

Texas Law Review

Volume 84, Number 4, March 2006

Articles

Specific Performance Versus Damages for Breach of Contract: An Economic Analysis

Steven Shavell*

When would parties entering into a contract want performance to be specifically required, and when would they prefer payment of money damages to be the remedy for breach? This fundamental question is studied here and a novel answer is provided, based on a simple distinction between contracts to produce goods and contracts to convey property. Setting aside qualifications, the conclusion for breach of contracts to produce goods is that parties would tend to prefer the remedy of damages, essentially because of the problems that would be created under specific performance if production costs were high. In contrast, parties would often favor the remedy of specific performance for breach of contracts to convey property, in part because there can be no problems with production cost when property already exists. The conclusions reached shed light on the choices made between damages and specific performance under Anglo-American and civil law systems, and they also suggest the desirability of certain changes in our legal doctrine.

I. Introduction

When would parties entering into a contract want performance to be specifically required, and when would they prefer payment of money damages to be the remedy for breach? I study this fundamental question here and come to a conclusion based on a simple distinction between two types of contracts: contracts to *produce* new goods or to provide services;¹ and

* Samuel R. Rosenthal Professor of Law and Economics, Harvard Law School. I thank Melvin Eisenberg, Allen Ferrell, James Gordley, Christine Jolls, Louis Kaplow, and Eric Posner for comments; David Katz and Gary Lee for research assistance; and the John M. Olin Center for Law, Economics, and Business at Harvard Law School for research support.

1. I will often refer to this category of agreements simply as contracts to produce things even though I mean to include contracts to provide services as well.

contracts to *convey* existing goods or other property.² Setting aside qualifications, the conclusion that I reach is that parties would tend to prefer the remedy of damages for breach of contracts to produce things, whereas they would often favor the remedy of specific performance for breach of contracts to convey property.³

This conclusion will help us to understand the choices made between damages and specific performance under Anglo-American⁴ and civil law systems⁵ and suggests the desirability of certain changes in our legal doctrine. The conclusion and the analysis underlying it differ significantly from those in previous writing, as I will indicate after describing the organization and content of the Article.

I begin in Part II with a theoretical, economically oriented examination of damages and specific performance.⁶ The question that I address there is what the parties to a contract would want the remedy for breach to be. The point of departure for the analysis of this question is that contracting parties should in principle agree *ex ante* to choose the remedy that would maximize the joint value of the contract to them—where the joint value is the value gained by the parties less any expenses, costs of bargaining, and risk-associated disutility. The parties should want to maximize joint value essentially because if a proposed remedy does not lead to the highest joint value, *both* parties can be made better off by agreeing to another remedy, generally after making a suitable price adjustment. If, for instance, they were contemplating specific performance but that remedy would lead to lower joint value than a damage measure, both the seller and the buyer can be made better off by changing from specific performance to the damage measure,

2. As will be discussed, I focus on contracts where the good or service is not readily available for purchase or sale on an organized market. But I address the possibility of cover within the context of contracts to produce things in section II(D)(2).

3. A different and, for some purposes, a better statement of the conclusion is that parties will tend to want damages to be the remedy when the reason for breach is high cost (as could only be true for a contract to produce) and would tend to prefer specific performance to be the remedy when the reason for breach is sale to an outside party (as could be true either for a contract to produce or for a contract to convey).

4. For an overview of equitable relief for breach of contract under the Anglo-American legal system, see generally JOHN D. CALAMARI & JOSEPH M. PERILLO, *THE LAW OF CONTRACTS* §§ 16.1–.6 (4th ed. 1998), E. ALLAN FARNSWORTH, *CONTRACTS* §§ 12.4–.7 (3d ed. 1999), and EDWARD YORIO, *CONTRACT ENFORCEMENT: SPECIFIC PERFORMANCE AND INJUNCTIONS* (1989).

5. For information on specific performance in France and Germany, the two civil law countries discussed in this Article, see generally KONRAD ZWEIGERT & HEIN KÖTZ, *INTRODUCTION TO COMPARATIVE LAW* 472–79 (Tony Weir trans., 3d rev. ed. 1998), John P. Dawson, *Specific Performance in France and Germany*, 57 *MICH. L. REV.* 495 (1959), and Guenter H. Treitel, *Remedies for Breach of Contract (Courses of Action Open to a Party Aggrieved)*, in 7 *INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW* §§ 16-7 to -39 (Arthur von Mehren ed., 1976).

6. The analysis is economic in the sense that, first, it is a systematic consideration of how parties would be expected to behave in the face of legal and other incentives and, second, it sometimes makes use of numerical examples. I do not believe that readers will have any difficulty following it.

after lowering the price to compensate the buyer if the buyer is made worse off because the seller no longer guarantees performance.

I initially consider the choice of remedy in the context of contracts to produce (say, a contract to excavate a construction site). Here I explain that specific performance involves four disadvantages that would often lower joint contractual value.⁷ First, sellers might have to perform even though performance is very expensive (suppose that an excavator unexpectedly encounters hard rock) and outweighs its value to the buyer. Of course, in such circumstances, sellers might also negotiate for their release, but that would involve bargaining costs and might not result in an agreement. Second, the prospect of these problems associated with high production expense might lead sellers to take wasteful avoidance steps (such as purchasing rock-crushing machines even though the expenditure is intrinsically uneconomic). Third, the possibility of having to pay large amounts for releases if performance would be very expensive (or worse, of actually having to perform) constitutes an undesirable risk for sellers. That is, even if excessive performance never occurs because sellers negotiate releases, sellers bear large risk, a form of cost.⁸ Fourth, the process of enforcement of an obligation to perform might involve substantial expense and result in subpar outcomes.

These joint-value-lowering disadvantages of specific performance generally would not arise under the expectation measure of damages, which is assumed to be the measure of damages in the analysis. Under the expectation measure, if it were very expensive to perform, sellers could, and usually would, breach and pay damages rather than perform (an excavator who encountered hard rock presumably would do this). Thus, sellers would not be forced to perform and ordinarily would avoid more than modest bargaining costs, would not be induced to spend wastefully on avoidance steps, and would not bear risk beyond that of expectation damages. Moreover, the parties would not bear the costs of enforcing specific performance.

Next, consider contracts to convey property. The uncertainty faced by a seller of such contracts concerns bids for the property (say a parcel of land) that outside parties might make. Importantly, production cost uncertainty would not be at issue, since by assumption the property to be conveyed already exists. Because the nature of the uncertainty is different for contracts to convey property, specific performance involves none of the disadvantages just reviewed for contracts to produce.⁹ Sellers obviously do not have to

7. The first and fourth of the disadvantages are well appreciated, whereas the second and third have not been emphasized. For further discussion, see *infra* subpart II(B).

8. The bearing of risk is a cost for parties who are “risk averse” in the parlance of economics. See ROBERT S. PINDYCK & DANIEL L. RUBINFELD, *MICROECONOMICS* 157–58 (5th ed. 2001) (defining risk aversion and explaining that risk-averse individuals will pay a certain amount of money to avoid taking a risk).

9. This contrast is a central point of the present Article.

perform or purchase a release when performance would be expensive, or bear associated risks; sellers can easily comply with specific performance by conveying the property that is by hypothesis in their possession. Moreover, a seller's performing when there is a high outside bid generally does not imply that the contracting parties would forgo a valuable opportunity for profit, since the usual presumption would be that the contract buyer could also sell to an outside bidder (an outside bidder who wanted a parcel of land could purchase it from the contract buyer as well as from the contract seller). Finally, enforcing specific performance of a contract to convey is ordinarily relatively straightforward and does not involve the difficulties often associated with mandated performance of a contract to produce something.

What has just been stated is that specific performance does not lead to losses in joint value for contracts to convey property, but this observation does not suggest that specific performance would be superior to the use of the expectation measure. Why might specific performance be superior, which is to say, why might use of the expectation measure lead to losses in joint value for the parties? The answer developed below is that there is a danger of joint losses if the value of performance is underestimated. In that event the seller might breach and sell to an outside bidder at a price below the value of the property to the contract buyer. There are then two possibilities. On one hand, the property might remain with the outside bidder, in which case the parties will clearly lose, as the property will have been sold at a price below the buyer's value. On the other hand, the contract buyer might purchase the property from the outside bidder. But in that case the buyer will generally have to pay more than the outsider had paid the seller, so that the outsider's profit will constitute a loss for the contracting parties. Under specific performance, in contrast, contract buyers will never sell property to outside bidders unless the amount that they receive exceeds their valuation. This explanation of why specific performance may be superior to the expectation measure applies to the degree that there is a chance that the expectation would be underestimated.¹⁰

In Part III, I review the contours of the use of specific performance versus damage measures in Anglo-American, French, and German contract law and relate the choices made to the analysis in Part II. Under Anglo-American law, as readers know, specific performance is an exceptional remedy,¹¹ employed mainly for contracts to convey property with unique or hard-to-evaluate aspects, but occasionally for contracts to produce things.¹²

10. These paragraphs summarizing the theoretical conclusions of Part II describe only central tendencies. As is discussed in subpart II(D), the conclusions about the mutually preferred remedy may change if various assumptions are relaxed. For example, if it is assumed that outside bids are made only to contract sellers (not to buyers as well), the parties to a contract to convey property might prefer the expectation measure to specific performance.

11. ZWEIGERT & KÖTZ, *supra* note 5, at 480.

12. *See id.* at 480–81 (noting that, in the United States, “a claim for performance is normally granted if the sale is of specific goods which are very rare or extremely valuable or of a special

It will be suggested that this pattern is broadly consistent with the theoretical analysis, especially because of the use of specific performance for contracts to convey property where the problem of joint loss to the parties under the expectation measure might be significant. However, it will also be suggested that the need for the inadequacy-of-damages test¹³ for use of specific performance for contracts to convey property is not apparent, and that it might be desirable to grant specific performance more widely for this class of contract.

Under the *French Civil Code*, the remedy for contracts to produce things is damages, whereas the remedy for contracts to convey property is specific performance,¹⁴ so the distinction drawn in the *Code* is precisely the one drawn in the theoretical analysis here. French courts, though, sometimes employ a type of penalty to achieve effective specific enforcement of contracts to produce things.¹⁵ Under German law, specific performance is generally available as the remedy for breach of contract,¹⁶ except for personal service contracts.¹⁷

I do not reach a confident conclusion that one of these legal systems is best in how it decides between specific performance and damages, but a tentative evaluation is that the German system is least consistent with the mutual interests of contracting parties. In any case, it will be interesting to observe that the three legal systems resemble each other in important qualitative respects, despite their nominal differences and the different legal histories and rationales supporting their legal policies. A helpful way to explain their substantive similarities is to view them through the lens of the mutual desirability of remedies, as revealed by the theoretical analysis of Part II.

In Part IV, I comment on major themes of thinking about specific performance versus damage payments for breach. Notably, I examine the idea that there is a moral duty to obey a contract and thus a general reason in principle for specific performance to be the remedy for breach. I suggest that this notion is misleading, as it does not reflect the fact that contracts often, if not typically, fail to provide explicitly for the particular contingencies that lead to breach, and thus that contracts are not natural to regard as promises

sentimental value,” but that “courts have sometimes granted specific performance even of sales of generic goods”).

13. The inadequacy-of-damages test refers to the concept that equitable relief will be denied if the legal remedy of damages constitutes adequate protection of the injured party. See FARNSWORTH, *supra* note 4, § 12.6.

14. See Treitel, *supra* note 5, § 16-18 (explaining that the *French Civil Code* distinguishes between “obligations to do or not to do,” which invoke damages in nonperformance situations, and obligations to transfer property, which allow a creditor “to be put into possession of the subject matter” in the case of nonperformance).

15. See ZWEIGERT & KÖTZ, *supra* note 5, at 476 (describing the *astreinte*, a “special coercive technique” used by French courts).

16. *Id.* at 472.

17. *Id.* at 474.

for which a moral duty would attach. Indeed, I explain that, under the expectation measure, breach tends to occur exactly when parties would have agreed on nonperformance in a detailed contract with express provisions for all contingencies. Hence, there is a sense in which the conception that a contracting party has a moral obligation to perform when the party would want to commit breach and pay expectation damages is mistaken at a fundamental level.

I next consider the familiar idea that inadequacy of damages as compensation for breach provides a rationale for use of specific performance. I stress, though, that it is not immediately clear why inadequacy of damages per se should lead contracting parties to want specific performance. For if a promisee knows that damages would not make him whole, he presumably could be compensated in advance for this disadvantage by an appropriate reduction in the contract price.¹⁸ Thus, the notion that inadequacy of damages is a general problem for contracting parties that calls for the use of specific performance seems erroneous. Still, for the reason that I sketched above, inadequacy of damages does lead to a joint difficulty for the parties that is answered by specific performance, but that logic is special to the context of contracts to convey property.

I then discuss the relationship between this Article and previous economically oriented writing on specific performance versus damages. With regard to production contracts, several of the points that I mention are well recognized: excessively costly performance may occur under specific performance but not under the expectation measure;¹⁹ bargaining can often mitigate the problem of excessive performance under specific performance, although at a cost,²⁰ and specific performance may be difficult to enforce.²¹ What I add is that, even if bargaining is costless and always prevents excessive performance, specific performance still presents two major problems: it imposes risk on sellers because sellers have to pay for their release (in principle, an amount up to their production cost), and it also motivates sellers to spend wastefully to avoid situations where production cost would be high and they could be held up by buyers.

The major contribution of this Article, however, flows from its observation that the comparison of specific performance to expectation

18. Compare, for example, the situation of a promisee who faces a 20% likelihood of breach and who would receive damages equal to his losses to the situation of the promisee if the damages he would receive would be \$10,000 less than his losses. If in the latter situation the promisee pays a price that is approximately \$2,000 lower, he should be approximately as well off as if he does not pay a lower price but instead would receive higher damages.

19. *See, e.g.*, RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* § 4.12, at 132 (6th ed. 2003) (noting that an injunction could force a promisor to pay a “possibly unlimited” amount that would “bear no relation to the costs to the promisee of the promisor’s failure to perform”).

20. *See, e.g., id.* § 4.12, at 131 (observing that while a seller could negotiate to be released from a specific performance obligation, “the additional negotiation will not be costless”).

21. *See, e.g.*, FARNSWORTH, *supra* note 4, § 12.7, at 780 (acknowledging that specific performance may entail heavy burdens of enforcement or supervision).

damages changes its entire nature for contracts to convey property. As I stated, none of the problems afflicting specific performance where there is production-cost risk apply where property is to be conveyed. Moreover, and importantly, I supply a new argument explaining why specific performance is jointly superior to expectation damages when such damages might be underestimated and property is to be conveyed. I distinguish this argument from one offered by Anthony Kronman,²² which I find unappealing because it is based on an assumption that buyers' beliefs are systematically different from sellers' beliefs.²³

I also discuss two articles, by Alan Schwartz²⁴ and Thomas Ulen,²⁵ who recommend that specific performance be made routinely available as a remedy for breach.²⁶ I find their proposal to be inadvisable for the basic reason that they do not consider adequately the problems of specific performance for contracts to produce things. Another article on which I comment is by Melvin Eisenberg.²⁷

Additionally, I briefly discuss evidence that we have about parties' preferences concerning the remedy for breach. Although this evidence is quite limited, it has some value and it does not lead one to suppose that parties have a strong desire for use of specific performance in domains where it is not now employed.

II. Theoretical Analysis

A. Assumptions and Framework of Analysis

In the theoretical analysis presented in this Part, I will be concerned with two stylized contractual contexts. As indicated in Part I, one context is where the seller contracts to produce a good; the other is where the seller contracts to convey property. I will emphasize situations where the good to be produced or the property to be conveyed cannot be obtained on an organized market, in other words, where there is something particular about the good or the property that is the subject of the contract that distinguishes it from what could readily be purchased on a market.²⁸

22. Anthony T. Kronman, *Specific Performance*, 45 U. CHI. L. REV. 351 (1978).

23. *See id.* at 367–69 (arguing that parties to a contract with a unique subject matter would prefer specific performance because of their ex ante, differing views regarding the probability of breach).

24. Alan Schwartz, *The Case for Specific Performance*, 89 YALE L.J. 271 (1979).

25. Thomas S. Ulen, *The Efficiency of Specific Performance: Toward a Unified Theory of Contract Remedies*, 83 MICH. L. REV. 341 (1984).

26. *Id.* at 365; *see* Schwartz, *supra* note 24, at 271 (“[T]he remedy of specific performance should be as routinely available as the damages remedy.”).

27. Melvin A. Eisenberg, *Actual and Virtual Specific Performance, the Theory of Efficient Breach, and the Indifference Principle in Contract Law*, 93 CAL. L. REV. 975 (2005).

28. *See infra* section II(D)(2), however, where I discuss cover within the context of contracts to produce things.

In both contractual contexts, I consider uncertainties that might lead the seller to want to commit breach. In particular, I will assume that for contracts to produce things, uncertainty exists about production cost, so that if the cost would turn out to be high, the seller might want to commit breach. I will suppose that for contracts to convey property, uncertainty exists about the bids that outsiders would make, so that if an outsider's bid would turn out to be high, the seller might want to commit breach and sell to the outsider.²⁹ In reality, uncertainty about bids from outsiders exists for contracts to produce things as well (after a contract to produce a new good is made, the seller could encounter an outsider who makes a bid). It will be expositionally convenient, however, to discuss this case only after proceeding through the analysis under the assumption that the sole uncertainty affecting contracts to produce is production cost uncertainty.³⁰

An issue that arises if problematic contingencies occur concerns postcontractual bargaining. One assumption that I will make is that there is no postcontractual bargaining; the seller simply commits breach or not, based on his self-interest and the remedy for breach. The alternative assumption that will be examined is that there is postcontractual bargaining and, notably, that the seller might negotiate for release from an obligation to perform. The assumption of no postcontractual bargaining might fit some circumstances, for a seller might need to make a decision on the spot and may not be in immediate contact with the buyer or might find the cost of bargaining too large to justify incurring. In many circumstances, however, postcontractual bargaining would be plausible. I will assume generally that such bargaining involves costs. I will also assume that bargaining might not succeed even though a mutually beneficial agreement exists in principle; asymmetry of information between the bargaining parties may lead them to misgauge one another and to reach an impasse.³¹

In order to focus on the choice between specific performance and damage remedies, I will assume that a contract is of a very simple character: it names an unconditional duty—to produce a good, or to convey property, as the case may be; a price; and a remedy for breach—either specific performance or expectation damages. A number of comments about these assumptions are worth making.

First, that the contractual duty is unconditional means that the contract does not provide for parties to be excused from the obligation to perform under problematic contingencies, such as high cost. A contract that provided

29. For simplicity, I will suppose that there is no uncertainty about the buyer's value from performance, so that the buyer would not want to commit breach.

30. I address both types of uncertainties for contracts to produce—production cost uncertainty and uncertainty over outside bids—in section II(D)(3).

31. On asymmetric information and bargaining, see ERIC RASMUSEN, *GAMES AND INFORMATION: AN INTRODUCTION TO GAME THEORY* 303–08 (3d ed. 2001), STEVEN SHAVELL, *FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW* 89–91 (2004), and John Kennan & Robert Wilson, *Bargaining with Private Information*, 31 *J. ECON. LITERATURE* 45, 100–01 (1993).

explicitly for *all* contingencies is a contract that the parties would want specifically enforced, since by definition it would reflect the true wishes of the parties, whatever might happen, and would say not only when there should be performance but also when there would be no duty to perform. In reality, of course, contracts usually mention some contingencies but still remain substantially incomplete; they do not provide expressly for many possible circumstances because of the impracticalities and costs that would be associated with making highly detailed contracts. The most convenient way to study the implications of incompleteness of contracts is to assume, as is done here, that contracts contain no contingent provisions. (If, instead, I assumed that there were some contingent provisions, but not a complete set of contingent provisions, I would arrive at essentially the same qualitative conclusions that I reach below.) I will return to these points later, in Part IV, when I discuss the view that there is a moral obligation to obey a contract, because the key to understanding the relevance of this ethical duty lies in recognizing that contracts are in fact incomplete.

Second, by the remedy of specific performance, I mean the remedy that assures that the contractual duty is performed. The interpretation of this remedy depends on the contractual context and will be of relevance for some of the issues considered below. In the context of contracts to produce things, specific performance might mean forcing the seller personally to perform. Such *literal* performance would be needed if the seller were the only party who could perform, for instance, if the seller were a well-known entertainer for whom there is no real substitute. Another possibility is that specific performance is *equivalent* performance, accomplished by having the seller arrange for, or pay for, a *covering* contract, whereby another party performs the stipulated contractual duty. That would be feasible if the seller were not the only party who could perform, for example, if the seller were providing a common service, such as plumbing or electrical work, or if the seller were producing a fairly standard good. In the context of contracts to convey property, specific performance might be literal, meaning that the seller would be forced to convey the very property in his or her possession, such as a parcel of land or a painting. Specific performance might also be equivalent, whereby a covering contract is employed to obtain essentially identical property (say bushels of wheat) for the buyer.³²

Third, the measure of damages is taken to be the expectation measure, the value of performance (net of the contract price to be paid), because this is the favored, central measure of damages that legal systems employ. It will

32. The reader should not be distracted by my interpreting specific performance either as literal or as equivalent. What I call equivalent specific performance would probably not be considered specific performance in Anglo-American law, although in civil law countries, such as Germany, it might well be. See *infra* subparts III(A)–(C). In any event, it should also be observed that, where a covering contract can be made, its cost is often different from expectation damages. A classic instance is where a covering contract is needed to complete a construction contract, and completion costs more than the value it adds.

be evident from the analysis how other damage measures would compare to specific performance.³³

Before proceeding, let me state how parties will be presumed to evaluate their contractual situations from an *ex ante* standpoint. One assumption that we will study is that parties are *risk neutral*.³⁴ A risk-neutral party evaluates a situation involving risk in terms of its probability-discounted or *expected* value. For instance, suppose that a risk-neutral seller would incur costs of \$1,000 with a 50% chance and costs of \$5,000 with a 50% chance. The expected value of costs would therefore be $(50\%)(\$1,000) + (50\%)(\$5,000)$ or \$3,000, and the seller would treat the risky cost situation as if the costs were \$3,000 for sure. An interpretation of an expected cost, such as the \$3,000 figure, is that it is the average amount parties would incur were they to find themselves repeatedly facing the same uncertainty.³⁵ The assumption of risk neutrality is simplifying and conventional to employ; it is useful to consider because it captures the notion that an individual cares about both the likelihood and magnitude of an outcome.

If parties are risk neutral, they will want to choose contractual terms that result in the highest joint expected value. To illustrate, suppose that the parties are contemplating a contract in which remedy *R* would be used for breach and from which the buyer's expected value would be 100 and the seller's expected value would be 150, so that the joint expected value would be 250. Suppose that they contemplate a change in the remedy to *R'*, and that this remedy would lead to an expected value of 80 for the buyer and 220 for the seller, so that the joint expected value would be 300, which is higher.³⁶ Why would the parties be thought to *agree* to switch to the different remedy *R'*? The answer is that the seller could afford to reduce the price by enough to make the buyer better off, and still the seller would be better off.³⁷ In

33. It should be noted that specific performance itself might be interpreted as a very high measure of damages, for if a substantial enough sum would have to be paid for breach, there would presumably be no breach (in the absence of the judgment-proof problem). Hence, in strict logic, one might view this Article as comparing expectation damages to a very high measure of damages.

34. On this concept, see, for example, PINDYCK & RUBINFELD, *supra* note 8, at 157–60, which defines risk neutrality as “indifferen[ce] between a certain income and an uncertain income with the same expected value.”

35. Were the seller to face the described risk one hundred times, his costs would be \$1,000 about fifty times and his costs would be \$5,000 about fifty times. Hence, his total costs would be about \$50,000 plus \$250,000 or \$300,000, meaning that his average cost would be about $\$300,000/100$ or \$3,000.

36. The reason that the joint expected value is higher might be that performance occurs more often when its cost is less than its value, or that breach occurs more often when the cost of performance would exceed its value.

37. Under the contract with remedy *R'* and the old price, the buyer's expected value is 80 and the seller's expected value is 220. As the seller reduces the price, the buyer will be made better off and the seller will be made worse off. At some price reduction, the buyer's expected value will have risen to 110, at which point the seller's expected value will have fallen to 190 (since the sum of values under remedy *R'* is 300—the change in price does not affect the sum of values, it is a mere transfer between the parties). At this price reduction, both the buyer and the seller are better off than under the initial contract with remedy *R* (the buyer is better off since 110 exceeds 100, the

effect, if the contractual “pie” the parties have to divide would be increased by a change in the remedy for breach, there has to be a way to slice the pie (by means of a price adjustment) so that each has more pie to enjoy and thus is happier.

We will also consider, and in parts emphasize, the often more realistic assumption that parties are *risk averse*—that they care not only about expected value but also about variability, and especially that they will want to avoid losing a significant amount.³⁸ If one or both parties is risk averse, the contract remedy that they would agree to choose might not be the one that results in the highest joint expected value, for it might leave a risk-averse party bearing substantial risk. They might prefer a remedy that sacrifices some joint expected value in order to reduce risk bearing by a risk-averse party, but one can still view them as seeking to maximize a broader concept of joint value.³⁹

B. *Contracts to Produce*

Here, as stated above, I examine a situation where production cost is uncertain when the contract is made. After the contract is signed, but before production would commence, I assume that the production cost becomes known. At this juncture the seller might commit breach. We want to compare specific performance to the expectation measure of damages for breach by examining to what degree these remedies promote or detract from joint expected value and risk since, as just explained, this tells us which remedy the parties would want to adopt.

1. *Efficiency of Performance.*—Let us initially consider whether performance tends to occur when and only when its value exceeds production cost—when performance is said to be “efficient.” Such performance maximizes the joint expected value of the contract (ignoring for the moment possible bargaining costs and also risk aversion).

Under the expectation measure, performance will automatically occur exactly when it would be efficient, as is well recognized.⁴⁰ To illustrate, suppose that the value of performance is \$100,000, that a price of \$40,000 is

seller is better off since 190 exceeds 150). A general proof that parties will always prefer to switch to a remedy that achieves a higher joint expected value can be given along essentially the lines of this example.

38. See, e.g., PINDYCK & RUBINFELD, *supra* note 8, at 158 (“Other things being equal, risk-averse people prefer a smaller variability of outcomes.”); STEVEN SHAVELL, *ECONOMIC ANALYSIS OF ACCIDENT LAW* 186 (1987) (stating that “*risk-averse* parties care not only about the expected value of losses, but also about the possible magnitude of losses”).

39. If one defines joint value as joint expected value minus some amount to take into account risk bearing by risk-averse parties, then one can often still phrase the parties’ objective as maximization of joint value.

40. SHAVELL, *supra* note 31, at 343–48; see also POSNER, *supra* note 19, § 4.9, at 120 (noting that the goal of motivating a promisor to perform when performance would be efficient can be accomplished “by giving the promisee his expected profit on the transaction”).

to be paid at the time of performance,⁴¹ and that there are two possible levels of production cost, a normal level of \$20,000, occurring with likelihood 90%, and an unusual level of \$200,000, occurring with probability 10%. Under the expectation measure, the seller would have to pay damages of \$60,000 for a breach (since performance would be worth \$100,000 to the buyer but the price he would pay would be \$40,000). Hence, the seller would be led to perform when the cost would be \$20,000 (earning a profit of \$20,000 is better than paying damages of \$60,000), but in the unusual event that the cost would be \$200,000, the seller would be led to commit breach (suffering a loss of \$160,000 is worse than paying damages of \$60,000). Hence, the seller would perform when and only when the production cost would be less than the buyer's value of \$100,000, which is efficient.⁴²

Under specific performance, in contrast, the seller would always perform, assuming provisionally (until section II(B)(2)) that there would be no postcontractual negotiation. In particular, the seller would perform when production cost would be \$200,000, even though the buyer's value is \$100,000 and performance is inefficient.

Because specific performance would result in a lowering of joint expected value, risk-neutral parties would choose the expectation measure over specific performance, according to the general logic discussed above in subpart II(A).⁴³ It may be helpful to demonstrate this explicitly. Suppose that the parties are discussing a candidate contract with a price of, say, \$40,000 and with specific performance as the remedy. We want to show that *both* parties would prefer to change the remedy to the expectation measure if an appropriate adjustment in the price is made. If specific performance is the remedy, the buyer's expected value is \$60,000 (namely, \$100,000 – \$40,000) and the seller's expected profit is \$2,000 (that is, (90%)($\$40,000 - \$20,000$) + (10%)($\$40,000 - \$200,000$)). If the parties contemplate a switch to the expectation measure with no change in the price, the buyer's value would obviously be the same, \$60,000 (since he either receives performance or a payment of \$60,000). The seller, however, would be better off, since the seller would escape having to spend \$200,000 when production cost would be high. The seller's expected profit would rise to \$12,000 (for it would be (90%)($\$40,000 - \$20,000$) + (10%)($-\$60,000$)). Since the seller would be

41. The assumption that the price is paid at performance rather than when the contract is made is not essential. If the price is paid at the outset, the expectation measure would equal the full value of performance rather than the difference between the value of performance and price, but breach would occur under the same circumstances and the comparison of remedies would be unaffected.

42. To verify this point algebraically, let V be the value of performance to the buyer, P the price, and C the cost of performance. Assuming that P is to be paid at the time of performance, damages for breach under the expectation measure are $V - P$. Now if the seller performs, his profit is $P - C$, whereas if he breaches his "profit" is $-(V - P)$. Hence, the seller will perform if and only if $P - C > -(V - P)$, or equivalently, if and only if $V > C$.

43. See *supra* notes 34–37 and accompanying text (explaining risk neutrality and noting that risk-neutral parties would prefer contractual terms that produce the highest joint value).

better off if the price is unchanged, the seller can afford to offer a reduction in the price so as to make the buyer affirmatively happy to switch to the expectation measure from specific performance. For instance, suppose that the price is reduced from \$40,000 to \$35,000. Then both parties will be better off than under the originally considered contract with specific performance, for the buyer's value will be \$65,000 instead of \$60,000 and the seller's expected profit will be \$7,000 instead of \$2,000.⁴⁴ Note that the sum of the two parties' expected values under specific performance would be \$62,000 (that is, \$60,000 + \$2,000) and would be \$72,000 under the expectation measure (that is, \$65,000 + \$7,000); the \$10,000 increase in the sum is due to the avoidance of wasteful performance 10% of the time.⁴⁵

The preceding demonstration, it should be stressed, shows that the parties find it *mutually* desirable to use the expectation measure. The point is not that it is socially desirable for them to employ the expectation measure so as to avoid wasteful performance (although that is also true). The point is rather that the parties each selfishly prefer to employ the expectation measure.

2. *Renegotiation and the Efficiency of Performance.*—Suppose that we now relax the assumption that there is no postcontractual bargaining between the buyer and the seller, and we examine the possibility that the parties would bargain when production cost becomes known to the seller. Assume too that such renegotiation would involve a cost. How does this alter the analysis?

The possibility of renegotiation would make no difference—it is a moot issue—under the expectation measure, as there is no reason for the parties to bargain about performance under that remedy. If production cost would be \$20,000, less than the value of performance, the parties obviously have no reason to bargain, for the seller will want to perform; and if the production cost would be \$200,000, exceeding the value of performance, the seller would commit breach and pay damages, so the seller does not need to bargain for discharge from the obligation to perform.

The possibility of renegotiation would clearly make a difference under specific performance, however, for when the production cost would exceed the value of performance, the seller would want to pay the buyer for release from having to perform. If the price were \$40,000 and the production cost would be \$200,000, the seller would want to purchase freedom from the obligation to perform; the seller would pay up to \$160,000 for a release since

44. The buyer's value will be $\$100,000 - \$35,000 = \$65,000$. The seller's expected profit will be $(90\%)(\$35,000 - \$20,000) + (10\%)(-\$65,000) = \$7,000$. This argument that both the buyer and the seller can be made better off by changing from specific performance to the expectation measure can be made regardless of the initially discussed contract price.

45. The waste is $\$200,000 - \$100,000$ or \$100,000. Since this waste is incurred 10% of the time under specific performance, the expected loss to the parties is \$10,000.

he would lose that amount if he performed, and the buyer would accept any amount over the \$60,000 that performance would be worth to him. If the parties bargain and reach an agreement for the seller's release, the waste due to inefficient performance, here \$100,000 (namely, \$200,000 – \$100,000) would be avoided.

Still, the renegotiation process would absorb time and resources, so these bargaining costs would lower joint value. Moreover, the renegotiation might not lead to an agreement; a breakdown in bargaining could lead to specific enforcement of the contract, so that wasteful performance would occur. Common experience and the expansive literature on bargaining tell us that mutually beneficial bargains are not always struck, even though they exist, a major reason being that parties may have different information and misconstrue one another's situation in some way.⁴⁶

In sum, although the possibility of renegotiation lessens the disadvantage of specific performance, that remedy still tends to lead to losses in joint expected value, due to bargaining costs and potential bargaining failure. The parties would thus still be thought to elect the expectation measure over specific performance.

3. *Wasteful Preventive Expenditures.*—Let us next consider the issue of sellers making wasteful preventive expenditures under specific performance, to avoid being held up by buyers when sellers face high production cost. Knowing that he might face a production cost of \$200,000 and have an obligation to perform, and knowing too that the buyer could extract as much as this amount, net of price, in exchange for a release, the seller has a motive to take steps to ameliorate the losses he would suffer were \$200,000 the production cost. The seller might, for example, be led to purchase equipment that would only be of aid were production cost to be high (like the rock-crushing equipment mentioned in Part I, of value only if an excavator ran into an unusual problem with hard rock). Suppose, for instance, that by spending \$5,000 on such equipment, the seller's high production cost would fall from \$200,000 to only \$125,000. The seller might find the \$5,000 expenditure worth making, since that would enhance his bargaining position with the buyer if the production cost were high—the buyer's maximum demand in that event would fall by \$75,000.⁴⁷ Yet such holdup-induced

46. If, for example, the buyer believes the seller's production cost would be \$500,000, the buyer might demand, say, \$250,000 for a release, an amount that the seller would refuse to pay, as it would exceed his true loss of \$160,000.

47. To illustrate why the seller might spend \$5,000, suppose that the seller would always conclude a successful agreement for release when production cost is high and would be forced to pay all of the gain from the release to the buyer. Assume that the contract price, paid at performance, would be as above, \$40,000. Hence, if the seller does not spend the \$5,000, he would pay \$160,000 for a release with probability 10%, and if he does spend the \$5,000, he would pay only \$85,000 (his loss were he to perform, since his cost would be \$125,000) with that probability. Therefore, the \$5,000 expenditure would yield an expected savings to the seller of (10%) (\$75,000) = \$7,500, which is greater. The qualitative point of the foregoing would not be altered if, instead of

expenditure by the seller would really constitute a waste for the parties, since the joint value maximizing outcome is for production not to take place whenever the production cost would exceed \$100,000, which \$125,000 does. One way to express this point is to say that, even if bargaining were a costless process and always led to efficient outcomes—to releases for sellers whenever the production cost would be high, exceeding \$100,000—the holdup-induced expenditure of \$5,000 might be made, lowering joint value. In other words, holdup-induced preventive expenditures constitute another reason why specific performance lowers joint value and why the parties would be thought to prefer expectation damages.

4. *Risk Imposition.*—Specific performance also may impose a substantial risk on the seller in comparison to the expectation measure. Under specific performance, the seller is faced with the risk of bearing a cost potentially as high as the loss he would suffer were he to perform. If the production cost would be \$200,000 and the price \$40,000, so that the seller would lose \$160,000 were he to perform, the seller might have to pay up to this amount for a release from the buyer, and if renegotiation were to fail, the seller would definitely have to bear this amount. Under the expectation measure, in contrast, the seller's risk is limited to the \$60,000, the value of performance net of price to the buyer.

The significance of the factor of risk imposition on the seller depends on the degree of risk aversion of the seller. An individual or a small business, for example, might be quite risk averse, whereas a large corporation not so. Also of relevance is the probability distribution of the cost of performance; in some situations, such as where the seller could purchase cover at a known price, the risk would be cabined; in others, that might not be possible, or the cost of cover might vary, so that the magnitude of the cost could be very high.

5. *Administrability.*—Last, let us consider courts' ability to enforce specific performance versus expectation damages. To enforce specific performance, the court must ensure that the stipulated performance is accomplished, meaning that the court must be able to ascertain the quality of performance to guard against its being inadequate. In some circumstances, the task could be difficult (whether an opera singer performed up to her usual standards), in others not (whether a plumber installed a new heating system). Another potential problem is recalcitrance of the seller. This might be an issue if specific performance is literal (the opera singer is required to perform) but should be essentially moot if specific performance is

the buyer's obtaining all of the gain from a release, he would only obtain part of the gain—it is still true that the seller would have an incentive to spend purely to improve his bargaining position, not to improve actual outcomes.

accomplished by cover (the buyer in a plumbing contract could hire another plumber to install the heating system).

To enforce expectation damages, courts do not have to assess and oversee the quality of performance, for by hypothesis there is no performance. But courts need to estimate the value of performance (if this is not named as liquidated damages in the contract) and then collect that amount.

One might expect that the costs and difficulties of enforcing specific performance would usually dominate those of enforcing the expectation measure of damages, especially where specific performance is literal. But cases where specific performance would be easier to enforce are probably not infrequent.⁴⁸

That it may be more difficult to enforce specific performance than the expectation measure is a consideration for courts, whereas what is relevant for us is the well-being of the parties. However, the problems courts face in enforcement will tend to affect the parties, especially since the parties are involved in the legal process and find it costly.

6. *Summary.*—What has been presented is a set of reasons suggesting that parties to a contract to produce something would prefer expectation damages to specific performance as the remedy for breach, since use of specific performance would tend to lower joint value and impose risk on the seller relative to use of the expectation measure. In particular, under specific performance, when production cost would be high, the parties would tend to bear costs of renegotiation, and wasteful performance might occur. Additionally, the prospect of high production costs may induce sellers to take wasteful defensive measures. Also, the possibility of high production costs imposes risks on sellers whether or not they are able to bargain for release. Finally, problems of administrability may be encountered under specific performance that would not be experienced under the expectation measure, although this latter factor applies mainly where specific performance is literal rather than accomplished by cover.

C. *Contracts to Convey Property*

I now consider a situation where the seller promises to convey property to the buyer, such as land or a moveable like a painting. After the contract is made, but before the property is conveyed, an outside party might make a bid

48. Suppose, for example, that the contract is to construct custom cabinets for a home in an area where there is no organized market for the kind of work involved and that the court can readily determine whether the job has been satisfactorily accomplished. At the same time, suppose that the value of performance to the buyer would be hard to determine and would be contested by the two sides (the degree to which the buyer cares about having custom cabinets instead of ready-made ones is very difficult to ascertain). Then enforcement of the expectation measure might be more costly than enforcement of specific performance.

for the property. I will generally assume that the outside party can as easily make a bid to the contract buyer as to the contract seller. This assumption is natural to make since, if an outside party is interested in purchasing property, the party would usually be able to determine who had rights to it and make his bid to that individual. (But alternative assumptions are examined in section II(D)(1), after the main analysis is presented.) I now compare specific performance to the expectation measure of damages.

1. Efficiency of Performance.—In the present context, the joint value maximizing or efficient outcome is for the property to be conveyed to, and retained by, the buyer if and only if his valuation of the property exceeds the amount the outsider would pay; if the outsider would pay more than the buyer's valuation, it would be efficient for the property to be sold to the outsider.

Under the expectation measure, performance will automatically occur when that would be efficient. Suppose, for example, that the value of the property to the buyer is \$100,000, that a price of \$40,000 is to be paid at the time of performance, and that there are two possible levels of the outside bid, \$80,000 with probability 80% and \$150,000 with probability 20%.⁴⁹ Under the expectation measure, the seller would have to pay damages of \$60,000 for a breach. Therefore, the seller would convey the property to the contract buyer when the outside bid is \$80,000 (since he would prefer to receive the contract price of \$40,000 than to obtain \$80,000 but pay \$60,000 in damages, yielding only \$20,000 on net), but the seller would breach and sell to the outsider when the outside bid is \$150,000 (since the seller would prefer to receive \$150,000 and pay \$60,000 in damages, yielding \$90,000 in profit, to performing and receiving only \$40,000). These outcomes are efficient, since it is joint value maximizing for the property to wind up in the hands of the outsider if his bid is \$150,000, as that exceeds the \$100,000 value of the buyer, but not for the property to go to the outsider if his bid is \$80,000.

Under specific performance, outcomes will also be efficient, since we are assuming that the outsider can as easily make his bid to the contract buyer as to the contract seller. If the outside bid is \$80,000, the contract buyer obviously will not accept the bid. But if the outside bid is \$150,000, the contract buyer will sell the property to the outsider. In particular, specific performance does not lead to the possibility of inefficient performance; the opportunity of the parties to avail themselves of a high outside bid of \$150,000 does not depend on whether specific performance is the remedy.⁵⁰

Because the disposition of the property would be the same under specific performance as under the expectation measure, the parties would be

49. More generally, there might be a probability of no outside bid as well as probabilities of many other outside bids.

50. See *infra* section II(D)(1), which discusses how the argument is affected if outside bids might not be made as easily to the contract buyer as to the contract seller.

indifferent between the two remedies under present assumptions. An illustrative calculation shows this. Suppose that the parties initially contemplate a contract under the expectation measure with a price of \$40,000. The value of this contract to the buyer is $\$100,000 - \$40,000 = \$60,000$, and its expected value to the seller is $(80\%)(\$40,000) + (20\%)(\$90,000)$ or \$50,000 (since when the seller receives a bid of \$150,000, the seller breaches, pays damages of \$60,000, and thus nets \$90,000 in profit). Note that the joint expected value is $\$60,000 + \$50,000 = \$110,000$. If the parties were to switch to specific performance and the price were not changed, the value of the contract to the buyer would rise to $(80\%)(\$60,000) + (20\%)(\$110,000) = \$70,000$ because the buyer would now be able to take advantage of high outside bids (he would sell for \$150,000, and make a profit of \$110,000 after paying the \$40,000 contract price). The value of the contract to the seller would fall to \$40,000 since the seller would not be able to sell when there is a high outside bid. Hence, for the buyer to induce the seller to agree to switch to specific performance, the buyer would have to raise the price by \$10,000 to \$50,000, so that the seller would be just as well off as he had been under the expectation measure. But then the value of the contract to the buyer would fall to \$60,000, leaving him exactly as well off as he had been under the expectation measure. Hence, a switch from expectation to specific performance that each party would be willing to make would leave each exactly as well off as before, and it is readily shown that there is no way to make both better off (or no way each would wind up worse off) by the switch. The reason for this conclusion is that the joint value of the property is the same, \$110,000, under the two remedies for breach.

2. *Renegotiation and the Efficiency of Performance.*—There would be no postcontractual bargaining between the contract buyer and the contract seller under the expectation measure, nor would there be such renegotiation under specific performance, given the assumptions that I have made. In particular, under specific performance, as we have just discussed, if a high outside bid of \$150,000 would be made, it would be made to the contract buyer, and the contract buyer and the seller would have no reason to negotiate for the seller to be released from his obligation to convey the property in order to take advantage of the high outside bid.⁵¹

3. *Wasteful Preventive Expenditures.*—There is no issue of wasteful preventive expenditures due to buyer holdup of the seller under specific

51. One way to express this point is to observe that the amount the seller would be willing to pay the buyer for a release equals the amount the buyer would demand, removing the incentive for the two to make an agreement for the seller's release. In our example, if the outside bid is \$150,000, the seller would be willing to pay, at most, \$110,000 for a release, since this is the extra profit he could obtain by selling to the outsider; but \$110,000 is also what the contract buyer would demand from the seller, since the buyer could also sell the property for \$150,000 and make \$110,000 in profit.

performance in the present contractual context. For the seller is not, in the nature of things, in a tight spot such that he could be pressured to pay a high amount to obtain release from his obligation to perform. Hence, the seller would not be led to take expensive joint-value lowering preventive steps to avoid holdup payments to the buyer.

4. *Risk Imposition.*—Similarly, there is no issue of risk imposition on the seller under specific performance. For the seller's obligation to convey property does not mean that the seller faces the risk of suffering any loss of funds; specific performance does not create a detrimental risk, as it does for contracts to produce things. Here the risk-related role of specific performance is very different: specific performance shifts the probabilistic opportunity to make additional profit from the seller to the buyer⁵² rather than creating a detrimental risk for the seller.

5. *Administrability.*—Specific enforcement of contracts to convey property should often be straightforward, for two reasons. First, enforcement requires only that the court locate the property in question and that it use its powers to achieve compliance. Second, determining whether compliance is adequate would normally not be an issue, for whether property has been conveyed is typically self-evident. In contrast, recall that specific enforcement of contracts to produce goods may be problematic, especially because of the need to judge the adequacy of performance.

The ability of courts to enforce the expectation measure of damages should be the same as was discussed above for contracts to produce things.

Hence, it seems that it is frequently easier to enforce specific performance of contracts to convey property than of contracts to produce things, and that there is no difference in the ability to enforce expectation damages of the two types of contract. Accordingly, it appears that the factor of administrability may favor specific performance of contracts to convey

52. Shifting of this beneficial risk still has implications if the parties are risk averse, for a risk-averse party will value the option to sell to a high outside bidder less than would a risk-neutral person. Thus, if the seller were risk averse, his ex ante evaluation of the 20% chance of being able to sell property for \$150,000 would be lower than that of a risk-neutral buyer. But this effect of risk aversion seems of a second-order nature in comparison to its effect in relation to the chance of bearing comparably large losses in the context of production and cost uncertainty. To formalize this point, suppose that a person has wealth y , utility of wealth $u(y)$, where u is concave (so the person is risk averse), and there is a probability p that he will lose an amount x . The certainty equivalent of this risk of loss is an amount h that would make him indifferent between facing the risk and not. That is, h is defined by $(1-p)u(y) + pu(y-x) = u(y-h)$. Now suppose instead that the person will gain x with probability p . The certainty equivalent of this risk is an amount z that if paid to him he would accept in lieu of the risky gain. Hence, z is defined by $(1-p)u(y) + pu(y+x) = u(y+z)$. Let us show that $h > z$, that a person will pay more to avoid a risk of loss than he needs to be paid to give up the same risk of gain. One can view h and z as functions of the amount x . If one implicitly differentiates the equations defining h and z and solves for $h'(x)$ and $z'(x)$, one obtains $h'(x) = pu'(y-x)/u'(y-h)$ and $z'(x) = pu'(y+x)/u'(y+z)$. It is thus clear that $h'(x) > z'(x)$, since $u'(y-x) > u'(y-h)$ and $u'(y+x) < u'(y+z)$. Also, $h(0) = z(0) = 0$. Hence, $h(x) > z(x)$, the result to be shown.

property, or at least that this factor favors the expectation measure less often than it does for contracts to produce things.⁵³

6. *Transaction Costs*.—The number of transactions in which the contracted-for property is exchanged is something that I have not yet commented upon, but it has relevance, as each transaction will involve some cost. Under specific performance, the number of transactions will tend to be greater than under the expectation measure. Under specific performance, there might be two transactions when an outside party bids more than the buyer's value, for then the contract buyer has a motive to sell to the outsider.⁵⁴ Under the expectation measure, however, there will be only one transaction when an outside party bids more than the buyer's value, for then the contract seller will breach and sell to the outside party. Still, this transaction cost advantage of the expectation measure is offset to a greater or lesser degree by a different cost: when a transaction is avoided because the seller commits breach, a litigation or settlement cost is incurred.

7. *Provisional Summary and Comparison to the Context of Contracts to Produce Things*.—Our examination of contracts to convey property has to this point not yielded any strong reason to believe that specific performance is either inferior to, or superior to, expectation damages; the two remedies seem to be rough equivalents. I first observed that both types of remedy lead to efficient performance, which is to say, to sale to outsiders if and only if their bids would exceed the value the buyer places on the property. This conclusion is very different from that with regard to contracts to produce things, where specific performance may result in inefficient performance or a need by the seller to bargain for release.

I then observed that, just because the seller in a contract to convey property has no need to bargain for his release under specific performance, there is no issue of holdup, and thus no problem of wasteful preventive effort, and also no imposition of detrimental risk. These conclusions again stand in substantial contrast to those in respect to contracts to produce things.

I also noted that implementing specific performance of contracts to convey property is often relatively straightforward and is not in an obvious sense either more or less difficult than enforcing expectation damages. Last, I noted that transaction cost considerations might work against specific performance, but probably only in a modest way.

53. Examples in which the expectation measure is still easier to administer are not difficult to adduce. Suppose that for some reason it would be relatively easy for a court to estimate the value of a painting to a buyer but difficult for courts to locate the painting and force the seller to convey it to the buyer.

54. I say "might" because, if the buyer is aware of the high outside bid before the property is conveyed to him, he and the seller might work out an agreement whereby the property would be sold by the seller in a single transaction to the outside party so as to avoid the extra transaction cost.

All tolled, then, there seems to be little general difference between specific performance and expectation damages, given the assumptions so far made. I now turn to examine a factor that could make specific performance mutually preferable to the expectation measure.

8. *Underestimation of the Value of Performance.*—Suppose now that the value of the property to be conveyed might be underestimated.⁵⁵ This could occur because of an inadvertent error in judicial assessment of value or because of a judicial policy of not attempting to ascertain certain subjective components of value (in order to avoid expense and other difficulties).

It should first be observed that the underestimation of value under the expectation measure does not per se suggest that the parties would not want the expectation measure. The reason is simply that any shortfall in expectation damages that the buyer would anticipate receiving can be compensated for in the form of a lower contract price. For example, if the buyer's expected compensation would be on average \$10,000 less than full compensation, he could be offered a \$10,000 lower price.⁵⁶

In order for underestimation of expectation damages to be undesirable for the parties, one must say why this would tend to lower the *joint* value for the parties. And there is such a reason, having to do with sale or loss of funds to outside parties. Consider our example, in which property is worth \$100,000 to the buyer and the price is \$40,000, but suppose that a court would estimate the value of the property to the buyer to be only \$65,000. Hence, the measure of expectation damages used by the court would be \$25,000 (rather than \$60,000). Then if the outside party bids \$80,000 (which, recall, was one possibility), the seller would have a reason to commit breach, since he would pocket \$55,000 in profit after paying damages of \$25,000 (rather than selling for \$40,000).⁵⁷ If that is the end of the matter, the parties will have suffered a joint loss of \$20,000 (the property will have been sold for \$80,000 even though its value to the contract buyer is \$100,000). However, the contract buyer might seek to purchase the property from the outsider. In this event, the buyer would typically have to pay more than the \$80,000 price that the outsider paid the contract seller. For instance, suppose the contract buyer pays the outsider \$90,000 for the property. Then there is again a joint loss to the original contracting parties, for although the property does ultimately come into the possession of the contract buyer, who

55. I am not ruling out the possibility of overestimation of value; as will be seen, all that is necessary for the argument to be made is that underestimation is a possibility.

56. For a similar example of this concept that takes into account likelihood of breach, see *supra* note 18.

57. Of course, the seller might not commit this inefficient breach, since he and the buyer might bargain and arrive at an agreement whereby the buyer pays him an extra amount to convey the property. But as was discussed generally at the beginning of Part II, bargaining costs and asymmetric information may prevent mutually beneficial agreements from being made even though they exist in principle.

values it most, \$10,000 in profits will have been given to the outsider in the process (the \$90,000 the outsider receives less the \$80,000 he paid to the contract seller). To sum up, underestimation of the value of the property may lead to sale to an outside party who values the property less than the buyer, and this creates two possible sources of joint loss for the parties: the property might simply remain with the outside party; and even if the property is purchased by the buyer, there will typically have been a leakage of funds to the outside party, as he will sell for a higher price than he had paid. In the latter case, there will also be the added costs of a needless transaction.⁵⁸

Under specific performance, in contrast, there is no possibility of joint loss to the parties. The reason is that, since the property must be conveyed to the contract buyer, it is he who will bargain with the outside party, and he will obviously not sell the property for \$80,000 when it is worth \$100,000 to him, for he naturally knows the value of the property to himself. He will sell the property to the outside party if, and only if, the bid exceeds the value he places on the property.

The importance of the possibility of joint loss to the parties under the expectation measure depends on the likelihood of underestimation by the courts, its degree, and the chance that an outside party would bid an amount exceeding the too-low expectation measure but less than the buyer's valuation. If courts are very likely to underestimate significantly the value of the property (say because courts do not attempt to ascertain subjective components and these are large), then the expected loss in joint value could be substantial, meaning that the parties would have a definite preference for specific performance. If courts are not likely to underestimate by very much the value of the property (say because the value is mainly commercial and not unusually difficult to determine), then the likely joint loss to the parties would be small. Yet in this situation, it would do no harm to the parties to elect specific performance, even though it would not yield a real benefit to them.

9. Conclusion and Comparison to the Context of Contracts to Produce Things.—I have explained why the possibility of underestimation of the value of property tends to lower joint value under the expectation measure—because it may lead to sale at a price below the value to the buyer and to leakage of funds to outside parties—whereas specific performance tends to result in the highest joint value for the parties because the buyer sells to outside parties if and only if they pay more than the value to him. Hence, we

58. The argument of this paragraph, that underestimation of the value of property is a problem for the parties, does not carry over to overestimation of the value of property. Suppose, for example, that the value of the property to the buyer in the example is mistakenly thought to be \$175,000 instead of its true value of \$100,000. Then if an outsider bids \$150,000 for the property, the seller would not be led to breach but would convey the land to the buyer. The buyer, however, would sell the property to the outsider, on my assumptions. Hence, the opportunity to sell to the outside party who bids \$150,000 would not be lost.

would expect the parties to prefer specific performance to the expectation measure, with the strength of this preference depending upon the likelihood and degree of the problems associated with underestimation of value under that measure.

Of course, uncertainty in the estimation of the value of performance also tends to lower joint value under the expectation measure in regard to contracts to produce things.⁵⁹ However, an imperfect expectation measure would still often be superior to specific performance, since specific performance is likely to be substantially inferior to the perfectly applied expectation measure. That is, in the context of contracts to produce things, the contest between specific performance and the perfectly applied expectation measure is won by the expectation measure by a large margin. Hence, the imperfectly applied expectation measure still tends to defeat specific performance (unless the imperfection in the expectation measure is severe).⁶⁰

D. Remarks

Before continuing, let me make a number of remarks that relate to and extend the analysis.

1. Contracts to Convey Property and the Availability of Outside Bids to the Original Contracting Parties.—In the context of contracts to convey property, it was assumed that outside parties are just as able to make bids to the contract buyer as to the contract seller. It is useful, though, to reconsider briefly the analysis if this assumption is relaxed. First, suppose that outside parties are most likely to make bids to the contract seller. For instance, imagine that the seller is a dealer in paintings and that the buyer is a private individual. In this situation, specific performance might not function well, for if the property is conveyed to the buyer, he, unlike the seller, probably cannot take advantage of high outside bids.⁶¹ Hence, the expectation measure might be preferred by the parties. Second, suppose the opposite, that outside parties are most likely to make bids to the contract buyer. For instance, imagine now that the buyer is a dealer in paintings and that the seller is a private individual. In this situation, specific performance would continue to function well, as under my assumptions. The expectation

59. The precise reasoning would be somewhat different. Underestimation of the value would lead to excessive breach, or bargaining by the buyer to obtain performance (and possible holdup of the buyer by the seller, with attendant incentives of the buyer to spend wastefully). Also, overestimation of the value would lead to problems of excessive performance and the general difficulties that were described as associated with specific performance in that context.

60. In the context of contracts to convey property, specific performance and the perfectly applied expectation measure are essentially tied. Hence, even a modest imperfection in the expectation measure puts specific performance ahead.

61. Of course, under specific performance, the seller would have a motive to renegotiate with the buyer for release from his obligation to perform if the seller encountered a high outside bidder.

measure would turn out to be usually irrelevant—the seller would not be likely to receive any outside bids, he would not breach, so the buyer would receive the property and would be able to take advantage of high outside bids.

2. *Contracts to Produce Things and Production Cost Risk: The Possibility of Cover; Idiosyncratic Versus Systematic Risk.*—The degree of risk associated with production cost is important to assess, as this risk is what leads to the disadvantage of specific performance for contracts to produce things. In that regard, one issue of significance is whether cover is possible or instead only the contract seller can produce the good in question. If cover is not possible, then the risk faced by the seller should generally be greater and the disadvantage of specific performance more significant than otherwise.⁶²

If cover is possible, it is useful to distinguish between *idiosyncratic risk*—a factor that would increase production cost only for the contract seller, not for other parties who could produce in his stead—and *systematic risk*—a factor that would increase production cost for any party who would produce the desired good. Consider, for example, a building contract, and suppose that the builder becomes ill, making the project more expensive for him (say because he is unable to monitor his employees effectively). This event reflects an idiosyncratic risk, since the costs faced by another builder would presumably be normal. In contrast, suppose that the builder finds it more expensive to perform because the price of a material input rises or because rock is discovered, making excavation of the site more expensive. These eventualities reflect systematic risks, since the costs faced by another builder would also be raised by the change in input prices or the difficulty of removing rock.

The significance of the foregoing distinction is that if the risk is only idiosyncratic, the seller can alleviate it substantially through a covering arrangement. If the builder becomes ill, making the project more expensive to undertake, he can have another builder do the job at the usual cost; hence the production-cost risk is really that of the additional cost of providing cover, not the higher cost that he would face if he himself had to do the job. If the risk is systematic, however, a covering arrangement would do no good for the builder. Equivalently, the disadvantage of specific performance is greater when the production-cost risk is due to a systematic factor that cover

62. The pure notion of cover is that an identical good or service is available from another seller, but perhaps at a price different from the contract price. In fact, courts may allow or insist on cover when the good or service is not identical, but still close to that of the contract good or service. See RESTATEMENT (SECOND) OF CONTRACTS §§ 350 cmt. c, 360 cmt. c (1981) (noting that it is often possible for the injured party to secure goods or services similar to those in the contract by looking elsewhere in the market and that if these are available, the damage remedy is usually adequate; however, if the goods or services are unique, the injured party is more likely to be granted specific performance).

cannot alleviate than when the production-cost risk is due to an idiosyncratic factor that cover can meliorate.

3. *Contracts to Produce Things and Seller Breach in Order to Sell to a High Outside Bidder.*—I have so far assumed that the risk associated with contracts to produce things is that attaching to production cost. Another risk is that an outside party could make a bid for the promised good, leading the seller to want to breach. A seller could contract with a buyer to construct a building, not encounter production cost difficulties, but decide to breach in order to sell the building to an outsider.

What does this Article's analysis suggest about seller breach of contracts to produce, in order to sell to outsiders making high bids? The answer is that for this kind of breach of a contract to produce, specific performance might be the desirable remedy. The reasoning is that which I offered for contracts to convey property: If the seller in our example completes the building and breaches, selling the building to an outsider, the contracting parties might suffer a loss in joint value. If the expectation is underestimated, the building might be sold to an outsider who bids less than the value to the buyer, and even if the buyer then purchases it from the outsider, there will be a leakage of funds to the outsider.⁶³

Thus, if parties make a refined choice of remedy, such that the type of remedy depends on the reason for breach, the parties might specify that the remedy be the expectation measure where the reason for breach is a production cost increase, and that the remedy be specific performance where the reason for breach is to sell to an outside party. Note that the way that specific performance would be enforced to prevent sale to an outside party would be through a negative injunction.

4. *The Judgment-Proof Problem and the Desirability of Specific Performance.*—It was presumed in the analysis that a party in breach would be able to pay expectation damages, but the party's assets may be limited such that he is unable to pay expectation damages. If so, the situation resembles that where damages are less than the expectation measure, and are effectively equal only to the seller's assets. This makes specific performance more desirable than it would otherwise be. Hence, it reinforces the case for specific performance for contracts to convey property and might make specific performance advantageous to employ for contracts to produce things. The problem that I discussed with specific performance for contracts to produce had to do with the possibility that buyers could hold up sellers facing high production costs exceeding the expectation. But if the seller's assets are less than the expectation, the buyer would be unable to extort the seller. Hence, the defects that afflict the use of specific performance would

63. One interpretation of the point of this paragraph is that once the building is produced, the contractual context effectively becomes one of a contract to convey property.

be dulled, yet there would be a problem of excessive breach when the seller's assets are below the expectation measure. Hence, the parties might find it beneficial *ex ante* to name specific performance as the remedy for breach of contracts to produce things.

5. *The Option to Choose Between Specific Performance and Damages Ex Post—At the Time of Breach.*—What has been investigated in the analysis is, of course, the question of which remedy the parties would want to elect *ex ante*, when making a contract. A related question is whether the parties would want to allow the remedy to be chosen *ex post*, by the victim of a breach at the time of the breach. The general answer is that the parties sometimes would not want to allow the choice of remedy to be made *ex post*, that sometimes they would not care whether this is done, and that sometimes they would want to permit the choice to be made *ex post*.

Consider first contracts to produce things, given the assumptions made in our analysis. If the victim of a breach is allowed to elect specific performance, he would tend to do that, since then he could engage in the very behavior that I emphasized was problematic: the buyer could hold up the seller who faces high production costs. Thus, when the parties' *ex ante* preference would be for expectation damages to be the remedy for breach, they would not want to allow the victim to choose the remedy for breach *ex post*, as that would negate their underlying mutual preference for expectation damages.

Now consider contracts to convey property, where I argued that the *ex ante* preference of the parties would often be for specific performance. Here, if the victim of a breach is permitted to choose the remedy at the time of a breach, he would be predicted to choose specific performance, given our assumptions: the reason for the breach would be that the seller would be able to sell at a high price to an outside party; because the buyer would want to secure this advantage for himself, he would prefer specific performance to expectation damages. Hence, allowing the victim of the breach to elect the remedy *ex post* would not interfere with the *ex ante* preferences of the parties for specific performance to be the remedy. At the same time, allowing *ex post* choice of the remedy would not be beneficial to the parties.

Yet in some circumstances, the parties might find it advantageous to allow *ex post* choice of the remedy. For example, consider a contract to convey a parcel of land in which there is little chance of substantial underestimation of its value to the buyer (say its use will be for a commercial purpose that can be fairly readily ascertained). Then our analysis suggested that the remedy of expectation damages and specific performance would be essentially tied, except for enforcement cost considerations. In the latter regard, suppose that either of the remedies might turn out to be the cheaper to

enforce and that which cannot be predicted in advance.⁶⁴ Then the parties would want to allow the victim of a breach to choose the cheaper of the remedies on an ex post basis.

III. The Law: Anglo-American, French, and German

Here I provide a synopsis of the law regarding the choice between specific performance and damages as remedies for breach of contract. I consider not only Anglo-American law, but also, as noted in Part I, French and German law, for they provide central examples of civil law systems. Additionally, I interpret the law in the light of the theory discussed in Part II.

A. Anglo-American Law

According to the *Restatement of Contracts*, specific performance means fulfilling the performance due in the contract as nearly as practicable, and it is ordinarily interpreted to imply that the party in breach is directly required to render performance.⁶⁵ Sometimes, however, specific performance is accomplished indirectly, by means of an injunction,⁶⁶ yet specific performance is not understood to include the award of damages in order to allow the victim of breach to make a covering purchase.⁶⁷ Specific performance is reserved for a limited set of circumstances in our legal system; the usual remedy for breach is the expectation measure of damages. The traditional rule is that specific performance may be granted only where expectation damages would be inadequate.⁶⁸ Expectation damages might be especially inadequate where they would be difficult to establish, where a suitable substitute cannot be purchased, or where the party in breach is likely to be judgment proof.⁶⁹ The *Restatement* restricts use of specific performance on various grounds,⁷⁰ one being that it would be difficult to enforce.⁷¹ Under Article 2 of the Uniform Commercial Code, applying to the sale of goods, specific performance is intended to be somewhat more

64. Specific performance might be cheaper to enforce if there would be little problem with eviction of the owner from the land and if damages would be hard to collect (say the seller's assets would be hard to locate). Specific performance might be more expensive to enforce in the reverse circumstances, if there would be problems with eviction and if damages would be easy to collect.

65. RESTATEMENT (SECOND) OF CONTRACTS § 357 cmt. a (1981).

66. *Id.* § 357(2)(b). Hereafter, for convenience, I will often use the term "specific performance" to embrace the injunction as well.

67. Although damages may be part of an order for specific relief, *id.* § 358 cmt. c, damages that allow cover normally are described as substitutionary relief. *See id.* § 347 cmt. a (describing a situation in which a party should be compensated based on having to obtain a substitute after breach).

68. *Id.* § 359(1).

69. *Id.* § 360.

70. *Id.* §§ 362–368.

71. *Id.* § 366.

liberally granted than under the principles of the *Restatement*—the Uniform Commercial Code does not require that expectation damages be inadequate for specific performance to be granted.⁷² But specific performance is still an unusual remedy under the Uniform Commercial Code, authorized only where the goods are unique or in certain other circumstances.⁷³ Commentators' descriptions of when specific performance is granted are in the same vein (although they note that the inadequacy-of-damages test has become less important, allowing the scope of specific performance to increase).⁷⁴

When the subject matter of contracts in which specific performance or the injunction is granted is considered, one finds the following. Contracts for the sale of real estate are routinely specifically enforced,⁷⁵ and typical additional examples where specific enforcement may be granted include contracts for the sale of paintings, antiques, patents, franchises, licenses, and untraded stock.⁷⁶ These are all, note, contracts to convey property. One finds less mention of the use of specific enforcement or the injunction for contracts to produce things.⁷⁷ Contracts to perform personal services generally cannot be specifically enforced,⁷⁸ but contracts to provide

72. JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 6-6 (5th ed. 2000).

73. *Id.*

74. Several authorities discuss the granting of specific performance. *See, e.g.*, CALAMARI & PERILLO, *supra* note 4, §§ 16.1–6; FARNSWORTH, *supra* note 4, §§ 12.6–7; YORIO, *supra* note 4, §§ 1.1–3.4.

75. *E.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 360 cmt. e (1981); CALAMARI & PERILLO, *supra* note 4, § 16.2; FARNSWORTH, *supra* note 4, § 12.6, at 776; YORIO, *supra* note 4, § 10.1, at 260.

76. *See* RESTATEMENT (SECOND) OF CONTRACTS § 360 cmt. b (1981) (listing among examples of interests typically incapable of monetary valuation, “heirlooms, family treasures and works of art,” as well as “contracts to transfer shares of stock”); CALAMARI & PERILLO, *supra* note 4, § 16.3, at 615 (“Contracts for the sale of unique personalty other than goods are also specifically enforceable . . .”); FARNSWORTH, *supra* note 4, § 12.6, at 776 (acknowledging the traditional view that, although specific performance may be inappropriate generally for contracts for the sale of goods, exceptions are made for “such ‘unique’ items as heirlooms and objects of art”); YORIO, *supra* note 4, §§ 11–12 (discussing the use of specific performance in the context of contracts for the sale of goods and for intangible personalty); Kronman, *supra* note 22, at 355–56 (listing as typical situations in which courts grant specific performance, contracts for the sale of “heirlooms, antiques, and certain licenses and patent rights,” as well as “contracts for the sale of a majority of shares in a particular corporation”).

77. References to the use of specific performance for contracts to produce things can, of course, be found. *See* RESTATEMENT (SECOND) OF CONTRACTS § 360 cmt. b, illus. 4 (1981) (discussing specific enforcement of an output contract); YORIO, *supra* note 4, § 13 (discussing specific enforcement of construction contracts); Kronman, *supra* note 22, at 356–57 (mentioning examples of specific enforcement of construction contracts).

78. RESTATEMENT (SECOND) OF CONTRACTS § 367(1) (1981); *see also* CALAMARI & PERILLO, *supra* note 4, § 16.5, at 617 (“No court will order an employee, or other person who is to render personal services, to perform.”); FARNSWORTH, *supra* note 4, § 12.7, at 781 (“A court will not grant specific performance of a contract to provide a service that is personal in nature.”); YORIO, *supra* note 4, § 14.1, at 355 (“Virtually all the authorities agree that a promise to render a personal service is not specifically enforceable.”).

nonpersonal services are occasionally specifically enforced;⁷⁹ injunctions not to provide goods and services to others are sometimes ordered.⁸⁰

What is the economic interpretation of the doctrines governing use of specific performance versus damages, and of the subject matter of the contracts in which we tend to observe specific enforcement as the remedy for breach?

First, the observed legal outcomes seem broadly consistent with the economic theory in the important sense that specific performance appears to be employed as a remedy primarily for breach of contracts to convey property rather than of contracts to produce things or to provide services.⁸¹

Second, the doctrinal requirements surrounding inadequacy of damages display a consistency with economic logic. The law's insistence that damages be inadequate serves to single out situations in which there is a risk of joint loss of value to the parties, and hence where the use of expectation damages would not be in the mutual interests of the parties. In particular, there are three tests bearing on inadequacy mentioned in the *Restatement*.⁸² One relates to uncertainty about the value of performance.⁸³ If such uncertainty is substantial, the risk of underestimation would be high. Another test is whether a substitute good is available, or equivalently, whether the good is unique.⁸⁴ Clearly, if a substitute is available for purchase, there is no danger of inadequate damages, since damages equal to the price necessary to acquire the substitute by definition will make the victim whole (it does not matter if the court does not know the utility provided by the good; all that matters is that the substitute can be purchased). Hence, the unavailability of a substitute means that there is a risk that the expectation measure might be underestimated, because the utility value of something to a person is often intrinsically difficult to ascertain. The third test concerns inability to pay expectation damages,⁸⁵ which, as I commented in section II(D)(4), might cause the parties to suffer joint losses under the expectation measure and thus might lead the parties to want to elect specific performance. Additionally, the requirement that supervision of specific performance not be difficult is obviously consistent with the economic

79. See CALAMARI & PERILLO, *supra* note 4, § 16.5, at 619 (noting that, while courts "have been reluctant to enforce even non-personal services contracts," they nevertheless "have granted such relief where particularly compelling circumstances" exist).

80. See RESTATEMENT (SECOND) OF CONTRACTS § 357 cmt. b (1981) ("A court may by injunction direct a party to refrain from doing a specified act."); see also YORIO, *supra* note 4, §§ 14.3-4, 16.2-3 (discussing negative injunctions, including the use of such injunctions to enforce noncompetition covenants and exclusive dealing contracts).

81. To state the point differently, the law would be inconsistent with economic theory if specific enforcement were carried out mainly for breach of contracts to produce things and to provide services.

82. RESTATEMENT (SECOND) OF CONTRACTS § 360 (1981).

83. *Id.* § 360(a).

84. *Id.* § 360(b).

85. *Id.* § 360(c).

analysis, for problems in supervision would be associated with a loss in joint value for the parties (because they would bear some of the costs of supervision and because the performance itself might be poor).

But questions may be also raised about the consistency of the law with the economic theory developed here. A major question is why specific performance is not granted for a greater range of contracts to convey property and, indeed, why the inadequacy-of-damages and the uniqueness test are required for its use. As was explained in the analysis of contracts to convey property,⁸⁶ specific performance is either essentially tied with expectation damages, when that measure would be assessed well, or else it is superior to expectation damages, when that measure would be likely to be inadequate. Hence, the legal system could employ specific performance as the standard remedy for breach of contracts to convey things; the inadequacy test is needed only if the background remedy for breach is the expectation measure. And since application of the inadequacy test presumably involves costs for the legal system and for contracting parties, one could question whether it should be used for contracts to convey property.⁸⁷ Moreover, this point that the legal system need not use the inadequacy test is illustrated by the fact that specific performance is routinely granted for contracts to convey real estate, that is, without any showing that damages would be inadequate.⁸⁸

Another important question concerns the use of specific performance for some contracts to produce things and to provide services, even though this use is limited. From the standpoint of the basic theory discussed in subpart II(B), specific performance for breach of such contracts tends not to serve the joint interests of contracting parties, because it creates difficulties when sellers face high production costs. Let us consider examples of the use of specific performance to see what can be said about this issue. One type of production contract where specific performance is sometimes employed is an output contract, stating that the seller must be prepared to provide his entire output to the buyer.⁸⁹ Specific performance of this type of contract does not raise problems when seller production cost would be high, for the contract does not say that a particular quantity must be delivered, only that the entire output, whatever quantity that might be, be delivered. Consequently, if production cost turns out to be high, the seller could choose to produce little or nothing and would still be in compliance with the output contract. Specific performance of an output contract therefore has the feature that,

86. See *supra* sections II(C)(7)–(8).

87. The test still might make sense as a requirement for specific performance for contracts to produce things, since the background rule for these contracts should be payment of expectation damages, as has been one of the major themes of this Article.

88. Yet it is acknowledged that adequate damages could often be calculated. For example, Edward Yorio observes that the risk of undercompensation in damages is “slight” for the “mass-produced development house or apartment.” YORIO, *supra* note 4, § 10.1, at 260.

89. See *id.* § 11.2.4 (analyzing the role of specific performance when output and requirements contracts are breached).

even though it concerns production, it does not involve problems when costs are high and thus is not inconsistent with the theoretical argument against specific performance. Another type of production contract where specific performance may be employed is a requirements contract, under which the seller must be prepared to provide whatever the buyer's requirements are.⁹⁰ Specific performance of this type of contract obviously does raise problems when production cost would be high, so that one wonders whether specific performance of such contracts is desirable, at least if the cause of breach is an increase in costs, rather than to sell to another party. Some construction contracts and some contracts for services are specifically enforced, as was noted, so here there is a potential for problems due to high production cost. Whether, when one examines the facts in the cases where specific performance is granted, these problems are significant is an issue that would be interesting to investigate.

The use of the negative injunction, rather than of specific performance, to enforce certain contracts to produce things or to provide services is of special note, since, in fact, it is consistent with economic theory. As was explained in section II(D)(3), the injunction, unlike specific performance, does not lead to problems for a seller who faces high production costs. Instead, the injunction operates to prevent a seller who, having produced his good or being able to provide his service (when production costs are not high), considers breach because he wants to sell to an outside party. Preventing an opera singer from singing at a competing opera house does not mean that if it is very difficult or onerous to appear, she must; it only prevents her from selling her services to an outside party, and thus prevents possible loss of value to the contracting parties for the general reasons supplied in subpart II(B).

In summary, then, the Anglo-American law regarding the use of specific performance and the negative injunction exhibits certain consistencies, some quite nuanced, with economic theory, the major one being that the greatest use of specific performance seems to be for contracts to convey property, not for contracts to produce things or to provide services. Yet it appears that specific performance could be employed more broadly than it is as a remedy for breach of contracts to convey property, raising questions about the need for the requirements of inadequacy of damages and of uniqueness for such contracts.

B. French Law

The *French Civil Code* draws a basic distinction between contracts to convey property, so-called contracts to give, and contracts to produce goods

90. *See id.* (discussing the use of specific performance to enforce output and requirements contracts); *see also* CALAMARI & PERILLO, *supra* note 4, § 4.13 (discussing requirements and output contracts, and defining the former as where “the buyer expressly agrees to buy all of the buyer’s requirements of a stated item from the seller who agrees to sell that amount to the buyer”).

or to provide services, so-called contracts to do.⁹¹ For contracts to give, the remedy is specific performance, and for contracts to do, the remedy is damages.⁹²

Hence, the general distinction that the *French Civil Code* draws as to when to employ specific performance and when damages is the same one developed in the economic theory of this Article.

There has been, however, a development in the operation of French law such that specific performance has been effectively granted for many contracts to do—excepting those for personal services.⁹³ Courts have increasingly employed a device peculiar to the French system called the *astreinte*, whereby a party who fails to fulfill his contractual obligation faces a possible penalty, mounting over the time of the breach, that has to be paid to the victim of the breach in addition to normal damages.⁹⁴ Use of the *astreinte* for contracts to do resembles specific performance and thus appears inconsistent with the analysis here, although it is not evident how often the *astreinte* is in fact imposed, and it is possible that application of the *astreinte* is restricted when sellers face high production cost.

C. German Law

Under German law, the general remedy for breach of a contract is specific performance, although contracts for personal services are enforced by damages.⁹⁵ If the contract is to convey moveable property, it is rendered by having the police, if necessary, forcibly take the property and give it to the contract buyer, or if it is to convey land, it may be accomplished by ejecting the seller from the land.⁹⁶ If the contract is to produce a good or provide a service, specific performance is frequently implemented by a covering contract.⁹⁷ Often, the victim of a breach purchases the good or service from someone else and the seller must pay the bill; it is apparently atypical for the

91. See Treitel, *supra* note 5, § 16-18 (discussing the *French Civil Code* and, in particular, its distinction between the “obligation to do or not to do (*de faire ou de ne pas faire*)” with the “*obligation de donner* or to transfer property”).

92. Article 1126 of the *Code* divides contracts into promises to give (to transfer specific assets) and contracts to do or not to do. CODE CIVIL [C. CIV.] art. 1126 (Fr.), translated in THE FRENCH CIVIL CODE 220 (John H. Crabb trans., rev. ed. 1995). Article 1142 states that contracts to do or not to do are resolved in damages. C. CIV. art. 1142, translated in THE FRENCH CIVIL CODE, *supra*, at 222. Articles 1136, 1138, and a number of other articles provide that contracts to give are specifically enforced. C. CIV. arts. 1136–1141, translated in THE FRENCH CIVIL CODE, *supra*, at 221–22.

93. ZWEIGERT & KÖTZ, *supra* note 5, at 475–76; see *supra* note 15.

94. See generally *id.* at 476–79 (providing an overview of the use of the *astreinte* in France); James Beardsley, *Compelling Contract Performance in France*, 1 HASTINGS INT’L & COMP. L. REV. 93 (1977) (same); Dawson, *supra* note 5, at 514–25 (same); Treitel, *supra* note 5, §§ 16-24 to -28 (same).

95. ZWEIGERT & KÖTZ, *supra* note 5, at 472–74.

96. *Id.* at 473.

97. *Id.* at 473–74.

seller of a contract to produce a good or provide a service himself to be forced to perform.⁹⁸ (Note, therefore, that what is described as specific performance in Germany would often probably be described as damages in our legal system.)

German law seems inconsistent with the economic analysis of this Article in the respect that specific performance is available for most contracts to produce things or to provide services, although the barring of specific performance for personal service contracts agrees with the economic theory. However, the problem discussed in the analysis with specific performance for such contracts, concerning sellers who face high production cost, is somewhat addressed under German law by the provision that specific performance is not supposed to be granted if production costs are disproportionate.⁹⁹ It is also important to remember that, as mentioned, the way in which specific enforcement tends to be implemented is by the party in breach paying for a covering contract.¹⁰⁰ This would usually mean that it is less expensive for that party to comply than if the party literally had to perform and cover were not available; the holdup, risk-bearing, and other problems associated with specific performance may thus often be less than would otherwise be true.¹⁰¹

D. Comments on the Fit Between the Law and Economic Theory

As has been described, the law seems to display an important consistency with economic theory in the general character of the choice that it has made between specific performance and money damages for breach. The consistency is that specific performance is employed at least for contracts to convey property where use of damages would not work well—under Anglo-American law, only for such contracts to convey property, and under French and German law, for all contracts to convey property—and that specific performance is used less for contracts to produce things than for contracts to convey property. Such broad consistency is not a surprise, since if the law deviated too much from what is mutually desirable for the parties (which is what the economic analysis here seeks to identify), we would expect there to be pressure for change.

98. *Id.* at 472–74; Dawson, *supra* note 5, at 527–32; Treitel, *supra* note 5, § 16-15. The unlikelihood of a person literally being forced to perform follows not only from German law but also from a consideration of actual practice. A recent article, Henrik Lando & Caspar Rose, *On the Enforcement of Specific Performance in Civil Law Countries*, 24 INT'L REV. L. & ECON. 473, 478–79 (2004), emphasizes the rarity of such literal specific enforcement in civil law countries, including Germany.

99. See Treitel, *supra* note 5, § 16-13 (explaining that one exception to Germany's general rule that the victim of breach is entitled to specific performance is “where the cost of putting the plaintiff into the position in which he would have been but for the default involves unreasonable efforts or expense”).

100. ZWEIGERT & KÖTZ, *supra* note 5, at 473.

101. See *supra* subpart II(B).

At the same time, I have pointed to apparent inconsistency with economic theory, in that questions may be raised about the need for the inadequacy test in Anglo-American law, and about the use of specific performance for contracts to do under French law (via the *astreinte*) and under German law (even though tempered by the defense of disproportionate seller cost). That there may be inconsistency with what is in the mutual ex ante interests of the parties, and differences among the legal systems, is also not surprising. On one hand, the rules at issue are to an important extent only default rules: the parties can often name their own remedy,¹⁰² reducing pressures for change of the law. On the other, the law is influenced by legal culture and history, which can produce results that depart from what is in the interests of contracting parties and that vary across countries. In this regard, it is of note that the inadequacy-of-damages requirement for use of specific performance in Anglo-American legal regimes is said to have its roots in the historical separation of courts of law and courts of equity.¹⁰³ Also of note is that civil law systems have been influenced by the traditions of the Roman law scholars, who engaged in a continuous discussion over the years about specific performance versus money damages, and who emphasized the distinction between contracts to convey property and contracts to produce things.¹⁰⁴

E. The Law As Default; The Power of Contracting Parties to Choose Between Specific Performance and Damages Ex Ante

As mentioned, it is of interest to see to what degree contracting parties are able to choose their own remedy when they contract, for if they have the freedom to do so, the consequences of mistaken choice by the legal system are reduced. Under Anglo-American law, parties can elect damages in their contract instead of specific performance.¹⁰⁵ However, they face problems if they want to choose specific performance where the law would award only damages; courts are unlikely to grant specific performance in such circumstances, and courts generally frown upon the imposition of high damages that appear to be penalties.¹⁰⁶ Still, the strategy of providing for arbitration of disputes in their contracts may increase the parties' chances of

102. See *infra* subpart III(E).

103. See, e.g., FARNSWORTH, *supra* note 4, § 12.4 ("When, during the long jurisdictional struggle between the two systems of courts, some means of accommodation was needed, an adequacy test was developed to prevent the chancellor from encroaching on the powers of the common law judges.").

104. See the account of Dawson, *supra* note 5, particularly at 496–510, which discusses the development of Roman and French contract remedies, and at 525–27, which focuses on Germany's departure from earlier civil law traditions.

105. See YORIO, *supra* note 4, § 20.2 (discussing various ways in which contracting parties can strip a nonbreaching party's specific performance rights).

106. See *id.* § 19.2 (noting that "a clause in a contract providing for specific performance . . . does not by itself bind a court to grant the agreed remedy," and discussing reasons why a court might not choose to enforce such a provision).

obtaining enforcement of specific performance or of high damages where the law would not otherwise allow that.¹⁰⁷ Under French and German law, it seems that parties can choose specific performance or damages and that the courts tend to enforce their choice.¹⁰⁸ Hence, with the exception of the difficulties the parties face in choosing specific performance as a remedy in Anglo-American law, parties usually enjoy the power to choose the form of remedy when they contract. Of course, from a general economic perspective, it is desirable to allow parties to contract as they wish, in the absence of external effects or lack of information on the part of one of the parties to the contract. Hence, the Anglo-American resistance to allowing parties to opt for specific performance, to the extent that it exists, seems problematic.

IV. Legal Commentary on Specific Performance Versus Damages, and Evidence About Parties' Preferences Between Them

My object here is first to discuss two general themes of legal thinking bearing on the choice between specific performance and damages. Then I remark on several articles in the law-and-economics literature dealing with specific performance versus damages and also on evidence concerning parties' preferences over the two major forms of remedy.

A. The Moral Duty to Keep Promises As an Argument for Specific Performance

A common view is that the moral duty to keep promises implies that contracts should not be breached and hence that the law should specifically enforce contracts. This view is widely noted by scholars,¹⁰⁹ is mentioned in authoritative sources, such as the *Restatement (Second) of Contracts*,¹¹⁰ and is presumably a motivation of the German rule that specific performance is the overarching remedy for breach. The corollary of the view that morality requires parties not to breach contracts is that it is immoral, or at least that it is not clearly moral, for a person to breach a contract and pay damages.

I will suggest here, however, that the foregoing ideas may be questioned from a moral perspective. In particular, the notion that a typical contract should be seen as the kind of promise that morality requires one to keep

107. *Id.* § 19.4, at 448.

108. See ZWEIGERT & KÖTZ, *supra* note 5, at 479 (noting that “[i]n both German and French law, . . . a contractor is in principle entitled to demand that his contract be performed in specie”).

109. See, e.g., FARNSWORTH, *supra* note 4, § 12.1, at 755–56; CHARLES FRIED, *CONTRACT AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION* 1–27 (1981); YORIO, *supra* note 4, § 1.4.3; Eisenberg, *supra* note 27, at 1012. Although the view that there is a moral obligation to obey contracts is usually stated by legal scholars, most do not suggest that it should justify wide use of specific performance.

110. RESTATEMENT (SECOND) OF CONTRACTS ch. 16, introductory note (1981).

derives from a failure to distinguish between complete and incomplete contracts.¹¹¹

To explain, the kind of promise that morality would require a person to honor is arguably a promise that the promisor and the promisee fully considered. Suppose that parties make a contract to excavate a building site and that there are two possible states of the site: a usual state in which digging is straightforward, and an abnormal state in which hard rock is encountered, making digging impossible and requiring blasting that would cost far more than it is worth to the buyer. In a completely considered contract, both possible states will have been discussed by the parties and explicitly addressed. For illustrative purposes, let us suppose that, having considered both states of the site, the completely detailed contract would say that the seller should excavate in the usual state of the site but that the seller is excused from having to excavate in the abnormal state. The moral duty to obey a promise arguably applies to this complete contract and thus would impose an obligation on the seller to excavate only in the normal state of the site. There would be no moral duty to excavate in the abnormal state. More generally, I assume that the moral requirement to perform in a contingency applies if and only if the completely detailed contract would impose a duty to perform in that contingency.

It should be noted too that economics is in accord with this assumption about what morality would require: If parties make a completely detailed contract, then they would agree *ex ante* that the contract should be specifically enforced, meaning that when and only when the contract calls for an action to be taken would that action be taken.¹¹² In the example, therefore, excavation of the site would occur in the normal state of the site but not in the abnormal state.

Now in reality, it is manifest that individuals do not make completely detailed contracts. Their contracts are considerably incomplete, omitting express terms for a vast multitude of individual contingencies. This is for well-recognized reasons, notably that parties save time and effort by not discussing and not providing for many possible contingencies, especially if they are unlikely.¹¹³ In the example, let us imagine that due to the

111. The argument to be made is to my knowledge first noted in Steven Shavell, *Damage Measures for Breach of Contract*, 11 BELL J. ECON. 466, 466–69, 487–89 (1980) [hereinafter Shavell, *Damage Measures*], is discussed in LOUIS KAPLOW & STEVEN SHAVELL, FAIRNESS VERSUS WELFARE 172–97 (2002), and is generally explained in Steven Shavell, *Is Breach of Contract Immoral?* (John M. Olin Ctr. for Law, Econ., and Bus., Harvard Law Sch., Discussion Paper No. 531, 2005), available at http://www.law.harvard.edu/programs/olin_center/papers/pdf/Shavell_531.pdf.

112. See, e.g., SHAVELL, *supra* note 31, at 305–06.

113. A second major reason for not including contingencies is that they may be difficult for courts to verify. For instance, if it would be difficult for a court to verify the occurrence of a technical production problem, then a contract that excused performance if that problem arose would be unworkable; hence the parties would not include the occurrence of this production contingency in their contract. On reasons for incompleteness of contracts, see, for example, *id.* at 299–301,

unlikelihood of the excavation site being abnormal, the parties do not discuss, and the contract does not provide for, that contingency; the contract simply says that the seller is supposed to excavate the site. If, then, the site turns out to be abnormal and would require very expensive blasting to excavate, does the seller have a moral duty to excavate? The answer would seem to be no. The seller never said that he would excavate in this contingency; and, by hypothesis, had he discussed the abnormal contingency, he and the buyer would have agreed that there would be no duty to excavate. The point illustrated here is that because contracts are incomplete, that is, do not explicitly address many contingencies, one cannot automatically say that a person has made a promise to, or has a moral duty to, do a particular thing in a problematic contingency even though the contract in a formal sense imposes an obligation to perform. One often has to examine the particular contingency to ascertain what the nature of the promise would have been for that contingency in order to say whether the person has a moral duty to perform.

Given the incompleteness of contracts in the sense of not providing explicitly for singleton contingencies, we can view the ability to commit breach and pay damages as not necessarily immoral and possibly as advantageous. The ability to commit breach affords promisors an escape hatch that often permits them not to perform in approximately the circumstances in which a complete contract would excuse them from the obligation to perform. In our example, the complete contract would not require the promisor to excavate in the abnormal state of the site with hard rock. Under the expectation measure, the promisor would decide to breach in this abnormal state because that would be cheaper than performing. In committing breach and paying damages, the promisor would be acting in exactly the way called for by a complete contract. Insisting on specific performance of the incomplete contract and having the promisor excavate in the abnormal contingency would conflict with the true promissory wishes of the parties, as represented by the notional completely detailed contract. Hence, there is a sense in which, from a moral perspective, criticism of contracting parties' ability to commit breach and pay expectation damages is confused and reflects the opposite of what ought to be seen as the truth—that there is no moral duty to perform in certain circumstances.

Let me make two additional observations about what has just been said before continuing. First, the conclusion from subpart II(B) that parties would tend to find expectation damages mutually desirable for contracts to produce things is of a piece with the point that contracts are incomplete and that in a completely detailed contract there would not always be a duty to produce.

Oliver Hart, *Incomplete Contracts*, in 2 THE NEW PALGRAVE: A DICTIONARY OF ECONOMICS 752, 753–55 (John Eatwell et al. eds., 1987), and Alan Schwartz, *Incomplete Contracts*, in 2 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 277, 279–82 (Peter Newman ed., 1998).

Second, it is quite possible that breaches of questionable morality occur under damage measures. If damages are less than the value of performance, a seller might be led to commit breach when performance would have been called for in a completely detailed contract. Suppose, for instance, that a photographer who has contracted to take pictures at a wedding decides to commit breach in order to photograph another event for which he would be paid modestly more, knowing that the damages he would owe for his breach would not adequately reflect the very high value the wedding couple attaches to having photographs of their ceremony. Here, the decision of the photographer to break his contract might well deviate from what would have been called for in a complete contract and could therefore be considered immoral. More generally, there are reasons to believe that expectation damages are systematically less than fully compensatory,¹¹⁴ so that the practical reality is that many breaches may be immoral, even though, were expectation damages truly compensatory, that would not be so.

B. The Notion That Contract Remedies Should Make the Victim of the Breach Whole

A common, if not the dominant, view of the underlying purpose of remedies in Anglo-American law is to redress injury to victims of breach.¹¹⁵ Under this view the expectation measure is an acceptable remedy if the value of performance is accurately determined, but if there is a substantial chance of underestimating the value, specific performance should be employed because, by definition, it guarantees that the victim of a breach is made whole. As many have observed, however, the view that remedies should be redressive would also justify the use of specific performance as the general remedy for breach (as in German law).¹¹⁶

In any event, from the economic perspective considered here, that is, from the perspective of the joint interests of the contracting parties, one does not assume that the remedy for breach ought to make the victim whole. Indeed, I stressed the point that although specific performance makes the victim whole, it often works against the joint interests of the parties who make contracts to produce things—ex ante the parties would both prefer damages to specific performance—for specific performance may create

114. An account of why damages are undercompensatory is given in Eisenberg, *supra* note 27, at 989–96. See also Schwartz, *supra* note 24, at 276 (explaining that damages are often undercompensatory because they are difficult to monetize).

115. Typical statements are that of the RESTATEMENT (SECOND) OF CONTRACTS ch. 16, introductory note (1981), stating, “The traditional goal of the law of contract remedies has not been compulsion of the promisor to perform his promise but compensation of the promisee for the loss resulting from the breach,” and that of FARNSWORTH, *supra* note 4, § 12.1, at 756, “Our system of contract remedies is not directed at *compulsion of promisors to prevent breach*; it is aimed, instead, at *relief to promisees to redress breach*.”

116. *E.g.*, Kronman, *supra* note 22, at 365 (“If the fact of breach is an adequate reason for protecting the promisee from a risk of undercompensation, it is unclear why a promisor should ever be permitted to substitute money damages for the actual performance of his obligation.”).

problems of wasteful breach, risk bearing, and buyer holdup of sellers. I also explained that, when the expectation would be underestimated in the context of contracts to convey property, specific performance tends to work in favor of the joint interests of the parties. The reason for the latter conclusion was not that the parties have a per se desire for the victim of the breach to be made whole, but rather that underestimation of the expectation measure might lead to sale of the property to an outsider who values it less than the buyer or to leakage of profits to the outsider.

It may be helpful to provide another illustration of the point that the parties may not want the agreed-upon remedy to make the nonbreaching party whole (even though this illustration does not relate to specific performance versus damages). Suppose that a small, risk-averse supplier of machine tools contracts with a large, risk-neutral corporation to produce and deliver tools and that if the tools are not supplied, the corporation will have to halt its production line and suffer a substantial loss in profits. Because the supplier of machine tools is risk averse, it does not want to bear the large risk of having to pay expectation damages equal to the corporation's loss in profits were it not to perform. And because the corporation is large, it would be able to absorb the risk in question. Hence, the ex ante arrangement that these two parties might well favor is one in which the supplier would not have to pay expectation damages. Instead, the parties might agree to a contract allowing the supplier to be excused from having to perform on a satisfactory showing that it would be difficult to perform (even though such a contract would be more expensive to implement than a simpler one allowing breach and payment of expectation damages). In other words, in this contract, the parties plausibly do *not* want the victim of the breach to be made whole.

Still another comment is that, as observed earlier,¹¹⁷ failure to make the victim of a breach whole is not in any clear way detrimental in an ex ante sense to the potential victim of a breach, as that party can secure a more favorable contract price to compensate for the ex post disadvantage he faces.

None of the foregoing is to say that remedies that compensate victims fully for losses due to breach are undesirable. As explained in Part II, the expectation measure of damages often promotes the ex ante interests of the parties, because it induces performance when and only when that would augment joint value. But the foregoing is meant to convey the point that, from the perspective of fostering the joint interests of parties to contracts, the goal of making the victim whole is logically arbitrary. One might or might not come to the conclusion that a remedy that makes a victim whole is

117. See *supra* note 18.

desirable for the parties, but one would not assume this to be the goal, as it can conflict with the interests of the parties.

C. Economically Oriented Literature on Specific Performance Versus Damage Measures

In early economic literature on breach of contract, it was often assumed that remedies for breach directly determined breach behavior—that renegotiation of contracts would not occur.¹¹⁸ From this perspective, specific performance is undesirable and inferior to expectation damages, for under specific performance, there will be excessive performance, when its cost outweighs the value of performance or when the buyer only could sell to a high outside bidder, whereas these outcomes do not occur under the expectation measure. However, when the assumption that renegotiation of contracts was considered,¹¹⁹ specific performance was no longer clearly inferior to the expectation measure, for the prospect of inefficient breach under specific performance would lead the promisor to bargain for release from his obligation to perform. This observation made the relative desirability of the remedies depend on factors such as the cost of renegotiation.¹²⁰ An additional element of the economic background relating to specific performance is the commonly expressed presumption that the cost of its implementation may be high, especially for contracts to produce goods or perform services.¹²¹

118. See, e.g., A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 25–36 (1983) (discussing how expectation, reliance, and restitution damages affect breach behavior); Robert Birmingham, *Breach of Contract, Damage Measures, and Economic Efficiency*, 24 RUTGERS L. REV. 273 (1970) (discussing how expectation damages encourage efficient breach); Robert Cooter, *Unity in Tort, Contract, and Property: The Model of Precaution*, 73 CAL. L. REV. 1, 11–19, 29–37 (1985) (discussing how damages for breach of contract influence precaution taking); Shavell, *Damage Measures*, *supra* note 111 (using an economic model to evaluate the effects of damage measures on breach behavior).

119. See, e.g., Richard Craswell, *Contract Remedies, Renegotiation, and the Theory of Efficient Breach*, 61 S. CAL. L. REV. 629, 631 (1988) (discussing how renegotiation affects the expectation remedy); William P. Rogerson, *Efficient Reliance and Damage Measures for Breach of Contract*, 15 RAND J. ECON. 39 (1984) (addressing the effect of renegotiation on the level of reliance and the measure of expectation damages).

120. See, e.g., ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 240–41 (3d ed. 2000) (discussing renegotiation as a possible reaction to the specific performance remedy, but noting that if renegotiations are costly, “the damage remedy for breach of contract has an advantage over specific performance”); POSNER, *supra* note 19, § 4.12 (noting that a specific performance decree is “not catastrophic, since the seller can always pay the buyer to surrender the right of specific performance,” but observing that such a payment could be greatly disproportionate to the cost to the buyer of the seller’s nonperformance). Another factor on which the remedies are compared is the degree of reliance expenditures that are induced. See, e.g., Rogerson, *supra* note 119; Shavell, *Damage Measures*, *supra* note 111 (examining how different damage measures affect decisions about breach and reliance).

121. See YORIO, *supra* note 4, § 3.3.2 (explaining that coercing performance of those contracts that can only be fulfilled with active participation on the part of the promisor poses three potential problems: the process of supervision imposed on the courts; issues involved in passing judgment on

I now describe several articles of an economic nature that focus on the comparison of specific performance and damages as remedies for breach, and I relate what they say to the analysis in this Article.

Anthony Kronman asks when specific performance would be in the joint interests of contracting parties.¹²² He suggests that the parties would ordinarily desire damages, mainly because of a view that use of specific performance could lead to expensive bargaining between them.¹²³ He also suggests that if the value of performance is difficult for courts to determine, specific performance would be in the mutual interests of the parties.¹²⁴ Thus, he appears to offer an endorsement of the Anglo-American use of specific performance.¹²⁵

The essential reason that Kronman provides to explain why uncertainty about the expectancy makes specific performance mutually attractive to contracting parties concerns a hypothesized difference of opinion between sellers and buyers about high outside bids.¹²⁶ In particular, he assumes that sellers systematically believe that high outside bids are unlikely,¹²⁷ yet that buyers believe high outside bids are likely.¹²⁸ Under this assumption, the parties might be expected to choose specific performance: A seller would regard specific performance as not very costly to grant (if a high outside bid is very unlikely, giving away the right to sell to an outside bidder is giving away very little), whereas a buyer would consider specific performance a valuable remedy to be granted (if a high outside bid is likely, obtaining the

the quality of performance rendered; and the possibility of supervision extending for some period of time).

122. Kronman, *supra* note 22, at 365–69.

123. *See id.* at 369 (asserting that contracting parties will usually prefer money damages for contracts that do not have a unique subject matter because, among other reasons, under specific performance, “the transaction costs of negotiating a transfer of the promisee’s contract rights are [in some cases] prohibitively high”). A roughly similar view is expressed in Timothy J. Muris, *The Costs of Freely Granting Specific Performance*, 1982 DUKE L.J. 1053, 1055, which argues that “the specific performance remedy can create higher costs than the simple damage remedy,” and in YORIO, *supra* note 4, § 23, which suggests that adopting specific performance as the usual remedy for breach of contract would likely result in losses in the form of inefficient negotiation costs.

124. *See* Kronman, *supra* note 22, at 366–69 (arguing that when a contract’s subject matter is unique, parties may prefer specific performance).

125. Specifically, Kronman argues:

In sum, promisors and promisees will typically favor a money damages rule if the subject matter of their contract is not unique. When the contract is for unique goods and services, on the other hand, . . . the opposite conclusion seems more plausible. There is thus some basis for believing the uniqueness test reflects the typical solution that contracting parties would arrange for themselves in light of their *ex ante* interests.

Id. at 369.

126. *See id.* at 367–68.

127. *See id.* at 368 (“[W]here the subject matter of his contract is genuinely unique, a promisor may estimate the likelihood of a preferable alternative offer as close to zero . . .”).

128. *See id.* (“Although the promisor thinks breach highly improbable, the promisee may not.”).

right to sell to outside bidders is obtaining something worthwhile). Hence, the buyer should be willing to pay enough for specific performance to induce the seller to grant it as the remedy in the contract.

The assumption of Kronman that buyers and sellers have systematically different beliefs about outside bids does not, however, seem appealing, or at least is of limited scope. For there is no apparent reason to presume that buyers generally believe that outside bids will be higher than sellers believe them to be.¹²⁹ In any case, the reason given in this Article for why specific performance may be mutually desirable for parties in contracts to convey property—having to do with the possible sale of property to an outside party at a lower price than the value to the buyer, and of leakage of funds to outside parties—is different. Also, Kronman's article does not distinguish between contracts to convey property and contracts to produce things, and it does not discuss risk bearing and buyer holdup of sellers who face high performance cost as problems due to use of specific performance for the latter contracts.

Alan Schwartz and Thomas Ulen argue in provocative articles that specific performance should be generally available as the remedy for breach,¹³⁰ as in the German system. They both emphasize the context of contracts to convey property,¹³¹ the point that specific performance is not problematic for the parties because an outside bidder can transact with the buyer if the outside party values the property more highly,¹³² and the belief that negotiation costs should not be systematically greater under specific

129. The natural and conventional assumption is that the contract buyer and the contract seller would have roughly the same beliefs about the probability distribution of bids that might be made for the subject matter of the contract, say for a parcel of land. Of course, it is possible that one side would believe the distribution of possible bids to be higher than the other, but there is no obvious reason to suppose that this party would be the buyer. One could imagine, for instance, that the buyer believes that outside bids are likely to be lower than the seller, because the seller better understands the value of his particular property than the buyer (the seller is usually more familiar with his property than the buyer, and the seller's property may have desirable characteristics that are not obvious to the buyer but would be to more knowledgeable buyers).

130. See *supra* note 26.

131. See Schwartz, *supra* note 24, at 289, 299, 301 (including examples of contracts for the sale of land); Ulen, *supra* note 25, at 356–64, 369–70 (discussing the economic efficiency of the restitution, reliance, and expectation damage measures by reference to a hypothetical involving a sale of a house, and then using the house sale hypothetical to illustrate that, if specific performance were routinely ordered, parties would “bargain in the understanding that specific performance will be enforced,” leading to efficient breach).

132. See Schwartz, *supra* note 24, at 284–88 (“If specific performance were available, B1 and S would negotiate over B1's share of the profit that S's deal with B2 would generate, or B1 would insist on a conveyance from S and then sell to B2.”); Ulen, *supra* note 25, at 370 (observing that under specific performance an outside bidder for a house can acquire the house “in several ways,” including purchasing the house from the contract buyer).

performance than under a damage remedy.¹³³ They also suggest that specific performance does not present substantial difficulties for the parties in the context of contracts to produce things, in part because of a view that the seller can usually obtain a covering contract if he has a need to breach.¹³⁴ They offer two principal arguments in favor of specific performance. First, assuming that a goal of remedies is to make the victim of a breach whole, Schwartz notes that specific performance assures satisfaction of the goal, whereas the expectation measure is likely to fall short of full compensation for loss in practice.¹³⁵ Second, assuming that achieving efficiency in use of resources is a goal of remedies, Schwartz and Ulen suggest that a too-low level of expectation damages could lead to excessive breach and also to expensive adjudication.¹³⁶

The recommendation of Schwartz and Ulen, that specific performance be routinely available to parties, obviously is not implied by the analysis of this Article.¹³⁷ The chief reason for the difference in conclusions is that these authors do not distinguish between contracts to convey property and contracts to produce things or provide services. Importantly, they pay little attention to the drawbacks discussed here of specific performance for contracts to produce things or to provide services, namely, to the risk that specific performance imposes on sellers and to the other adverse consequences of possible buyer holdup of sellers who find that performance would be expensive.¹³⁸ Also, they do not offer the affirmative argument that

133. See Schwartz, *supra* note 24, at 287 (concluding that specific performance “would not generate higher post-breach negotiation costs than the damage remedy”); Ulen, *supra* note 25, at 401, 379–83 (concluding that “[t]he contention that specific performance will greatly increase administration costs or post-breach negotiations costs has been shown to be inaccurate”).

134. See Schwartz, *supra* note 24, at 287 (arguing that “no basis exists for assuming that buyers generally have significantly lower cover costs than sellers”); Ulen, *supra* note 25, at 385–89 (discussing cover under specific performance and arguing that, even if the buyer could more easily procure cover, the parties could take this into account in the contract, such that the use of specific performance would still be efficient).

135. Schwartz, *supra* note 24, at 274–78.

136. See the summary descriptions of their arguments in Schwartz, *supra* note 24, at 291–92, and Ulen, *supra* note 25, at 365–66.

137. The recommendation of theirs that is under discussion is that specific performance be available *ex post* to the victim of a breach at his option. A very different recommendation, emphasized especially by Schwartz, *supra* note 24, at 284, is that parties should be able to elect specific performance *ex ante*. With this recommendation, I of course agree (assuming that parties are well informed); the recommendation is just an application of the general point that if contracting parties know best what is in their joint interests, it is desirable to allow parties to choose their contractual terms (where here the term in question happens to concern the form of remedy for breach). However, as I argue broadly in the Article, I doubt that parties would often choose specific performance as the remedy for breach of contracts to produce things or provide services.

138. One reason for their discounting these drawbacks may be an opinion that in the usual case of breach of a contract to produce things, cover can be procured at modest cost. It is undoubtedly true that sometimes this is the case, but often cover is very expensive or impossible, as was discussed in section II(D)(2).

I do for specific performance for contracts to convey property when the expectation measure is underestimated.

Melvin Eisenberg proposes in a recent article that specific performance be more widely employed than it now is in this country, but, unlike Schwartz and Ulen, not that it be routinely available.¹³⁹ He assumes that the primary goal of remedies is to make the victim of a breach whole, and he argues that the expectation measure falls systematically short of full compensation for victims' losses in broad categories of contract, implying that specific performance is often needed to ensure that victims are made whole.¹⁴⁰ He does not urge that specific performance be made generally available, due to potential problems with its use, including difficulties in administering it, error, delay, and opportunism.¹⁴¹ The chief differences between his article and this one are that he does not organize his analysis of remedies around the fostering of the *ex ante* interests of the parties, that he does not make the general distinction between contracts to convey property and contracts to produce things or to provide services, and that he does not emphasize the problems that specific performance creates for the latter category of contracts.

A previous article of mine distinguishes between contracts to produce things and contracts to convey property, emphasizing that specific performance may lead to inefficient performance of contracts to produce things but not of contracts to convey property given that outside bids would be made to the buyer.¹⁴² The article does not, however, develop the leakage of funds argument favoring specific performance for contracts to convey property when the expectation measure would be underestimated, it only adumbrates the point that risk bearing constitutes a disadvantage of specific performance for contracts to produce things, and it does not discuss the incentive problems caused by buyer holdup of sellers under specific performance of such contracts.¹⁴³

139. Eisenberg, *supra* note 27, at 1027.

140. Eisenberg discusses the goal of making the victim whole (or, in his terms, granting him relief such that he would be indifferent between performance or breach), *id.* at 979–89, and the tendency for expectation damages to be inadequate, *id.* at 989–96. See *id.* at 1048–50, for a summary of his argument.

141. *Id.* at 1019–28. The problem of opportunism that Eisenberg mentions in his list of possible problems with specific performance is, as the reader knows, the chief difficulty discussed in this Article with specific performance for contracts to produce things or to provide services.

142. Steven Shavell, *The Design of Contracts and Remedies for Breach*, 97 Q.J. ECON. 121 (1984).

143. The article also omits discussion of legal doctrine, as it is written for the audience of economists. William Bishop extends the analysis of the article, principally by considering buyer breach. William Bishop, *The Choice of Remedy for Breach of Contract*, 14 J. LEGAL STUD. 299 (1985).

D. Evidence About Contracting Parties' Preferences for Specific Performance Versus Damages

Two general kinds of evidence exist bearing on the question whether parties prefer specific performance to damages as the remedy for breach of contract. One kind of evidence is the law itself, since we would expect the law to reflect the desires of contracting parties, at least to some degree. And in our review of three major legal systems, we have found that in all of them, specific performance is more often employed for contracts to convey property than for contracts to produce things or to provide services. This constitutes rough evidence about parties' preferences and it is consistent with the theory concerning the mutual desirability of the forms of remedy. As I also discussed, however, significant differences exist among the legal systems in their use of specific performance versus damages, making more than gross inference from the contours of the law difficult.

The other kind of evidence of contracting parties' preferences is their explicit specification of remedies in contracts, especially where the remedy they name is different from the remedy that courts would be likely to employ. Consider first the question whether there is a greater demand for specific performance than the law in this country allows.¹⁴⁴ There is little sign that parties want to employ specific performance where the law would not give them that right; at least relatively few cases are reported in which parties request specific performance.¹⁴⁵ A partial explanation for the scarcity of such cases may be that our courts generally frown on attempts to employ specific performance where contract law would not sanction the remedy. Yet, a clearly expressed desire of the parties does influence the courts, especially where specific performance would not be very difficult to enforce.¹⁴⁶ Also, parties apparently have real opportunity to have specific performance clauses enforced by courts if they make use of arbitration agreements, for courts are generally bound to enforce arbitration agreements.¹⁴⁷ Hence, the apparent infrequency of attempts to name specific performance as the remedy for breach suggests that there is not a substantial pent up demand for use of the remedy.

Now consider whether parties would like to employ damages where our legal system would grant a party specific performance. In such situations, courts generally respect a stated desire of the parties to employ damages.¹⁴⁸ There is little indication that parties desire to do this, however. One

144. I consider here and in the next paragraph only the situation in the United States.

145. Kronman, *supra* note 22, at 371.

146. YORIO, *supra* note 4, § 19.3.

147. *Id.* § 19.4.

148. *Id.* § 20.1.

commentator stated that clauses barring use of specific performance are rare,¹⁴⁹ and he surveyed twenty-one lawyers working in real estate, and reported that none had ever encountered a contract for conveyance of property in which the parties sought to employ damages rather than specific performance.¹⁵⁰

Although of interest, this evidence is obviously very limited and based mainly on commentators' impressions. It would thus be fruitful for researchers in the future to gather information about parties' choice of remedy for breach, especially from arbitration agreements, using social scientific empirical methodology. Of particular value would be information about parties' choice of remedy in Germany for contracts to produce things or to perform services, since specific performance is the general remedy there; yet this Article's theory suggests that specific performance would often be disadvantageous for the parties.¹⁵¹

149. *Id.* § 23.3.1, at 540 ("If parties to unique goods contracts would prefer a damages remedy to specific performance, one would expect clauses depriving the promisee of his right to specific performance to be relatively common, but such clauses are, in fact, rare.").

150. *Id.* § 23.3.1, at 540 n.28.

151. It is apparently true that in Germany victims of breach often elect damages rather than specific performance ex post. *See, e.g.,* ZWEIGERT & KÖTZ, *supra* note 5, at 484 (explaining why damages are often preferred in Germany even though the primary legal remedy is specific performance). Yet the ability to obtain damages ex post does not negate the advantage of naming damages ex ante, when the contract is made. As emphasized above in section II(D)(5), the right to obtain specific performance may constitute a problem for the parties because it allows the victim of a breach to hold up the promisor; to eliminate this problem, the parties would have to name damages as the remedy ex ante.