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Actual and Virtual Specific Performance, the Theory of Efficient Breach, and the Indifference Principle in Contract Law

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INTRODUCTION

Among the basic principles that underlie contract law are the bargain principle and the indifference principle. Under the bargain principle, bargains should normally be enforced according to their terms. Under the indifference principle, the remedial regime for breach of bargain contracts should make promisees indifferent between performance and legal relief.

Two central remedial doctrines in contract law give the appearance of reflecting these principles. Under the first doctrine, damages for breach of a bargain contract are determined by the expectation measure, which puts the promisee where he would have been if the contract had been performed. On its face, the expectation measure implements both the bargain principle and the indifference principle. Under the second doctrine, specific performance is an exceptional remedy, to be granted only if damages would not be adequate, and not always even then. The second doctrine seems to follow from the first; after all, if expectation damages make the promisee indifferent between performance and remedy, there would be little need for specific performance.

In fact, however, there is a serious tension betwecn the bargain principle and the indifference principle, on the one hand, and the expectation-measure and specific-performance doctrines, on the other. First, damages under the expectation measure always fall short of making a promisee indifferent between performance and legal relief. Second, in light of that shortfall, and the fact that contracting parties bargain for performance, not for legal relief, the reluctance to grant specific performance seems anomalous.

These and other problems have led many commentators to take one of two extreme positions that bear on specific performance. Some commentators have argued that spccific performance should be routinely granted. In contrast, other eommentators embrace the theory of efficient breach, which holds that if a promisor would gain more from breaching the contact, even after payment of expectation damages, than the promisee would lose,

breach is efficient and for that reason should be encouraged. Under that theory, specific performance would be granted even less frequently than traditional doctrine suggests, because requiring the promisor to specifically perform prevents her from reaping the gain from breach.

Neither of these extreme approaches is correct. In its most significant application, the theory of efficient breach does nothing to promote efficiency. On the contrary, if widely adopted the theory would promote inefficiency. However, routine specific performance would also be undesirable. Even though specific performance is often a highly desirable remedy, in part because it implements both the bargain principle and the indifference principle better than expectation damages, it raises a number of problems. Specific performance is a very intrusive and highly coercive remedy. It entails special problems of error. It allows the promisee to avoid a jury trial where it is in his interest to do so. Routine specific performance would also conflict with the principle of mitigation and would raise severe problems of opportunism. Furthermore, a promisee can often achieve the same outcome as *actual* specific performance, without raising the problems presented by that remedy, through the market solution of cover—an outcome that I call *virtual* specific performance.

Given the advantages of specific performance, on the one hand, and its potential problems, on the other, I develop the following principles to govern specific performance and cover: Actual specific performance should be awarded unless a special moral, policy, or experiential reason suggests otherwise in a given class of cases, or the promisee can accomplish virtual specific performance. A promisee can accomplish virtual specific performance if he can readily find in the market a commodity that he could not in good faith reject as an equivalent of the breached performance, given his demonstrable preferences—by which I mean subjective preferences whose existence can be satisfactorily demonstrated. Cover damages, in turn, should be awarded if a buyer who made a substitute purchase shows that his choice of the covering substitute was made in good faith, given his demonstrable preferences, after he conducted a reasonable search.

Here is a roadmap of this Article: In Part I, I discuss the principle that the remedial regime for breach of bargain contracts should make promisees indifferent between performance and legal relief. In Part II, I develop the systematic shortfall between expectation damages and the indifference principle. In Part III, I consider the theory of efficient breach. In Parts IV and V, I consider the remedy of specific performance. Finally, in Part VI, I consider the remedy of cover, or virtual specific performance.

I
THE INDIFFERENCE PRINCIPLE

The traditional objective of remedies in most areas of private law is to compensate a wrongfully injured party for the effects of the injury by restoring him to the position he was in before he interacted with the wrongdoer.[1] A compensatory regime therefore implements what I will call the *cost principle*, because it makes injured parties whole for the costs that their injuries entailed. Although the remedial regime in contract law is also characterized as compensatory,[2] the classic contract-law remedies—expectation damages and specific performance—do not reflect the cost principle and therefore are not compensatory in the normal sense of that term.[3] Instead, these remedies are designed to put the plaintiff forward, by implementing what I will call the *indifference principle*. Richard Craswell has captured this principle descriptively as follows: "The stated goal of contract damages"—and, he might have added, of specific performance—is "'to put the plaintiff in as good a position as he would have been in had the defendant kept his contract.' In economic analysis, this is usually translated as . . . the amount necessary to leave the plaintiff absolutely indifferent, in subjective terms, between having the defendant breach and pay damages or having the defendant perform."[4]

That the classic contract-law remedies are not compensatory is not a strike against them. Whether a given remedial regime is desirable in any area of law does not depend on whether the regime is compensatory. Instead, it depends on what remedial regime is best justified, in that area, by considerations of policy and fairness. In the area of contracts—or more accurately, in the area of bargain contracts—the remedial regime that is best justified by considerations of policy and fairness is one that implements the indifference principle.

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1. Here, and in the balance of this Article, unless the context indicates otherwise, I use feminine pronouns to refer to promisors and masculine pronouns to refer to promisees.

2. *See, e.g.*, Hawkins v. McGee, 146 A. 641, 643 (N.H. 1929) ("By 'damages,' as that term is used in the law of contract, is intended compensation for a breach."); RESTATEMENT (SECOND) OF CONTRACTS ch. 16 introductory note at 100 (1981) [hereinafter RESTATEMENT SECOND] ("The traditional goal of the law of contract remedies has . . . [been] compensation of the promisee for the loss resulting from breach.").

3. As classically stated by Fuller and Perdue, "[O]ne frequently finds the 'normal' rule of contract damages (which awards to the promisee the value of the expectancy . . .) treated as a mere corollary of a more fundamental prineiple, that the purpose of granting damages is to make 'compensation' for an injury. Yet in this case we 'compensate' the plaintiff by giving him something he never had. This seems on the face of things a queer kind of 'compensation.'" L.L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages* (pt. 1), 46 YALE L.J. 52, 52-53 (1936-37) (footnote omitted).

4. Richard Craswell, *Contract Remedies, Renegotiation, and the Theory of Efficient Breach*, 61 S. CAL. L. REV. 629, 636 (1988) (quoting *Hawkins*, *supra* note 2, at 643).

A. The Efficiency and Fairness of the Indifference Principle

To begin with, strong reasons of efficiency support a remedial regime based on the indifference principle. It is always possible that events will give a bargain-promisor an incentive to breach. For example, the cost of performance may increase significantly, or performance may become very difficult because the promisor did not take adequate precautions to ensure that she would be able to perform when the time came. Even if the cost and difficulty of performance remain unchanged, a new, more profitable contract may present itself to the promisor, and this new contract might be available to her only if she breaches the old one.

If a promisor was only liable for the promisee's costs—that is, if a promisor faced a remedial regime that only implemented the cost principle—the full value of a contract to the promisee would not enter into a purely self-interested calculation by the promisor, and promisors might therefore take too few precautions and breach too often. In contrast, a remedial regime based on the indifference principle places on the promisor the full value of the contract to the promisee, thereby efficiently sweeping that value into the promisor's calculus of self-interest when she makes decisions about precaution and breach. At least in principle, therefore, under such a regime the promisee can reliably make contract-specific investments and engage in other types of planning, because he can invest and plan with confidence that he will realize the value of the contract, either by performance or by legal relief.

There are also strong reasons of fairness for a remedial regime based on the indifference principle. If A has rendered a bargained-for performance to B, we know that A was willing to render that performance to B for the agreed-upon price. We cannot know whether A would have rendered that performance to B for any lesser price. Requiring A to accept any lesser price would therefore unfairly convert A from a voluntary to an involuntary actor, because if A had known in advance that the contract price would not be paid in full, he might not have performed. Even where A has only partially performed, he may have done so because he expected full payment; and even where A has not begun to perform, he may have passed up other opportunities, or have forborne the exploration of other opportunities, whose worth is now difficult to quantify. In these cases, too, fairness normally requires that A be allowed to measure damages based on the contract price that induced him to act or forbear. Furthermore, in most cases allowing a promisor to measure damages by anything less than the contract price would have the same unfair quality as allowing a person who has lost a fair bet to renege.

B. *Recent Efficiency-Based Arguments Against the Indifference Principle*

Recently, some law-and-economics scholars have argued against the indifference principle—or more particularly, against the expectation measure—on the ground that expectation damages are inefficient when compared with alternative damage remedies, many of which are based on models that give primacy to goals other than precaution or performance.[5] These arguments are deeply flawed, in part because the models on which they are based ignore real-world institutional considerations.[6]

The most significant of the recent alternative models is the theory of overreliance.[7] Essentially, the argument of this model is as follows: the expectation measure (and by extension, specific performance) fully insures a promisee against the promisor's breach.[8] However, there is almost always some probability that a promisor will breach. Accordingly, the full insurance provided by the expectation measure gives a promisee an incentive to inefficiently overinvest in costs—that is, to spend at too high a level in reliance on the contract—because it allows him to ignore the probability of breach. In contrast, an efficient remedial regime would require promisees to calibrate their reliance to the probability of breach.

The theory of overreliance is defective because it fails to take into account such institutional considerations as the economics of business practice, the actual formulas used in computing expectation damages, the limits of legal remedies in general, and the limits of contract remedies in particular.[9] For example, in many kinds of cases the prospect of

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5. Although on the surface these arguments focus on the expectation measure, on a deeper level they address the indifference principle, upon which that measure rests. Accordingly, if the arguments were accurate, at least some of them would call into question the efficiency of specific performance as well as expectation damages. However, since the rhetoric of these arguments concerns the expectation measure, I will consider them in those terms.

6. Because the major focus of this Article concerns specific performance, it would be tedious to examine in detail here each of the competing remedial models that have recently been put forward. I will briefly analyze the most prominent models in the text of this Section. Comparable analyses apply to other models, a few of which will be considered in note 27, *infra*.

7. This theory was first developed by Steven Shavell. *See* Steven Shavell, *Damage Remedies for Breach of Contract*, 11 BELL. J. ECON. 466, 472 (1980); Steven Shavell, *The Design of Contracts and Remedies for Breach*, 99 Q.J. ECON. 121, 124 (1984).

8. For example, Craswell states that "[b]ecause the expectation measure guarantees B [the promisee] full compensation whether S [the promisor] performs or not, it generates the moral hazard problem that arises under any full insurance scheme, for it means that B can ignore the risk that S's nonperformance might leave B's reliance expenditures wasted." Richard Craswell, *Performance, Reliance, and One-sided Information*, 18 J. LEGAL STUD. 365, 376-77 (1989). *See also* Richard Craswell, *Offer, Acceptance, and Efficiency Reliance*, 48 STAN. L. REV. 481, 494 (1996) ("[E]xpectation damages allow *B* to capture all of the upside potential of his reliance without making him bear any of the downside potential . . . .").

9. The discussion of the theory of overreliance in this Section is adapted from Melvin A. Eisenberg & Brett McDonnell, *Expectation Damages and the Theory of Overreliance*, 54 HASTINGS L. J. 1335 (2003). *See also* Aaron S. Edlin & Stefan J. Reichelstein, *Holdups, Standard Breach Remedies, and Optimal Investment*, 86 AM. ECON. REV. 478 (1996); Aaron S. Edlin, *Cadillac Contracts and Up-Front Payments: Efficient Investment Under Expectation Damages*, 12 J.L. ECON. & ORG. 98 (1996).

expectation damages cannot give the promisee an incentive to overinvest in costs in reliance on a contract, because the promisee's damages will not depend on his costs. Consider a seller's damages for breach by a buyer. One formula to calculate such damages is based on the differential between the contract price and the market price. A seller's expectation damages under this formula normally do not depend on his costs, because the contract price is fixed and the market price does not vary with the seller's costs.[10] The same is true of a buyer's market-price or cover damages for breach by a seller.

Overreliance also cannot occur where a commodity identical to the commodity that a seller has agreed to provide is readily available on the market, because in that case no costs will be wasted if the seller breaches. For example, a buyer of wheat cannot overrely, because if the seller breaches, the buyer can always buy replacement wheat and thereby realize the value of any investment he has made in reliance on the contract. Similarly, overreliance cannot occur where, if the promisor breaches, the promisee can put his investment to an equally valuable alternative use.

In many other kinds of cases it would be inefficient for a promisee to take the promisor's rate of breach into account. This is true, for example, when an investment in reliance on a contract must be made in lumps that cannot be scaled down at the margin to take account of the probability of breach. Take the following illustration: Boatmaker agrees to build a vessel, *Seafarer*, for Sailor, to be delivered in six months. Sailor plans to charter out *Seafarer* to cruise lines at a rate of $100,000 per month. Under Coast Guard rules, a vessel like *Seafarer* cannot take on passengers unless it is equipped with radar, which costs $50,000, and ten life boats, which cost $4,000 each. This equipment must be custom made and ordered two months in advance. Boatmaker is not responsible for supplying this equipment. Because the radar and life boats are custom made, they will lose most of their value if Boatmaker breaches. Under these circumstances, even if Sailor knows that Boatmaker has a 10% probability of breach, Sailor should order all of the equipment two months before the due date for delivery of *Seafarer*: *Seafarer* cannot sail with 90% of a radar and nine

10. Another formula for measuring a seller's damages is $P + C$, where P equals the contract price minus the seller's total variable costs for performing the contract and C equals the variable costs incurred by the seller prior to the breach. Under this formula, an increase in the seller's variable costs drives up C but it also typically drives down P dollar for dollar. As a result, this formula also does not provide an incentive to the seller to inefficiently overinvest in costs.

It might sometimes happen that by incurring costs earlier rather than later, the seller can decrease its total costs. Spending earlier may allow the seller to plan better, lock in better prices, and so forth. In such cases, the timing of the seller's costs might increase net revenues, rather than decreasing net revenues dollar-for-dollar. However, the possibility of incurring (or forgoing) timing costs of any sort will seldom lead to inefficient overreliance. This issue is discussed in Eisenberg & McDonnell, *supra* note 9, at 1344-46, 1349-50.

lifeboats, and if Sailor does not order the equipment until *Seafarer* is delivered, he will lose $200,000 in income.

Calibrating reliance to the probability of breach would also usually be inefficient when an enterprise requires making multiple contracts to get it off the ground. For example, suppose a film producer must engage ten key artists—a writer, a director, and eight actors—to launch a movie. Each artist's probable rate of breach is 10%. If the market is such that each artist must be signed well in advance of production, and if production cannot start unless all ten artists have been signed, it would be inefficient for the producer to sign only nine artists.

Moreover, the central assumption of the theory of overreliance—that the expectation measure fully insures the promisee's reliance—is incorrect, because a rational promisee would expect to bear most or even all of the costs of his reliance if the promisor breaches. In determining the expected value of any future recovery against the promisor, the promisee must discount prospective damages to reflect litigation risks, litigation costs, and the limits of expectation damages. Litigation risks include the risk of errors by the law-finder or the fact-finder and the possibility that the promisor may successfully establish a defense to the promisee's claim. Litigation costs, such as attorney's fees, can run very high. Expenditures in reliance that are less than litigation costs are likely to be wholly uninsured by expectation damages, and even damages in excess of litigation costs will be co-insured by the promisee. The limits of expectation damages will be discussed below, in Part II. In brief, expectation damages fall substantially short of making a promisee indifferent between a promised performance and legal relief. Given litigation risks, the cost of litigation, and the limits of expectation damages, the expected value of expectation damages at the time a promisee invests in reliance on a contract is relatively low. A rational promisee therefore would never calibrate that investment on the assumption that the investment is fully or even substantially insured by the expectation measure. [11]

Another recent argument against the expectation measure is that expectation damages inefficiently give promisees an incentive to continue performing after breach for the purpose of running up damages needlessly.[12] This argument is implausible. Where the promisor has breached,

11. Another problem with the theory of overreliance concerns its failure to distinguish between the consequences of minor and material breach. Even under the theory of overreliance, the probability of minor breach does not influence a promisee's efficient level of reliance. For example, suppose Contractor agrees with Owner to build a commercial building to certain specifications, and promises that the building will be completed and ready for occupancy on July 1. If Contractor breaches by leaving minor defects in construction, which do not prevent Owner from taking occupancy on July 1, Owner's investment in reliance on the contract will not be wasted as a result of the breach. Accordingly, if—as seems likely—the rate of material breach is generally very low, overreliance normally would not be economically significant even in those relatively few cases in which it could occur.

12. *See* Richard Craswell, *Instrumental Theories of Compensation: A Survey*, 40 SAN DIEGO L. REV. 1135, 1153-54 (2003).

the promisee knows that a lawsuit will be required to recover damages. Only the hardiest promisee would spend additional money after the promisor's breach in the hope of recovering increased damages years in the future, particularly given the relatively low expected value of expectation damages. In any event, it is a basic principle of contract law that after breach by the promisor, the promisee must take reasonable steps to mitigate his loss from breach. The mitigation principle will almost always prevent a promisee from running up damages by continuing to perform after the promisor's breach.[13]

In opposition to this point, Richard Craswell has argued that the mitigation principle may itself be inefficient.[14] Craswell's argument is that this principle requires courts to evaluate the promisee's behavior and applies only to those promisees whose behavior is found wanting. As a result, he says, the mitigation principle entails the administrative costs of such an evaluation. Furthermore, the principle may introduce "additional uncertainty, and additional risk of judicial error, by leaving it to courts to decide what kind of behavior is 'reasonable.'"[15]

In fact, however, there will seldom be any significant costs in terms of either judicial time or the risk of error in evaluating whether a promisee acted reasonably in continuing to perform after the promisor's breach, because it would seldom be reasonable for a promisee to continue to perform after the promisor has breached. Moreover, courts are quite accustomed to making determinations of reasonableness and fault. It's not easy to see why it is harder to make a determination about the reasonableness of mitigation

13. *See generally* Charles J. Goetz & Robert E. Scott, *The Mitigation Principle: Toward a General Theory of Contractual Obligations*, 69 VA. L. REV. 967, 969 (1983).

UCC § 2-704 permits a manufacturer of goods to continue manufacture after the buyer breaches, under certain conditions. Under that section, "[w]here the goods are unfinished an aggrieved seller may in the exercise of reasonable commercial judgment for the purposes of avoiding loss and effective realization either complete the manufacture and wholly identify goods to the contract or cease manufacture and resell for scrap or salvage value or proceed in any other reasonable manner." However, a seller who continues to manufacture under this section would normally not increase her profits by doing so, and the buyer will probably be better off. For example, suppose that the contract price is $5,000; the seller's total out-of-pocket costs if the goods were completed would be $4,000; the buyer breaches when the seller has incurred costs of $2,000; and the scrap value of the goods at that point is $500. If the seller stops production at that point, and sells the partly completed goods for scrap, her damages will be $2,500—costs incurred of $2,000, plus lost profits of $1,000, minus scrap value of $500. The seller's net recovery will be $1,000, since she will have incurred net costs of $1,500. The buyer will have nothing to show for his damages. Now suppose that the seller completes production. Her damages will then be $5,000, but her net recovery will still only be $1,000, since she will have incurred $4,000 in costs. The buyer will pay $5,000 rather than $2,500, but will have a commodity that presumably is worth close to $5,000.

14. Craswell, *supra* note 12, at 1154. Shawn Bayern was instrumental in formulating the analysis in the balance of Part I.B.

15. *Id.*

than it is to make all the other determinations of reasonableness that courts make every day.[16]

A third recent argument against the expectation measure concerns cross-subsidization and adverse selection. The argument begins like this: Suppose a product is defective; to use Craswell's example, suppose toasters sometimes catch fire.[17] Buyers with expensive homes suffer greater damages as a result of such fires than those with modest homes.[18] If toaster manufacturers impound the expected average expectation damages of buyers into toaster prices, buyers living in modest homes will subsidize—or "cross-subsidize"—buyers living in expensive homes.

Cross-subsidization, by itself, only transfers wealth; it does not cause a net social loss. However, the argument continues, cross-subsidization may inefficiently discourage buyers whose expected cost from breach is low from purchasing toasters, or other goods and services that they would purchase if the price reflected only their own low prospective damages, rather than all buyers' average damages. This problem is known as adverse selection.[19]

The problem with this argument is that cross-subsidization and adverse selection arise only when sellers cannot differentiate among buyers—that is, only when sellers cannot charge each buyer a price that impounds that buyer's expected losses.[20] In fact, however, both contract doctrine and common business arrangements allow sellers to make such differentiations. The principle of *Hadley v. Baxendale*[21] bars a promisee from recovering damages that were not reasonably foreseeable to the promisor at the time the contract was made. Under this principle, in many cases either a seller will know about a buyer's abnormally high expected loss from breach, so that she can increase the price accordingly, or the seller will not know and will not be liable for the abnormally high loss. Moreover, sellers can and do typically avoid cross-subsidization by a variety of contractual mechanisms. These mechanisms include provisions that

16. Furthermore, Craswell gives no reason to suppose that the alternative he proposes, a systematic reduction in damages, would be less expensive to administer than determining the reasonableness of a failure to mitigate. Determining the appropriate systemic reduction to promisees' damages would have a social cost, as would the risk of adverse systemic effects if the wrong determination is made.

17. *See* Craswell, *supra* note 12,. at 1158-59.

18. *Id.* at 1158.

19. *See id.* at 1159. As Craswell notes, even if cross-subsidization is not in itself inefficient, it might be unfair because it tends to transfer wealth from poorer to richer promisees. *Id.* However, alternatives to expectation damages also tend to be unfair, because they defeat reasonable expectations and allow promisors, in effect, to renege on a fair bet. *See supra* Part I.A. In any event, it is doubtful that cross-subsidization occurs on a large scale.

20. Craswell, *supra* note 12, at 1158-59.

21. 9 Exch. 341 (Exch. 1854). For a fuller discussion of the principle of *Hadley v. Baxendale*, see *infra* text accompanying notes 37-43 and Melvin Aron Eisenberg, *The Principle of* Hadley v. Baxendale, 80 CALIF. L. REV. 563 (1992).

limit or eliminate the seller's liability for consequential damages, provisions under which the seller's only obligation is to repair or replace a defective product, and provisions that offer a menu of price and liability combinations from which buyers can choose.[22] For example, carriers commonly allow shippers to purchase different levels of "insurance"—really, different prices—for their goods. Each shipper then can select a price that impounds the loss he expects if his shipment is mishandled, and neither cross-subsidization nor adverse selection will result.

Furthermore, even if cross-subsidization and adverse selection were significant problems, it is unlikely that any alternative to expectation damages would cure the problem. If adverse selection exists, it is not a result of expectation damages; rather, it can arise whenever courts compensate individual promisees at different levels and sellers cannot discriminate among customers in order to adjust individual prices.

A fourth recent argument against expectation damages is that the expectation measure does not provide an efficient incentive for precaution by the promisor because it fails to take into account the value that the promisee puts on the promisor's precaution.[23] The argument is as follows: As the chance of breach decreases, the expected value of the contract, and therefore the promisee's wealth, increases. Therefore, a promisee who faces a 2% chance of breach has greater wealth than one who faces a 25% chance of breach. Correspondingly, each 1% reduction in the risk of breach is equivalent to a fixed dollar increase in the promisee's wealth. However, because of the diminishing marginal utility of wealth, this fixed amount is worth more to promisees with less wealth (for example, those facing a 25% risk) than to promisees with greater wealth (for example, those facing a 2% risk). Accordingly, the "wealthier" promisees who face a 2% risk would pay less for a 1% decrease in risk than would the "less wealthy" promisees who face a 25% risk. Since the value to a promisee of a marginal increase in the promisor's precaution can vary with risk, the argument goes, damages should also vary with risk to give the promisor the right incentives for precaution.

However, no measure of damages based on this argument would be administrable. How could the courts possibly measure the subjective value that a promisee places on marginal changes in precaution? Furthermore, the subjective value that a promisee assigns to a promisor's precautions can vary for many reasons, not just because of the expected wealth created under the contract. For example, not all promisees have the same levels of wealth to begin with, and a promisee with a net worth of $10 million will value a 1% reduction in the risk of breach less than a promisee with a net

22. Eisenberg, *supra* note 21, at 606-08.

23. *See* Craswell, *supra* note 12, at 1160-62. The argument described here is adapted from that article.

worth of $1,000. The effect of a promisee's total wealth would probably well outweigh the wealth effect under a given contract, but a remedial regime that considers a promisee's total wealth in setting ordinary damages would break sharply and undesirably from the common law's tradition against making such damages turn on wealth.[24]

In short, the recent arguments against the expectation measure, and by extension against the indifference principle, are uniformly implausible when real-world institutional considerations are taken into account. Moreover, most and probably all of the models on which these arguments are based completely fail to yield an administrable alternative to expectation damages. As just shown, this is true of the diminishing-utility-of-wealth model. Similarly, Richard Craswell, who is sympathetic to the alternative models, concludes that the optimal damage measure under a model whose goal is to provide efficient incentives for investigating potential risks "could be either above or below expectation damages, with the exact measure depending on the exact costs and benefits of further investigation."[25] Of another model, whose goal is to promote efficiency in the search for contracting partners, Craswell concludes, "[H]ere, too, it is difficult to say whether the optimal measure of damages would be either higher or lower than the expectation measure, for this may depend on the exact structure of the costs and potential returns to [a factor to be optimized]."[26] Of a third model, whose goal is to promote efficiency in eontract enforcement through the use of a multiplier, Craswell notes, "Unfortunately [economic analyses] suggest that the exact size of the efficient multiplier will depend on a number of factors that are likely to be hard to measure."[27]

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24. *Cf.* Michael J. Trebilcock, *The Role of Insurance Considerations in the Choice of Efficient Civil Liability Rules*, 4 J.L. ECON. & ORG. 243, 247 (1988) ("[A] given loss reduces the utility of a rich person less than [that of] a poor person [but these are considerations] that by long historical tradition in common law civil disputes the courts are supposed sedulously to eschew. If they were now to become influential in determinations of liability, they would cast courts in a radically new role.").

25. Craswell, *supra* note 12, at 1164.

26. *Id.* at 1165.

27. *Id.* at 1169. Additional models have also been formulated, but these models are even less likely to provide the foundation of a meaningful remedial regime than are the alternative models considered in the text. For example, one model would apply multipliers to damage calculations to account for the possibility that promisors know they might escape liability. It is correet that if a wrongdoer expects to be able to avoid liability some of the time, even perfect disgorgement won't be a sufficient deterrent. However, it would be inappropriate to use the same multiplier in all cases, and impracticable to determine multipliers on a case-by-case basis. Other models are intended to give appropriate incentives for precontractual behavior, such as the investigation of the risks of nonperformance and the search for contracting partners. However, those goals are unlikely to be much affected by remedial regimes and do not yield administrable remedies. As Craswell points out, the problems with respect to the precontractual investigation of risks "are likely to vary from case to case and may be impossible to observe precisely." Richard Craswell, *Precontractual Investigation as an Optimal Precaution Problem*, 17 J. LEGAL STUD. 401, 422 (1988).

Furthermore, for the most part each of the alternative models conflicts with every other model. As Eric Posner has pointed out, each model focuses on one or at most two incentives and brackets out all the rest.[28] The result is that the measure of damages that any given alternative model promotes to satisfy the goal on which the model is based almost invariably conflicts with the measure of damages that the alternative models promote to satisfy other goals.

When a choice must be made among remedial regimes that promote competing goals, the determination of which goals should be treated as paramount is a matter of prudential judgment. Among the factors to be weighed are the extent to which a given regime is administrable, the extent to which a remedial regime is likely to significantly advance the goal it seeks to promote, and the relative importance of competing goals. Remedies based on the indifference principle are preferable to alternative regimes on all three counts.

To begin with, the alternative regimes are generally not administrable.

Next, it is unlikely that the alternative regimes can significantly advance the goals they seek to promote. For example, one regime seeks to provide the best incentives for an actor's search for contracting parties. However, an actor's decisions concerning this kind of search will be dominated by his determinations about which contracting partner is most likely to maximize his profit, and when the expected gain from further search is unlikely to exceed the expected cost. These determinations will swamp any marginal effect on search that might result from adopting one remedial regime rather than another. A similar analysis applies to the goals of many of most of the other alternative models, such as the goal of maximizing the efficiency of precontractual investigation of risks. In contrast, remedial regimes can have substantial effects on contracting parties' decisions about the goals that the indifference principle serves—that is, efficient levels of precaution, performance, contract-specific investment, and other forms of planning. Even the alternative models that do seek to promote one of those goals, such as the theory of efficient reliance and the argument that the level of precaution should be based on promisees' wealth effects, serve those goals poorly: Damage measures based on these models would be so highly uncertain that promisees could not safely make reliance investments and promisors could not safely determine the appropriate level of precaution.

Moreover, my own judgment, which I believe is widely shared, is that the goals of attaining efficient levels of precaution, performance, contract-specific investment, and other forms of planning, which are reflected in the indifference principle, are more weighty—indeed, significantly more

28. Eric Posner, *Economic Analysis of Contract Law After Three Decades: Success or Failure?*, 112 YALE L.J. 829, 834-39 (2003).

weighty—than competing goals that have been modeled to justify alternative remedial regimes.

Finally, unlike the indifference principle, none of the alternative models and remedial regimes are rooted in fairness as well as efficiency.

Accordingly, if we put aside handcrafted remedies, such as liquidated damages or large upfront payments, then on both efficiency and fairness grounds, primacy should be given to a remedial regime that gives effect to the indifference principle.

II
THE SHORTFALL BETWEEN EXPECTATION DAMAGES AND THE INDIFFERENCE PRINCIPLE

The basic remedy for breach of contract is the expectation measure of damages. The idea that animates this measure is that the promisee should be put in the position that he would have been in if the contract had been performed. The same idea animates the indifference principle: if a promisee is put in the position that he would have been in if the contract had been performed, then at least in principle he will be indifferent between performance, on the one hand, and breach and damages, on the other. If expectation damages gave full effect to the indifference principle, there would normally be no need to grant specific performance, because by hypothesis that remedy would not make the promisee any better off than would expectation damages.

In fact, however, as I will show in this Part, *conventional expectation damages*—by which I mean damages measured either by the difference between contract price and market price or by the promisee's lost profits—regularly fall short of giving full effect to the indifference principle.[29]

A. Market-Price Damages

Suppose that a buyer contracts to purchase a commodity (by which I mean anything that can be purchased and sold, including services). If the seller breaches, the buyer may choose to sue for conventional expectation damages—that is, for damages based on the difference between the contract price and the market price ("market-price damages"); for damages based on the buyer's lost profits as a result of the breach; or for both.

If a commodity is homogeneous—that is, fungible or undifferentiated—then market-price damages will normally satisfy the indifference principle, at least if we put aside the systemic limits on all legal remedies—for example, the rule that a winning party normally cannot recover litigation costs.[30] In the case of homogeneous commodities, "market price"

29. Another form of expectation damages, cover damages, will be considered in Part VI.

30. These kinds of limits will be discussed below in Part II.C.

means just that: an observable price on an observable market. Accordingly, a buyer's subjective valuation will normally be satisfied by market-price damages in such cases, because the buyer can go into the market, purchase a commodity that is identical to the contracted-for commodity, and sue for the difference between the contract price and the market price. The buyer will then be in just the position that he would have been in if the contract had been performed (putting aside systemic limits), because the buyer's net price for the commodity, after recovering damages, will be the contract price. For example, suppose the contract price of a homogeneous commodity is $10, the market price of the commodity at the time of breach is $12, and the buyer's valuation of the commodity at the time of breach is $14. If the contract had been performed, the buyer would have enjoyed a surplus of $4. He will also enjoy a surplus of $4 if he recovers market-price damages, because he can purchase an identical commodity on the market for $12, and his market-price damages of $2 will bring his effective price down to $10. Moreover, if the buyer planned to make a profit through his use of the commodity, he can still do so.

The situation is very different, however, where the seller breaches a contract to sell a differentiated commodity. In such cases, the buyer cannot go into the market and purchase an identical commodity. In fact, the "market price" for a differentiated commodity is typically not a real entity. Rather, it is a construct—an extrapolation from prices charged in transactions that involve roughly comparable but different commoditics and that occur in roughly comparable but different places at roughly comparable but different times. This price construct is unlikely to map perfectly onto the buyer's subjective valuation of the commodity.

To some extent, whether the market-price measure will result in a shortfall between expectation damages and the indifference principle in such cases depends on random error. If the market-price construct is too low because of erroneous extrapolations, damages will result in a shortfall; if the construct is too high, damages will result in a windfall.

In one major class of cases, however, market-price damages will regularly result in a shortfall. These are cases in which even though the extrapolation is not erroneous, the market-price construct, which is objective and based on the valuations of other parties for their own purposes, is less than the value that the buyer places on the commodity. If the buyer's valuation of the commodity exceeds this market-price construct, the expectation measure will not leave the buyer indifferent between performance and damages.

For example, suppose that a buyer has contracted to purchase a used 1998 Schwabe SR8I 150-ton die press for $60,000 and that he intends to use the die press in his production process. The die press is to be delivered at the buyer's place of business in Omaha on March 1. On that date, the

seller defaults. The buyer now sues and seeks to measure damages by the difference between contract price and market price. Assume, as is probable, that no other 1998 Schwabe SR81 150-ton die press was sold in Omaha on that day. If sales of that model occurred at roughly comparable times in roughly comparable places, the court might extrapolate from the prices in those sales. However, it is extremely unlikely that the other die presses would be identical or even highly comparable in condition to the die press the seller agreed to deliver to the buyer. Or suppose, as is also likely, that no 1998 Schwabe SR81 150-ton die presses were sold at roughly comparable times in roughly comparable places. Then the market price of a 1988 Schwabe SR81 150-ton die press might be extrapolated from roughly contemporaneous sales of Schwabe SR81 150-ton die presses manufactured in 1997 or 1999, or even from sales of other Schwabe models, or perhaps other makes of die press. The market-price construct that results from such extrapolations may be much lower than the buyer's value for the Schwabe 1998 SR81 150-ton die press that he contracted to purchase. This could occur, for example, because that die press suited the buyer's needs better than comparable but different used die presses, or because the buyer had experience with that model die press but not with the makes and models of other used die presses sold around March 1.

In such cases, if damages are based on a market-price construct, rather than on the buyer's valuation, there will be regular shortfalls between expectation damages and the amount required to make the buyer indifferent between performance and damages. Buyers of such commodities will typically contract to pay a price that is less than their valuation—otherwise they would not buy—but will rarely if ever contract to pay a price that exceeds their valuation. Accordingly, buyers' valuations of differentiated commodities will regularly exceed constructed market prices, and damages based on the difference between the contract price and the constructed market price of such commodities will regularly fail to satisfy the indifference principle.

B. Lost Profits

In addition to or in lieu of market-price damages, a buyer may sue to recover profits that he lost as a result of breach. Recovery of lost profits, however, will also regularly fail to satisfy the indifference principle, partly because of the way in which the certainty rule is administered in contract law and partly because of the principle of *Hadley v. Baxendale.*

1. The Certainty Rule

It is a well-established rule of contract law that damages must be proved with reasonable certainty. This rule is in itself unobjectionable, but the question is how the rule is applied. Tort law has a similar rule, but there

it is applied in an openhanded way to allow fact finders to determine damages even when the level of uncertainty is fairly great.[31] In contrast, in the law of contracts, courts often set the required degree of certainty at a very high level, with little or no sensitivity to conceptions of probability. As the rule is applied in contract law, it is not enough for a promisee to show that it was probable that he suffered a loss as a result of breach. Instead, he must prove the *amount* of this loss with sufficient certainty. So, for example, a manufacturer who contracts to purchase component parts under a just-in-time inventory system may have no problem showing that he suffered a loss from late delivery, but he may have enormous problems establishing his loss in a way that satisfies the certainty rule. In practice, the certainty rule is usually applied to cut off damages resulting from buyers' lost profits. Therefore, the certainty rule, like the market-price construct, regularly results in a shortfall between expectation damages and the amount required to satisfy the indifference principle.

For example, in *Kenford Co. v. County of Erie*,[32] Erie County entered into a contract with Kenford and its affiliate, Dome. Under the contract, the County agreed to construct a stadium and either to lease it to Dome for forty years or, if the parties could not agree upon the terms of a lease, to enter into a twenty-year management agreement with Dome. The terms of this agreement were stated in the contract. Under those terms, Dome would manage the stadium, the County would receive a stated percentage of gross revenues from stadium operations, and Dome would retain the balance. The stadium was never constructed because the County breached the contract after it learned that it had significantly underestimated the cost of construction. Dome sued the County for breach. To establish damages, Dome presented statistical projections of the profits that it would have made under the management agreement.

At trial, Dome recovered a verdict for $25.6 million. The New York Court of Appeals reversed. Although the Court admitted that "the procedure for computing damages selected by [Dome] was in accord with contemporary economic theory and was presented through the testimony of recognized experts"[33] and that "[t]he quantity of proof is massive and, unquestionably, represents business and industry's most advanced and

31. *See* RESTATEMENT (SECOND) OF TORTS § 912 cmt. d (1979) (noting, for instance, that in tort law "it is not fatal to the recovery of substantial damages that [the injured party] is unable to prove with definiteness the amount of the profits he would have made or the amount of harm that the defendant has caused," and that it is sufficient merely to "present such evidence as might reasonably be expected to be available under the circumstances"); RESTATEMENT (SECOND) OF CONTRACTS § 352 cmt. a ("Courts have traditionally required greater certainty in the proof of damages for breach of a contract than in the proof of damages for a tort.").

32. 493 N.E.2d 234 (N.Y. 1986).

33. *Id.* at 235.

sophisticated method for predicting the probable results of contemplated projects,"[34] the Court held that the proof was insufficient:

> [D]espite the massive quantity of expert proof submitted by [Dome], the ultimate conclusions are still projections, and as employed in the present day commercial world, subject to adjustment and modification. We of course recognize that any projection cannot be absolute, nor is there any such requirement, but it is axiomatic that the degree of certainty is dependent upon known or unknown factors which form the basis of the ultimate conclusion. Here, the foundations upon which the economic model was created undermine the certainty of the projections. . . . Quite simply, the multitude of assumptions required to establish projections of profitability over the life of this contract require speculation and conjecture, making it beyond the capability of even the most sophisticated procedures to satisfy the legal requirements of proof with reasonable certainty.[35]

Kenford Co. reflects an approach to the certainty rule that often results in a shortfall between expectation damages and the indifference principle, partly because the required degree of certainty is unduly high, and partly because this approach fails to recognize that contractual rights have value even if the value is probabilistic. For example, Dome owned a financial asset—its economic rights under the management agreement. Like many financial assets, this asset was risky. The fact that a financial asset is risky does not render the asset valueless. Rather, the riskiness of an asset is impounded into its expected value—the present value of a weighted average of the various income streams that the asset can be expected to generate—for instance, a 10% probability of earning $7 million, a 20% probability of earning $4 million, and so forth. To make Dome indifferent between performance and damages, the Court should have awarded that expected value. Although some courts have adopted a modern, probabilistic approach to the certainty rule, the restrictive approach employed in *Kenford Co.* is not unusual.[36]

2. *The Principle of* Hadley v. Baxendale

In the great case of *Hadley v. Baxendale*,[37] the Exchequer Chamber held that a party injured by a breach of contract can recover only those damages that either (1) should "reasonably be considered as . . . arising naturally, [that is,] according to the usual course of things"[38] from the

34. *Id.* at 236.

35. *Id.*

36. *See, e.g.*, Schonfeld v. Hilliard, 218 F.3d 164 (2d Cir. 2000); Evergreen Amusement Corp. v. Milstead, 112 A.2d 901 (Md. 1955).

37. 156 Eng. Rep. 145 (Ex. Ch. 1854).

38. *Id.* at 151.

breach, or (2) might "reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract as the probable result of the breach of it."[39] The two branches of the court's holding have come to be known as the first and second rules of *Hadley v. Baxendale*. The second rule has traditionally been conceived to mean that consequential damages can be recovered only if, at the time the contract was made, the seller had reason to foresee that the damages would be the likely result of breach.[40] Under this conception of the second rule, the first rule is simply a special case of the second: if a given type of harm arises "according to the usual course of things" from a breach (the first rule), then a promisor will have reason to foresee that the given type of harm will be the likely result of the breach (the second rule). Therefore, in the balance of this Article, I will refer to this conception of the second rule as *the principle of Hadley v. Baxendale*.[41] The principle is most commonly applied to prevent recovery of lost profits.

The bite of the principle of *Hadley v. Baxendale* is most easily illustrated by comparing its operation with the principle of proximate cause, which governs damages in almost every area of law except contracts. The difference between the two principles is not that the principle of *Hadley v. Baxendale* includes an element of foreseeability and the principle of proximate cause does not. Under the ascendant conception of proximate cause, that principle is also based on foreseeable risks, except perhaps for personal injuries that result from a tortious impact. The difference between the two principles therefore lies in two other elements.

First, the two principles require different degrees of likelihood. Under the principle of proximate cause, a wrongdoer will be liable if the injury that occurred was foreseeable at even a relatively low level of likelihood.[42] In contrast, under the principle of *Hadley v. Baxendale*, the degree of required likelihood was traditionally very high. Originally, a consequential loss could only be recovered if it was more probable than not. Under modern law that level has decreased, so that "reasonably likely" or some similar test may suffice.[43] Nevertheless, the degree of likelihood required under

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39. *Id.*

40. *See, e.g.*, RESTATEMENT SECOND, *supra* note 2, at § 351(b).

41. For a more complete exposition of this principle, see Eisenberg, *supra* note 21, from which the analysis here is adapted.

42. *See, e.g.*, Koufos v. C. Czarnikow Ltd. [The Heron II], [1969] 1 A.C. 350, 385-86 (H.L. 1967) ("The [tort] defendant will be liable for any type of damage which is reasonably foreseeable as liable to happen even in the most unusual case, unless the risk is so small that a reasonable man would in the whole circumstances feel justified in neglecting it.").

43. *See id.*; Hector Martinez & Co. v. S. Pac. Transp. Co., 606 F.2d 106 (5th Cir. 1979). *Hector Martinez* was a suit for the lost use value of machinery resulting from a delay in delivery by Southern Pacific, the carrier. The court said, "Southern Pacific replies that it was as foreseeable that the goods were to be sold as that they were to be used. This contention proves too much because *Hadley* allows recovery for harms that should have been foreseen. The general rule does not require the plaintiff to

the principle of *Hadley v. Baxendale* remains higher than the degree of likelihood required under the principle of proximate cause.

Second, under the principle of proximate cause, the issue is what loss was foreseeable by the wrongdoer at the time of the wrong. In contrast, under the principle of *Hadley v. Baxendale*, that issue is irrelevant. Instead, the issue is what loss to the promisee was foreseeable to the promisor at the time the contract was made. Therefore, the principle of *Hadley v. Baxendale* bars damages even for losses that the promisor foresaw with certainty at the time of breach, as long as those damages were not reasonably foreseeable at the time the contract was made.

As a result of these elements of probability and timing, the principle of *Hadley v. Baxendale* frequently cuts off lost profits that stem from a seller's breach, and therefore results in still another shortfall between expectation damages and the indifference principle.

C. *The Cost of Dispute Settlement, the Time Value of Lost Gains, and the Risk of the Promisor's Insolvency*

There are three further reasons, which are in part systemic to all remedies, why expectation damages will rarely, if ever, make a promisee indifferent between performance and damages.

First, the amount necessary to make a promisee indifferent between performance and damages must include the costs of dispute settlement, because a promisee will not incur these costs if the promisor performs. In fact, however, the costs of obtaining damages are almost never included in expectation damages. Specifically, expectation damages do not include the value of the promisee's time in determining his losses, the cost of retaining experts to aid in that determination, the value of the promisee's time in negotiating to recover his losses, and legal fees and other costs of litigation.

Second, to make a promisee indifferent between performance and damages, he must be paid the time value of his lost gains during the period between the date of breach and the date on which judgment is rendered, measured by compound interest at the rate he pays for borrowed funds. If a contract is performed, the promisee has the use of his gains under the contract from and after the time of performance. In contrast, if a contract is breached, the promisee loses the time value of those gains during the period between the date on which performance was due and the date of the judgment. The general legal rule, however, is that pre-judgment interest will be awarded only if the amount of the plaintiff's loss is "liquidated"—

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show that the actual harm suffered was the *most* foreseeable of possible harms. He need only demonstrate that his harm was not so remote as to make it unforeseeable to a reasonable man at the time of contracting." *Id.* at 110.

that is, certain or at least reasonably ascertainable in amount.[44] The specific rule in contract law, embodied in the *Restatement Second*, is that pre-judgment interest on a recovery for breach of contract is recoverable as a matter of right only if the breach consists of a failure to pay a definite sum of money or to render a performance with fixed or ascertainable monetary value.[45] Otherwise, the award of pre-judgment interest is discretionary.[46] Furthermore, even when pre-judgment interest is allowed, it is often not compounded.[47] Finally, pre-judgment interest is often computed on the basis of an artificially low statutory rate,[48] such as the interest rate on U.S. Treasury Bills,[49] which is typically well below the market rate of interest for most borrowers.[50] Therefore, as Judge Posner recognized in *Patton v. Mid-Continent Systems, Inc.*,[51] another reason why expectation damages will not make a promisee indifferent between performance and damages is that if the promisor performs, the promisee will have the time value of his gains from the point of performance forward, while if the promisor breaches, the promisee will seldom recover the full time value of his lost gains.

Third, once a promisor performs, the promisee no longer bears the risk that the promisor will become insolvent. In contrast, if a promisor breaches, the promisee bears the risk of insolvency between the time of the breach and the time that damages are paid. For this reason too, a promisee will almost invariably prefer performance to damages.

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44. *See* 1 DAN B. DOBBS, LAW OF REMEDIES § 3.6(1), at 336 (2d ed. 1993).

45. *See* RESTATEMENT SECOND, *supra* note 2, at § 354.

46. It has been said that the trend is to award pre-judgment interest in contracts cases even where damages are unliquidated. *See Report in Support of Pre-Verdict Interest in Personal Injury Cases*, 55 THE RECORD 496 (July/Aug. 2000) (citing Funkhouser v. J.B. Preston Co., 290 U.S. 163, 168 (1933) (holding that pre-judgment interest is proper in contract actions, even if damages are unliquidated, "for the purpose of securing a more adequate compensation")). However, not all cases take that position. *See* Buono Sales, Inc. v. Chrysler Motors Corp., 449 F.2d 715, 723 (3d Cir. 1971) (holding that a successful plaintiff in an aetion for breach of contract is not entitled to pre-judgment interest as a matter of right where damages are unliquidated); Black Gold Coal Corp. v. Shawville Coal Co., 730 F.2d 941 (3d Cir. 1984) (same).

47. *See, e.g.*, Big Bear Props., Inc. v. Gherman, 95 Cal. App. 3d 908 (1979).

48. *See, e.g.*, 815 ILL. COMP. STAT. 205/2 (1993).

49. *See, e.g.*, McCrann v. U.S. Lines, Inc., 803 F.2d 771, 774 (2d Cir. 1986) (approving award of pre-judgment interest in admiralty case based on six-month Treasury Bill rates); ECDC Envtl., L.C. v. New York Marine & Gen. Ins. Co., 1999 U.S. Dist. LEXIS 9836, at *37-39 (S.D.N.Y. June 29, 1999) (applying interest rate paid on six-month Treasury Bills); Barwil ASCA v. M/V SAVA, 44 F. Supp. 2d 484, 489 (E.D.N.Y. 1999) (same); Zim Isr. Navigation Co. v. 3-D Imps. Inc., 29 F. Supp. 2d 186, 193-94 (S.D.N.Y 1998) (same); Weeks Marine, Inc. v. John P. Picone, Inc., 1998 U.S. Dist. LEXIS 15053, at *24-25 (S.D.N.Y. Sept. 23, 1998) (applying twelve-month average Treasury Bill rate); MICH. COMP. LAWS § 600.6013(8) (2004) (except for judgments on written instruments, "interest on a money judgment recovered in a civil action is calculated at 6-month intervals from the date of filing the complaint at a rate of interest equal to 1% plus the average interest rate paid at auctions of 5-year United States treasury notes during the 6 months immediately preceding July 1 and January 1").

50. *See* Michael S. Knoll, *A Primer on Prejudgment Interest*, 75 TEX. L. REV. 293, 315 (1996).

51. 841 F.2d 742, 751 (7th Cir. 1988) (Posner, J.).

In summary, although the expectation measure appears to rest on the indifference principle, expectation damages regularly fall short of satisfying that principle.

III
THE THEORY OF EFFICIENT BREACH

The theory of efficient breach holds that breach of contract is efficient, and therefore desirable, if the promisor's gain from breach, after payment of expectation damages, will exceed the promisee's loss from breach. If the theory were correct it would provide a rationale for placing narrow limits on specific performance, because that remedy prohibits breach. Accordingly, this Part examines the theory of efficient breach as a preface to considering the principle that should govern specific performance.

Richard Posner gives probably the best-known exposition of the theory of efficient breach in his book, *Economic Analysis of Law*.[52] This exposition has changed somewhat over the six editions of that book. Here is the core of the exposition in the first edition:

> [I]n some cases a party [to a contract] would be tempted to breach the contract simply because his profit from breach would exceed his expected profit from completion of the contract. If his profit from breach would also exceed the expected profit to the other party from completion of the contract, and if damages are limited to loss of expected profit, there will be an incentive to commit a breach. There should be.[53]

Although commentators typically present the theory of efficient breach in very generalized terms, the theory can only be understood and evaluated in the context of paradigm cases to which it might meaningfully be applied. Three paradigm cases are especially salient; I will call these the Overbidder Paradigm, the Loss Paradigm, and the Mitigation Paradigm. In this Part, I will consider the theory in the context of the first two Paradigms. I will focus principally on the Overbidder Paradigm, which is most central to the theory of efficient breach and which probably accounts

52. *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW (1st ed. 1972). The theory was apparently originated by Robert Birmingham in his article *Breach of Contract, Damage Measures, and Economic Efficiency*, 24 RUTGERS L. REV. 273, 284 (1970) ("Repudiation of obligations should be encouraged where the promisor is able to profit from his default after placing his promisee in as good a position as he would have occupied had performance been rendered.").

53. POSNER, *supra* note 52, at 57. Posner states here that "*if* damages are limited to loss of expected profit" there should be an incentive to commit breach when the promisor's gain from breach will exceed the promisee's loss. *Id.* (emphasis added). Clearly, however, Posner's conclusion is that when the promisor's gain from breach will exceed the promisee's loss, the remedy for breach of contract *should* be limited to the promisee's loss.

for most of the cases in which the theory might be applied. I will consider the Mitigation Paradigm in Part IV.C.3.

A. The Overbidder Paradigm and its Inefficient Consequences

In the Overbidder Paradigm, a seller who has contracted to sell a commodity to a buyer breaches the contract in order to resell the commodity[54] to a third party—the "overbidder"—who comes along later and offers a higher price. The Overbidder Paradigm is the poster child of the theory of efficient breach. Proponents of the theory, including Posner, typically include an illustration that exemplifies this Paradigm as part of their argument for the theory. Here is the centerpiece illustration of the theory of efficient breach in the first edition of Posner's *Economic Analysis of Law*:

> I sign a contract to deliver 100,000 custom-ground widgets at $.10 apiece to A, for use in his boiler factory. After I have delivered 10,000, B comes to me, explains that he desperately needs 25,000 custom-ground widgets at once since otherwise he will be forced to close his pianola factory at great cost, and offers me $.15 apiece for 25,000 widgets. I sell him the widgets and as a result do not complete timely delivery to A, who sustains $1000 in damages from my breach. Having obtained an additional profit of $1250 on the sale to B, I am better off even after reimbursing A for his loss. Society is also better off. Since B was willing to pay me $.15 per widget, it must mean that each widget was worth at least $.15 to him. But it was worth only $.14 to A—$.10, what he paid, plus $.04 ($1000 divided by 25,000), his expected profit. Thus the breach resulted in a transfer of the 25,000 widgets from a lower valued to a higher valued use.[55]

There are two major criteria by which the theory of efficient breach needs to be evaluated. One is whether the predicates of the theory are correct; the other is whether the theory is justified even if its predicates are correct. The theory could be valid only if it satisfies both criteria. In the context of the Overbidder Paradigm, the theory satisfies neither.

The theory of efficient breach rests on two basic predicates: (1) the expectation measure makes the promisee indifferent between performance and damages, and (2) the promisor knows the value that the promisee places on the commodity. In the context of the Overbidder Paradigm, both predicates are incorrect.

Posner states the first predicate as follows:

> [I]f the profit that [the breaching party] would make from a breach . . . is greater than his profit from completion, then

54. Recall that I use the term *commodity* to mean anything that can be sold, including services. I use the term *sell* to include provide, lease, and license. I use the term *resell* to mean a sale of a commodity that the seller has already contracted to sell.

55. POSNER, *supra* note 52, at 57.

> completion will involve a loss to him. If that loss is greater than the gain to the other party from completion, it is clear that commission of the breach would be value maximizing and should be encouraged. And because the victim of the breach is made whole for his loss, he is indifferent [betwcen performance and damages].[56]

Essentially, in the context of the Overbidder Paradigm the theory of efficient breach treats the indifference principle not only as normatively correct but also as descriptively accurate.

In evaluating the first predicate in the context of the Overbidder Paradigm, it is important to bear in mind that the theory of efficient breach normally has no bearing on contracts for the sale of homogeneous commodities that are in abundant supply. This is because in the case of such a commodity the amount by which the overbidder's price will exceed the contract price is also normally the measure of the buyer's damages.

For example, suppose that on January 2, Seller agrees to sell Buyer 1,000 bushels of US No. 2 Hard Red Wheat ("No. 2 wheat") for $4.00/bushel, delivery on March I. On February 15, Seller sets aside I,000 bushels and identifies them to Buyer's contract. On March I, the market priee of No. 2 wheat for immediate delivery is $4.50/bushel. That day, Overbidder offers to buy 1,000 bushels of No. 2 wheat from Seller. Seller sells to Overbidder the 1,000 bushels she had identified to Buyer's contract. Because No. 2 wheat is an abundant, homogeneous commodity, Overbidder will pay the market price—$4.50/bushel—for the wheat, no more and no less. But Buyer will be entitled to damages equal to the difference between this price and the contract price ($4.00/bushel). As a result, Seller's gain from breach ($500) will be equal to Buyer's loss and damages (also $500). Accordingly, at least in principle, Seller will have no incentive to breach—and indeed under the theory of efficient breach she should not breach, because her gain will not exceed Buyer's loss. (Of course, experience suggests that sellers of homogeneous eommodities sometimes do breach. Such breaches, however, are not motivated by efficiency and are not explained by the theory of efficient breach. Instead, they are typically motivated by the limits of expectation damages—limits that, as the seller knows, dampen a buyer's incentives to bring suit.)

Accordingly, the theory of efficient breach normally applies only to contracts for the sale of differentiated commodities. In the case of such contracts, however, a buyer will rarely if ever be indifferent between performance and damages. To begin with, as shown in Part II, expectation damages will systematically fail to satisfy the indifference principle. Therefore, the first predicate of the theory of efficient breach, that expectation damages will make a promisee indifferent between performance and damages, is incorrect, at least in the context of the Overbidder Paradigm.

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56. *Id.*

So is the second predicate—that at the time of the perform-or-breach decision the promisor knows the promisee's value. At the time a contract for the sale of a differentiated commodity is made, the seller will often know the general nature of the buyer's intended use of the commodity. The seller will also know that the buyer values the commodity at more than the contract price; otherwise, he would not agree to buy at that price. However, rarely, if ever, will a buyer quantify for the seller the profits he intends to make from that use, because the price of a differentiated commodity is usually bargained out within a range, and knowledge of the profits that the buyer will generate from the commodity would give the seller a bargaining lever to extract a price higher in the range. Furthermore, the seller's lack of information concerning the buyer's value will grow as time goes on. After the contract is made, the value of the commodity to the buyer may increase, either because the buyer creates or discovers a more valuable use for the commodity than he had when the contract was made, or because the buyer has engaged in various forms of contract-specific investment that will lose value if the commodity is not delivered. In short, at the time of the perform-or-breach decision the seller often or usually will not know whether the overbidder values the commodity more highly than the buyer, because the seller will not know the buyer's value with any degree of precision. Instead, the seller will know with precision only that the overbidder is willing to *pay* more now than the buyer agreed to pay at an earlier time.[57]

This informational flaw in the theory of efficient breach is thrown into sharp relief by a competing theory, which I will call the *theory of efficient termination*. This theory simply holds that it is often more efficient to terminate a contract than to perform it. As stated by Paul Mahoney, "Efficient termination is possible when the amount of money, Y, that [the promisor] would pay to escape performance at a particular point in time is greater than the amount of money, Z, that the promisee . . . would accept in lieu of performance. In that situation there is a potential gain of $Y - Z$ from terminating the contract."[58]

The difference between the two theories is as follows. At the risk of oversimplification, a contract can be terminated in two very different ways—mutually, by rescission, or unilaterally, by breach. The theory of efficient breach contemplates only unilateral termination by breach, and in

57. This reality is masked by the form of the illustrations used by proponents of the theory of efficient breach. In real life, a perform-or-breach decision must be made by a seller who will have highly imperfect information about both the buyer's value and the overbidder's value. In contrast, proponents of the theory support it with illustrations that feature an omniscient narrator who looks down from academic Heaven, has perfect information, and knows everyone's subjective value. So, for example, the narrator of Posner's custom-ground-widgets illustration—that is, Posner—knows to the penny how much profit the buyer would make if the seller performed rather than breached. *See* POSNER, *supra* note 52, at 57.

58. Paul G. Mahoney, *Contract Remedies and Option Pricing*, 24 J. LEGAL STUD. 139, 141 (1995).

the context of the Overbidder Paradigm, the theory incorrectly assumes that a breaching seller will have full information about the value the buyer places on the contracted-for commodity. In contrast, the theory of efficient termination contemplates termination by mutual consent, because it is only through mutual consent that the parties can establish an amount that the promisee will accept in lieu of performance.[59] This theory therefore contemplates termination through a process that involves a much richer mix of information, and that allows the promisee to insist on being paid his actual value for the contracted-for commodity, not simply the value that the promisor may believe the promisee has.

This point is nicely illustrated by *Walgreen Co. v. Sara Creek Property Co.*,[60] decided by Judge Posner. Walgreen operated a pharmacy in a mall owned by Sara Creek. Under Walgreen's lease, Sara Creek promised not to rent space in the mall to anyone else who wanted to operate a pharmacy. Well into the term of the lease, Sara Creek informed Walgreen that it intended to buy out the anchor tenant in the mall and install a Phar-Mor discount store in its place. This store would include a pharmacy the same size as Walgreen's and would be within 200 feet of Walgreen's store. Moreover, Phar-Mor probably would sell pharmaceuticals at lower prices than Walgreen. Walgreen sought an injunction against the new lease. (Injunctive relief is often equivalent to specific performance, particularly where, as in *Walgreen*, the promise is to not do a certain act.[61])

Posner began by pointing out that issuing an injunction could entail transaction costs: if the injunction was granted, Sara Creek and Walgreen might then enter into costly negotiations looking toward Walgreen's surrender of its right to enforce the decree, in exchange for a payment equal to Walgreen's prospective lost profits from the new competition. Posner nevertheless granted the injunction, on the ground that post-decree negotiation would produce better information concerning Walgreen's expected loss than would the adjudicative process:

> The benefits for substituting an injunction for damages are twofold. First, it shifts the burden of determining the cost of the defendant's conduct from the court to the parties. If it is true that Walgreen's damages are smaller than the gain to Sara Creek from allowing a second pharmacy into the shopping mall, then there must be a price for dissolving the injunction that will make both parties better off.... [A] premise of our free-market system, and the lesson of experience here and abroad as well, is that prices and costs are

59. As Sidney DeLong has put it, "[T]he promisee's consent to a reallocation of performance resources is the only certain proof of the efficiency" of termination. Sidney W. DeLong, *The Efficiency of a Disgorgement as a Remedy for Breach of Contract*, 22 IND. L. REV. 737, 754 (1989).

60. 966 F.2d 273 (7th Cir. 1992).

61. *See* 1 DOBBS, *supra* note 44, § 2.8(1), at 190. Indeed, specific performance can be viewed as a form of injunctive relief. *Id.*

> more accurately determined by the market than by government. A battle of experts is a less reliable method of determining the actual cost to Walgreen of facing new competition than negotiations between Walgreen and Sara Creek over the price at which Walgreen would feel adequately compensated for having to face that competition.[62]

It is true that requiring the promisor to perform her contract with the promisee rather than allowing her to render the performance to an overbidder may in some cases do more than force information to the surface. If the promisor's gain from dealing with the overbidder exceeds the promisee's loss from breach, requiring the promisor to perform will also give the promisee a lever to extract part of that gain. Indeed, this could have been the effect of the decree in *Walgreen* itself. But surely Posner recognized that possibility. Presumably, his decision to uphold the injunction anyway was based on one or more of three reasons: (1) Over the long run (and perhaps

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62. *Walgreen*, 966 F.2d at 275-76. As *Walgreen* demonstrates, the costs of post-decree negotiation will not justify a categorical rule *against* routine specific performance. There are several reasons why this is so.

First, the total social costs of post-decree negotiation may be insignificant, because many parties who are awarded a decree of specific performance will not be interested in contracting around it. *Cf.* Ward Farnsworth, *Do Parties to Nuisance Cases Bargain After Judgments? A Glimpse Inside the Cathedral*, 66 U. CHI. L. REV. 373 (1999) (examining twenty nuisance cases and finding no bargaining after judgment, apparently in part because of animosity between the parties).

Second, parties may contract around not only decrees of specific performance, but judgments for damages. A judgment-debtor may offer to pay less than the amount of the judgment in full satisfaction of the judgment, and a judgment-creditor may accept that offer to get his money quickly and easily. Contracts like this raise problems of consideration under the legal-duty rule. *See* Foakes v. Beer, 9 App. Cas. 605 (H.L 1884) (creditor's promise held unenforceable). However, good lawyering can get around those problems, and in any event the courts are increasingly unfriendly to applying that rule in this context. *See, e.g.*, Sugarhouse Fin. Co. v. Anderson, 610 P.2d 1369 (Utah 1980) (creditor's promise held enforceable). Contracting around judgments will be just as costly as contracting around decrees. Furthermore, most cases are settled, and pre-suit settlement negotiations will be at least as costly in damages cases as they are in specific-performance cases. *See* Timothy J. Muris, *The Costs of Freely Granting Specific Performance*, 1982 DUKE L.J. 1053, 1059.

Third, as Ulen points out, even if a general rule of specific performance would require more contracting-around than a general rule of damages, which is uncertain, the additional costs would probably be very low. *See* Thomas S. Ulen, *The Efficiency of Specific Performance: Toward a Unified Theory of Contract Remedies*, 83 MICH. L. REV. 341, 377 (1984).

Fourth, whether promisees have a right to specific performance affects the decisions of promisors whether to perform or breach. The social benefits from selecting the legal rules that will give actors the best incentives in deciding whether to perform or breach contracts will swamp the differential—if any—between the transaction costs of contracting around decrees of specific performance and contracting around judgments for damages.

Fifth, with a rule favoring specific performance, there will likely be less breach. Accordingly, there will be less post-litigation negotiation.

Sixth, and perhaps most importantly, post-decree negotiations between the parties may be a less costly, more accurate, and therefore more efficient way to determine the value that the promisee places on the promisor's performance than an adjudicative attempt to measure that value. This is precisely the ground for Posner's decision in *Walgreen*. *See id.* at 365 (under a specific performance regime, "the costs of determining willingness-to-pay are borne by those most efficiently to determine that amount"—that is, the contracting parties).

even in *Walgreen*), the social gain from forcing information to the surface exceeds the possible social loss from giving the promisee this kind of lever. (2) Cases in which it is apparent that the promisee seeks specific performance for the purpose of opportunistically appropriating part of the promisor's gain can be singled out for special treatment. (3) In any event, a promisor in the typical overbidder case has, by virtue of making a contract with the promisee, bargained away to the promisee the potential for gains that may arise because of overbids. The promisor therefore cannot justly complain if she must give up part or all of such a gain to the promisee.

In short, the theory of efficient breach is based on the predicates that the expectation measure makes a promisee indifferent between performance and damages, and that at the time of breach the promisor knows what value the promisee puts on the contracted-for commodity. In the context of the Overbidder Paradigm, these predicates are incorrect. A buyer will never be indifferent between performance and damages, because of the way in which market-price damages are calculated, the way in which the certainty rule is administered, the principle of *Hadley v. Baxendale*, the cost of dispute settlement, the limitations on pre-judgment interest, and the risk of promisor insolvency after performance was due. Similarly, a seller will almost never know with any degree of precision what value the buyer puts on the contracted-for commodity. Accordingly, at least in the context of the Overbidder Paradigm, the theory of efficient breach cannot be sustained because the predicates of the theory are incorrect.

The second major criterion for evaluating the theory of efficient breach is whether encouraging breach would in fact promote efficiency, even assuming, counterfactually, that the predicates of the theory were correct. As I will show, in the context of the Overbidder Paradigm the theory not only lacks an efficiency justification but would promote inefficiency.

The standard efficiency justification for the theory of efficient breach in the context of the Overbidder Paradigm is that if a seller's gain on breach and sale to an overbidder exceeds the buyer's loss, breach is an instrument for transferring a commodity to a higher-valued use. This justification, however, cannot be sustained.

Consider first a resale in a world in which there are no transaction costs. In such a world, the higher-valued-use rationale would clearly be incorrect. Under the Coase Theorem, in the absence of transaction costs the efficient outcome will occur without regard to the content of legal rules. Accordingly, in a world without transaction costs, commodities will always flow to higher-valued uses. Therefore, if a third party values the

commodity more than the buyer, he will end up with the commodity even under a regime that freely grants specific performance.[63]

Commodities will also normally flow to higher-valued uses even in a world *with* transaction costs. In such a world, if a third party values the commodity more than the buyer and knows the buyer's identity, he will purchase from the buyer either an assignment of the contract or the commodity itself. If the third party does not know the buyer's identity, a rational seller will either negotiate with the buyer for a release from the contract or will sell the third party's identity to the buyer or the buyer's identity to the third party.[64]

Furthermore, there is no reason to believe that in the Overbidder Paradigm the overbidder has a higher-valued use for the commodity than the buyer. It is true that the amount the overbidder offers to pay now is, by hypothesis, greater than the amount that the buyer agreed to pay earlier. However, this tells us little or nothing about the parties' respective valuations at the time of breach. Indeed, in the context of the Overbidder Paradigm, the seller may breach and sell the commodity to the overbidder although she *knows* that the value the overbidder places on the commodity is less than the buyer's value. Even if she knows that, she will also know that the buyer may choose not to sue because of the cost of litigation and the limits on expectation damages.

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63. Indeed, as Daniel Farber dramatically puts it, in a world without transaction costs, if a third party has a higher-valued use for a commodity than the buyer he will end up with the commodity even if breach is a capital offense and sellers therefore never breach:

> [Assume that] *B* (a buyer) and *S* (a seller) contract for the production of unique goods. Before the delivery date, *X* (a third party) offers to buy the goods from *S*. Assum[e] zero transaction costs .... To take the most extreme case, suppose that breach of contract were a capital offense. S would not be willing to breach even if *X* offered to pay far more than the goods are worth to *B*. *X* would still ultimately receive the goods, however, as *X* would either pay B to assign him the contract or buy the goods from *B* after delivery. Absent transaction costs, no assignment of liability will prevent the parties from achieving this distribution of goods.

Daniel A. Farber, *Reassessing the Economic Efficiency of Compensatory Damages for Breach of Contract*, 66 VA. L. REV. 1443, 1449-50 (1980).

64. In the third edition of *Economic Analysis of Law*, Posner changed the rhetoric of his efficiency justification from higher-valued use to Pareto superiority:

> Having obtained an additional profit of $1,250 on the sale [of the widgets to B, the seller is] better off even after reimbursing A [the buyer] for his loss, and B is no worse off. The breach is Pareto superior, *assuming that A is fully compensated* and no one else is hurt by the breach. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 107 (3d ed. 1986) (emphasis added).

In the context of the Overbidder Paradigm, however, the Pareto-superiority justification is no more persuasive than—and indeed just a variant of—the higher-valued-use justification. Posner's conclusion explicitly turns on the assumption of full compensation. That assumption does not hold when compensation means the amount required to make a promisee indifferent between performance and breach. Because the assumption does not hold, the buyer will be worse off from breach. Indeed, breach would not be Pareto superior even if Posner's full-compensation assumption did hold. Even with full compensation for his losses, the buyer is worse off in the breach state than in the performance state, because in the breach state he loses the possibility of himself reselling the widgets to the third party for a higher price.

Accordingly, the theory of efficient breach cannot be justified in the Overbidder Paradigm on the ground that breach will move commodities to higher-valued uses. Posner implicitly recognizes this problem and falls back on an argument that the transaction costs of moving commodities to higher-valued uses will be less under an efficient-breach regime than under a regime that generously allows specific performance.

Choices among competing legal regimes that purport to be based on small differences in transaction costs usually rest on very shaky foundations. Often transaction costs are trivial, and as Paul Mahoney observes, "[t]he transaction costs approach yields . . . no persuasive conclusion when transaction costs are low (unless we can mcasure them with extremc precision)."[65] Moreover, even where transaction costs are more than trivial, it is frequently impossible to reliably identify and quantify all the transaction costs of alternative legal regimes. Ian Macneil points out that "it is extremely easy to introduce selected transaction costs to show that the model 'proves' what the modeler wants it to prove, while ignoring countless other transaction costs of equal or greater pertinence in the real world—costs yielding different conclusions."[66] Therefore, transaction-cost arguments often adorn rather than control a preference for one legal regime over another.

Transaction-cost arguments, then, are typically suspect. In the context of the Overbidder Paradigm, the transaction-cost argument is worse than suspect; it is wrong. Posner's argument is that if the overbidder has a higher-valued use for the commodity than the buyer, and if the law allows the buyer to obtain specific performance, then there would be a transaction cost for negotiating an assigument of the buyer's rights to an overbidder. However, breach and resale also entail transaction costs—and heavy ones. To begin with, a transaction between a seller and a third party will involve the same kinds of negotiation costs as a transaction between a buyer and a third party.[67] Furthermore, if the seller breaches, she must pay damages to the buyer. Because the buyer's damages will normally be both uncertain and contested, determining damages will normally require costly negotiation and often costly legal fees. Accordingly, as Ian Macneil and Daniel Friedmann have shown, it is impossible to definitively establish whether the transaction costs of moving commodities to higher-valued uses would be greater under an efficient-breach regime or under a regime in which buyers of differentiated commodities are freely awarded specific

65. Mahoney, *supra* note 58, at 142.

66. Ian R. Macneil, *Efficient Breach of Contract: Circles in the Sky*, 68 VA. L. REV. 947, 961 (1982).

67. *See* James Gordley, *A Perennial Misstep: From Cajetan to Fuller and Perdue to "Efficient Breach," in* ISSUES IN LEGAL SCHOLARSHIP, Article 4 (2001).

performance.[68] If anything, the transaction costs of breach are likely to be significantly greater, on average, than the transaction costs of performance.

In short, in the context of the Overbidder Paradigm there is no convincing efficiency justification for the theory of efficient breach. But there is more. If the theory were widely followed, it would lead to three kinds of *inefficiency*: (1) it would inefficiently remake contracts, (2) it would inefficiently provide disincentives for planning, and (3) it would decrease the efficiency of the contracting system.

1. Inefficiently Remaking Contracts

One way to measure the efficiency of a contract rule is to ask what rule well-informed contracting parties would normally agree upon if bargaining were cost-free. This is not the only way to measure the efficiency of a contract rule, nor will the answer to this question necessarily be easy to determine. Nevertheless, the question is worth pursuing, because all things being equal, parties normally are the best judges of their own utility, so that if the great majority of well-informed contracting parties would favor one rule over another, that rule is probably the most efficient.

There is an easy way to determine whether the theory of efficient breach corresponds to the rule that contracting parties in the Overbidder Paradigm would normally agree upon if they address the issue at the time the contract is made. Suppose that Seller and Buyer have negotiated a contract under which Seller agrees to sell a differentiated commodity to Buyer—say a home to live in, custom-made widgets that Buyer will use as an input in production, or a used die press that Buyer will employ as a factor of production. As the parties are about to sign a written contract, Seller says to Buyer, "In all honesty, I should tell you that although I have no present intention to breach this contract, neither do I have a present intention to perform. If a better offer comes along, I will take it and pay you expectation damages. In fact, I will begin actively looking for a better offer right after we sign this contract. Let's insert a provision that recognizes I

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68. *See* Daniel Friedmann, *The Efficient Breach Fallacy*, 18 J. LEGAL STUD. 1 (1989); Ian R. Macneil, *supra* note 66, at 950-51. Presumably under the impetus of critiques like those of Friedmann and Macneil, in later editions of *Economic Analysis of Law*, Posner reworked his transaction-costs passage to concede that breach, as well as performance, entailed transaction costs:

> True, if I [the seller] had refused to sell to B [the third party], he could have gone to A [the buyer] and negotiated an assignment to him of part of A's contract with me. But this would have introduced an additional step, with additional transaction costs—and high ones, because it would be a bilateral-monopoly negotiation. On the other hand, litigation costs would be reduced.

RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 119 (4th ed. 1992). The grudging nature of this concession is evidenced by the glaring defects in the argumentation and the imbalanced nature of the rhetoric. For example, Posner characterizes the costs of negotiation between the seller and the buyer as "high," but says nothing about the magnitude of litigation costs in an efficient-breach regime. Similarly, Posner persists in failing to point out that in an efficient-breach regime there will be costs for contracting between the seller and the third party.

will do just that." What would be Buyer's likely response? Under the theory of efficient breach, Buyer would say, "Of course, I expect no more." Experience strongly suggests, however, that in real life, most buyers would be surprised if not shocked by such a statement and would either walk away; insist on an explicit contractual provision stating that the seller has a present intent to perform and that any profit on breach and resale will go to buyer; or demand a payment, in the form of a lower price, for the seller's right to resell. Buyers will react this way because, as Ian Ayres and Gregory Klass conclude, normally one point of a bargain promise is to convince the promisee that the promisor has an intent to perform:

> [T]here are good reasons why promisors want to implicitly say that they intend to perform *simpliciter*, rather than that they intend to perform or pay damages, or that they do not intend not to perform, or nothing at all about their intent. Promisees care about promisor intent because they care deeply about whether or not the promisor will perform. If a promisee thinks that the promisor does not intend to perform and is seriously considering the option of paying damages instead, he is much less likely to rely on her promise, be it by entering into a binding contract or by otherwise ordering his behavior as if performance were going to happen. But the whole point of promising is to convince others to rely on one's future actions. Thus promisors have a natural incentive to communicate with their promisees an intent to perform. This fact explains why most promises represent an intent to perform and why the law should adopt a default interpretation that recognizes this fact.[69]

To put this differently, as stated in the Comments to the Uniform Commercial Code, "the essential purpose of a contract between commercial [actors] is actual performance and they do not bargain merely for a promise, or for a promise plus the right to win a lawsuit."[70] Accordingly, "a continuing sense of reliance and security that the promised performance will be forthcoming when due . . . is an important feature of the bargain."[71]

Why is it that, as the UCC Comments put it, a promisee bargains for actual performance, not for a promise plus the right to win a lawsuit—or, as Ayres and Klass put it, that most promisors implicitly represent that they have an intent to perform? One reason is that, as shown above, expectation damages are far from sufficient to make a promisee indifferent between performance and damages. But there is an even stronger reason. When buyers contract for the purchase of a differentiated commodity, they are

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69. Ian Ayres & Gregory Klass, *Promissory Fraud Without Breach*, 2004 WISC. L. REV. 507, 513-14.

70. U.C.C. § 2-609 cmt. 1 (2003).

71. *Id. See also* 3 GEORGE E. PALMER, THE LAW OF RESTITUTION § 15.9 at 440 (1978) ("In most contracts, . . . [t]he expectation that deserves protection is the promised performance, which the promisee desires for a multitude of reasons that may have nothing to do with whether it is worth more than he agreed to pay. . . .").

typically motivated in significant part by a desire to coordinate and stabilize planning, production, and distribution by locking in the supply of inputs and factors of production and distribution. This lock-in allows buyers to confidently engage in long-term production projects and to make expenditures on contract-specific and wealth-enhancing reliance, such as advertising or the acquisition of control over complementary inputs and factors of production and distribution. Indeed, even where allocation of the risk of price changes is an important purpose of a contract, the buyer's desire to acquire control over inputs and factors of production and distribution is often equally or more critical. An example is a contract for just-in-time delivery of manufacturing components, where delays in delivery would ordinarily be much more adverse to the buyer than price increases.

Furthermore, even if, counterfactually, expectation damages made a promisee indifferent between performance and damages *when* damages are granted, because of the vagaries of litigation, a promisee cannot be sure *whether* damages will be granted. Buyers do not contract for the expensive, emotionally draining, hassling game of chance that litigation constitutes. Instead, buyers contract for goods and services to be delivered when they are supposed to be delivered, and they want to *know* that those goods and services will be delivered and delivered on time. That is why, as the UCC Comments state, a continuing sense of reliance and security that the promised performance will be forthcoming when due is an important feature of a bargain.

Survey evidence also supports the conclusion that a contracting promisee normally expects that the promisor is committed to performance. In 1990, David Baumer and Patricia Marschall surveyed 119 North Carolina corporations about their attitudes towards willful breach. One question was, "If a trading partner deliberately breaches a contract because a better deal can be had elsewhere, is such behavior unethical?" One hundred and five respondents said yes.[72] These responses make sense only if buyers understand a contract of sale as a commitment by the seller to perform, not as a commitment to perform or pay damages at the seller's option.

Moreover, not only does a buyer expect a seller to perform, but a buyer will normally pay an implicit premium for the seller's implied promise not to continue offering, and not to sell, the commodity that she has agreed to deliver to the buyer. At the time a contract for the sale of a differentiated commodity is made, the buyer and the seller know that an overbid might later be made.[73] Because the buyer and the seller know this, the

72. David Baumer & Patricia Marschall, *Willful Breach of Contract for the Sale of Goods: Can the Bane of Business be an Economic Bonanza?*, 65 TEMP. L. REV. 159, 165 (1992). In addition, eighty six said that they would always or almost always withhold future business from a party who had willfully breached. *Id.*

73. As Alan Schwartz states:

buyer will need to pay the seller an implicit premium for taking the risk of forgoing an overbid. The amount of this premium will be the expected value of an overbid, based roughly on a probability-weighted average of potential overbid prices. Having been paid this premium, the seller should not be allowed to abrogate the insurance that she sold to the buyer by selling to an overbidder and confiscating the value of the overbid. To put it differently, making a forward contract for the sale of a differentiated commodity reflects a decision by the seller, embodied in a binding commitment, that her best bet is to take the buyer's present offer rather than to wait for a possible higher offer in the future. If the seller keeps searching for, or accepts, a higher offer, she is reneging on her bet.

The point that a contract for the sale of differentiated commodities implicitly prohibits a seller from searching for an overbidder, or accepting an overbid, is forcefully made in *Greer Properties, Inc. v. LaSalle National Bank*,[74] a Seventh Circuit opinion that Judge Posner joined. In February 1987, the Sellers contracted to sell a parcel of real estate to Searle Chemicals for approximately $1,100,000. Searle had the right to terminate the contract if the soil was contaminated by environmental waste. The deal fell through because an environmental consulting firm that Searle hired reported that the site was contaminated and that clean-up would cost more than $500,000.

The Sellers then contracted to sell the property to Greer for $1,250,000. Under this contract, the Sellers were required to remove the environmental contamination at their own expense but were allowed to terminate the contract if the cost of the clean-up became economically impracticable. The Sellers then retained a soil consultant, who estimated the cost of the clean-up at only $100-200,000. At that point, the Sellers went back to Searle and entered into a new round of negotiations. A purchase price of $1,455,000 was proposed in these negotiations and embodied in a draft contract prepared by Searle. The Sellers then terminated the contract with Greer, purportedly under the clean-up provision.

> [Markets for unique goods] often are well organized; the antique market provides an example. Such markets have two distinguishing features. First, they are usually characterized by greater price dispersion than obtains in the market equilibria for roughly fungible goods. In addition, sellers of unique goods face a lower "rate of arrival" of potential buyers than do sellers of roughly fungible goods. These two phenomena are related; a high "buyer arrival" rate implies extensive comparison shopping among firms, whereas the degree of price dispersion a market can sustain varies inversely with the amount of comparison shopping. . . . [A seller] of unique goods consequently has grounds to believe that the offers he receives are to some extent random, and that later offers could be much higher than earlier ones.

Alan Schwartz, *The Case for Specific Performance*, 89 YALE L.J. 271, 281 (1979-80). Schwartz uses the term "unique," rather than "differentiated," but it is clear from his text that he is referring to non-homogeneous—that is, differentiated—goods. *See id.*

74. 874 F.2d 457 (7th Cir. 1989).

Greer brought an action for specific performance and damages. The district court held for the Sellers, on the ground that upon receipt of the soil consultant's study, the Sellers had broad discretion to terminate the contract under the clean-up provision. The Seventh Circuit reversed, on the ground that by making the contract with Greer, the Sellers had given up their right to look for a better price:

> Under Illinois law, "every contract implies good faith and fair dealing between the parties to it." . . . This implied obligation of good faith and fair dealing in the performance of contracts acts as a limit on the discretion possessed by the parties. . . . With this limitation on the discretion of the Sellers in mind, their decision to terminate the contract must be analyzed to determine if they acted in good faith. If the Sellers terminated the contract to obtain a better price from Searle, their action would have been in bad faith. *When the Sellers entered the contract with Greer and Greer agreed to pay them a specific price for the property, the Sellers gave up their opportunity to shop around for a better price.* By using the termination clause to recapture that opportunity, the Sellers would have acted in bad faith.[75]

In short, in a contract for the sale of a differentiated commodity, the buyer contracts to purchase the commodity, and the seller contracts to deliver the commodity and to forgo the positive risk that an overbidder may come along. Whether that positive risk materializes before or after delivery is not relevant. Just as the buyer takes the negative risk that the value of the commodity may fall before or after delivery, so the seller forgoes the positive risk that the value of the commodity may rise before or after delivery, an overbidder may be found, or both. Accordingly, the theory of efficient breach, which approves and indeed encourages searching for and accepting overbids, would inefficiently remake contracts.

Of course, there may be cases where at the time the contract is made, the buyer is willing to allow the seller to resell and to keep the gain from an overbid in exchange for a reduction in price. These cases are easy to deal with. If a seller wants the right to resell in exchange for a reduction in the buyer's price, and the buyer finds this deal attractive, the parties can use explicit contract language that gives the seller that right and waives any right the buyer would otherwise have to seek specific performance.

2. *Inefficiently Providing Disincentives for Planning*

The theory of efficient breach also provides inefficient disincentives for planning. Where the buyer's damages are based on the difference between contract price and market price, under the theory of efficient breach the seller will gain from breach only if the price paid by the overbidder

75. *Id.* at 460 (emphasis added).

exceeds the market price. There are two basic reasons why an overbidder may pay more than market price.

First, market price is an inexact, midpoint construct based on extrapolations from comparable transactions, and the overbidder may be willing to pay a price above the artificial midpoint. In that case, the theory has no positive efficiency implication: there is no reason to believe that the overbidder values the commodity more highly than the buyer, because the buyer may also have been willing to pay a price above the constructed market price.

Second, the commodity may have a strategic value to the overbidder that is higher than its value to anyone else, and the constructed market price may not impound that strategic value. However, if the overbidder had a special strategic need for the commodity when he made his overbid, he probably had a prospect of the strategic need when the original contract was made. The question then arises, why didn't the overbidder make a contract with the seller at that time? The answer to this question is likely to involve issues of foresight and investment. For example, it may be that the commodity takes time to produce; the buyer foresaw a future need for the commodity; and the buyer was willing to invest in a contract for production of the commodity at a time when the overbidder lacked the foresight, was unwilling to make the investment, or both. Or it may be that the commodity essentially consists of productive capacity; the buyer foresaw a future need for that capacity; and the buyer was willing to invest in a contract to lock up that capacity at a time when the overbidder lacked the foresight, was unwilling to make the investment, or both.

In either type of case, the overbidder may be willing to pay more than the constructed market price because the supply or productive capacity that he needs has now become scarce. But providing the seller with an incentive to sell the commodity to the overbidder would deny the buyer the benefit of his foresight and investment. Efficient incentives should be just the other way around. The law should reward the ant, not the grasshopper. It is the buyer who has earned the opportunity to acquire the commodity, by having foresight and investing when the overbidder was either not smart enough or not willing enough to do so. Accordingly, the theory of efficient breach would also have efficiency costs in cases like these, because it would diminish the incentives for developing foresight and investing. As stated by Doug Laycock:

> It is common ground that one economic function of contract is to allocate risk. One of the risks that is allocated by contracts is the risk of doing without in time of shortage. Those who plan ahead when shortage is merely a risk should reap the benefits when shortage comes to pass. . . . [B]reaching sellers should not be able

> to reallocate the risk after the fact by . . . keeping the specific thing and paying damages that cannot be used to replace it.[76]

3. Weakening the Contracting System

There is a third way the theory of efficient breach, if widely followed, would reduce efficiency. The theory of efficient breach is based on a static and short-run approach to the issue of breach, because it addresses only the efficiency of performing or breaching an individual contract. In contrast, a dynamic, long-run approach to the issue of breach addresses the efficiency of the contracting system as a whole. From that perspective, the theory of efficient breach is inefficient because if widely followed, it would diminish the efficiency of that system.

The efficiency of the contracting system does not rest, as the theory of efficient breach implies, solely on legal remedies. Rather, the efficiency of the contracting system rests on a tripod whose legs are legal remedies, reputational effects, and the internalization of social norms, in particular the moral norm of promise-keeping. These three legs are mutually supportive. Legal rules rest in significant part on social norms, reputational effects rest in significant part on social norms, and social norms are reinforced by legal rules and supported by reputational effects.

All three of these legs are necessary to ensure the reliability of the contracting system. Legal rules are not alone sufficient, because dispute settlement under law is expensive and chancy. The moral norm of promise-keeping is not alone sufficient, because not all actors fully internalize moral norms. Reputational effects are not alone sufficient, because reputations are fully effective only if third parties have reliable information concerning a promisor's history of breach, and this kind of information is hard to come by, both because many breaches do not become widely known and because promisors will often claim that they had a valid excuse for not performing.

Because all three legs are necessary to support the efficiency of the contracting system, anything that weakens one leg seriously threatens the efficiency of the system. The theory of efficient breach, if widely adopted, would do precisely that, because the effect of the theory would be to remove the moral force of promising in a bargain context. The moral meaning of making a promise is to commit yourself to take a given action in the future even if, when the action is due to be taken, all things considered you no longer wish to take it. The theory of efficient breach turns this upside down. Under that theory, if you don't wish to take a promised action when it is due, because all things considered you believe that the cost to you of taking the action would exceed the gain to the promisee, *you shouldn't*

76. DOUGLAS LAYCOCK, THE DEATH OF THE IRREPARABLE INJURY RULE 253-54 (1991).

keep the promise. Indeed, removing the moral force of promises in a bargain context is not only an effect of the theory of efficient breach, it is a purpose of the theory. Robert Birmingham, who apparently originated the theory, was explicit on this point:

> [P]rotection of the expectation interest . . . encourages optimal reallocation of factors of production and goods without causing material instability of expectations. More rigorous adherence to this standard would promote proper functioning of the market mechanism. Encouragement of repudiation where profitable through elimination of moral content from the contract promise might also be socially desirable.[77]

To the same effect, recall Posner's conclusion that if the seller's gain from breach will exceed the buyer's loss, then "if damages are limited to loss of expected profit, there will be an incentive to commit breach. *There should be*."[78]

Given the dilution or elimination of the moral force of bargain promises under the theory of efficient breach, that theory, if widely adopted, would decrease the efficiency of the contracting system in three ways. First, it would increase the need to resort to litigation, which is very expensive, as opposed to achieving performance of contracts through the internalization of the moral norm of promise-keeping, which is very inexpensive. Second, it would lead contracting parties to make greater use of costly noncontractual measures, such as security deposits, to ensure performance. Third, it would diminish the force of reputational constraints, because such constraints rest in significant part on moral norms.

To summarize, in the context of the Overbidder Paradigm, the theory of efficient breach is inefficient in three major respects. First, the theory would inefficiently remake the parties' bargain by converting a contract to provide a commodity, and to not search for or sell to an overbidder, into a contract that allowed and indeed encouraged sellers to search for and sell to overbidders. Second, the theory would provide a disincentive to plan and invest, by encouraging sellers to transfer commodities away from buyers who have planned and invested, to overbidders who have done neither. Third, the theory would reduce the efficiency of the contracting system by seriously weakening one of the three legs upon which that efficiency rests.

In light of the failure of the predicates of the theory of efficient breach in the context of the Overbidder Paradigm, and the inefficiency to which the theory would lead if it was widely followed, at least in that context the theory is invalid, and therefore fails to provide a reason against specific performance.

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77. Birmingham, *supra* note 52, at 292.

78. POSNER, *supra* note 52, at 57 (emphasis added).

B. The Loss Paradigm

I now consider the theory of efficient breach in the context of the Loss Paradigm. In this Paradigm, a seller who has contracted to render a performance to a buyer breaches the contract because she determines that her cost of producing the performance would exceed the value that the buyer places on the performance.[79]

The theory of efficient breach makes a stronger claim on efficiency grounds in this Paradigm than it does in the Overbidder Paradigm. In the Overbidder Paradigm, there is no reason to believe there will be an efficiency gain from breach; on the contrary, the theory of efficient breach, if widely followed, would lead to efficiency losses in that context. In contrast, in the Loss Paradigm an efficiency gain is possible, because if the seller's cost of production exceeds the buyer's value, performance may involve a social cost.

Accordingly, in a world in which expectation damages made the buyer indifferent between performance and legal remedies, and the seller knew the buyer's value, it might well be undesirable to grant specific performance in cases that fall within the Loss Paradigm. However, in the actual world, where expectation damages do not make a buyer indifferent between performance and legal remedies and information is highly imperfect, in the normal case specific performance should not be withheld simply because a case falls within this Paradigm.

To begin with, even if the seller's cost of production exceeds the buyer's value, the buyer may be worse off from breach than from performance because of the limits of expectation damages. For example, assume that the seller agrees to produce a machine for the buyer for $50,000. At the time the contract is made, the buyer values the machine at $53,000, and the seller's anticipated cost of production is $47,000. Now suppose that the seller's costs rise to $57,000, and the buyer's value rises to $55,000. The buyer will have a surplus of $5,000 if the contract is performed ($55,000 in

79. It is not clear how often this kind of case occurs. To begin with, most contracts, even for production, are short term, and costs are unlikely to drastically increase over the short term. If a contract is long term, there is a greater likelihood that the seller's costs of production will come to exceed the buyer's value. However, many long-term contracts either are cost-plus, include escalator provisions, or are pegged to market price because they are intended to ensure supply, not to shift the risk of price changes. Moreover, if the seller's costs of production increases, usually the buyer's value will increase in tandem. This is because usually the costs of a given seller, S, for producing a certain kind of commodity, are pretty much the same as the costs of other sellers for producing that commodity. Therefore, if S's costs increase so will those of all other sellers. But if the costs of all sellers increase, the price of the commodity will increase, and if the price of the commodity increases, so will the buyer's value. For example, suppose that Seller S agrees to build a house for buyer B. If S's costs increase, so, in all likelihood, will those of all other home builders, and therefore the price of houses. If the price of houses increases, B's value for a house will also increase. Therefore, in the normal case an increase in a seller's cost of production will not cause that cost to exceed the buyer's value, because the buyer's value will rise with the seller's costs.

value minus the contract price of $50,000). Because of the limits of expectation damages, however, the expected value of those damages will be much less than $5,000, and the buyer therefore is not made as well off by damages as he would be from performance.

Next, in practice the seller will not know the buyer's value and the buyer will not know the seller's cost of production. Accordingly, the seller can rarely make an informed decision on whether her cost of production will exceed the buyer's value. Indeed, a seller will normally not even be interested in whether her cost of production exceeds the buyer's value. A seller's only interest is whether her cost of production exceeds the contract price. If the seller's cost of production is less than the contract price, she will not unilaterally terminate the contract even if the cost of production far exceeds the buyer's value. Furthermore, because the data concerning the cost of production may be subject to manipulation, if nonperformance was routinely permitted in the context of the Loss Paradigm, a seller might opportunistically terminate on the false ground that her cost of production exceeds the buyer's value, when in fact the seller just wants to get out of a contract in which her cost of performance exceeds the contract price.

Therefore, in the Loss Paradigm, as in the Overbidder Paradigm, if a seller concludes that her cost of production will exceed the buyer's value, normally her appropriate course of action is to negotiate a termination of the contract.[80]

There is, however, a class of cases that fall within the Loss Paradigm in which specific performance should not be granted. These are cases in which the difference between the seller's cost of performance and the value of the performance to the buyer is so large that it is clear that the buyer does not really want specific performance. Instead, the buyer only wants a decree that he can opportunistically use as a lever to capture a portion of the difference between the seller's cost and the buyer's value. This class of cases will be discussed in Part IV.C.5.

C. *Conclusion*

The theory of efficicnt breach cannot be sustained in its general form, because it normally fails in its two most significant applications, the

80. In a somewhat analogous case, a study of the contract practices of nineteen English engineering manufacturers found that when buyers wished to cancel, typically the sellers would release the buyers in exchange for reimbursement of costs plus a modest profit component. H. Beale & T. Dugdale, *Contracts Between Businessmen: Planning and the Use of Contractual Remedies*, 2 BRIT J.L. & SOC'Y 45, 53 (1975). It seems likely that buyers would take a comparable approach to sellers who wished to cancel. *See* Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963). For a discussion of the role of reciprocity in contract modification, see Melvin Aron Eisenberg, *The Emergence of Dynamic Contract Law*, 88 CALIF. L. REV. 1743, 1762-67 (2000).

Overbidder Paradigm and the Loss Paradigm. There is a Paradigm in which breach may be justified: the Mitigation Paradigm. In this Paradigm, a buyer who has contracted to purchase a commodity that takes time to produce countermands performance by the seller because he determines that the value of the performance to him, if completed, will be less than the contract price. This Paradigm will be discussed in Part IV.C.3, *infra*. Suffice to say for now that the justification of breach in that Paradigm does not rescue the theory of efficient breach, both because the theory purports to be general in nature, rather than confined to one class of cases, and because the number of cases that fall within the Mitigation Paradigm are likely to be only a small fraction of the number of cases that fall within the Overbidder and Loss Paradigms.

IV
ACTUAL SPECIFIC PERFORMANCE: THE SPECIFIC-PERFORMANCE PRINCIPLE

A. Introduction

Under traditional doctrine, specific performance is an exceptional remedy, to be granted only if damages would not be adequate. This doctrine is elaborated by three important subsidiary rules: (1) Damages are not considered adequate when the subject matter of the contract is unique. (2) Real property is normally deemed to be unique. (3) Even if damages would not be adequate, specific performance will not be awarded in the case of contracts for personal services or if it would require undue judicial supervision.[81]

The commentators generally agree that the adequacy test, which lies at the center of the traditional doctrine, is an unsatisfactory and heavily eroded instrument for determining when specific performance should be granted. As Dobbs puts it:

> The adequacy test is repeatedly invoked today when the plaintiff seeks equitable relief. Nevertheless its importance has declined. Many cases do not mention the test at all. Some cases mention the test but find plenty of grounds for saying that the legal remedy is not adequate. Adequacy of the legal remedy is often judged quite liberally in favor of the equitable remedy. When equitable relief is denied, it is quite often on grounds entirely distinct from the adequacy grounds. . . . So although the rule is often invoked, it is also often ignored, sidestepped, or invoked in a way that means something else altogether. It is probably fair to say that the adequacy test has been evolving from a rule to a factor in the court's balance of costs and benefits. . . .

81. *See, e.g.*, RESTATEMENT SECOND, *supra* note 2, at §§ 357, 359-60, 366-67; LON FULLER & MELVIN A. EISENBERG, BASIC CONTRACT LAW 334, 337-39 (7th ed. 2001).

> The adequacy rule, as a rule that simply bars the gate, is virtually dead and probably should be.[82]

The commentators also generally agree that specific performance is granted more freely today than traditional doctrine suggests.[83]

Beyond these two points of agreement, however, the principles that should govern specific performance have been the subject of intense dispute among warring contracts scholars. Some scholars have enlisted in the Specific Performance Army, which takes the position that specific performance should be routinely granted.[84] Others have enlisted in the Damages Army, which takes the position that specific performance should be awarded with great restraint.[85] The analyses have been illuminating, but none of the scholars has convinced members of the opposing Army to defect. Even within each Army, most scholars have operated as independent units, largely out of contact with their comrades. In this Part, I set up my flag in the admittedly dangerous zone between the two Armies. The principle that I develop in this Part is as follows: Actual specific performance should be awarded unless a special moral, policy, or experiential reason suggests otherwise in a given class of cases, or the promisee can accomplish virtual specific performance. A promisee can accomplish virtual specific performance if he can readily find in the market a commodity that he could not in good faith reject as an equivalent of the breached performance, given his demonstrable preferences. I will call this the Specific-Performance Principle. The Specific-Performance Principle puts a thumb on the scale in favor of specific performance—but only a thumb.

The remainder of Part IV is organized as follows. Part B discusses three reasons that favor a regime of routine specific performance: the indifference principle, the bargain principle, and informational effects. Part C then shows that although these reasons are weighty enough to put a thumb on the scale in favor of specific performance, they are not sufficiently weighty to justify a regime of routine specific performance, because there are a number of countervailing reasons against such a regime, such as the nature of the enforcement process, and problems of mitigation, opportunism, and jury trial. Finally, Part D develops the Specific-Performance Principle and compares it to traditional doctrine. Thereafter, in Part V, I

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82. 1 DOBBS, *supra* note 44, § 2.5(3), at 135-41 (footnotes omitted); *see also* ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 1142 (2003 ed.) ("Objections on the ground of inadequacy of money damages are less often made than formerly and are given less consideration by the judges."); Ulen, *supra* note 62, at 374 (adequacy is often not mentioned in the cases, and where mentioned is not given much weight); LAYCOCK, *supra* note 76 at 5 ("[T]he irreparable injury rule is dead.").

83. *See, e.g.*, LAYCOCK, *supra* note 76, *passim*.

84. *See, e.g.*, Schwartz, supra *note* 73; Ulen, *supra* note 62.

85. This position is implicit in the theory of efficient breach. *See also, e.g.*, Anthony T. Kronman, *Specific Performance*, 45 U. CHI. L. REV. 351 (1977-78); Muris, *supra* note 62; Edward Yorio, *In Defense of Money Damages for Breach of Contract*, 82 COLUM. L. REV. 1365 (1982).

consider the application of the Specific-Performance Principle to contracts for the sale of goods, the sale of real estate, and the provision of services, and in Part VI, I consider cover, or virtual specific performance.

B. Three Reasons in Favor of a Regime of Routine Specific Performance

I begin with three reasons that favor a regime of routine specific performance: the indifference principle, the bargain principle, and informational effects.

1. The Indifference Principle

As shown in Part I, the indifference principle of contract law remedies is well grounded in both policy and fairness. The remedy of expectation damages often fails to leave the promisee indifferent between performance and damages. In contrast, specific performance comes closer to giving the promisee just what he contracted for, putting aside systemic limits on remedies, such as the costs of dispute settlement. Accordingly, one reason in favor of a regime of routine specific performance is that this remedy is the best way to effectuate the indifference principle.

2. The Bargain Principle

It is a fundamental principle of contract law that contracting parties are the best judges of their own utility and that, accordingly, bargains will normally be enforced according to their terms, absent defenses such as fraud, mistake, or unconscionability. The traditional doctrinal rule that makes specific performance an unusual remedy undermines that principle, because under that rule contracts normally are not enforced according to their terms. After all, those terms require performance, not the money equivalent of performance. If I promise to sell you my home, *that* is what I promise to do—not to either sell you my home or pay you money. The law may not require me to perform my promise, and may instead allow me to pay damages, but that doesn't change the fact that I promised performance, not damages.[86] It is one thing to monetize injuries caused by torts. In those

86. Oliver Wendell Holmes famously said that "the duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it, — and nothing else." Oliver W. Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897), *reprinted in* 110 HARV. L. REV. 991, 995 (1996-1997). This aphorism is often interpreted to mean that in Holmes's view a contract is only a promise to perform or to pay damages. If that was Holmes's view, he was wrong. *See supra* Part III.A.1. However, Joseph Perillo has shown that taking Holmes's writings as a whole, that was not Holmes's view. Joseph M. Perillo, *Misreading Oliver Wendell Holmes on Efficient Breach and Tortious Interference*, 68 FORDHAM L. REV. 1085 (2000). For example, in a letter to Sir Frederick Pollock of December 11, 1928, Holmes takes issue with "the impression that I say that a man *promises* either X or *to pay damages*. I don't think a man promises to pay damages in contract any more than in tort. He commits an act that makes him liable for them if a certain event does not come to pass, just as

cases, there is no alternative. The law cannot restore the full use of an injured limb or the full sight of an injured eye; money is the best the law can do. In the case of contracts, however, unless it is too late to perform, the law can give the injured party exactly what he would have had if the wrongdoer had acted properly. Why shouldn't it do so?

3. Informational Effects

Often, the parties to a contract could be made better off by mutual termination of the contract than by performance. As pointed out in Part III, however, there is an important difference between efficient termination and efficient breach. One predicate of the theory of efficient breach is that the promisor will know the promisee's valuation of the contracted-for performance at the time of the perform-or-breach decision. Based on that predicate, the theory of efficient breach contemplates unilateral termination of contracts by the promisor without the consent of, or even discussion with, the promisee. For the reasons discussed in Part III, that predicate is incorrect: there is little or no reason to suppose that a promisor will always or even typically know the value that the promisee places on the contracted-for performance at the time of the perform-or-breach decision. In contrast, a regime of routine specific performance would ensure that a promisor normally could not terminate a contract without the promisee's consent. Such a regime would drive to the surface, before a termination decision is made, information concerning the value that the promisee places on the contracted-for performance.

C. Reasons Against a Regime of Routine Specific Performance

The reasons in favor of a regime of routine specific performance are weighty enough to justify abandoning the existing doctrinal rules and placing a thumb on the scale in favor of specific performance. However, these reasons are not weighty enough to justify routine specific performance, because in many cases they are counterbalanced by reasons of policy, morality, and experience that point in the opposite direction. Some of these reasons are general in nature; others apply only to certain categories of cases. I will discuss the general reasons here and the category-specific reasons in Part V.

1. The Enforcement Process

Two of the general reasons why specific performance should not be routinely granted stem from the process by which an award of specific performance is enforced. This process differs radically from the process by

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his act in tort makes him liable *simpliciter*." Letter from Oliver W. Holmes to Sir. Frederick Pollock (December 11, 1928), *in* 2 HOLMES-POLLOCK LETTERS, at 223 (Mark D. Howe ed. 1941).

which an award of damages is enforced. An award of damages is embodied in a *judgment*, which states that the defendant is liable to the plaintiff for a designated amount of money. Judgments are enforceable by a variety of techniques known collectively as supplementary proceedings. If a judgment is neither paid nor settled, typically the court issues a writ of execution to a sheriff in a county in which the defendant has property or income. The sheriff then seizes and sells the property, or levies on the income, to pay the judgment.[87]

In contrast, an award of specific performance is embodied in a *decree*, which orders a promisor to perform. Violation of such a decree constitutes contempt of court and is punishable by jail, a civil fine, or both.[88]

Against that background, specific performance raises problems concerning both social norms and the risk of error.

a. Social Norms

Specific performance is a very intrusive remedy, in which the state orders an actor to perform certain specified and often complex actions. In our society, there is a general preference for market solutions over intrusive state action.

Furthermore, specific performance is a highly coercive remedy. Not only does the court order an actor to take a specific action, but it also threatens to treat him as a kind of criminal if he does not do so. The prospect of jailing or fining one actor to enhance another actor's private gain is inharmonious with social norms concerning the appropriate use of the state's monopoly on force. It is also inharmonious with the moral idea that there should be proportionality between wrongs and penalties: although breach of contract is a wrong, it is a low-intensity wrong as compared, say, with injuries to the person, fraud, or breach of trust.[89] (It is true that technically speaking, the promisor is punished for disobeying the court, not for breaking a contract. However, this is true *only* technically speaking, because there will be no contempt if the contract is performed.)

b. The Problem of Error

The legal system may make two very different kinds of errors in a contracts case. First, a court—I here conflate judge and jury—may make an error at the liability stage. Thereafter, a court may make an error at the

87. *See* 1 DOBBS, *supra* note 44, § 1.4, at 14-16.

88. The supplementary proceedings that sometimes follow an award of damages may occasionally include orders to the defendant or others in implementation of the proceedings, and violation of these orders may be treated as contempt, but such orders are out of the ordinary course. *See id.* § 1.4, at 18.

89. *See* Henrik Lando & Caspar Rose, *On the Enforcement of Specific Performance in Civil Law Countries*, 24 INT'L REV. L. ECON. 473, 483 (2004). *See also* Doug Rendleman, *The Inadequate Remedy at Law Prerequisite for an Injunction*, 33 U. FLA. L. REV. 346, 355-56 (1981).

enforcement stage. The risk of error in determining whether a money judgment has been paid is very small. Enforcement is normally a matter for a sheriff, and it is very easy for a sheriff to determine whether a money judgment has been satisfied. In contrast, the risk of error in determining whether a defendant has properly performed its contractual obligations under a decree of specific performance is very large. Contracts often leave a lot of room for interpretation concerning exactly what performance must be rendered. A decree that requires performance of a contract will be open to comparable problems of interpretation. Accordingly, two kinds of errors can occur in the enforcement of a specific-performance decree: either the promisor may interpret the contract incorrectly and therefore erroneously violate the decree, or the court may interpret the contract incorrectly and therefore erroneously conclude that the promisor has violated the decree.

More important, the magnitude of the effect of the risk of error is much greater in the case of specific performance than in the case of damages. In the case of an error concerning whether a judgment for damages has been satisfied, the defendant may be required to pay more than she really owes. In the case of an error concerning whether a decree of specific performance has been satisfied, the defendant may be fined or sent to jail.

There are ways to ameliorate this problem. For example, in a contempt hearing the court might give the promisor the benefit of the doubt or give her a second bite at the apple. Nevertheless, in the end, the threat of jail or a fine always stands behind a decree of specific performance, and the risk of error in determining whether those sanctions apply provides another reason why specific performance should not be routinely awarded.

2. *The Problem of Jury Trial*

Normally, a party is entitled to a jury trial in a suit for damages but not in a suit for specific performance.[90] However, a promisee who has a right to sue for specific performance does not for that reason lose his right to sue for damages. Accordingly, a routine right to specific performance would undesirably vest in promisees a power to freely deny promisors the right to a jury trial; that is, a promisee could sue for either specific performance or damages, depending on whether he wanted a jury trial, while a promisor would not have a corresponding choice.

3. *The Problem of Mitigation*

The argnments in favor of routinely granting specific performance often seem to implicitly assume that specific performance is awarded instantaneously. In fact, however, litigation takes time. It is true that specific performance, especially in the form of temporary injunctive relief, can

90. *See* 1 DOBBS, *supra* note 44, § 2.6(2), at 153.

sometimes be awarded very quickly. Often or even typically, however, a suit for specific enforcement is not finally resolved until months or years after the breach.[91]

In the context of specific performance, the element of delay can give rise to problems concerning the mitigation of damages. It is a general principle of contract law that an aggrieved party should take reasonable steps to mitigate his loss from breach, and therefore the promisor's damages.[92] The duty to mitigate is desirable as a matter of policy, because it reduces social costs. It is also desirable as a matter of morality. If, in a contractual setting, A is at risk of incurring a significant loss, and B could prevent that loss by an action that would not require B to forgo a significant bargaining advantage, undertake a significant risk, or incur some other cost that is significant under the circumstances, then as a matter of fairness, B should be under a duty to take that action.[93]

A regime of routine specific performance would conflict with the principle of mitigation because a promisee under such a regime could get specific performance even if he had not mitigated. This issue can be expressed in terms of the Mitigation Paradigm. In this Paradigm, a buyer who has contracted to purchase a commodity that takes time to produce countermands performance by the seller because he determines that the value of the commodity to him, if completed, would be less than the contract price.

The Mitigation Paradigm differs from the Loss Paradigm in two significant respects. First, in the Loss Paradigm the decision to breach is made by the seller, the two critical variables are the seller's cost of production and the buyer's value, and the seller will normally know only the first of these variables. In contrast, in the Mitigation Paradigm the decision to breach is made by the buyer, the two critical variables are the buyer's value and the contract price, and the buyer will know both. Second, expectation damages for breach by the buyer come closer to satisfying the indifference principle than expectation damages for breach by a seller. A buyer pays money, rather than delivering a commodity. Therefore, breach by a buyer normally does not involve the problem of measuring the promisee's subjective valuation, because no given dollar has greater subjective value than any other dollar. Similarly, breach by a buyer seldom involves problems under the certainty rule or the principle of *Hadley v. Baxendale*, since a seller normally will not be required to forgo profitable opportunities simply because a given buyer has not made payment.

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91. *See, e.g.*, Weathersby v. Gore, 556 F.2d 1247 (5th Cir. 1977) (contract made in 1973, appeal decided in 1977).

92. *See generally* Goetz & Scott, *supra* note 13, at 969.

93. *See* Melvin A. Eisenberg, *The Duty to Rescue in Contract Law*, 56 FORDHAM L. REV. 647, 654-65 (2002).

In cases that fall within the Mitigation Paradigm, specific performance would involve a significant social cost, because on the one hand, the buyer values the seller's performance at less than the cost of production, while on the other, by continuing performance the seller drives up the buyer's costs *without benefiting herself.* This is illustrated by *Rockingham County v. Luten Bridge Co.*[94] Rockingham County and Luten Bridge had entered into a contract under which Luten would construct a bridge for the County. After Luten had begun to construct the bridge, the County decided that it didn't want a bridge, and instructed Luten to stop work. Separately, the County cancelled construction of a road that was to lead to the bridge. Luten disregarded the countermand, completed the bridge, and sued for the price. Because the County didn't want the bridge, and indeed had no possible use for the bridge in the absence of the road, the cost of building the bridge was a social loss, and Luten increased that loss by completing performance.[95]

This social loss is not offset by a private benefit to the seller. In cases that fall within the Mitigation Paradigm, the seller's damages are typically measured by the contract price minus the variable costs remaining to be incurred by the seller at the time of breach.[96] Under this formula, if the buyer countermands, the seller recovers its lost profits (including overhead) whether or not it continues to perform. Failure to obey the countermand by continuing to perform therefore drives up the buyer's damages but not the seller's net recovery.

For example, assume that in *Rockingham County*, the contract price was $100,000, the variable costs of building the bridge were $80,000, and the County breached when Luten had incurred $40,000 of those costs. In that case, if Luten stopped work at the time of the County's countermand, its damages would have been $60,000—the contract price ($100,000) minus variable costs remaining to be incurred ($40,000). Luten's net recovery, however, would have been only $20,000, because $40,000 of the $60,000 damages would merely reimburse Luten for variable costs incurred before breach. Now suppose that instead of stopping performance, Luten continued to completion, as in fact it did. If that were permissible, Luten's damages would simply be the contract price ($100,000); there would be no deduction for variable costs remaining to be incurred because no such costs would remain. However, Luten's net recovery would still be

94. 35 F.2d 301 (4th Cir. 1929).

95. The court properly held that Luten could not recover the contract price. *Id.* at 307. This is the American rule, although the English rule is different. *See* White & Carter (Councils) Ltd. v. McGregor, [1962] A.C. 413; Eisenberg, *supra* note 93, at 656-57.

96. Under an equivalent formula, the seller's damages are measured by lost profits (based on the contract price minus total variable costs) plus variable costs incurred prior to the breach. Both formulas are subject to an offset for amounts previously paid by the buyer, which can be disregarded for present purposes.

only $20,000, because $80,000 of the $100,000 damages would merely reimburse Luten for variable costs incurred. Accordingly, Luten's continuation of performance after the County's countermand would increase the County's loss from $60,000 to $100,000 without making Luten any better off. By continuing performance after the countermand, therefore, Luten increased the social cost of building a useless bridge without deriving any corresponding private benefit. In such cases, the seller should not have a right to specific performance—that is, the seller should not be able to enjoin the buyer from countermanding.

Another facet of the conflict between the mitigation principle and a regime of routine specific performance is illustrated by the facts of *Weathersby v. Gore*.[97] On March 6, 1973, Gore, a farmer, agreed to sell Weathersby the cotton that Gore would produce on 500 acres of land during that year, at thirty cents per pound. On May 3, Gore gave Weathersby notice that he was canceling the contract. Weathersby could have covered, then or later, but did not. Soon after May 3, cotton was selling for around thirty-five cents. On September 28, Weathersby sued for specific performance. By that date, cotton had soared to eighty cents. Awarding specific performance to Weathersby would have conflicted with the strong policy reasons in favor of the duty to mitigate, and the court properly held that Weathersby was not entitled to specific performance because he could have covered:

> Weathersby was adequately protected from any damages occasioned by Gore's breach of the contract, if any occurred. He could have acquired additional cotton on the open market when Gore informed him he would no longer perform under the contract. He did not do so and thus, if entitled to damages at all, must settle for the difference between the contract and the market price at the time Gore cancelled.[98]

4. Suit by a Seller

Even outside the Mitigation Paradigm, specific performance is almost always inappropriate in a suit by a seller. Almost invariably, the only obligation of a buyer is to pay money. In the case of breach by a seller, the buyer's damages often fall far short of the indifference principle, partly because the constructed market price of a differentiated commodity often fails to account for the buyer's subjective value and partly because a buyer's lost profits are often cut off by the certainty rule or the principle of *Hadley v. Baxendale*. In contrast, breach by a buyer normally does not involve the problem of measuring the promisee's subjective valuation, because no given dollar has greater subjective value than any other dollar.

97. 556 F.2d 1247 (5th Cir. 1977).

98. *Id.* at 1258-59; *see also* Duval & Co. v. Malcom, 214 S.E.2d 356 (Ga. 1975).

Similarly, breach by a buyer seldom involves problems under the certainty rule or the principle of *Hadley v. Baxendale*, since a seller normally will not be required to forgo profitable opportunities simply because a given buyer has not made a payment.

Ordinarily, therefore, a seller would be indifferent between damages for the nonpayment of money and a decree ordering the buyer to pay the money, except insofar as the seller values the draconian sanctions for noncompliance with a decree. Accordingly, a suit for damages for the nonpayment of money is a form of virtual specific performance, so that routinely granting specific performance to sellers would be unnecessary. A right to routine specific performance against buyers would also be inappropriate because it would deny buyers a right to a jury trial, and subject them to the threat of imprisonment for debt, for no sufficient reason.

5. The Problem of Opportunism

Alan Schwartz has made the following argument in favor of a regime of routine specific performance: (1) Specific performance is often an unsatisfactory remedy because a promisor is likely to render a defective performance if her performance is coerced. (2) Therefore, a promisee will sue for specific performance only if damages would be inadequate to put the promisee where he would have been if the contract had been performed. (3) That being so, if a promisee sues for specific performance, we know that damages are inadequate. (4) Accordingly, specific performance should be routinely granted.[99] The defect in this argument is that the second premise is incorrect. It is not the case that a promisee will sue for specific performance only if damages would be inadequate. Instead, a promisee may sue for specific performance opportunistically, because specific performance offers the potential for a kind of extortion.

For example, a right to specific performance of contracts for the sale of homogeneous goods would create a serious potential for opportunism. Take *Weathersby v. Gore*. Cotton of a given grade is fungible, and nothing in the case indicated there was anything special about Gore's cotton. Accordingly, Gore presumably could have satisfied a decree of specific performance either by delivering his own cotton or by purchasing an equivalent amount of the same grade of cotton on the market and then delivering the purchased cotton. Therefore, specific performance in this case would have been economically indistinguishable from a case in which the buyer sued for damages based on the difference between the contract price and the market price at the time of the *decree*, except that under specific performance, the seller rather than the buyer must purchase the commodity at that price. But a promisee who has a right to specific performance also

99. Schwartz, *supra* note 73, at 276-78.

has a right to sue for damages in lieu of specific performance. If the promisee sues for damages, his damages will be measured by the market price at the time of the *breach*. In such cases, therefore, an opportunistic buyer will sue for both specific performance and damages. If the price of the commodity goes up after the breach, the buyer will drop his suit for damages and make the seller purchase the commodity for the buyer at the market price at the time of the decree. If the price of the commodity goes down after the breach, the buyer will drop his suit for specific performance and collect damages based on the market price at the time of the breach. The law should not allow the buyer to opportunistically put the seller in this fork in cases where the buyer can achieve virtual specific performance.[100]

The possibility of error in enforcing specific performance also creates the potential for opportunism on the part of the promisee. A promisee who has a decree of specific performance in his pocket may opportunistically insist on a gold-plated performance, threatening that if the performance is anything less, he will go back to the court for an order of contempt.

A regime of routine specific performance would also create a potential for opportunism in cases where the difference between the seller's cost of performance and the value of the performance to the buyer is so large that it is clear that the buyer who seeks specific performance does not really want performance. Instead, the buyer wants only a decree that he can opportunistically use as a lever to capture a portion of the difference between the seller's cost and the buyer's value.

For example, in *Eastern Steamship Lines, Inc. v. United States*,[101] the Government requisitioned Eastern's merchant vessel *Acadia* for use in World War II, and agreed that before it redelivered the *Acadia*, it would either restore the vessel to the condition the vessel was in at delivery or pay Eastern the amount required to restore the vessel to that condition. The Government did neither, and Eastern brought suit for the projected cost of restoration. The cost of restoring the vessel would have been $4 million, but the value of the *Acadia* as restored would have been only $2 million. In these circumstances, it was clear that Eastern did not really want performance. If the court ordered the Government to specifically perform, Eastern would not have enforced the decree, but would instead have bargained with the Government to surrender its right to specific performance in exchange for a payment of some amount between $2 million and $4 million.

Similarly, in *Jacob & Youngs, Inc. v. Kent*,[102] Jacob & Youngs contracted to build a country house for Kent. The contract required the use of cast-iron plumbing pipe manufactured by Reading. After the house had been completed, Kent learned that Jacob & Youngs had installed cast-iron

100. *See* 3 DOBBS, *supra* note 44, § 12.8(1), at 195.
101. 112 F. Supp. 167 (Ct. Cl. 1953).
102. 129 N.E. 889 (N.Y. 1921).

pipe manufactured by Cohoes. Cohoes pipe was equal in quality, appearance, market value, and cost to Reading pipe—"indeed, the same thing, though manufactured in another place."[103] Because the pipe was largely encased within the walls of the eompleted house, installation of Reading pipe in place of the Cohoes pipe would have required a huge expenditure to demolish and reconstruct substantial parts of the house. If a court ordered Jacobs & Youngs to specifically perform in this circumstance, clearly Kent would not have enforced the decree. Instead, he would have bargained with Jacob & Youngs to surrender his right to specific performance in exchange for a payment of an amount between (1) the value of the difference to him between the Cohoes pipe and the Reading pipe and (2) the cost of demolishing and reconstructing the house. In cases like *Eastern Steamship* and *Jacobs & Youngs*, the fact that the promisee asks for specific performance is no reason to grant it.

D. The Specific-Performance Principle

The Specific-Performanee Principle balances the considerations for and against routine specific performance. This Principle requires actual specific performance to be awarded unless a special moral, policy, or experiential reason suggests otherwise in a given class of cases, or the promisee can achieve virtual specific performance. Under this Principle, specific performance should be liberally but not routinely granted. Often, the result under the Specific-Performance Principle would be the same as the result under traditional doctrine. There are, however, three major differences between this Principle and traditional doctrine.

First, the tests under traditional doctrine are *court*-centered; that is, they depend on whether damages are adequate, or a commodity is unique, in the view of the *court*. This is true even for the most elegant version of the uniqueness test, developed by Anthony Kronman:

> Although it is true in a certain sense . . . that every good has substitutes—this is an empty truth. What matters, in measuring money damages, is the volume, refinement, and reliability of the available information about substitutes for the subject matter of the breached contract. When the relevant information is thin and unreliable, there is a substantial risk that an award of money damages will either exceed or fall short of the promisee's actual loss. Of course this risk can always be reduced—but only at great cost when reliable information is difficult to obtain. Conversely, when there is a great deal of consumer behavior generating abundant and highly dependable information about substitutes, the risk of error in measuring the promisee's loss may be reduced at much smaller cost. In asserting that the subject matter of a

103. *Id.* at 890.

> particular contract is unique and has no established market value, a court is really saying that it cannot obtain, at reasonable cost, enough information about substitutes to permit it to calculate an award of money damages without imposing an unacceptably high risk of undercompensation on the injured promisee.[104]

In contrast to traditional doctrine, the Specific-Performance Principle is *promisee*-centered. The question under this Principle is whether there is or was a commodity readily available in the market that the promisee could not in good faith reject as an equivalent of the breached performance, given his demonstrable preferences. As Tom Ulen states:

> [S]ubjective valuation rather than uniqueness . . . makes specific performance attractive. Clearly, there is a relationship between uniqueness and subjective valuation: someone is more likely to attach a value greater than market value to a rare, one-of-a-kind item than to a highly fungible item. However, the class of things to which someone attaches a subjective valuation is greater than the class of unique items.[105]

The second difference between the Specific-Performance Principle and traditional doctrine is that in many cases the Principle will easily lead to the conclusion that specific performance should be granted, while a court applying the adequacy test could reach that conclusion only with difficulty, if at all. For example, in *Allegheny Energy, Inc. v. DQE, Inc.*,[106] the issue was whether Allegheny, a large publicly held utility, could specifically enforce a merger contract with another large publicly held utility, DQE. Applying traditional doctrine, the district court denied specific performance on the ground that damages were adequate. The Court of Appeal also applied traditional doctrine, but reversed, and granted specific performance, on the basis of a long analysis exploring in great detail why damages were inadequate because they were difficult to measure. In contrast, under the Specific-Performance Principle no detailed analysis would have been required. It would strain credibility to believe that Allegheny could have readily found on the market an alternative merger partner with the business and financial characteristics of DQE, let alone one willing to agree to merge on the same terms and conditions as DQE.

A third difference between the Principle and traditional doctrine is that the Principle provides a clear standard. Once adequacy of damages became transformed from a test to a factor, traditional doctrine ceased to provide a standard to govern the issue of when specific performance should be awarded. In effect, the rules of traditional doctrine became a mere checklist with highly uncertain application. In contrast, the Specific-

104. Kronman, *supra* note 85, at 362 (citations omitted).
105. Ulen, *supra* note 62, at 375-76.
106. 171 F.3d 153 (3d Cir. 1999).

Performance Principle is both a better explanation of the cases and a better predictor of results.

V
THE APPLICATION OF THE SPECIFIC-PERFORMANCE PRINCIPLE

In this Part, I will elaborate on the Specific-Performance Principle by illustrating its application to several types of contracts. It would be tedious to discuss every type of contract in which the issue of specific performance can arise, so I will focus on contracts for the sale of goods, real estate, and services.

A. Contracts for the Sale of Goods

Whether specific performance of a contract for the sale of goods should be awarded under the Specific-Performance Principle depends on four variables: the nature of the goods, the nature of the market, the nature of the contract, and whether the buyer or the seller breached the contract. I begin with breach by the seller.

1. Breach by the Seller

For purposes of considering whether specific performance should be ordered in contracts for the sale of goods, goods can be divided into three categories: homogeneous (that is, undifferentiated or fungible) goods; highly differentiated goods; and moderately differentiated goods. I consider each type of good in turn.

a. Homogeneous Goods

The concept of homogeneous goods typically conjures up basic commodities, like wheat, coal, or steel. For purposes of specific performance, however, new manufactured goods may also be homogeneous. So, for example, new 2005 Toyota Camry LEs with a given set of factory-installed options are homogeneous, and so, usually, are new Timken roller bearings of a given description. However, neither new cars as a class nor new roller bearings as a class are homogeneous.

(i) *The normal case.* In the normal case, homogeneous goods are sold on a relatively thick market for delivery in the relatively near future. In such a case, specific performance should not be granted for breach by the seller, because the buyer can accomplish virtual specific performance by purchasing an identical substitute on the market and suing for the difference between the cover price and the contract price. The result will not produce a shortfall as compared to specific performance. Because the commodity is homogeneous, subjective valuation is not an issue. Because a covering buyer normally will not incur lost profits as a result of the breach,

neither the certainty principle nor the principle of *Hadley v. Baxendale* should present problems.

For example, assume that Seller agrees to sell 1,000 bushels of No. 2 wheat to Buyer at $4.00/bushel, delivery on September 1. Buyer plans to use the wheat to fill a contract he has made to sell wheat to T at $4.50/bushel. On September 1, Seller breaches. At the time of breach, the market price of No. 2 wheat is $4.25/bushel. If Buyer were instantaneously awarded specific performance, he would obtain the wheat from Seller at $4.00/bushel, deliver the wheat to T, and earn a profit of 50¢/bushel. If specific performance is not an available remedy, Buyer will cover at $4.25/bushel, deliver the wheat to T, and sue Seller for cover damages. Buyer will end up with a net recovery of 50¢/bushel—a profit of 25¢/bushel on his sale to T and damages of 25¢/bushel—and therefore will have aecomplished virtual specific performance. A similar analysis applies if Buyer purchases the wheat for use rather than resale—for example, if Buyer is a baker who plans to use the wheat to make bread to sell to supermarkets.

Of course, the buyer will not be as well off with virtual specific performance as he would have been if the contract had been performed, because to accomplish virtual specific performance the buyer must pay the costs of dispute-resolution, and may not be adequately compensated by pre-decree interest. However, those shortfalls will also occur if the buyer seeks specific performance. Accordingly, even though the buyer is not as well off with virtual specific performance as he would have becn if the contract had been performed, he is as well off as he would have been with actual specific performance.

Alan Schwartz has argued that specific performance should be routinely available even in the case of homogeneous goods. A lynchpin of his argument is that a seller can cover just as effectively as a buyer and can then specifically perform by transferring the replacement goods to the buyer.[107] It is certainly not self-evident that this is true. Sellers are experts in knowing the best channels through which to sell, but buyers are often experts in knowing the best channels through which to buy. However, even if a seller can cover as easily as a buyer, that would not provide a sufficient reason to allow actual specific performance when the buyer can easily accomplish virtual specific performance. Why use a highly intrusive and coercive remedy, and deny the seller the right to a jury trial, when a market transaction will put the buyer in exactly the same position?

Moreover, in the normal case of a contract for the sale of homogeneous goods, specific performance is not only unnecessary but inappropriate, because it would conflict with the principle of mitigation.[108] As Anthony

107. Schwartz, *supra* note 73, at 286.

108. *See supra* Part IV.C.3.

Kronman has observed, a right to specific performance is like a property right.[109] A promisee who has a right to specific performance doesn't lose that right by not mitigating, any more than a property owner loses his property if he doesn't use it in the most efficient way. As pointed out above, lack of a duty to mitigate would entail significant social costs.[110]

(ii) *Long-term supply contracts.* Suppose that a contract for the sale of homogeneous goods is a long-term supply contract rather than a contract to deliver goods in the relatively near future. In that case, specific performance should be required. Long-term contracts for the sale of homogeneous goods differ from the normal case in two related respects.

First, buyers who enter into a long-term contract for the supply of homogeneous goods often do so because they place an especially high premium on the reliability of supply. Usually, only actual specific performance will provide the buyer with the high degree of reliability for which he bargained.

Second, and more importantly, in the case of a long-term contract for the supply of homogeneous goods, the subject-matter of the contract is *not* homogeneous. What the buyer contracts for is not simply a certain number of homogeneous goods at a given price, but a certain number of homogeneous goods at a given price over a given period of time. Accordingly, the issue is not whether the *goods* are homogeneous, but whether *contracts to supply such goods over the same period of time* are homogeneous. In cases where the buyer has contracted for a long-term supply of goods, the fact that goods of the same kind are readily available on the market does not mean that the buyer can cover. Rather, the buyer can cover only if contracts for the sale of such goods over the same period of time are readily available on the market. Normally, that will be unlikely, so virtual specific performance will be unavailable. As a result, actual specific performance should be granted.

These points are nicely illustrated by the facts of *Laclede Gas Company v. Amoco Oil Company.*[111] In 1970, Amoco Oil and Laclede Gas (more accurately, the parties' predecessors in interest) entered into a master contract designed to allow Laclede to provide local propane-gas distribution systems to residential developments in Missouri until natural-gas mains were extended to a development. The master contract contemplated that developers would apply to Laclede for a local propane system. Laclede could then ask Amoco to supply propane to the development. Laclede would make these requests in supplemental letters whose form was prescribed by the master agreement. If Amoco decided to supply the propane,

109. Kronman, *supra* note 85, at 352.
110. *See supra* Part IV.C.3.
111. 522 F.2d 33, 40 (8th Cir. 1975).

it would bind itself to do so by signing the letter. Laclede, for its part, agreed to pay Amoco's posted price for propane plus four cents per gallon. Given Laclede's agreement to pay a changing price that was geared to the market, clearly the primary purpose of the contract was to ensure reliability of supply, not to ensure reliability of price.

In breach of the supplemental letters it had executed, Amoco stopped supplying propane to Laclede. At the time of the breach, propane was readily available on the open market. The court nevertheless ordered specific performance because there was uncontradicted expert testimony "that Laclede probably could not find another supplier of propane willing to enter into a long-term contract such as the Amoco agreement, given the uncertain future of worldwide energy supplies."[112]

(iii) *Goods not readily available in the market.* Specific performance of a contract for the sale of homogeneous goods should also be granted if the goods are not readily available in the market. This would be the case, for example, if the seller is a monopolist and there is no well-developed aftermarket for its goods, or if the relevant kind of goods have come into critically short supply—perhaps because of a shock such as war—and obtaining the goods on the market would be very difficult. For example, in *Kaiser Trading Co. v. Associated Metals & Minerals Corp.*,[113] Associated agreed to supply Kaiser with 3,500 tons of cryolite, an indispensable chemical compound used in the production of aluminum, for use in Kaiser's aluminum plants.[114] Associated breached the contract at a time when only a few hundred tons of cryolite were available on the open market. The court ordered specific performance. Similarly, in *Eastern Air Lines, Inc. v. Gulf Oil Corp.*,[115] Gulf contracted to supply Eastern with its requirements of aviation fuel in certain cities. Gulf attempted to breach the contract during the energy crisis caused by the OPEC boycott. The court found that if Gulf ceased to supply Eastern with fuel, "the result will be chaos," and it ordered specific performance.[116]

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112. *Id.*

113. 321 F. Supp. 923 (N.D. Cal. 1970).

114. *Id.* at 925.

115. 415 F. Supp. 429 (S.D. Fla. 1975).

116. *Id.* at 442. *See also* Texas Co. v. Cent. Fuel Oil Co., 194 F. 1 (8th Cir. 1912) (crude oil); Kann v. Wausau Abrasives Co., 129 A. 374 (N.H. 1925) (garnet); G.W.S. Serv. Stations, Inc. v. Amoco Oil Co., 346 N.Y.S.2d 132 (N.Y. Sup. Ct. 1973) (gasoline); DeMoss v. Conart Motor Sales, Inc., 72 N.E.2d 158 (Ohio Ct. App. 1947), *aff'd*, 78 N.E.2d 675 (Ohio 1948) (new autos). Furthermore, even if a commodity is generally available, specific enforcement will be granted if the commodity is not available promptly or in the local marketing area. *See* Bomberger v. McKelvey, 220 P.2d 729, 735-36 (Cal. 1950) (salvaged plate glass and skylights); Cumbest v. Harris, 363 So. 2d 294 (Miss. 1978) (stereo components).

b. HighlyDifferentiated Goods

If a good is highly differentiated—one of a kind—then by hypothesis virtual specific performance is not available, and actual specific performance should be granted. The high degree of differentiation may be either objective or subjective. An Old Master painting is highly differentiated from any other painting as an objective matter. So is any other nontrivial work of art. A closely held corporation is highly differentiated as an objective matter. So are shares of stock in the corporation. A dollar bill is ordinarily not highly differentiated as an objective matter, but it may be highly differentiated as a subjective matter if it is the first dollar that a business earned.

c. Moderately Differentiated Goods

Suppose a contract for the sale of goods involves goods that are moderately differentiated. An example is a used good that is similar but not identical to other used goods of the same kind, such as the used die press in the hypothetical developed in Part II.A. Another example is a roller bearing made by a given manufacturer—say, Timken. For example, suppose that Timken agrees to sell to Buyer 20,000 Timken 400-millimeter spherical roller bearings. The roller bearings are substantially but not completely identical to 400-millimeter spherical roller bearings made by several other manufacturers. Timken breaches. There is no significant aftermarket for new Timken roller bearings.

Under the Specific-Performance Principle, the issue should not be whether other manufacturers' 400-millimeter spherical roller bearings are objectively close substitutes (even extremely close substitutes) for Timken's, but whether the buyer can in good faith decline to accept other manufacturers' roller bearings on the basis of his demonstrable preferences—because, for example, a certain aspect of Timken roller bearings is specially useful for his purpose, or because he wants all of his machines to have the same roller bearings, or because Timken roller bearings have a reputation for reliability. In any of these cases, the buyer cannot achieve virtual specific performance by a market transaction and therefore should be entitled to actual specific performance. This approach is reflected in the *Restatement Second*:

> A contracts to sell to B the racing sloop "Columbia," this sloop being one of a class of similar boats manufactured by a particular builder. Although other boats of this class are easily obtainable, their racing characteristics differ considerably and B has selected the "Columbia" because she is regarded as a witch in light airs and, therefore, superior to most of the others. A repudiates the contract

and B sues for specific performance. Specific performance may properly be granted.[117]

2. Breach by the Buyer.

I turn now to breach by the buyer. In the normal case, a seller of goods should not be awarded specific performance against a breaching buyer. Because a buyer normally agrees only to pay money, a seller ordinarily can achieve virtual specific performance by reselling the contracted-for commodity on the market and bringing a damages action for any difference between the resale price and the contract price (plus the cost of making the second sale). This is just the position taken in the Uniform Commercial Code. Article 2 of the Code contemplates actions for specific performance in appropriate cases by buyers, but not by sellers.[118]

Now suppose the seller is unable, after reasonable effort, to resell the goods at a reasonable price or that the circumstances indicate that such an effort will be unavailing. Section 2-709 of the Code provides that a seller can then bring an action for the price of goods, if he has identified the goods to the contract. This action for the price has sometimes been characterized as one for specific performance,[119] probably because it requires the buyer to do exactly what he promised to do—that is, to pay the purchase price. In fact, however, the action is at law for damages and therefore constitutes virtual, not actual, specific performance. Because the action is at law, the buyer is entitled to a jury trial, and the judgment is enforceable by a levy on the buyer's property or income, not by contempt.

B. Contracts for the Sale of Real Property

1. Breach by the Seller

The traditional rule is that specific performance is always an available remedy for breach of a contract for the sale of real property—a rule expressed in the doctrine that all real property is unique.[120] In fact, this is not the case. Real property may be either highly differentiated, like a Frank Lloyd Wright home or a landmark commercial building; moderately

117. RESTATEMENT SECOND, *supra* note 2, at § 360 cmt. b, illus. 2.

118. *Compare* U.C.C. § 2-703 (1998) (seller's remedies in general) *with* U.C.C. § 2-711 (1998) (buyer's remedies in general). In the recent process of revising Article 2, which stretched over a number of years, some drafts included a provision that would have permitted a seller to bring an action for specific performance. *See, e.g.*, ALI, Uniform Commercial Code Revised Article 2, § 2-722, Council Draft No. I at Note 3 (Nov. 9, 1995); ALI, Uniform Commercial Code Revised Article 2, § 2-807, Discussion Draft at Note 1 (Apr. 14, 1997); ALI, Uniform Commercial Code Revised Article 2, § 2-807, Proposed Final Draft at Comment 3 (May 1, 1999); ALI, Uniform Commercial Code Revised Article 2, § 2-716, Discussion Draft (Apr. 14, 2000). However, this provision was eventually dropped.

119. *See, e.g.*, LAYCOCK, *supra* note 76, at 252.

120. RESTATEMENT SECOND, *supra* note 2, at § 360 cmt. e.

differentiated, like most homes and commercial properties; or homogeneous, like much tract housing and some raw land.

A few cases recognize this reality and criticize the traditional rule. For example, in *Semelhago v. Paramadevan*,[121] decided by the Canadian Supreme Court, the seller breached a contract to sell a home. Although the case did not involve a decree of specific performance, the court forcefully pointed out that not all real estate is unique:

> While at one time the common law regarded every piece of real estate to be unique, with the progress of modern real estate development this is no longer the case. Both residential, business and industrial properties are mass produced much in the same way as other consumer products. If a deal falls through for one property, another is frequently, though not always, readily available. It is no longer appropriate, therefore, to maintain a distinction in the approach to specific performance as between realty and personalty. It cannot be assumed that damages for breach of contract for the purchase and sale of real estate will be an inadequate remedy in all cases. . . .[122]

In *Watkins v. Paul*,[123] an Idaho case, the court refused, on comparable grounds, to order specific performance of an option to purchase a tract of land:

> The evidence fails to show that the plaintiffs need the land in question for any particular, unique purpose, which is one of the main reasons for granting specific performance; on the contrary, the plaintiffs' own evidence shows that they seek to obtain the land only so that they may resell it for profit. Under these circumstances, specific performance would bring the plaintiffs no greater relief than would damages in the amount of their lost profit.[124]

Although *Semelhago* and *Watkins* are correct in stating that some real estate is homogeneous, there are two related reasons why contracts to sell real estate nevertheless should be specifically enforceable by the buyer in all cases.

The first reason concerns administrability. Homogeneous real estate is the exception, not the rule. Most real estate will have special characteristics that would justify a buyer's good-faith determination that a substitute is not readily available in the market, given the buyer's demonstrable preferences. Because most real estate will have such characteristics, it is administratively preferable to adopt a simple rule covering all real estate rather than to engage in an expensive case-by-case analysis.

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121. [1996] 136 D.L.R. (4th) 1.
122. *Id.* at 21-24.
123. 511 P.2d 781 (Idaho 1973).
124. *Id.* at 783.

The second reason is that specific performance against a seller of real estate does not raise the problems normally associated with that remedy. Under modern statutes, an action for specific performance of a contract to sell real estate normally does not terminate in a decree enforceable by contempt. Instead, it normally terminates in the judicial issuance of a self-executing decree that has the effect of a deed, and can be recorded in the Registry of Deeds.[125] Accordingly, the seller's property is normally transferred without action on her part. As a result, specific performance against a seller of real estate is normally neither highly intrusive nor highly coercive and is not subject to a serious risk of error at the enforcement stage.

2. Breach by the Buyer

Specific performance of contracts for the sale of real property is also usually appropriate against buyers. Almost invariably, the purpose of a decree in such cases is not to require the buyer to pay money but simply to cut off—or "foreclose"—the buyer's interest in the property so that the seller can resell it free and clear. Although a foreclosure decree is commonly referred to as specific performance, it is self-executing. Therefore, like the decree a buyer of real estate obtains against a defaulting seller, it does not entail the problems that specific performance normally raises.

C. Contracts for the Provision of Services

The application of the Specific-Performance Principle to contracts for the provision of services raises several kinds of problems, which I explore in this Section. I begin with contracts for personal services, such as employment contracts.[126] I then consider contracts for the provision of services more generally.

1. Contracts for Personal Services

a. Breach by the Employee

Where an employee breaches an employment contract, an employer will often be unable to achieve virtual specific performance because she will be unable to find an equivalent employee. Nevertheless, specific performance should not (and will not) be awarded to an employer because of a special moral problem: a decree ordering an employee to specifically perform an employment contract would seem too much like involuntary servitude or peonage. As Doug Laycock puts it:

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125. *See, e.g.*, GA. CODE ANN. § 9-11-70; *see also* Silverman v. Alday, 200 Ga. 711, 38 S.E.2d 419 (1946).

126. For ease of exposition, I will use the term *employee* to mean a person who contracts to provide personal services and the term *employer* to mean a person who contracts to have personal services rendered to her. Accordingly, for present purposes, I treat contracts with professionals and non-employee agents as employment contracts.

> The reason for [the rule that employment contracts will not be specifically enforced against employees] is a substantive law commitment to free labor. Despite the vast social distance between chattel slavery and specific performance of contracts with professional athletes and entertainers, similar policies apply to both. . . . An order to work on pain of contempt produces servitude that is involuntary when the services are performed.[127]

There is less objection to enjoining a breaching employee from working for a competitor of the employer during the duration of the breached contract. Often, however, such an injunction would be tantamount to ordering specific performance, because if the employee cannot work for a competitor, he might be unable to earn a reasonable living. In that case, he may be forced to choose between working for his original employer or not working at all. Accordingly, the rule in such cases, embodied in the *Restatement Second*, is that an injunction against working for a competitor will not be issued if it will effectively force the employee to work for his former employer.[128]

b. Breach by the Employer

The moral prohibition on involuntary servitude does not provide a reason for refusing specific enforcement against an employer. Moreover, an employer is not like an ordinary purchaser of services, who simply pays cash for the performance of work. An employer not only pays for work but also provides the employee with an opportunity to learn skills, to flourish, and to be a member of a workplace community. As a result, an employee typically cannot obtain virtual specific performance by a market transaction.

However, where an employment relationship involves an important element of trust and confidence—for example, in the case of a management-level employee, a professional, or an agent—specific enforcement against the employer would be undesirable for a different reason. Trust and confidence cannot be imposed by judicial decree, and without trust and confidence, the employment relationship would be something different from what the employer bargained for. Requiring an employer to rehire an employee would therefore force the employer to pay for something that he can no longer obtain, albeit due to his own breach.

On the other hand, where the relationship does not involve trust, specific performance should be granted against the employer. That is not the law now, but in some respects it is the practice. Labor arbitrators

127. LAYCOCK, *supra* note 76, at 169.

128. RESTATEMENT SECOND, *supra* note 2, at § 367(2).

commonly order reinstatement of improperly discharged employees.[129] Reinstatement is also routinely ordered by the National Labor Relations Board in cases of discharge in violation of the National Labor Relations Act,[130] and other federal statutes also provide for reinstatement.[131]

2. Other Contracts for the Provision of Services

Courts often refuse to specifically enforce contracts for the provision of services even when personal services are not involved, on the ground that specific performance in such cases would entail undue judicial supervision. For example, in *London Bucket Co. v. Stewart*,[132] London Bucket had agreed "to furnish and install (subletting installation)" a heating system in Stewart's motel that was guaranteed to heat the motel to seventy-five degrees in winter and "to supervise all work."[133] Stewart alleged that London Bucket had installed the system "in an incompleted, unskilled unworkmanlike manner, never finishing same, and of such size, type and inferior quality of materials that same does not to a reasonable degree perform the purpose contemplated."[134] Stewart asked that London Bucket be compelled to specifically perform before cold weather set in. The Kentucky Supreme Court declined to award specific performance, on the ground that "[i]t is the general rule that contracts for building construction will not be specifically enforced . . . in part, because of the incapacity of the court to superintend the performance."[135]

Courts apply the supervision rule irregularly and inconsistently. In *London Bucket* itself, for example, the lower court had awarded specific performance, relying on two Kentucky cases, *Schmidt v. Louisville & N.R. Co.*[136] and *Pennsylvania Railroad Co. v. City of Louisville*.[137] In *Schmidt*, the defendant was ordered to operate a railroad under the terms of a lease. In *Pennsylvania Railroad*, several railroad companies were ordered to eliminatc grade crossings, as they had contracted to do. In reversing the lower court in *London Bucket*, the Kentucky Supreme Court distinguished

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129. *See* Martha S. West, *The Case Against Reinstatement in Wrongful Discharge*, 1988 U. ILL. L. REV. 1, 22 ("The universal arbitration remedy for an improper discharge is reinstatement . . . .").

130. 29 U.S.C. § 160(c) (2000); *see also* Paul Weiler, *Promises to Keep: Securing Workers' Rights to Self-Organization Under the NLRA*, 96 HARV. L. REV. 1769, 1791 (explaining that reinstatement is a "standard form of relief" under the NLRA).

131. *See* 42 U.S.C. § 2000e-5(g)(1) (2000) (Civil Rights Act); 42 U.S.C. § 12117 (2000) (Americans with Disabilities Act); 29 U.S.C. § 626(b) (2000) (Age Discrimination in Employment Act).

132. 237 S.W.2d 509 (Ky. 1951). *See also, e.g.*, N. Del. Indus. Dev. Corp. v. E.W. Bliss Co., 245 A.2d 431 (Del. Ch. 1968).

133. 237 S.W.2d at 509.

134. *Id.*

135. *Id.* at 510.

136. 41 S.W. 1015 (Ky. 1897).

137. 126 S.W.2d 840 (Ky. 1939). *See also, e.g.*, City Stores Co. v. Ammerman, 266 F. Supp. 766 (D.D.C. 1967), *aff'd mem.*, 394 F.2d 950 (D.C. Cir. 1968).

these cases on the thin ground that both "involve[d] matters of great magnitude and were of public interest and welfare. In each case the court in effect said, 'Proceed to do what you contracted to do.' There was no question of partial or incomplete or faulty performance of a building contract."[138]

There is a reason why courts apply the supervision rule irregularly and inconsistently. Denying specific performance of a contract to provide services on the ground that it would entail undue judicial supervision is almost never justified, because normally no more judicial supervision is required for specific performance than for damages. Take *London Bucket*. If the court had awarded specific performance, it would have issued a decree requiring London Bucket to fulfill its obligations under the contract. If, following performance under the decree, Stewart (the owner of the motel) was satisfied that London Bucket had fulfilled its obligations under the contract, that would be the end of the matter. If Stewart believed London Bucket had not fulfilled its obligations under the contract, he would bring London Bucket back to court for a contempt hearing. At that hearing, Stewart would introduce evidence to show that London Bucket had not fulfilled its obligations under the decree—that is, under the contract. The evidence at such a hearing would be identical to the evidence at the hearing that would have been conducted if Stewart had sued London Bucket for the cost of cover plus any consequential and incidental damages.

To put this differently, a decree of specific performance against a service-provider normally will not require the judge either to leave the courtroom or to make a determination different from what would be required in a suit for damages. There may be some cases, probably rare, in which that would not be true. In such cases, the court might decline to grant specific performance on the ground that the decree would not be easily administrable. There is no justification, however, for a general rule that treats the provision of services differently from the provision of goods on the ground that specific enforcement of such a contract requires undue—or any—judicial supervision.

Once the supervision rule is put off the table, the issue is squarely raised: when should contracts for the provision of services be specifically enforceable against the seller? The answer is that contracts for the provision of services (other than personal services) should be treated like contracts for the sale of goods; that is, actual specific performance should be awarded if, but only if, the promisee cannot achieve virtual specific performance. As in the case of goods, virtual specific performance has two advantages over actual specific performance. First, virtual specific

138. 237 S.W.2d at 834.

performance avoids the problems of intrusiveness, coercion, the potentially drastic effect of error, and denial of a jury trial at the promisee's option. Second, because promisees can obtain virtual specific performance immediately, while they usually cannot obtain actual specific performance for a significant period of time, virtual specific performance normally prevents the social and private losses that result from delay.

It might be thought that services are almost always highly differentiated, so that virtual specific performance will seldom be available in service-provision contracts. However, this is not the case. A basic principle of contract law, set forth in the *Restatement Second*, is that a promisor can delegate her contractual duties to a third person unless the promisee has a "substantial interest in having [the promisor] perform or control the acts promised."[139] The Comment to this section adds, "Delegation of performance is a normal and permissible incident of many types of contract. . . . The principal exceptions relate to contracts for personal services and to contracts for the exercise of personal skill or discretion."[140] The thrust of Section 318 is exemplified by Illustration 3: "A contracts to build a building for B in accordance with specifications, and delegates the plumbing work to C. Performance by C has the effect of performance by A."[141]

This principle should apply, with appropriate adjustment, to specific performance. If a promisor who has agreed to render services could have delegated performance under the contract, the promisee has implicitly agreed that performance by a delegee is equivalent to performance by the promisor. Accordingly, in such cases, the promisee can achieve virtual specific performance by making a covering contract with an alternative service provider and suing for cover damages. Since the promisee can achieve virtual specific performance, he should not be entitled to actual specific performance. Conversely, if the promisor's performance could not be delegated, either because the principles of assignment law did not permit delegation in her case or because the contract prohibits delegation, then a substitute performance normally would not constitute virtual specific performance, and actual specific performance should be decreed.

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139. RESTATEMENT SECOND, *supra* note 2, at § 318.

140. *Id.* § 318 cmt. c.

141. *Id.* § 318 cmt. a, illus. 3. Indeed, several cases have held that where a contractor knows it will be unable to perform, it is obliged to find a substitute contractor to perform in its place. *See* S.J. Groves & Sons Co. v. Warner Co., 576 F.2d 524 (3d Cir. 1978); Travelers Indem. Co. v. Maho Mach. Tool Corp., 952 F.2d 26 (2d Cir. 1991); Shea-S & M Ball v. Massman-Kiewit-Early, 606 F.2d 1245 (D.C. Cir. 1979).

VI
COVER—OR VIRTUAL SPECIFIC PERFORMANCE

To recapitulate, actual specific performance should be awarded unless a special moral, poliey, or experiential proposition suggests otherwise in a given class of cases, or the promisee can accomplish virtual specific performance. A promisee can accomplish virtual specific performance if he can cover by readily finding in the market a commodity that he could not in good faith reject as an equivalent of the breached performance, given his demonstrable preferences. In this Part, I will show that cover has significant advantages over both actual specific performance and conventional expectation damages. Against the background of these advantages, I will develop the principle that should govern cover. Under this principle, which parallels the Specific-Performance Principle in significant part, cover damages should be awarded if a buyer can show that his choice of a covering substitute for the breached commodity was made in good faith, given his demonstrable preferences, after he conducted a reasonable search. To put this differently, in determining whether a buyer can measure his damages on the basis of a substitute purchase in the market, the courts should review the adequacy of the buyer's *search* for cover under the standard of reasonableness, while the adequacy of the buyer's *choice* of cover should be reviewed under the standard of good faith.

The idea of cover embraces two separate but intimately related concepts. First, cover is an act. Conventionally, cover in this sense refers to the act of purchasing goods in the market to replace goods that a seller failed to deliver. In a wider sense, however, the act of cover occurs whenever a buyer goes into the market to replace any kind of contracted-for commodity, including services, that a seller failed to provide. Second, cover is a remedy, a judgment for the difference between the contract price and the cost of cover. For ease of exposition, in the balance of this Part, I will refer to the contracted-for commodity as the *breached commodity*, and I will use the term *cover damages* to include incidental damages, such as the costs incurred by the buyer in searching for and completing the cover transaction.

Section 2-712 of the Uniform Commercial Code reflects the bifurcated nature of cover. Section 2-712(1) concerns the act of cover: "After a breach . . . the buyer may 'cover' by making in good faith and without unreasonable delay any reasonable purchase of or contract to purchase goods in substitution for those due from the seller."[142] Section 2-712(2) concerns the remedy of cover: "The buyer may recover from the seller as

142. U.C.C. § 2-712(1) (1998).

damages the difference between the cost of cover and the contract price . . . ."[143]

As a remedy, cover has the look and feel of damages, because the buyer ends up with a money judgment. As an act, however, cover is often a form of virtual specific performance.[144] By covering, the buyer may find a replacement performance that, together with the remedy of cover, is equivalent to what the buyer would have received if the seller had been ordered to specifically perform.

Often a buyer cannot cover—for example, because no adequate replacement for the breached commodity is readily available on the market, or because breach occurs at a time when it is too late to cover. Where cover can be achieved, however, it presents four substantial advantages over conventional expectation damages and specific performance.

First, because the buyer chooses the substitute performance himself, the act of cover reflects the buyer's subjective preferences. Therefore, cover avoids the shortfall that often results when the buyer's damages depend on the objectively constructed market price of a differentiated commodity.

Second, in the case of a differentiated commodity, cover damages are often much easier to prove than market-price damages. To prove market-price damages, the buyer needs to locate, and then extrapolate from, comparable transactions—a process that the seller will inevitably contest. In contrast, if the buyer covers, he normally needs to show only the cover price.

Third, the act of cover normally prevents or minimizes the social cost of consequential losses. For example, if a seller breaches a contract to supply an input or a factor of production, timely cover will prevent or minimize the buyer's loss of profits as a result of the breach. Correspondingly, timely cover will also prevent or minimize the private cost that results from the operation of the certainty rule and the principle of *Hadley v. Baxendale*.

Finally, as discussed in Part IV, specific performance involves a number of problems, including the nature of the enforcement process and problems of mitigation, opportunism, and jury trial. Cover does not present these problems.

In view of these advantages, the principle that should govern cover is as follows: Cover damages should be awarded if the buyer shows that his choice of a covering replacement was made in good faith, given his demonstrable preferences, after he conducted a reasonable search. I will eall

143. *Id.* § 2-712(2).

144. *Cf.* Muris, *supra* note 62, at 1055-56 (referring to "specific performance of [a] contract through the market"); Subha Narasimhan, *Modification: The Self-Help Specific Performance Remedy*, 97 YALE L.J. 61 (1987) (using the phrase "self-help specific performance," although in a different context).

this the Cover Principle. In the balance of this Part, I will develop the reasons that support this Principle. In particular, I will show why the buyer's search for cover should be reviewed under the standard of reasonableness, while the buyer's actual choice of a covering substitute should be reviewed only for good faith.

Where the act of cover is unexceptionable, the advantages of cover are obvious. Often, however, the seller claims that although the buyer acquired a replacement performance, he is not entitled to the full difference between the contract price and the cover price. For example, the seller may claim that the buyer paid an unduly high price for the replacement. Or she might claim that that the replacement was better than the breached commodity—that the breached commodity was copper-plated while the replacement was gold-plated.

Two classical legal dichotomies are relevant in considering how such claims should be addressed. The first is that between process and substance. Applying this dichotomy to the act of cover, the *search* that a buyer conducts to find a replacement involves process, while the buyer's ultimate *choice* of a replacement involves substance.

The second dichotomy concerns the standards by which to review the propriety of the buyer's search and choice. Although the law has a number of standards of review in its armory, for present purposes the two most salient standards of review are reasonableness and good faith. A standard of reasonableness is purely objective. In applying this standard, the question is whether an actor conducted himself in the way that an abstract reasonable person would have done. A standard of good faith is more complex. To satisfy a good-faith standard, a person must at least have acted in a way that he believed was proper—a subjective test. However, this subjective test is overlaid with several objective tests. First, it is not enough that an actor actually believed that his conduct was proper; his belief must be honest in the sense that it has some basis in social or critical morality. Next, although the actor's belief need not be *reasonable* to be in good faith, it must at least be *rational.* This element was best described by Judge Friendly in *Sam Wong & Son v. New York Mercantile Exchange*,[145] where he stated that good faith presupposed "a minimal requirement of some basis in reason—[although] not a showing that the . . . action constituted the optimal response. Absent *some* basis in reason, action could hardly be in good faith even apart from ulterior motive."[146] Finally, under the version of Article 2 of the Uniform Commercial Code that is in force in most states, in contracts for the sale of goods, in the case of a merchant good faith means not only "honesty in fact" but also the observance of

145. 735 F.2d 653 (2d Cir. 1984).
146. *Id.* at 655 (emphasis added).

reasonable commercial standards of fair dealing.[147] This definition should apply to all contracts, not just contracts for the sale of goods.

With this background, consider the propriety of the buyer's search, which the seller might question in two ways. Where the buyer's chosen replacement is virtually identical to the breached commodity, the seller may claim that if the buyer had conducted a more extensive search, he would have found another virtually identical replacement at a lower price. Where the buyer's chosen replacement is better than the breached commodity, the seller may claim that if the buyer had conducted a more extensive search, he could have found a replacement that was more closely comparable to the breached commodity and therefore cheaper.

As to both kinds of claims, the standard of review of the buyer's search should be reasonableness.[148] There is no persuasive reason why a good-faith standard should apply to search, because the kind of search the buyer conducts should not depend on his subjective preferences. However, that in retrospect it can be shown that a more comprehensive search would have turned up a lower price or a more closely comparable replacement does not prove that the buyer's search did not satisfy the standard of reasonableness. The issue of what constitutes a reasonable search in the context of cover is a special case of the general problem of search. Search is costly, and the more extensive the search, the more it will cost. If the costs of searching for information were zero, then a decision maker would conduct a comprehensive search and arrive at the best possible result. Because searching for information does involve costs, however, search will rarely,

147. The UCC is promulgated by the National Conference of Commissioners on Uniform State Law (NCCUSL) and the American Law Institute (ALI). However, it is only effective to the extent it is adopted by state legislatures. Prior to 2001, Section 1-201(19) of Article 1 (General Provisions) defined good faith narrowly, to mean "honesty in fact in the conduct or transaction concerned." In contrast, Section 2-103(b) of Article 2 (Sale of Goods) defined good faith broadly, to mean, in the case of a merchant, "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." In 2001, NCCUSL and the ALI promulgated a revised version of UCC Article 1. Section 1-201(20) of revised Article 1 defined good faith broadly, for all of the UCC except Article 5, to mean "honesty in fact and the observance of reasonable commercial standards of fair dealing." The adoption of this broad definition in the revised version of Article 1, as promulgated, rendered superfluous the definition of good faith in Article 2, as promulgated. Accordingly, that definition was deleted from the promulgated version of Article 2. *See* UCC Article 1, Appendix 1 (Conforming Amendments to Other Articles), Section 2-103(b) (prior definition of good faith in Article 2 struck through).

However, the revised version of Article 1 has not been widely adopted by state legislatures. In states that did not adopt the revised version, the broad definition of good faith remains in Article 2. *See, e.g.*, Cal. Commercial Code Section 2103(b). At present, therefore, there is a disjunction between the versions of Articles 1 and 2 promulgated by NCCUSL and the ALI, and the versions of Articles 1 and 2 on the books of most states. For purposes of this Article, however, this disjunction is not material because states that did not adopt revised Article 1 retain the broad definition of good faith in Article 2.

148. *See* Productora E Importadora De Papel v. Fleming, 383 N.E.2d 1129 (Mass. 1978).

if ever, be comprehensive, and a reasonable search may fail to reach the best possible result.[149]

Under a model of search developed by George Stigler, a rational actor invests in search until the expected marginal cost of further search equals the expected marginal benefit from further search.[150] For example, a buyer shopping for a refrigerator may visit three dealers before deciding to buy at the lowest price his search has produced. The buyer realizes that he might find a still lower price if he visited more dealers, but he also realizes that the expected value of finding a still lower price is less than the expected cost of continuing his search. Even if it turns out that a cheaper refrigerator was available elsewhere, the buyer's bounded search may still have been reasonable.

The same principle applies to cover. The reasonableness of the buyer's search for a replacement does not depend on whether he found the best price and the most closely comparable replacement that could have been obtained in a perfect, costless, unbounded search. Instead, the question is whether the buyer searched until the expected value of a lower price or of the likelihood of finding a more closely comparable replacement did not exceed the expected cost of continuing the search.

In contrast to search, which should be reviewed under the standard of reasonableness, the buyer's actual choice of a replacement should be reviewed under the standard of good faith.[151] There are two reasons for using the good-faith standard in this context.

First, under the indifference principle, contract remedies should give effect to a promisee's demonstrable preferences. A good-faith standard of review reflects that goal; a reasonableness standard does not.

Second, if courts are too quick to hold that replacements made in good faith do not constitute cover, there will be a disincentive for buyers to cover rather than pursue some other remedy. Because of the advantages of cover as compared to other remedies, cover should be encouraged within appropriate limits. Accordingly, courts should give deference to the buyer's choice of a replacement, to reduce the need for buyers to resort to specific performance or market-price damages. *Cetkovic v. Boch, Inc.* usefully operationalized that standard in this context.[152] A helpful guide, the court said,

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149. *See* James G. March, *Bounded Rationality, Ambiguity, and the Engineering of Choice*, 9 BELL J. ECON. 587, 590 (1978); *see also* HERBERT A. SIMON, ADMINISTRATIVE BEHAVIOR 79-109 (3d ed. 1976); Herbert A. Simon, *Rational Decisionmaking in Business Organizations*, 69 AM. ECON. REV. 493, 502-03 (1979) (sketching the development of the theory of the strategies that actors use under bounded rationality).

150. George J. Stigler, *The Economics of Information*, 69 J. POL. ECON. 213 (1961).

151. *See* JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 6-3, at 206-08 (5th ed. 2000).

152. 2003 Mass. App. Div. 1 (Mass. Dist. Ct. App. Div. 2003).

> is to pose the question how, when and where would the buyer have procured the goods [if he] had no prospect of a court recovery from another. If a buyer can truthfully answer he would have spent his own money in that way with no prospect of reimbursement, the court should not demand more.[153]

The state of the law on this issue is not completely clear. The Uniform Commercial Code is somewhat ambiguous on the standard of review that should govern the buyer's choice of a replacement. Section 2-712 states that the buyer may cover "by making in good faith . . . any reasonable purchase of . . . goods in substitution for those due from the seller."[154] The phrase "reasonable purchase" can be interpreted to mean that the choice of a replacement must satisfy a test of reasonableness. A better interpretation, however, is that "reasonable purchase" refers to the process of search. That interpretation finds some support in the Official Comment: "The test of proper cover is whether at the time and place the buyer acted in good faith and in a reasonable *manner* . . . ."[155]

The cases are not uniform on the standard of review that applies to a buyer's choice of a replacement. Some cases have employed a good-faith test. *Cetkovic* is one example. Another is *R.K. Cooper Builders Inc. v. Free-Lock Ceilings, Inc.*[156] Free-Lock breached a contract with Cooper under which Free-Lock was to install lighting fixtures. Cooper then paid a third party $5,681.34 to perform the work remaining under the contract. The trial court found that "the reasonable amount of money required to complete the work was $2,500.00."[157] Cooper argued that "the issue is not . . . the reasonable value of the work and materials required to complete the job,"[158] and the Court of Appeals agreed:

> Instead, controlling weight should be given to the actual expenditures, made in good faith, that are necessary to complete the job covered by the original contract. But we hasten to add that a mere showing of the actual expenses for completion is not determinative of the issue of damages, for the general rule permits the defaulting subcontractor to go forth with evidence in order to set off the cost of completion. Such evidence should go toward proving waste, extravagance, or lack of good faith, but the courts will not hear a defaulting subcontractor's claim that the party who was forced to complete the job spent too much absent evidence as to [those] factors.[159]

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153. *Id.* at 2.
154. U.C.C. § 2-712(1) (1998).
155. *Id.* § 2-712 cmt. (emphasis added).
156. 219 So. 2d 87 (Fla. Dist. Ct. App. 1969).
157. *Id.* at 88.
158. *Id.*
159. *Id.* at 88-89. *See also* In re Lifeguard Indus., Inc., 42 B.R. 734 (Bankr. S.D. Ohio 1983) (different siding constituted cover).

In some cases, however, the courts have rejected replacement purchases as unreasonable,[160] and in other cases the courts have simply sent the issue to the jury.[161]

The uncertain state of the law may reflect a concern that under a good-faith standard of review, a buyer will act opportunistically, by unjustifiably choosing a gold-plated replacement when the commodity the seller promised to deliver was only copper-plated, and falsely claiming that he acted in good faith. Such a concern would be overstated. There are several reasons why, even under a good-faith standard, a buyer is unlikely to opportunistically and unjustifiably attempt to replace a copper-plated breached commodity with a gold-plated cover.

To begin with, the requirement that the buyer must have actually engaged in the act of cover serves as an important control on opportunism. Self-regard is likely to keep a buyer from making an overly expensive, opportunistic purchase in the hope that ultimately the law will make the seller pay: litigation involves costs and risks, and if the buyer loses he will be left holding the bag.

Moreover, the requirement that the buyer conduct a reasonable search helps ensure that he will not act opportunistically. The seller can learn the results of the buyer's search through discovery, so the buyer cannot expect to easily get away with ignoring replacements that came to his attention and would have satisfied his demonstrable preferences. The rise of the Internet also helps keep buyers honest. Business-to-business websites, eBay, and similar technology-driven marketplaces make it easy for buyers to conduct very thorough and inexpensive searches, and they also make it easy for sellers to determine what replacements were readily available to buyers.

Finally, if it is clear that the replacement purchase will give the buyer higher profits than he would have earned if the contract had been performed, the excess profits can be deducted from the buyer's recovery.[162]

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160. *See, e.g.*, Martella v. Woods, 715 F.2d 410 (8th Cir. 1983) (holding that different-weight cattle did not constitute cover); Kanzmeir v. McCoppin, 398 N.W.2d 826 (Iowa 1987) (same); Freitag v. Bill Swad Datsun, 443 N.E.2d 988 (Ohio 1981) (holding that buyer's purchase of a 1980 Datsun was not a reasonable substitute for a differently equipped 1979 Datsun).

161. *See, e.g.*, Thorstenson v. Mobridge Iron Works Co., 208 N.W.2d 715 (S.D. 1973) (different tractor); Dickson v. Delhi Seed Co., 760 S.W.2d 382 (Ark. Ct. App. 1988) (different kind of oats); Mueller v. McGill, 870 S.W.2d 673 (Tex. App. 1994) (1986 Porsche Targa 911 purchased as cover for a 1985 Porsche Targa 911).

162. As stated by White and Summers:

> Suppose, for example, that seller breaches a sales contract for four-speed food blenders. . . . [B]uyer procures a substitute contract for more expensive eight-speed food blenders. . . .
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> If the eight-speed blenders were the only available substitute, then what? One can argue that the buyer should recover the full difference . . . . [H]ere the buyer has not elected to increase its damage recovery. If the added quality of the cover item will not benefit the buyer in any way, then it should be allowed to claim the full differential from the breaching seller. However, if because of the added quality the seller can prove that the buyer stands to make a

All this brings us back to the Cover Principle: cover damages should be awarded if the buyer shows that his choice of a replacement was made in good faith, given his demonstrable preferences, after he conducted a reasonable search. There is an intimate relationship between this Principle and the Specific-Performance Principle. Under the Cover Principle, buyers should be allowed great latitude in making a covering purchase. The greater the latitude afforded buyers to effect cover and thereby achieve virtual specific performance, the harder it should be for buyers to obtain actual specific performance. Correspondingly, the less latitude buyers have to effect cover, the easier it should be for buyers to obtain actual specific performance.[163]

To put this differently, the Specific-Performance Principle is a loose reciprocal of the Cover Principle, with one exception. The Cover Principle is applied retrospectively: the issue is whether a purchase that *has already occurred* satisfies the Cover Principle. If it does, the promisee is entitled to cover damages; if it doesn't, he isn't. In contrast, the Specific-Performance Principle is applied prospectively: the issue is whether the promisee *should be* awarded specific performance.

An operational difference flows from the retrospective nature of the Cover Principle and the prospective nature of the Specific-Performance Principle. If the promisee seeks cover damages, he must show that he made a reasonable search before covering. In contrast, if the promisee seeks specific performance, he may be able to show that a search was unnecessary because he would have been unable to find a satisfactory replacement for the breached commodity. The promisor can rebut such a showing by producing evidence that there is a commodity readily available in the market

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> greater profit on resale, then the buyer's damage recovery under [U.C.C. §] 2-712 should be reduced sufficiently to put it in the same position as performance would have.
>
> If the aggrieved buyer will itself consume the cover goods, as for example by the use of furniture or equipment in a business, the problem is more difficult. Should the damage recovery . . . be reduced because the cover machinery which the aggrieved buyer purchased is marginally more efficient? Because the waiting room furniture is slightly more attractive than that contracted for? We think the damage recovery should not be reduced unless the seller comes forward with persuasive evidence that the buyer will reap added profits because of the superior quality of the cover merchandise.

WHITE & SUMMERS, *supra* note 151, § 6-3, at 209 (footnotes omitted). *See also* Cetkovic, 2003 Mass. App. Div. at 2 ("The recovery for 'cover' goods ought not to be denied merely because there exists a possibility of a windfall unless the seller demonstrates persuasively the likelihood of a significant windfall due to the superior quality of the cover goods.").

163. On the relationship between cover and specific performance, see Uniform Commercial Code § 2-716(1) (2003) (providing that the buyer has a right to specific performance where goods are unique "or in other proper circumstances."). According to the Official Comment, "inability to cover is evidence of 'other proper circumstances.'" *Id.* § 2-716 cmt. 2 (quoting *id.* § 2-716(1)). Similarly, Section 2-716(3) of the Code provides that "[t]he buyer has a right of replevin for goods identified to the contract if after reasonable effort he is unable to effect cover for such goods or the circumstances reasonably indicate that such efforts will be unavailing." *Id.* § 2-716(3).

that the promisor could not in good faith reject as a replacement for the breached commodity, given the promisee's demonstrable preferences.

CONCLUSION

Under the indifference principle, which is supported by both policy and morality, contract remedies should be designed to make a promisee indifferent between performance by the promisor and legal relief for breach. As a practical matter, no contract remedy is likely to satisfy this principle completely, given the institutional characteristics of American law, especially the rule that each party must pay its own costs of dispute settlement. In addition, the indifference principle may fail to reflect the motivational structure of contracting parties, because most contracting parties would not regard legal remedies of any kind as equivalent to assured and uncoerced performance. Within these limits, which contract law alone cannot resolve, the indifference principle remains the standard by which to judge remedies for breach of contract.

Conventional expectation damages, although animated in theory by the indifference principle, fall far short of implementing that principle, because of the way in which market-price damages are measured, the way in which the uncertainty rule is administered in contract law, and the principle of *Hadley v. Baxendale*.

In contrast to conventional expectation damages, specific performance gives the promisee just what he contracted to obtain, at least if we put aside the limits that are endemic to all legal remedies. Accordingly, specific performance comes much closer than conventional expectation damages to satisfying the indifference principle. Specific performance is also attractive because it requires an actor who has made a legally and morally binding promise to do just what she has contracted to do. Finally, a right to specific performance puts desirable pressure on promisors who wish to terminate a contract to do so efficiently and properly through a mutually negotiated termination based on a rich mix of information, rather than inefficiently and improperly through a unilateral breach based on limited information about the value the promisee places on performance.

However, specific performance has costs as well as benefits. It is highly intrusive and highly coercive. It is backed by draconian penalties that are out of scale with the end to be achieved. It can give rise to opportunistic exploitation. It effectively gives a promisee a unilateral right to decide whether his case will be tried by a judge or by a jury. It conflicts with the principle of mitigation. Finally, error at the enforcement stage has peculiarly severe consequences.

Motivated either by the benefits of specific performance or by its costs, some commentators argue that specific performance should be routine, while others argue that it should be exceptional. These arguments are

typically based on a single metric, such as the theory of efficient breach or the shortfall of expectation damages. For the reasons discussed in the body of this Article, these single-metric arguments will not stand up to close scrutiny. Where a choice involves both costs and benefits, as is true of specific performance, there is no escape from the need to craft a principle that rests on prudential judgment and that gives appropriate weight to all costs and benefits, rather than a principle that uses a single metric that inevitably ignores some of the costs or some of the benefits.

The Specific-Performance Principle, which puts a thumb on the scale in favor of specific performance—but only a thumb—is based on such a judgment. Under that Principle, actual specific performance should be awarded unless special moral, policy, or experiential reasons suggest otherwise in a given class of cases, or the promisee can accomplish virtual specific performance. Among the special moral, policy, and experiential reasons why specific performance should not be granted in given classes of cases are the need to stay well clear of anything that looks like involuntary servitude and the need to preserve the principle of mitigation.

A promisee can accomplish virtual specific performance if he can readily find in the market a commodity that he could not in good faith reject as an equivalent of the breached performance, given his demonstrable preferences. Where virtual specific performance can be accomplished it is superior to actual specific performance because it has none of the major costs of actual specific performance. At the same time, virtual specific performance is superior to conventional expectation damages because it comes much closer to satisfying the indifference principle. Given the great advantages of virtual specific performance, the remedy of cover, through which virtual specific performance is accomplished, should be liberally administered. Accordingly, under the Cover Principle, cover damages should be awarded if a covering buyer shows that his choice of a replacement was made in good faith, given his demonstrable preferences, after he conducted a reasonable search. When cover is not available, however, the indifference principle is normally best satisfied by liberally awarding actual specific performance.