory of ‘efficient theft’ or ‘efficient conversion.’ The analogy works only if a promisee’s entitlement to a promise’s action terms involves the same form of near-total dominion that characterizes an owner’s entitlements concerning her chattels. But the typical promisee has waived the right to such dominance by accepting a contract that creates surplus sharing through the price mechanism.

Moreover, the idea that the promisee has dominion over the promisor’s actions plays an equally central role in the arguments of more modest and deliberate moral critics of the expectation remedy. Indeed, like its doctrinal predecessor, this idea exercises a hold over intuitions that draws commentators back in even as they try to shake loose of it. A recent example is Richard Brooks’s proposal for replacing “efficient breach” with a remedial regime designed to ensue “efficient performance.”

Brooks acknowledges “that both supporters and opponents of efficient breach seem to agree that promise-breaking is morally wrong. They just disagree about the nature of the promises made in contracts.” But Brooks appears to accept the moral critique. Thus he supposes that “it would be surprising if, for most people, contractual promises do not share


Courts have in recent years increasingly made similar noises. As one prominent decision observes, at least where “the defendant’s wrongdoing is intentional or substantial,” the wrongdoer should not be allowed to retain the fruits of her wrong. Earthinfo, Inc. v. Hydrosphere Resource Consultants, Inc., 900 P.2d 113, 119 (Colo. 1995).

Brooks’s efficient performance hypothesis – because it is more carefully elaborated than Friedman’s accusations concerning “efficient theft” – helpfully illustrates what the substantive intuition at the heart of the moral critique of the expectation remedy involves. In order to square contract remedies with the assumed morality, Brooks would give a promisee the right to determine how a promisor conducts herself in respect of a contract’s action terms. Thus, he would make specific performance the standard remedy for breach of contract and allow a promisee who forgoes specific performance to force his promisor to disgorge any

some of the moral imperatives behind promises generally,”\textsuperscript{59} and he assumes that these are imperatives to act rather than to act or to transfer, even going so far as to characterize the latter view (ours) as “morally permissive.”\textsuperscript{60} Indeed, Brooks frames his discussion as an effort to construct a remedy that preserves the efficiency-properties of expectation damages but “is consistent with more robust notions of contractual duty” than those immanent in the expectation remedy; or, as he alternatively puts it, to construct a remedy that “can allow for optimal allocation of resources while achieving a higher degree of moral force than the intermediate level associated with efficient breach.”\textsuperscript{61} In all of this, Brooks, like Friedmann, is concerned to prevent promisors from profiting from the moral wrong involved in substituting transfer for action: “What provokes disapproval of the efficient breach hypothesis,” Brooks says, “are strong moral sentiments that nonperformance of a contractual promise is not a right, but in fact is a wrong, and that promisors should not profit from unilateral exercise of their power to perform or not.”\textsuperscript{62}
gains that the promisor’s rejection of trade created. Indeed, Brooks’s remedy must give the promisee not just an entitlement to the benefits of a promisor’s management of her actions (as in Gassner’s constructive trust) but rather (going Gassner one better) to give them an entitlement actually to control the promisor’s actions. This control includes forcing the promisor to “breach” and then to “disgorge” even when the promisor wishes to trade (in our language, to transfer even when the promisor wishes to act). Together, the two prongs of this remedy secure promisees’ dominion over their promisors’ actions in respect of the promises. In this way, Brooks has constructed a mirror image of the expectation remedy which, like that more familiar remedy, requires the party who chooses how a contracted-for action will be disposed of to internalize the full social costs of his choice. (The expectation remedy makes promises choose between the costs of action to themselves and the costs of non-action to their promisees; and Brooks’s remedy makes promisees choose between the costs of non-action to themselves and the (opportunity) costs of action to their promisors.) This is the central insight of Brooks’s argument concerning economic efficiency.

63 Brooks’s text never makes clear whether he endorses this feature of his remedy-regime. He backs away from the suggestion at a critical juncture, recognizing that “it may seem a little odd to think of promisees forcing promisors to breach their promises and then making them pay for the breach (and, indeed, there is extensive case law discouraging the practice of induced breach,” Richard R.W. Brooks, The Efficient Performance Hypothesis, 116 Yale L.J. 568, 582 (2006), and in a footnote he suggests that his remedy does not, strictly speaking, give the promisee a pure option on his promisor’s performance but instead involves a “Dual Chooser Rule, whereby the promisor’s initial action (choice) can trigger the promisee’s . . . option.” Richard R.W. Brooks, The Efficient Performance Hypothesis, 116 Yale L.J. 568, 582 n.30 (2006). But Brooks, in the very next sentences, hedges his hedge, and suggests that the idea of promisee choice is “not so strange.” Richard R.W. Brooks, The Efficient Performance Hypothesis, 116 Yale L.J. 568, 582 (2006). In any event, the efficiency claims that form the core of Brooks’s argument leave him structurally committed to the unfettered promisee choice that the main text analyzes. As Jody Kraus has pointed out, See Jody S. Kraus, A Critique of the Efficient Performance Hypothesis, 116 Yale L.J. Pocket Part 424 (2007), the symmetry between Brooks’s remedy and the expectation remedy, and therefore the chooser-cost-internalization that is necessary for Brooks’s claims concerning efficiency to get off the ground, will be achieved only if promisees may force promisors to “breach” and “disgorge” in the manner that we describe.
We doubt the efficiency of Brooks’s remedy.\textsuperscript{64} But we are for the moment more concerned with explaining that Brooks’s remedy and the expectation remedy are equally one-sided: they equally imagine that control over contractual trade is vested unilaterally in a purely self-interested party; and they differ as to which party this should be. Brooks’s remedy imports no more cooperation – no greater promissory solidarity – into the ex post contract relation than do expectation damages. Moreover, Brooks’s unilateralism seems to us less attuned to the folk understandings of the promise relation than the opposite unilateralism associated with the expectation remedy. But in a way this is beside the present point because whatever the facts concerning folk understandings turn out to be, it surely runs counter to the central place that freedom occupies in the morality of promising to insist – as Friedmann, Brooks, and other moralist critics of the expectation remedy do insist – that promissory morality requires that ex post control be allocated unilaterally to promisees even where (in the pursuit of their joint interests) promisors and promisees have actually and not just hypothetically agreed otherwise. And our model shows that ordinary commercial contracts – because of the way in which they share surplus in both the trade and transfer states – involve precisely this actual agreement.

\textsuperscript{64}An argument against Brooks’s efficiency claims, in its sparsest and most intuitive form, is the following: As the main text explains, Brooks’s cost-internalization claim is accurate only if promisees have a right to exercise total control over their promisors’ conduct in respect of their contracts’ action terms. Brooks’s remedy thus makes promisees into the managers – with full rights to exercise command and control – of their promisors’ contractually promised actions. Speaking loosely, one might even say that, under the regime Brooks proposes, promisees in effect become owners of their promisors’ businesses in respect of a contract’s action terms. This way of speaking invokes the Coasean theory of the firm, according to which the firm boundary – the boundary between coordination through ownership and managerial control and coordination by contract – is fixed by the balance between the transactions costs of each coordinating mechanism. \textit{See generally}, RONALD COASE, \textit{The Nature of the Firm}, in \textit{THE FIRM, THE MARKET, AND THE LAW} 33, 44 (1988). But now it is inevitable to ask: if the balance of these transactions costs really did make it efficient, as Brooks’s remedy supposes, for promisees to exercise managerial control over their promisors’ actions, those actions would already fall within the promisees’ firms, so that there would be no need for the contracts that Brooks’s remedy seeks to vindicate? Put simply, where the allocation of discretion and control associated with Brooks’s remedy really is efficient, there will be no separate legal entities to begin with and hence no contracts. The expectation remedy produces efficiency across the firm boundary, and Brooks’s regime is, in effect, a re-description of efficient decision-making procedures within it. This argument puts in an industrial organization context our contract argument that parties commonly prefer to share through prices, which assume the existence of independent firms, rather than through property rights renegotiations, which threaten to collapse firm boundaries.
These remarks – and in particular the observation concerning ex post contractual solidarity – lead naturally to the final moral criticism of the expectation remedy that we consider. Unlike the arguments advanced by Friedmann and Brooks, which invoke moral intuitions concerning how to adjudicate the *competition* between promisors and promisees, this argument invokes a moral ideal of promissory *solidarity*, according to which promises (and hence also contracts) achieve their moral value by replacing, or at least dampening, this competition in favor of a more cooperative relation between promisors and promisees. According to this account, the moral value of promises lies precisely in the *ex post* sharing that promises can involve. One of the basic, formal features of promising is that promisors make promisees special for them – they take promisees’ out of the general sea of humanity and become especially attentive to the promisee’s person. As Joseph Raz once observed, promises establish a special relationship between promisors and promisees, and the value of this special relationship plausibly explains why it is not a sufficient reason for breaking a promise that doing so is best overall.65 Perhaps, then, the unilateralism associated with the expectation remedy wrongly eliminates such promissory solidarity, while other remedies (including, but not limited to, traditional specific performance) might make better room for it.

This moral position is implausible if the ex post sharing that it contemplates is presumed to occur in the context associated with ex post sharing in our model. To begin with, as long as the parties can predict what ex post sharing will require of them, they will adjust their bargains ex ante to the fact that they will be forced to share. (And, as our model makes clear, these adjustments will reduce the surplus that is available for sharing.) Moreover, even at the moment that it occurs, such ex post sharing is no more other-regarding or solidaristic than ex ante sharing: it is merely the product of a competitive renegotiation among purely self-interested parties bound to each other in bilateral monopoly as a result of the contract.

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65 CITE to “Promises and Obligations.”
established by their initial negotiations. Indeed, the same features of the situation that make this kind of ex post sharing contravene the parties’ ex ante interests will likely make the negotiations that lead up to it ruthless and manipulative – just the opposite of what promissory solidarity might reasonably be thought to involve.

But contractual sharing ex post may arise in another context also – in which the parties to a contract abandon, or at least constrain, purely self-interested behavior within the contractual relation and instead cooperate in pursuing a fair balance of their interests. This kind of ex post sharing, which we call *cooperative sharing*, is certainly known to contract law – it is displayed by joint venturers or other fiduciaries, for example, as in Cardozo’s famous remark that joint venturers owe one another “the punctilio of an honor.”66 Moreover, it is plausible to suppose that there exists a close connection between contract and cooperative sharing, and in particular that, at least among parties who begin their relations at arm’s length, cooperative sharing can be achieved only ex post, that is, within the solidaristic relation established by an exchange of (contractual) promises.

Cooperative sharing has an at best uncertain appeal for the efficiency-minded. To be sure, a legal regime that supports or even imposes cooperative sharing may serve efficiency in the narrow class of circumstances in which the at least one of the parties cannot anticipate at the time of contracting what the optimal exchange will turn out to involve (and perhaps also cannot verify ex post whether the other party has satisfied whatever standards the contract attempts to set).67 But in the broader class of cases in which performance can be described in advance and is verifiable, cooperative sharing reduces the promisee’s expected return and increases transaction costs. However, efficiency is not the only value, and at least some moralists about contract may be understood to propose another, broader, justification of

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66 CITE TO MEINHARDT v. SALMON,
67 CITE AND GET EFFICIENCY CLAIM RIGHT.
cooperative sharing in contract, based on such sharing’s *intrinsic* moral value. In its most general form, this moralism about contract claims that the morality of promise requires cooperative sharing in *all* promise relations, and that since all contracts contain promises, the morality of promise also requires the law to support, or at least not to undermine, cooperative sharing in contracts. On this view, the moral value of cooperative sharing outweighs the preferences of commercial parties for the unilateralism of the expectation interest.

A moralism that insists on cooperative sharing in contract will naturally oppose the expectation remedy because cooperative sharing *is* undermined by the expectation remedy, as indeed it is equally (if oppositely) undermined by the remedy that Brooks prefers. Both remedies quarantine contractual sharing within the ex ante state and allow one party or the other unilaterally to pursue exclusively her own interests ex post. Indeed, both remedies achieve their efficiencies in part by carrying the competitive relationship that characterizes pre-contractual bargaining into the interstices of the contract relation. We therefore conclude our moral analysis of the expectation remedy by asking how this feature of the expectation remedy stands with respect to the morality of promising. We take up the question of cooperative sharing in contract relations, first demonstrating that an ideal of cooperative sharing is the immanent source of certain moralist attacks on the expectation remedy, and then by assessing whether this ideal is in fact appealing, at least in the special context of commercial contracts.

The most sustained elaboration of this moral criticism of the expectation remedy appears in the work of Seana Shiffrin, who, in a recent article, identified the expectation remedy and the practice of “efficient breach” as one of several places at which contract law unappealing departs from the morality of promising, and who has now elaborated the nature of this departure in greater detail. Cooperative sharing does not figure expressly in Shiffrin’s

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argument, however, and so it takes some interpretive work to show that this ideal is indeed the foundation of her objection to the expectation remedy.

Shiffrin makes two critical observations concerning the phenomenology of the expectation remedy that provide a point of entry to her argument’s deeper structure. First, Shiffrin observes that under the expectation remedy, a contractual promisor who (using our terms) transfers rather than trades leaves her promisee bearing the burden of converting the transferred funds into the action that the contract specifies – in a sales contract, for example, the expectation remedy leaves the buyer bearing the burden of covering – and that such a promisor therefore effectively makes her promisee into her involuntary employee.70 And second, and relatedly, Shiffrin observes that the expectation remedy renders the disappointed promisee still less free. It is not just that she must cover if she wants the goods or services that her contract’s action terms identified, but rather that she falls under a legal obligation to act on her promisor’s behalf. The expectation remedy is connected, both in its doctrinal elaboration and in its immanent structure, to a requirement that promisees act reasonably to mitigate their damages,71 where the demands of reasonableness are often thought to require all mitigation that is joint cost minimizing.72 Shiffrin is hostile to the mitigation requirement: she suggests that a disappointed promisee (whom she casts as having been betrayed) must weigh the promisor’s interests equal to his own in responding to the breach almost literally adds insult to injury.

These characterizations are valid only on the assumption that the typical contract obligates the promisor always to trade. On this assumption, it is possible to characterize the promisee who is given a transfer sufficient for him to cover as acting on his promisor’s behalf (or, as Shiffrin says, acting as her employee). Shiffrin’s assumption, however, is what we

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71 See Seana Shiffrin, The Divergence of Contract and Promise, ___ Harv. L. Rev. ___ (____).
72 CITE TO GOETZ AND SCOTT.
challenge. Our approach to the choice between transfer and trade may naturally be expanded to address the choice of who should cover. A seller who decides not to deliver goods that she makes or grows has a choice: she can pay expectation damages, which permit the buyer to cover, or herself cover by procuring the goods on the market and delivering them to the buyer. Both parties benefit when the cover obligation is assigned to the party who can perform it most cheaply (the resultant increase in the contract’s net expected surplus is shared through the price). Parties thus accept the law’s default mitigation obligation, which has the buyer covering, only when the buyer is the efficient party. A buyer who is required to cover thus is not made his seller’s involuntary employee; rather, the buyer has agreed – actually agreed – himself to make the substitute purchase.

But Shiffrin (unlike Friedmann and Brooks) identifies a non-conclusory ground for insisting that promisors are obligated specifically to act, a ground that sounds in the character of the contract relation. This comes out later in her argument, when she suggests that it is strange that though a promisee generally could not have forced his promisor to enter into a contract by offering to pay the price of the contract’s action terms (a buyer may not force someone to sell by offering to pay the good’s market price), once a contract is made, a promisor may force her promisee to replace her action with someone else’s (a seller may force her buyer to cover). \(^{73}\) It is at least “peculiar,”\(^ {74}\) Shiffrin says, that a promisor enjoys greater

\(^{73}\) This is not quite literally so: A seller cannot require her buyer to cover but only to choose between covering and not getting the good at all. But the law, for example, through the difference between the UCC’s more demanding standard of proof for market based damages and its less demanding evidentiary standard for cover-based damages, does put a thumb on the scale in favor of covering. GET CITES TO UCC. And in any event, this is just a quibble in the current context. Shiffrin is right to observe that the promisee is exposed to unilateral action by the promisor within the contract in a way in which the promisor was not exposed to unilateral action by the promisee without it.

protection against involuntary interference from her promisee without the contract relation than her promisee enjoys against involuntary interference from her within it. “[T]here is no clear reason why after the relationship is formed, [the] nonconsensual behavior [involved in a promisor’s unilateral decision to transfer rather than to trade] should be more morally anodyne than it would have been ex ante.”

Indeed, Shiffrin suggests, such behavior is simply wrong. Shiffrin also makes a second argument against understanding contracts, as we do, to involve promises to trade or to transfer. She observes that promisees typically enter into contracts because they are interested in receiving the specific goods or services that the contracts’ promises specify rather than the generic value of these goods or services, as reflected in the contracts’ transfer terms. Seana Shiffrin, Why Breach of Contract May Be Immoral, ___ Mich. L. Rev. ___ (forthcoming 2008). M-S p. 24. She then invites one to “[c]onsider the absurd result if the payment of expectation damages were the universalized, reflexive response to agreements. No promisee would ever get what she sought. As a further consequence of this universalized response, the agreements would then never be made.” Id.

This argument seems to us simply to involve a mistake. The maxim that we propose is not that promisors will replace trade with transfer but only that they may. And universalizing the right to transfer rather than trade does not produce the result that there will never be trade, or indeed that there will be too much transfer and too little trade. As we have explained: parties contract in order to trade (and expecting to trade) but write contracts which take into account that in some ex post states of the world trading will not be in the parties’ best interests.

Now it is not immediately obvious why Shiffrin would find the asymmetry that she observes inconsistent or troubling. Indeed, one might interpret the promisee’s exposure to unilateral action by the promisor within the contract as simply the natural extension of the promisor’s protection against unilateral action by the promisee without it. One might think that the promisor has, by exercising her right against unilateralism by the promisee, reserved the right to unilateralism for herself. On this view, the promisor’s right unilaterally to replace trade with transfer within the contract is of a piece with her right, without the contract, to refuse the contractual relation tout court. That is the view implicit in our model and our doctrinal arguments, and we shall return to give it a moral interpretation in a moment.

But first we observe that Shiffrin’s concern is justifiable on a different view of the contract relation. According to this view, entering into a contract changes the relationship between contracting parties, so that even where they have approached each other at arm’s

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length, the contract makes their relation *within it* closer than arm’s length. The parties’ duties within a contract are not limited by the content of their express or implied agreement,\(^77\) but instead include an open-ended duty to cooperate, and in particular to cooperate in respect of the contractual trade, which is to say that each party should reasonably respect the interests and motives that led the other to enter into the contract and to adjust to new facts and circumstances in a way that is not purely self-interested, but is instead other-regarding in respect of these motives and interests. This duty explains why Shiffrin thinks that although a promisor may refuse to enter into a contract, including when her potential promisee offers a fair price, she cannot enter and still keep the promisee at arm’s length, reserving the right to respond to new facts and circumstances in a self-interested way. Insofar as a promisor retains the right to transfer rather than to trade whenever this serves her interests, this undermines the cooperative sharing ex post that constitutes the moral essence of the promissory relation, and hence also of contract.

Shiffrin’s view does not commit her to the proposition that every contract necessarily involves cooperative sharing ex post, so that contracting parties may not (and perhaps even *cannot possibly*) agree to cabin their sharing according to their arrangements ex ante, as our model supposes. But Shiffrin’s view that the promisors who transfer rather than trade draft their promisees into their service in just the same way as promisees would do if they could force promisors to contract by offering a market price makes sense only on the assumption that contracts typically, and perhaps even characteristically, do replace arm’s length sharing ex ante.

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\(^77\) Here it is worth noting a contrast between such an open-ended duty to cooperate and the mandatory duty of good faith in performance that contract law imposes. The content of the duty of good faith is limited by the content of the parties promises: good faith forbids each party from exploiting vulnerabilities that arise over the course of a contract relationship in ways that prevent the other from realizing the benefits that the contract confers. Good faith is thus a duty that exists only at arm’s length – a duty not to exploit subsequent events in ways that undermine the division of surplus that the initial arm’s length agreement fixed. Unlike cooperative sharing, good faith does not involve any open-ended obligation to attend to the motives and interests of the other party in ways that extend beyond the division of surplus agreed to in arm’s length sharing, ex ante. ADD CITES CONCERNING GOOD FAITH.
with cooperative sharing ex post. This view commits Shriffrin to the paternalistic view that the law should override the parties’ preferences in order to force them to be good.

To understand this objection, consider the circumstances in which the positive law applies a cooperative model of ex post sharing within promisory or contractual relations: marriage and, more generally, joint ventures. Sharing in these relations is expressly not cabined (and indeed by their natures cannot possibly be cabined) by the terms of the agreements that establish them: something that is self-consciously announced by the language of the marriage vow – “for better or for worse” – and by the fact that (as we have noted) joint venturers owe each other fiduciary fidelity. Sharing is not cabined ex ante because such relations involve the adoption of a shared project: a family, in the case of marriage; and a business enterprise, in the case of a joint venture. The promises that establish such relations involve commitments to treat these shared projects as non-instrumentally valuable. The parties to them agree to pursue the projects (at least in some measure) apart from the contributions that the projects make to their antecedent or independently specifiable interests – as measured by these interests, they quite literally agree to pursue the shared projects for better or for worse. And in these cases something like Shiffrin’s analysis of breach applies. A promisor who transferred rather than traded would betray the joint venture’s shared project in favor of precisely the antecedent purely personal interests that the project was intended to replace, and vindicating her promisee’s expectation interests would similarly measure the value that she placed on performance in a metric that the initial contract agreed to abandon. But note that the betrayal is of the relation that the parties ex ante agreed to establish. The law requires cooperative behavior ex post to implement the parties’ ex ante preference for a sharing regime. And most parties, in most circumstances, will not prefer this regime.

\[78\] Note that marriage is considered a joint venture as a matter of positive law. This matters for the legal management of ante-nuptial agreements. GET CITES.
Thus, even purely personal promises seem intuitively often to involve only ex ante sharing cabined by the terms of the promise rather than cooperative sharing ex post. Suppose, for example, that a sports-lover promises to treat her opera-loving friend to a performance of Pelléas et Mélisande, and that when she goes to buy the tickets she learns that only unexpectedly expensive seats remain available and therefore decides not to give the treat. What ought she now to do? To be sure, she cannot vindicate her promise by giving her friend a cash payment equal to the value that he ascribes to seeing the opera. But the reason why the ordinary morality of promising balks at such cash payments is not necessarily that it rejects the idea of equivalent performance, tout court, but only that introducing money payments into personal relations quite generally has commodifying and alienating effects, and hence is quite generally taboo. Moreover, suppose that the promisor discovers that Rodrigue et Chimène is playing across town, that ordinarily-priced seats remain available there, and that her friend loves both operas equally. If she unilaterally substitutes the second opera for the first, has she committed a wrong, or indeed even broken her promise?

We think that, save in unusual circumstances, she has not. Ordinarily, an arrangement of this sort is best understood as a promise to give her friend a treat of a certain (rough) cost and value. As it turned out, delivery of the treat that the promise expressly named – the analog of trade – was unexpectedly, and inefficiently, expensive, and so the promisor substituted an alternative performance – the analog of transfer – that made her friend whole and cost her less. That there is no breach may be seen intuitively by observing that, although the promisor might in this case owe her friend an explanation for the change, she would not, once the explanation

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79 The same effect may readily seen in a tort-like context, for example, when a dinner guest breaks one of his host’s wine glasses. Although the guest clearly has a duty of redress, paying the host the cash value of the glass will not satisfy it (and may even make matters worse). Moreover, although the guest might satisfy my duty by giving the host a replacement glass, he might also (and indeed better) make redress by providing some alternative (and roughly equivalent) gift, for example of a bunch of flowers or a box of chocolates.
had been given, owe any further *apology*. Indeed, if the friend sought to extract an apology then he, and not she, would conventionally be thought to be violating the norms implicit in their relationship. Things might be different if the friends were both opera-buffs whose promises established the shared project of finally seeing *Pelléas et Mélisande*, as the personal equivalent of a joint venture. In this case, the friends have made a commitment to seeing that particular opera as a non-instrumentally valued shared goal, and so the first friend might be unable to acquit herself of her part in the plan by substituting another opera of equivalent instrumental value. But most personal promises, we think, are more like the original case than like the modification. They are viewed by those who make and receive them as instruments useful in pursuing antecedent and independent purposes, and they may therefore be honored by means alternative to those that they expressly name.

Moreover, we are quite confident that, whatever turns out to be the case in the personal realm, this instrumental account better captures the character of commercial promises – and hence of contracts – than the non-instrumental alternative associated with the joint venture model. The parties to contracts typically do view both their contracting partners and the trades that their contracts’ action-terms describe as instrumental (and hence in principle interchangeable) means in the pursuit of commercial ends that pre-date, and are not altered by, the commitments that the contracts establish. This is as it should be.\(^80\) Contract law’s moral (and not just economic) purpose is to enable coordination on neutral terms in an open and pluralist economic and political order, which requires that it is at least in principle possible for contracts to arise between parties on either side of every economic and political dispute within

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\(^80\) One of us has previously argued that contracts establish a certain form of joint activity among the parties to them, that this activity is characterized by sharing the end of achieving the contractual performance, and that this sharing underwrites the contract relations moral worth. See Daniel Markovits, Contract and Collaboration, __ Yale L.J. __ (____). But the kind of sharing described there remains quite different from the ex post cooperation associated with a view like Shiffrin’s. It is confined within the contract, and has its content fixed by the terms of the contract, and it is therefore much thinner than cooperative sharing (a point emphasized by calling such sharing collaboration and expressly rejecting the idea that it involves cooperation, see Id. at __).
that order. And contract law can be open in this way only if parties may engage one another contractually without ceding control over their larger purposes – that is, while cabining whatever sharing they accept ex ante, and in particular without committing themselves to cooperative sharing ex post, in service of non-instrumental values that they have had to agree on in making their contracts. One might even say, now focusing on contract law’s connection to liberty rather than to neutrality, that a legal order that insisted on cooperative sharing ex post would be inconsistent with freedom of contract: it would convert the contract relation into a kind of organic community, almost a status order, which, even if it might be avoided entirely, could not be freely shaped and limited by the parties to it.

Indeed, the tension between the modes of sharing associated with ordinary contract and cooperative sharing is greater still. To see why, observe that the mode of sharing involved in promise and, a fortiori, contract is incompatible with there being a total identification between the parties – this is just a way of characterizing the familiar thought that to make a promise to oneself is impossible. Moreover (although this will likely be a more controversial claim), promissory and contractual sharing are also difficult to establish among parties who, although not totally self-identical, nevertheless posses very close antecedent connections. In the personal realm, for example, it is difficult to make effective promises within fully companionate marriages, because both partners’ commitments to maximizing their joint outcome (viewed as a non-instrumental value) mean that any promissory rights that might arise between them will immediately be waived when this is no longer, from the point of view of the couple, best overall. And in the commercial realm, there exist narrow limits on freedom of contract within fiduciary relationships, because the self-interest that lies at the core of contractual sharing is incompatible with the cooperative attitudes required by the fiduciary

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81 CITE TO CONFLICTS RULES IN LEGAL ETHICS, FOR EXAMPLE, AND POINT OUT THAT CORE CONFLICTS ARE NON-CONSENTABLE.
Cooperative sharing, on Shiffrin’s model, therefore does not just present an alternative to the thinner forms of solidarity associated with contractual sharing as we understand it; rather, where it arises or is imposed, cooperative sharing makes contractual solidarity impossible. Shiffrin’s model is therefore strictly speaking *incompatible* with the forms of sharing associated with contract.

The ex ante sharing associated with the expectation remedy and the view that contracts involve promises to trade or to transfer therefore better matches not just the economic but also the moral purposes of contract than does Shiffrin’s alternative. For these reasons, we reject cooperative sharing ex post as the right model of the contract relation. Instead, the substantive values associated with promissory morality, when applied to the special case of contractual promises, favor arm’s length, ex ante sharing. Moreover, our economic model reveals that contracting parties who engage in arm’s length sharing ex ante will produce agreements that do not support fetishizing trade over transfer but rather, to the contrary, support the expectation remedy’s approach of allowing promisors to honor their promises by performing the promises’ transfer terms instead of acting. This is a case in which the morality of promising aligns with the economics of contract. These reflections suggest that in addition to being formally consistent with taking a moralistic view of contract law, the expectation remedy (properly understood as an interpretive presumption) is also consistent with promissory morality’s substantive ideals, at least when these are applied to the ordinary circumstances of commercial contracting.

**IV. CONCLUSION**
We have develop a series of interconnected economic, doctrinal, analytic, and moral arguments to defend the expectation remedy, as it is conventionally understood in contract law, against a set of recent attacks that argue in favor of replacing the expectation remedy with a regime that gives promisee’s property rights in the performance of a contract’s action terms.

These attacks assume that a promisor make a simple promise, to trade the relevant goods or services, so that the failure to trade entails a breach. We show, in contrast, that the dual performance hypothesis follows from the assumptions regarding contracting that the critics presuppose. In particular, parties agree to permit promisors either to trade under the contract’s terms that describe trade or to make a transfer to the promisee in the amount of the gain that he would have realized had trade been efficient. This agreement should be taken to exist, we show, because competition requires sellers to offer it when and because the agreement maximizes the promisee’s ex ante return from contracting.

Our doctrinal argument pursues an interpretive engagement with contract law which reveals that, in spite of sometimes explaining itself in misleading terms, the law operates in a way that is consistent with the two-promises approach elaborated in our economic model, so that voluntarily paying expectation damages is an alternative form of performance, so-called “efficient breaches” of contract are not in fact breaches at all, and the expectation remedy is best understood as a special case of specific performance. With this doctrinal background in place, we show that the expectation remedy is analytically consistent with the immanent normative structure of contract. Moreover, we argue that the expectation remedy is also formally consistent with taking a moralistic approach to contract law, according to which true breaches of contract are wrongs that can qualify for punitive damages. Additionally, we argue
that the ex ante sharing associated with the expectation remedy best captures the substantive ideals behind promissory morality, at least as these ideals are worked out for the case of promises among strangers in open, pluralist economic and political orders. Together, these arguments renew the overall case for making expectation damages the standard remedy for breach of contract. They affirm the positive law.

Finally, although our argument’s main focus is trained firmly on the merits, we conclude with a methodological observation. Economic and philosophical approaches to private law generally tend to display opposite strengths and weaknesses: economic approaches capture the law’s instrumental appeal, but they tend to neglect the law’s formal existence as a structure of rules and meaning and hence risk presenting an unappealingly reductionist picture of law, overall; philosophical approaches, by contrast, capture the law’s rule based structure and its immanent meanings, but they tend to neglect that law is also an important tool for serving extra-legal ends and hence risk presenting an unappealingly unworldly picture of law.

Our argument aspires to exploit the strengths of both approaches while avoiding the weaknesses of each. Thus, although we begin with an economic model that is driven by the law’s instrumental properties, we elaborate the model with an eye to characterizing the law’s instrumental properties in terms – specifically concerning the immanent structure of contractual surplus-sharing – that invite non-instrumental interpretation. Then, when we take up philosophical ideas concerning the formal structure and moral meanings of legal rules, we apply philosophy’s reconstructive techniques to a set of doctrinal understandings arrived at with the law’s instrumental powers and purposes in mind. These features of our argument emphasize the appeal that interdisciplinary work holds: the possibility that when several
disciplines engage one another, each will help the others to avoid certain characteristic failings, so that the whole of the interdisciplinary argument is greater than the sum of its more conventional parts.

October 20, 2008

Appendix

Write the promisee/buyer’s expected return under the price sharing contract as

\[ \pi(B_{p}) = \beta_s(V - p_k) + \beta_t(V_L - p_k) \]. The first term on the right hand side is the buyer’s expected gain in trading states and the second term is the buyer’s expected gain in nontrading states. The buyer’s expected return under the property rights contract is

\[ \pi(B_{p}) = \beta_s(V - p) + \beta_t \left[ (V_L - p) + \frac{(C_H - V_L) - (V_L - p)}{2} \right] \]. The first term on the right hand
side again is the buyer’s expected payoff in trading states. The second term is the buyer’s payoff in nontrading states: the first term in brackets is the buyer’s expectation and the second term is the buyer’s share of the remaining nontrading surplus.

The question is whether \( \pi(B_{pk}) > \pi(B_p) \). Define the left hand side (LHS) as the ex ante sharing contract plus the first term in \( \pi(B_p) \),

\[
\text{LHS} = \beta_a V - \beta_a p_k - \beta_a V + \beta_a p + \beta_t V - \beta_t p_k - \beta_t V + \beta_t p
\]

This simplifies to

\[
\beta_a (p - p_k) + \beta_t (p - p_k)
\]

Note that \( \beta_a + \beta_t = 1 \). The second, sharing, term in brackets in the property rights contract is the RHS. Simplifying,

\[
\text{RHS} = \beta_t \left( \frac{S_T}{2} \right) (\beta_a + \beta_t) = \beta_t \left( \frac{S_T}{2} \right)
\]

because \( \beta_a + \beta_t = 1 \). Recalling that \( S_T = C_H - V_L \), LHS > RHS if \( V_L > p \).

Recalling that \( p > p_k \), the buyer prefers the ex ante sharing contract whenever he expects to have an expectation to protect: that is, whenever he expects that his value will exceed the price in every state of the world. Thus, property rights sharing is better for the buyer when he
expects his value in nontrading states to be below the price, so that he would realize no gain without a property contract. This contract permits the buyer to force a renegotiation, and so extract some of the nontrading surplus. Further, the seller trades if the contract price exceeds her high cost. Therefore, the condition for property rights contract to be better holds when $C_{H} \cdot p > V_{L}$. Recalling that $p$ is the sum of the seller’s expected cost and one half of the relatively high expected trading surplus, the property rights contract thus is better only when $C_{H}$ much exceeds $V_{L}$ but $C_{H} - V_{L}$ remains lower than $V - C$. 