The Expectation Remedy and the Promissory Basis of Contract

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I. CONTRACT AS PROMISE

Charles Fried's *Contract as Promise* stands as a model of principled legal argument. It took a single, integrating thought—that a promise lies at the heart of every contract—and then reconstructed broad swaths of doctrine as elaborations of that thought.

The book's argument is all the more impressive because the promissory ideal in whose name it seeks to unify contract law is not straightforward. On the contrary, grounding contract in promise highlights two of contract law's most distinctive yet least understood features: that the law establishes liability strictly, rather than based on fault; and that it creates forward-looking rather than the usual backward-looking entitlements, entitlements to be made better off rather than to secure the status quo ante. These features of promissory obligation have long been considered mysterious by a chain of thinkers whose pedigree goes back at least to David Hume and, in the law, to Lon Fuller and William Perdue.[1]

Fried understood the unusualness of promissory obligation and hence the shaky foundation that emphasizing promise places beneath contract law. He thus began *Contract as Promise* by addressing the problem of establishing the ground of promise head on, in two separate ways.

One line of Fried's argument emphasized the connection between forward-looking, strict liability in contract and the dignity of the promisor. "[H]olding people to their obligations," Fried wrote, "is a way of taking them seriously and thus of giving the concept of sincerity itself serious content."[2] He further argued, on "a more abstract level," that "respect for others as free and rational requires taking seriously their capacity to determine their own values."[3] To respect someone is to allow her to fix her obligations, according to the content that *she* gives them—her "will binding itself"—and not according to the costs

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1. *See* DAVID HUME, *Of Morals*, *in* A TREATISE OF HUMAN NATURE 293, 331 (David Fate Norton & Mary J. Norton eds., Oxford Univ. Press 2000). *See generally* L.L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages* (pts. 1 & 2), 46 YALE L.J. 52, 373 (1936-1937).

2. CHARLES FRIED, CONTRACT AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION 20 (1981).

3. *Id.*

that establishing those obligations may impose on others.[4] Promise and contract are commensurate to the dignity of persons—to their reasoned freedom—precisely in respect of reaching beyond the ordinary, fault-based morality of harm.

This line of argument carries an echo of Nietzsche's remark that "[t]o breed an animal *that is permitted to promise*—isn't this precisely the paradoxical task nature has set for itself with regard to man? isn't this the true problem *of* man?"[5] It also bears all the burdens associated with succeeding at this "paradoxical task." To observe that it would be useful to a person to possess the capacity to promise, or indeed that it would imbue her with a dignity that creatures without this power lack, is not yet to establish that persons *actually possess* such promissory capacity. The normative power associated with promissory capacity—the will's power to bind itself directly and unmediatedly, without invoking the ordinary morality of fault and harm—is odd indeed. A promissory obligation is a kind of reason, and reasons (one might think) track values. Thus, the normative power of promising involves a capacity to generate value simply by intending it into existence. Perhaps it is not a capacity that ordinary, mortal persons generally possess. Indeed, it has been suggested, for example by Hume, that such a generative capacity is the distinctive marker of divinity, which is why Hume thought promissory obligation quite as mysterious as transubstantiation.[6] Nietzsche, aware of all this, remarked that a person who possesses promissory capacity holds "his kick in readiness for the frail dogs who promise although they are not permitted to do so."[7] One worries that we are all, in this respect, frail dogs.

Contract as Promise never seriously took up the questions that a dignity-based contract law raises. Although Fried seemed to believe that persons possess the dignity associated with the normative power to promise, and may have been right to think so, the best reading of the text pursues a quite different account of the foundations of promise and thus also of contract.

This second line of the argument in *Contract as Promise* emphasized that promissory fidelity follows from the relationship that promises establish between promisors and promisees. Fried wrote that promise is "the device that gives trust its sharpest, most palpable form."[8] The foundation of promissory trust, for Fried, is that promises put in the hands of the promisee a "new power to accomplish his will," namely, by putting the promisor's "future performance

4. *Id.* at 19.

5. FRIEDRICH NIETZSCHE, *Second Treatise: "Guilt," "Bad Conscience," and Related Matters*, *in* ON THE GENEALOGY OF MORALITY 35, 35 (Maudemarie Clark & Alan J. Swensen trans., Hackett Publ'g Co. 1998).

6. *See* HUME, *supra* note 1, at 293.

7. NIETZSCHE, *supra* note 5, at 37.

8. FRIED, *supra* note 2, at 8.

into [the promisee's] hands."[9] Fried observed that trust is such a "remarkable" thing that, although we encounter it as a "tool," we "in the end . . . pursue it for its own sake; we prefer doing things cooperatively when we might have relied on fear or interest or worked alone."[10]

The turn to trust attempts to give promissory obligation, and thus contract as well, a more solid foundation.[11] But trust is, itself, a notoriously slippery phenomenon and can display a wide variety of forms, three of which are worth identifying in particular. The weakest, or thinnest, of the three varieties arises where one person relies on the credible representations of another and takes actions that expose her to harm if the representations are false. The strongest, or thickest, variety arises where one person trusts another to be generally well-motivated towards her, in the sense pursuing her interests even against his own. One might say, in such a case, that she entrusts herself to him. A third variety of trust arises when one person forms expectations regarding the future based on another's representations, so that she exposes herself to disappointment if he is unfaithful with respect to her expectations. This variety of trust falls between the other two. It is thicker than trust associated merely with reliance because it invokes the idea that the trusted party will be faithful to forward-looking expectations and not just that he will avoid causing backward-looking harm. It is thinner than trust in another's motivations because it invokes only the idea that the trusted party will be faithful to his word and not that he will faithfully promote the trusting party's interests.

These three varieties of trust map naturally onto three forms of moral and legal obligation.

The thinnest form of trust—trust connected to reliance—involves the moral and legal ideas associated with tort law. Where trust is based on the statements of another, the thin form of trust invokes the various misrepresentation torts. There are several such torts, and their elements vary. Nevertheless, they share

9. *Id.* at 8, 13.

10. *Id.* at 8. Others have also sought to ground promissory obligation in the special relation that promises establish between the parties to them. *See* JOSEPH RAZ, *Promises and Obligations*, *in* LAW, MORALITY, AND SOCIETY 210, 227-28 (P.M.S. Hacker & J. Raz eds., 1977). Raz adds that the value of this bond might "explain[] not only why one ought to keep promises one has made, but also why it is good to make promises." *Id.* at 228.

11. Some might think this trust-based account of the foundations of promising suffers a difficulty analogous to the one attributed to the account involving a normative power. In order to ground promissory obligation, a promisee's trust must be justified; but in order for it to be justified, trust must refer not to the likelihood of performance but rather to the promisee's entitlement. The grounds of this entitlement cannot be promisee trust itself, however, because the account would then be circular. Hence, the entitlement must be grounded in the promise, most naturally in the promisor's communicated intentions. Fried recognizes this in *Contract as Promise*, writing that "[t]here is reliance because a promise is binding, and not the other way around." FRIED, *supra* note 2, at 19. But now the promisor's normative powers come back into play. The turn to trust may not leave *everything* where it was, however, and emphasizing the value of the relationship between promisor and promisee may provide a way out of the circle. *See* Daniel Markovits, *Contract and Collaboration*, 113 YALE L.J. 1417, 1442-45 (2004).

a basic structure: the misrepresentation torts announce fault-based standards of care;[12] they emphasize (and indeed generally require) that misrepresentations cause harm, generally in the form of reliance costs, in order to count as tortious;[13] and they adopt backward-looking rather than forward-looking remedies that reject the goal of vindicating the expectations that tortious statements engender and, instead, aspire only to undo the harms that the misrepresentations cause—that is, to compensate for lost reliance.[14]

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12. *See* RESTATEMENT (SECOND) OF TORTS § 304 (1965) (Negligent Misrepresentation Affecting Conduct of Others); *id.* § 310 (Conscious Misrepresentation Involving Risk of Physical Harm); *id.* § 311 (Negligent Misrepresentation Involving Risk of Physical Harm); RESTATEMENT (SECOND) OF TORTS § 525 (1977) (Liability for Fraudulent Misrepresentation); *id.* § 526 (Conditions Under Which Misrepresentation is Fraudulent (Scienter)); *id.* § 530 (Misrepresentation of Intention); *id.* § 552 (Information Negligently Supplied for the Guidance of Others); *id.* § 557A (Fraudulent Misrepresentations Causing Physical Harm). Exceptions exist for certain classes of transactions, including, most notably, transactions that arise in and around consumer sales. *See* RESTATEMENT (SECOND) OF TORTS § 402B (1965) (Misrepresentation by Seller of Chattels to Consumer); RESTATEMENT (SECOND) OF TORTS at § 552C (1977) (Misrepresentation in Sale, Rental or Exchange Transaction); RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 9 (1998) (Liability of Commercial Product Seller or Distributor for Harm Caused by Misrepresentation). Although these cases are included in doctrinal summaries of tort law, they arise in and around contract relations. Finally, the Restatement (Second) of Contracts famously acknowledged representation-based liability, independent of fault, and without the full formalities of offer and acceptance that contract obligation classically requires. RESTATEMENT (SECOND) OF CONTRACTS § 90 (1981). Much has been written about that section, and this Article does not restate the arguments here; it is enough to observe that promissory estoppel under Section 90—whose title, after all, is "Promise Reasonably Inducing Action or Forbearance"—does not naturally extend to creating liability generally for representations in the absence of an intent to be bound. *See generally* Alan Schwartz & Robert E. Scott, *Precontractual Liability and Preliminary Agreements*, 120 HARV. L. REV. 661 (2007).

13. *See* RESTATEMENT (SECOND) OF TORTS § 525 (1977) (including, among the requirements for such liability, "inducing another to act or to refrain from action in reliance upon it"); *id.* § 538 (Materiality of Misrepresentation); *id.* § 544 ("The recipient of a fraudulent misrepresentation of intention is justified in relying upon it if the existence of the intention is material and the recipient has reason to believe that it will be carried out."). Tort law's commitment to requiring reliance, and in particular, its resistance to suggestions that might allow expectation-based liability to bleed into tort by recasting expectations in terms of reliance, is vividly emphasized by Restatement (Second) of Torts Section 548. *Id.* § 548 ("The maker of a fraudulent misrepresentation is not liable to one who does not rely upon its truth but upon the expectation that the maker will be held liable in damages for its falsity.").

14. *See id.* § 552B (1977) ("[T]he damages recoverable for a negligent misrepresentation do not include the benefit of the plaintiff's contract with the defendant."). Fraud damages represent an exception to this rule. *See id.* § 549 (Measure of Damages for Fraudulent Misrepresentation). Subsection (2) of Section 549 states, "The recipient of a fraudulent misrepresentation in a business transaction is also entitled to recover additional damages sufficient to give him the benefit of his contract with the maker, if these damages are proved with reasonable certainty." As the comments to Section 549 observe, this is an exceptional rule. The rules "normally applicable to determine the measure of damages recoverable for a fraudulent misrepresentation" in a tort action are fixed, by Subsection (1) of Section 549, at reliance damages (approximately). *Id.* § 549 cmt. g. This reflects "the logical rules for a tort action, since the purpose of a tort action is to compensate for loss sustained and to restore the plaintiff to his former position, and not to give him the benefit of any contract he has made with the defendant." *Id.* These special rules were adopted only because the contractual settings of many frauds threaten to leave plaintiffs subject to ordinary tort rules without a meaningful remedy and, indeed, worse off than plaintiffs whose counterparties in their bargains breached innocently rather than fraudulently. Giving contract-like remedies for frauds committed in contract-like settings addresses this injustice. But where frauds do not implicate contract relations, for example, "[w]hen the plaintiff has not entered into any transaction with the defendant but has suffered his pecuniary loss through reliance upon the misrepresentation

The thickest form of trust—connected to faith in another person's other-regarding motives—invokes the moral and legal ideas associated with fiduciary law. This body of law again possesses a distinctive structure: fiduciary law announces a standard of conduct that requires not just care but also loyalty;[15] it imposes on fiduciaries a duty not just to avoid harming or disappointing the principal but also to avoid benefiting themselves through actions taken on the principal's behalf;[16] and it adopts remedies that aspire to undo a disloyal fiduciary's gains by ordering that those gains be disgorged to the betrayed beneficiary.[17]

Finally, the intermediate form of trust—connected to expectations that another person will faithfully execute her promises—invokes the moral and legal ideas associated with contract. Contract law once again possesses a distinctive legal structure, which falls between the structures of tort law and fiduciary law: contract law requires promisors not merely to display due care for their promisees but rather strictly to honor their promises. The law, however, constrains its requirement of fidelity to the four corners of the contractual promise, and it rejects any broader requirement that promisors display benevolence toward promisees. Rather, although the law emphasizes the promisee's interest in avoiding not just harm but also disappointment, it also denies that promisees have any legitimate interest in respect of the promisor's enrichment in connection with the promised performance. Contract remedies vindicate the expectations that breaches disappoint, but they (traditionally) do not require breaching promisors to disgorge any gains from their breaches.

Contract so conceived stands on insecure moral and legal ground, caught in

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in dealing with a third person," then the reliance-based remedy rules "are the rules that must of necessity be applied." *Id.*

15. *See* RESTATEMENT (THIRD) OF AGENCY § 8.01 (2006) ("An agent has a fiduciary duty to act loyally for the principal's benefit in all matters connected with the agency relationship."). A comment to the Restatement section adds that "the general fiduciary principle requires that the agent subordinate the agent's interests to those of the principal and place the principal's interests first as to matters connected with the agency relationship." *Id.* § 8.01 cmt. b.

16. *See id.* § 8.02 ("An agent has a duty not to acquire a material benefit from a third party in connection with transactions conducted or other actions taken on behalf of the principal or otherwise through the agent's use of the agent's position.").

17. *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 40(2) (Tentative Draft No. 4, 2005) (generally requiring that "[a] conscious wrongdoer . . . will be required to disgorge all gains (including consequential gains) derived from the wrongful transaction"); RESTATEMENT (THIRD) OF AGENCY § 8.01 cmt. d ("The law of restitution and unjust enrichment also creates a basis for an agent's liability to a principal when the agent breaches a fiduciary duty, even though the principal cannot establish that the agent's breach caused loss to the principal. If through the breach the agent has realized a material benefit, the agent has a duty to account to the principal for the benefit, its value, or its proceeds. The agent is subject to liability to deliver the benefit, its proceeds, or its value to the principal."); RESTATEMENT (THIRD) OF AGENCY § 8.02 cmt. e ("When an agent breaches the duty stated in this section, . . . [t]he principal may recover any material benefit received by the agent through the agent's breach, the value of the benefit, or proceeds of the benefit retained by the agent.").

the squeeze between two doctrinally simpler and more morally well-grounded legal constellations. This position leaves contract at risk of being swallowed up when an expansionist mood comes over one of its doctrinal neighbors.

When Fried wrote *Contract as Promise*, tort law presented just such an expansionist threat. Substantial scholars, in their most serious work, were suggesting that contractual obligation *should not* exceed the general obligation not to harm—applied to the special case of harm by misrepresentation.[18] They also argued that contract law, properly understood, *did not* establish any duties that might not be equally well described and better grounded in tort law.[19] This "tortification" of contract law focused on contract remedies to argue that a disappointed promisee's recovery should be limited to his lost reliance (that is, to the remedy that tort law would award). Lawyers have known, since Fuller and Perdue, that a promisee's reliance includes gains from alternative contracts forgone on account of the arrangement made with the promisor.[20] In competitive markets, such opportunity costs will have a value equivalent to the promisee's expectation under the contract. The turn to tort thus left room for the law's conventional preference for the expectation remedy. But where markets are not competitive, so this opportunity-cost argument fails to apply, tortified contract law should reject expectation damages in favor of a narrower reliance remedy. Fried wrote in the face of a threat that courts might accept this logic and refuse to vindicate contractual expectations that apparently were windfalls. Courts had begun to reason that contract law protected reliance on promises, not expectations of gain. This is a tort model of contractual obligation.[21]

Fried made resisting tort's encroachment upon contract one of the central themes of *Contract as Promise*. He thus observed, early on in the book's introduction, that the "conception of contractual obligation as essentially self-imposed has been under increasing pressure over the last fifty years."[22] He especially sought to counter the view "that often what is taken as enforcement of a promise is in reality the compensation of an injury sustained by the plaintiff because he relied on the defendant's promise."[23] Fried insisted that "large theoretical and practical matters turn on" the distinction between this

18. Sometimes this point was made directly in response to Fried's argument. Anthony Kronman thus observed, in an early review of *Contract as Promise*, that Fried's suggestion that a promisee's trust underwrites a promisor's obligation to perform had to contend with the counter-suggestion that a promisor might reasonably be thought entitled to trust the promisee to release her in exchange for restoring him to the status quo ante (by vindicating not his promissory expectations but only his lost reliance). *See* Anthony Kronman, *A New Champion for the Will Theory*, 91 YALE L.J. 404, 412-13 (1981).

19. *See, e.g.*, P.S. ATIYAH, ESSAYS ON CONTRACT (1986); P.S. ATIYAH, THE RISE AND FALL OF FREEDOM OF CONTRACT (1979); GRANT GILMORE, THE DEATH OF CONTRACT (1974).

20. *See generally* Fuller & Perdue, *supra* note 1.

21. *See generally* Overstreet v. Norden Labs., Inc., 669 F.2d 1286 (6th Cir. 1982).

22. *See* FRIED, *supra* note 2, at 2.

23. *See id.* at 4.

tort-based account of contract and the true, promise-based account.[24] Most importantly, Fried observed that the "assimilation of contract to tort is . . . the subordination of a quintessentially individualist ground for obligation and form of social control, one that refers to the will of the parties, to a set of standards that are ineluctably collective in origin and thus readily turned to collective ends."[25] Fried's complaint against those who would reduce contract to tort thus arose directly out of the values of personal dignity and private trust from which he constructed the affirmative case for contract as promise.

Perhaps because it was constructed to join argument with a tort-based approach to contract that emphasized reliance as both a basis for contractual obligation and a limitation on contract remedies, the argument of *Contract as Promise* gave contract remedies a distinctive prominence. *Contract as Promise* addressed other doctrines in later chapters that cast themselves as doctrinal applications of a more fundamental promissory idea. The expectation remedy, by contrast, was addressed in the book's initial chapter, entitled "Contract as Promise," in the course of introducing and developing that fundamental idea. Thus, Fried insisted that a contract's promissory foundations entail not just promisors' obligations to respect promisees' contractual expectations but also that the law should vindicate these expectations where promisors fall short. "If I make a promise to you," he wrote, "I should do as I promise."[26] Fried added, at once and as if it followed directly, "if I fail to keep my promise it is fair that I should be made to hand over the equivalent of the promised performance."[27] He observed, furthermore, "In contract doctrine this proposition appears as the expectation measure of damages for breach . . . [which] gives the victim of a breach no more or less than he would have had had there been no breach—in other words, he gets the benefit of his bargain."[28] Thus, the expectation remedy had pride of place in Fried's doctrinal elaboration of the basic moral structure of contract law.

The legal situation today is dramatically different from when Fried wrote. Contract law is squeezed from the other direction—coming under pressure not from tort but from fiduciary law. One important thing is unchanged, however. The focus of the squeeze play is once again on contract remedies.

A growing chorus of increasingly prominent critics argues against limiting contract remedies to vindicating a disappointed promisee's contractual

24. *See id.*

25. *See id.* at 4-5.

26. *See* FRIED, *supra* note 2, at 17.

27. *See id.*

28. *See id.* Fried's characterization tracks the language of the Restatement (Second) of Contracts. The Restatement observes that courts ordinarily protect a promisee's contractual expectations "by attempting to put him in as good a position as he would have been in had the contract been performed," which is to "give the injured party the 'benefit of the bargain.'" RESTATEMENT (SECOND) OF CONTRACTS § 344 cmt. a (1981). The Uniform Commercial Code similarly observes that contract remedies are designed to put the aggrieved party "in as good a position as if the other party had fully performed." U.C.C. § 1-305 (2004).

expectations.[29] The expectation remedy, these critics claim, allocates to the promisor the full gains generated by her breach. This allows her to profit from her wrong and, moreover, encourages her to commit the wrong (the breach) to begin with. According to the critics, the conventional contract remedy thus stands at odds with the underlying morality of promise (and its condemnation of breach as wrongful) and threatens to undermine the immanent normativity of contract obligation (by building into contract law permissions, and even inducements, to violate the very obligations that the law purports to create).

The normative structure of contract, the critics say, requires supracompensatory remedies for breach. Some revisionists propose making specific performance the standard remedy for breach of contract, replacing contract law's conventional liability rule protection for contractual expectations with property rule protection. Other revisionists accept money damages as the appropriate response to breach of contract, but argue that money awards should vindicate the promisee's restitutionary interest by requiring a breaching promisor to disgorge whatever gains she received by breaching. The two proposals converge in practice, at least as long as the law will not or cannot enable the promisee to *require* the promisor to breach and disgorge. Both specific performance and disgorgement engender a renegotiation between promisor and promisee, allowing the promisor to divert her performance in exchange for passing some, but not all, of the proceeds from the diversion to the promisee.

In addition, some American courts have begun not only to vindicate the promisees' contractual expectations but also to require the promisor to disgorge any gains that her refusal to trade created.[30] Courts in England and Israel are also beginning to award "gain based damages" more broadly.[31] The Uniform Commercial Code (U.C.C.) liberalized the right to specific performance,[32] and the recently adopted Restatement of Restitution gives courts discretion to replace the expectation remedy with disgorgement for breaches that are material, deliberate, and profitable, on the generic ground that expectation

29. *See generally* Richard R.W. Brooks, *The Efficient Performance Hypothesis*, 116 YALE L.J. 568 (2006); Melvin A. Eisenberg, *Actual and Virtual Specific Performance, the Theory of Efficient Breach, and the Indifference Principle in Contract Law*, 93 CALIF. L. REV. 975 (2005); Melvin A. Eisenberg, *The Disgorgement Interest in Contract Law*, 105 MICH. L. REV. 559 (2006); Daniel Friedman, *The Efficient Breach Fallacy*, 18 J. LEGAL STUD. 1 (1989); Seana Shiffrin, *Could Breach of Contract be Immoral?*, 107 MICH. L. REV. 1551 (2009); Seana Shiffrin, *The Divergence of Contract and Promise*, 120 HARV. L. REV. 708 (2007).

30. *See generally* Univ. of Colo. Found., Inc. v. Am. Cyanamid Co., 342 F.3d 1298 (Fed. Cir. 2003); Dastgheib v. Genentech, Inc., 457 F. Supp. 2d 536 (E.D. Pa. 2006); Daily v. Gusto Records, Inc., 2000 U.S. Dist. LEXIS 22537 (M.D. Tenn. Mar. 31, 2000); EarthInfo, Inc. v. Hydrosphere Res. Consultants, Inc., 900 P.2d 113, 119 (Colo. 1995).

31. *See generally* Adras Bldg. Material Ltd. V. Harlow & Jones, GmbH, 42(1) PD 221 [1988] (Isr.), *translated in* 3 Restitution L. Rev. 235 (1995); Ralph Cunnington, *The Assessment of Gain-Based Damages for Breach of Contract*, 71 MOD. L. REV. 559 (2008).

32. *See* U.C.C. § 2-716 (2004).

damages are "inadequate."[33]

The academic and doctrinal developments summarized above share, as a unifying theme, a commitment to what Richard Brooks called a "more robust notion[] of contractual duty" than the law's conventional commitment to the expectation remedy recognizes.[34] At its core, this robust account of contract imposes a duty on promisors to administer their contractual performance not only in the service of their own interests but also in the service of the promisees' interests.

The expectation remedy is, by definition, as valuable to the promisee as performance would have been—not less valuable, but also not more.[35] Supracompensatory remedies can therefore be justified only insofar as a promisor comes under an obligation to administer contractual performance in the interests of the promisee, with respect to any further gains that become possible. This obligation amounts to a requirement that promisors display greater benevolence toward their promisees in respect of unallocated gains within the contract than they were required to display without the contract (including, in particular, during the negotiations through which they allocated contractual gains). The metes and bounds of this requirement are, moreover, necessarily open-ended because the requirement is not limited to respecting the surplus allocation fixed in the initial contract. These reflections reveal that the "more robust" account of contractual duty that the expectation remedy's contemporary critics have in mind is, in its nature, a species of fiduciary obligation: it recasts contract law to include an open-ended obligation, within every contract, to abandon the arm's length perspective from which the contract was made.

Although they approach contract law from a very different direction, contemporary critics of contract's promissory foundations thus share a basic motivating thought with the critics against whom Fried wrote. Both doubt the value of private, voluntary coordination among persons who, even as they respect one another's moral powers, nevertheless interact self-interestedly and at arm's length. The older, tort-based critique sought to replace this relation with collective principles of loss avoidance. The new critique seeks to replace arm's length dealings with a mandatory and collectively imposed principle of surplus sharing. But both sets of critics reject the idea that commercial life is best administered by a legal order that encourages arm's length dealing and the mutually respectful and yet mutually self-interested attitudes that such arm's

33. *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 39 (Tentative Draft No. 4, 2005); *see also* Andrew Kull, *Disgorgement for Breach, the "Restitution Interest," and the Restatement of Contracts*, 79 TEX. L. REV. 2021, 2023-24 (2001).

34. Brooks, *supra* note 29, at 573.

35. *See* RESTATEMENT (SECOND) OF CONTRACTS § 344 cmt. a (1981). As the Restatement says, expectation damages "put [the promisee] in as good a position as he would have been in had the contract been performed, that is, had there been no breach." *Id.*

length dealing involves. In particular, both sets of critics reject the idea that contractual obligation should be strictly limited according to the terms that contracting parties, ex ante, adopt.

These pages argue that arm's length dealing remains the right model for private law, especially commercial law, by taking up Fried's mantel for a new age and once again championing contract as promise, only now defending this conception against accounts of contract that sound not in tort but in fiduciary law. In particular, the argument defends contract law's expectation-based remedial regime against supracompensatory remedies based on the complex of specific performance and restitution.

II. EXPECTATION DAMAGES RIGHTLY UNDERSTOOD

Our earlier work mounts a theoretical defense of the promissory conception of contract—and especially of that conception's emphasis on vindicating contractual expectations through a liability rule—against alternative fiduciary conceptions that emphasize restitution and property rule protections.[36] A brief summary of that argument follows.

The case for the expectation remedy sets out from what we call the "dual performance hypothesis." The hypothesis holds that promisors (or, as we shall sometimes say, sellers) commonly make promises in the alternative: *either* to trade goods or services to buyers *or* to make a monetary transfer to buyers, equal to the value the buyers would realize from receiving the goods or services. If contractual promises are understood in this way, as involving a promise either to *trade* or to transfer, then a seller who voluntarily transfers rather than trades does not breach the contract; and a court that requires the promisor to pay expectation damages provides not substitutionary but direct relief.

Where it applies, the dual performance hypothesis takes the wind out of the sails of contemporary critics of the expectation remedy.[37] If parties agree to make a transfer of the expectation interest count as an alternative performance of the promisor's obligation, then a promisor who makes such a transfer commits no wrong. Therefore, any gains that avoiding trade allows the promisor to obtain cannot "unjustly" enrich her. And where a court, confronting a promisor who refuses both to trade and to pay, orders expectation damages, it neither countenances a wrong nor protects an unjust enrichment.

36. *See* Daniel Markovits & Alan Schwartz, *The Myth of Efficient Breach: New Defenses of the Expectation Interest*, 97 VA. L. REV. 1939 (2011).

37. *See* RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 39 (Tentative Draft No. 4, 2005). The same section that introduces the broader availability of restitutionary remedies for breach of contract accepts that "if the parties' agreement authorizes the promisor to choose between performance of the contract and a remedial alternative such as payment of liquidated damages," then restitution is inappropriate. *Id.* § 39(4)(a). This Article argues that both the economics and the morality of promissory coordination recommend that contracts be generally interpreted to so authorize.

This statement of the argument is purely formal: *if* promises are understood in a particular way to have a particular substantive content, *then* there are no good grounds for preferring supracompensatory remedies over conventional expectation damages. It is a separate question whether contractual promises actually do have the substantive content that this formal recharacterization supposes them to have. Nevertheless, there exist good reasons for suspecting that actual contracts take on the form that the argument identifies.

To begin with, under realistic conditions, contractual surplus is greater in a dual performance contract than in a contract that gives promisees the supracompensatory entitlements—to property rule protections or restitutionary remedies—that fiduciary critics of the expectation remedy champion. This is because the ex ante negotiations concerning the dual performance contracts' transfer terms will be more orderly and less acrimonious, and hence also less transaction costly, than the ex post renegotiations that inevitably ensue under a property rule when a seller who might increase contractual surplus by diverting trade must bargain for the right to do so with a buyer who is entitled to a supracompensatory remedy. This will be clear, moreover, to anyone who understands that although parties typically contract because they expect, ex ante, to trade, circumstances might change in ways that make trade inefficient, ex post. Appreciating this possibility makes it natural for parties to negotiate not only about the terms of trade (price, quantity, quality) but also about what will happen should circumstances undermine trade, including about transfer. Dual performance contracts, which apply in the trade and the no-trade states, thus appeal even to only modestly sophisticated contracting parties.[38]

Furthermore, dual performance contracts are not just efficient but also constitute the contract relation in a morally desirable way. These contracts create well-formed instances of promissory obligation, whose breach is morally wrong in the ordinary way. Thus, while a seller who volunteers payment instead of trade performs such a contract, a seller who refuses both to trade and to transfer breaches it. Such a breach is wrong both morally and legally. In appropriate circumstances, the breach violates the norms associated not just with contract but also with tort; it might even be grossly tortious, in the fashion that warrants adding punitive damages to compensatory relief (although it remains doubtful, for practical reasons, that a wise legal order will too readily treat breaches of contract in this way).

Moreover, dual performance contracts deploy the formal morality of contract in a distinctively appealing, substantive way. Parties to dual performance contracts recognize that they are assuming genuinely promissory moral and legal obligations. Dual performance contracts prescribe conduct for both the trade and the no-trade states. As long as parties respect the constraints

38. *See generally* Markovits & Schwartz, *supra* note 36; Alan Schwartz, *The Myth that Promises Prefer Supracompensatory Remedies: An Analysis of Contracting for Damage Measures*, 100 YALE L.J. 369 (1990).

that these prescriptions create, they are as free to pursue their respective self-interests within these promissory relations as they were without them, including when they initially negotiated their promissory engagements. Unlike fiduciary engagements, which, by their nature, impose open-ended obligations of general benevolence towards the other party, contracts, properly understood, limit the obligations they impose according to the terms of the initial agreements that the parties struck. Dual performance contracts, and the expectation remedy with which they are associated, enact this central feature of contract.

By contrast, supracompensatory remedies impress contracting parties into obligations of fiduciary benevolence in the administration of contracts. If any doubt about this remains, consider how proponents of supracompensatory contractual remedies should instruct contracting parties to carry out the renegotiations that such remedies inevitably engender. Parties who apply ruthless self-interest to these negotiations surely fall foul of the ideals in whose name the supracompensatory remedies are proposed: a breaching promisor who uses her bargaining power to retain any share of the surplus generated by the breach continues to profit from her own "wrong" just as surely as one who simply keeps the entire ex post surplus under the traditional expectation remedy. Proponents of supracompensatory remedies must therefore condemn such hard bargaining ex post, for the very same reason they condemn the "opportunistic" efficient breach that they associate with current law. Honoring the ideals that underwrite the case for supracompensatory remedies thus requires parties to renegotiate in a manner that departs radically from the norms governing their initial negotiations. And this is the essence of a fiduciary relationship.[39]

39. This formulation suggests that the dispute between the conventional understanding of contract and critics who seek to remake contract on a fiduciary model might be characterized in another way, emphasizing doctrines concerning performance rather than remedies for breach. Arguments that favor supracompensatory remedies by invoking fiduciary-like principles of other-regard within the contract relation propose, in effect, to revise the duty of good faith in contract performance. The duty of good faith in performance—imposed through one of the rare mandatory rules of contract law—has conventionally been understood to require only that promisors refrain from using vulnerabilities promisees incurred as a result of contracting to deprive the promisees of benefits that the contracts were intended to secure. *See* U.C.C. § 1-201(20) (2011) (limiting good faith to "honesty in fact and the observance of reasonable commercial standards of fair dealing"). The substantive content of the duty of good faith in performance is thus conventionally fixed according to the terms of the parties' agreement. This renders it entirely consistent with good faith for a promisor single-mindedly to pursue her self-interest within the contract relation, as long as she accepts the agreement as a side-constraint. That is why it is not bad faith for a promisor to reject trade, pay expectation damages, and retain the gains that reallocating resources created. By paying damages that vindicate the promisee's expectation, the promisor gives the promisee the benefit that the contract was intended to provide, and renders her independent self-interest not bad faith. Critics who accuse the expectation remedy of encouraging efficient breachers to exploit their promisees or profit from their own wrongs thus implicitly reject the conventional understanding of good faith in performance. These critics favor an alternative account, on which good faith requires not just respecting the promise but open-ended, fiduciary-like regard for the other party. *See* Daniel Markovits, *Market Solidarity* (unpublished manuscript) (on file with author) (defending conventional, prosaic conception of good faith against more highly idealized alternatives).

Dual performance contracts are thus not only more efficient than contracts associated with supracompensatory remedies, they are also more solicitous of contract law's core moral values. Because dual performance contracts leave the contracting parties in control of the substance of their obligations, and, in particular, because they do not impose any obligations that the parties did not agree to ex ante, they better respect freedom of contract, something that Fried would likely emphasize. Dual performance contracts also work better than fiduciary contracts at fashioning contractual trust in a manner appropriate to the relations among traders who approach one another at arm's length in open, cosmopolitan economies (as even the critics of the expectation remedy accept that traders typically do). Trading partners in such economies approach their exchanges with not just divergent interests but also may have divergent conceptions of fairness and the general interest. A large part of contract law's moral and political appeal lies in its capacity to support respectful exchange among persons who agree on little (or perhaps nothing) besides the terms of their exchange. In order to support exchange under such circumstances of pluralism, contract law must allow trading partners to cabin their obligations as narrowly as they wish, and thus to remain, in spite of their contracts, at arm's length in respect of all matters that their agreements do not cover.

By allowing such arm's length exchange, moreover, contract law supports a valuable and distinctive form of interpersonal respect. Exchange partners appreciate each other's universal humanity, recognizing each other in respect of the deliberative and intentional capacities that all persons share (whatever their interests) rather than in respect of more particular, and hence also more contingent, substantive interests and concerns. Precisely because it cabins contractual enforcement according to the terms of the parties' initial agreement, the expectation remedy supports broad-based contracting that embodies this model of interpersonal respect. A contract law that imposed supracompensatory remedies and embraced a fiduciary ideal would cast its net more narrowly and replace this conception of respect with another.[40]

The purpose of these pages is not to recapitulate or to promote prior arguments, however. They must persuade, or not, as written down elsewhere. Rather, this Article wishes to take a page (literally) from Fried's book and to devote itself to arguing that the positive law of contract remedies embodies the conception of the contract relation just set out.

The Article thus turns to contract doctrine and argues, more specifically, that the expectation remedy, as it is articulated in doctrine and administered by courts, is best understood in terms of the dual performance hypothesis. Expectation damages constitute direct enforcement of the transfer prong of a dual performance promise rather than substitutionary relief for a promise

40. *See generally* Daniel Markovits, *Promise as an Arm's Length Relation*, *in* PROMISES AND AGREEMENTS: PHILOSOPHICAL ESSAYS (Hanoch Sheinman ed., 2011); Markovits & Schwartz, *supra* note 36.

simply to trade. Therefore, contract law, rightly understood, has only one remedy for breach of contract, and that remedy is specific performance.

III. DOCTRINE

The doctrinal ideas that follow from the dual performance hypothesis—including the idea that expectation damages constitute direct enforcement of a contract's transfer prong—apply when the parties agree that both trade and transfer count as performance. The doctrinal arguments therefore set out from an interpretive engagement with the actual contracts that parties conventionally make. The typical contract contains a promise in the alternative: to trade *or* to transfer. The paragraphs below explain why.

Parties contract in order to realize gains from trade and commonly divide those gains through the price. Sophisticated parties, however, know that trading may not generate gains in every future state. Perhaps the seller's costs will go up—either her direct costs, in the sense of the costs of acquiring the inputs that she uses to make the goods to be traded, or her opportunity costs, in the sense of the gains that she might make by diverting these inputs or goods to other uses or buyers. Perhaps the buyer's value will go down. In either event, if the seller's costs come to exceed the buyer's value ex post, then a surplus can be had by *not trading*.

Because contractual surplus might be generated by not trading as well as by trading, parties (who wish to maximize total surplus ex ante) have reason to plan both for the case in which trade is efficient ex post and for the case in which not trading is efficient. The expected contractual surplus across both states is maximized by agreeing that when trade turns out to be inefficient ex post, the seller may divert performance as efficiency requires, as long as she makes a transfer equal to the buyer's valuation of trade. The seller may retain any additional surplus.

Allowing the seller to retain the entire gains received ex post from refusing to trade under the expectation remedy does not mean, however, that she acquires the entire expected value of the non-trading surplus ex ante. The contracting parties, after all, bargain ex ante over the whole expected contractual surplus. Further, a contract term that increases non-trading surplus ex post also increases contractual surplus ex ante and thus (because the term cannot by itself alter the parties' relative bargaining powers) also increases the buyer's surplus ex ante. This result is achieved through the mechanism of the price; the contract price falls where a contract allows the seller to avoid inefficient trade by making a transfer equal to the buyer's expectation. The lower price allows the buyer to share in *both* the trading and the non-trading gains from contracting.[41]

41. Fried, incidentally, recognized this connection between "remedies" and price. FRIED, *supra* note 2, at

The lower price has another consequence. Because the buyer's gains from contracting equal her value minus the price, the lower price just contemplated increases the buyer's expectation interest. In this way, the lower price also increases the transfer that the seller must make in lieu of trading. The contract's price term and transfer term are thus necessarily intertwined. Put differently, contracting parties (who can anticipate not just trade but also the possibility of not trading) necessarily choose the remedies associated with the prices that they set. The transfer prong of a dual performance contract is therefore just as real as the trade prong; it is memorialized in the contract through the price term (which, once again, fixes the gain to buyers not just from trade but from transfer, because the required transfer amount equals the value to them of trade, minus the price). A contract's price term is thus an implied-in-fact liquidated damages clause that establishes the liquidated amount as an alternative performance. Ordinary contracts, rightly understood, are dual performance contracts.

With these facts established, this Article turns to the law. The following pages argue that the doctrines through which contract remedies are

117. As it happens, Fried took up the issue in connection with an odd set of fact patterns involving sellers who breach on discovering that their buyers, having already paid, are in losing contracts: He thus imagined that a driller, having received $100,000 to drill an exploratory oil well for a landowner, learns that there is no oil under the owner's land and refuses to drill the well, but keeps the money on the ground that this put the buyer in the same position that performance would have done, thus vindicating the buyer's expectation interest. *Id.* at 115-16. Fried argued that the buyer should be entitled to restitution in such a case, and he cast this example as refuting the dual performance hypothesis, or at least the version associated with Holmes's option theory of contract. *See id.* at 118. To the contrary, this strange example (how can the seller learn that there is no oil without drilling?) does not refute the dual performance hypothesis. Rather, under the hypothesis, the driller should have paid expectation damages of $100,000. To see why, realize first that the standard remedy for breach of a construction contract is the cost of completion. Then assume (a) the owner purchased drilling services at the market price, and (b) the market price did not change between the contract and expected performance times. Denoting the market price as "p_m" and expectation damages as "d," the owner is entitled to recover $d = p_m = \$100{,}000$. Courts are sometimes reluctant to grant cost-of-completion damages when the contracted service would not have materially increased the value of the owner's land. Rather, courts use the standard expectation measure—value less price—that this Article utilizes. To see how this measure is applied in the typical case, assume (a) the seller and buyer contracted for the seller to supply a service but the buyer did not prepay; (b) the buyer paid a third party the sum "r" to provide other services in connection with the project; and (c) the sum "r" would be wasted if the project is not pursued. If the seller refuses to perform, the buyer's expectation damages are value less contract price plus reliance: $d = (v - p) + r$. The first term is the buyer's net profit; the second term is reimbursement for costs incurred. If the buyer could not recover these amounts, he would not be in the position that he would have been in had the contract been performed, but rather in a worse position, for costs incurred would have been *subtracted* from the net gain. Now assume that the buyer instead paid "r" to the seller. The buyer still must recover "r" to have his expectation—his net gain—protected. Expectation damages, that is, necessarily have a reliance or restitutionary component when the buyer incurs sunk-cost expenses but the seller does not complete performance. *See generally* Alan Schwartz & Robert E. Scott, *Market Damages, Efficient Contracting and the Economic Waste Fallacy*, 108 COLUM. L. REV. 1610 (2008). Turning to Fried's scenario, recall that the law does not award negative damages. When value is less than price, the buyer does not pay the seller the difference but instead recovers nothing. Applying the standard measure to Fried's case, $d = (v - p) + r = 0 + r = \$100{,}000$ because $v < p$ (the land has no oil) and the buyer incurred a $100,000 cost. Under the dual performance hypothesis, the seller should either have drilled or transferred $100,000 to the buyer. Thus, Fried's case is consistent with the hypothesis.

administered are best understood by casting expectation damages as direct enforcement of the transfer prong of the dual performance promises that ordinary contracts contain.[42]

To be sure, courts and other lawmakers occasionally *characterize* contract doctrine in ways that are inconsistent with the dual performance hypothesis. It is, after all, one of the banalities of contract law that the expectation remedy involves money *damages*. Talk of damages conjures up an image of substitutionary relief for breach of a single-pronged promise rather than direct enforcement of one alternative of a two-pronged promise.

The dual performance hypothesis nevertheless underwrites a better reconstruction of case-holdings and of the doctrines that produce them—a reconstruction that is more comprehensive, internally consistent, and deeply rooted in contract law's animating commitment to support voluntary coordination by implementing party intent—than the alternatives, including the contrary characterizations that the law sometimes elaborates. The law's accounts of its own rules can provide important information about the law. But where such editorializing conflicts with the immanent structure of *actual* legal rules and decisions, the law is finally found not in the editorializing, but in the doctrine and the actions taken under it. Even sophisticated courts can misunderstand their own decisions and therefore also mischaracterize them.[43]

This Article's unconventional reconstruction of contract doctrine begins by taking up the most conventional statement of the law. Restatement (Second) of

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42. This Article does not claim that matters were always so. Thus, as Frederick Pollock pointed out in a letter to Holmes, the declaration in assumpsit required from plaintiffs "averment of *neither* performance *nor* tender of damages." Letter from Frederich Pollock to Oliver Wendell Holmes (Nov. 29, 1928), *in* 2 HOLMES-POLLOCK LETTERS: THE CORRESPONDENCE OF MR. JUSTICE HOLMES AND SIR FREDERICK POLLOCK 1874-1932 233 (Mark DeWolfe ed., 1941).

43. This Article does not mean, by taking this approach, to take sides in the methodological dispute that Jody Kraus recently proposed exists between economic and consequentialist theories of contract, which take outcomes of cases as the principal data of contract law, and those who rely on philosophical or deontic theories, which instead focus on doctrinal statements. *See generally* Jody S. Kraus, *Philosophy of Contract Law*, *in* THE OXFORD HANDBOOK OF JURISPRUDENCE AND PHILOSOPHY OF LAW 687 (Jules Coleman & Scott Shapiro eds., 2002). This Article avoids this question for two reasons. First, where Kraus distinguishes between two views of what constitutes law (outcomes and doctrines) this Article's argument implicitly distinguishes among three: (1) outcomes, (2) doctrines, and (3) editorial comments about the character of either of the first two. This Article is skeptical of (3) but takes both (1) and (2) seriously in legal analysis. Second, and more fundamentally, it is unclear whether Kraus's distinction has the right general form for capturing the dispute between economic and philosophical approaches to private law. This Article's authors suspect, although do not here argue the point in a manner that could seriously join issue with Kraus, that the core difference lies not in the outcome-doctrine distinction but rather in the opposite answers that the two approaches give to the question whether or not the law consists of rules in a fundamental way (that is, of rules whose normative force is prior to the outcomes that they generate in particular cases). This distinction is different from Kraus's because the rules need not be expressed in doctrine but might instead be immanent in the pattern of outcomes reached across cases. Llewellyn subscribed to something like this view, and he thus searched for what he believed were the true contract-law rules rather than the rules that could be reconstructed from what the courts said. *See generally* Alan Schwartz, *Karl Llewellyn and the Origins of Contract Theory*, *in* THE JURISPRUDENTIAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW 12 (Jody S. Kraus & Steven D. Walt eds., 2000).

Contracts Section 344 identifies the several promisee interests contract law protects—expectation, reliance, and restitution—and announces a general preference for the expectation interest. This preference is consistent with the dual performance hypothesis. The law neither enforces trade (as conventional specific performance would do) nor requires promisors to disgorge their gains from rejecting trade (as restitution would do); instead, the doctrine accords promisees a right to transfer.

The congruence between this Article's hypothesis and the law may be apparent only, however. The question is not what the law permits but rather *how to understand* what the law is up to when it permits what it does; that is, whether the law regards a promisor who voluntarily pays as performing or as breaching and, analogously, whether it treats an order to pay expectation damages as direct enforcement of a promise in the alternative or as substitutionary relief for breach of a promise simply to trade. The best reconstruction of the law adopts the first half of each of these two distinctions.

The Restatement comments apparently adopt the opposite understanding. The comments to Section 344 describe the expectation remedy as "attempting to put [the promisee] in as good a position as he would have been in had the contract been performed, that is, had there been no breach."[44] This language seemingly suggests that the remedy provides substitutionary relief and (by implication) that the voluntary transfer of an amount equal to a promisee's expectation constitutes a breach.

The Restatement's suggestion, however, illustrates the hazards of too ready inference from the law's editorializing to its basic conceptual structure. The suggestion turns out to be cheap talk because it does not, by its own terms, make a difference to either doctrine or to outcomes. If a promisor refuses *both* to trade and to transfer, then there is a breach. And when the promisor breaches, the law follows the Restatement comment. It puts the promisee in as good a position as he would have occupied had the promisor complied with the contract's transfer term by specifically enforcing that term. The dual performance hypothesis and the substitutionary account of the expectation remedy therefore differ on the ground only in the relatively rare case in which a promisor tenders the transfer that the expectation remedy involves but the promisee demands a greater remedy: typically, either specific performance of the trade that the contract contemplates or a larger transfer.

Recent criticisms of the law's preference for the expectation remedy hold that the promisor's failure to perform the contract's trade terms is a breach. It follows that the appropriate remedy is for the law to determine, not the promisor; the transfer that she offers is irrelevant to the promisee's remedial entitlement. If reasons exist to award the promisee a different or a greater

44. RESTATEMENT (SECOND) OF CONTRACTS § 344 cmt. a (1981).

remedy than the expectation, critics hold, the law should provide it.

The Restatement again appears superficially to provide some support for this view. Section 361 recites: "Specific performance or an injunction may be granted to enforce a duty even though there is a provision for liquidated damages for breach of that duty."[45] The first comment to this section adds that "[m]erely by providing for liquidated damages, the parties are not taken to have fixed a price to be paid for the privilege not to perform,"[46] so that "[s]uch a provision does not, therefore, preclude the granting of specific performance or an injunction if that relief would otherwise be granted."[47] If liquidated damages are substitutionary, as the Restatement apparently suggests, then the expectation remedy should be substitutionary as well.

This interpretation of the Restatement text is incorrect, however. The Restatement authors do not reject the dual performance hypothesis but rather underestimate how frequently parties contract in the alternative. Section 361 thus instructs courts not to infer a party intention to price the refusal to perform the contract's trade terms from the "mere" presence of a liquidated damage clause. Parties, however, are plainly permitted to price this refusal. The comment goes on to say: "there is no reason why parties may not fix such a price [at which a promisor may replace trade with transfer] if they so choose."[48] Further, the comment refers to transfer as a price "for the privilege *not to perform*."[49] Although the reference to performance is confusing, calling a transfer a *privilege* implies that a promisor may exercise it consistent with her legal obligations under the contract. The next sentence, moreover, adopts the dual performance hypothesis in language that embraces the view developed here, telling courts to deny an injunction to enforce a contract's trade terms whenever "a contract contains a provision for the payment of such a price as *a true alternative performance*."[50]

Moreover, courts applying the Restatement are receptive to the possibility that the contract reflects an alternative promise. Although it is common to hear courts admit that (as indicated in Section 361) courts may award specific

45. *Id.* § 361.

46. *Id.* § 361 cmt. a.

47. *Id.*

48. RESTATEMENT (SECOND) OF CONTRACTS § 361 cmt. b (1981).

49. *Id.* (emphasis added).

50. *Id.* (emphasis added). The comment does not entirely overcome its earlier confusion, suggesting that even where a liquidated damages clause establishes transfer as an alternative form of performance, if a promisee refuses to make the transfer, then "specific performance or an injunction," presumably enforcing the contract's trade prong, may be granted. *Id.* A promisor who refuses both to trade and to transfer should face an injunction in such a case. But it is not clear why the injunction should order specific performance as conventionally understood—that is of the contract's trade prong—rather than ordering specific performance of the contract's transfer prong. To recognize that transfer can be an alternative form of performance, as the dual performance hypothesis's conceptual claim entails, implies that the question whether specific performance involves direct enforcement of the contract's trade or its transfer term becomes an interpretive question.

performance despite an express transfer term where the transfer is "intended to be mere security for the performance of the principle [sic] obligation," courts nevertheless insist that "where the sum specified may be substituted for the performance of the act at the election of the person by whom the money is to be paid, or the act done, equity will deny specific performance."[51] Courts following this reasoning deny specific performance of the trade terms to a promisee whose promisor complied with a liquidated damages clause.[52] As Pomeroy's treatise on Specific Performance of Contracts observes:

> Where the parties to an agreement, *whatever* may be the subject-matter or the terms, have added a provision for the payment, in case of a breach, of a certain sum which is truly liquidated damages and not a penalty—in other words, where the contract stipulates for one of two things in the alternative, the performance of certain acts, or the payment of a certain amount of money in lieu thereof—equity will not interfere to decree a specific performance of the first alternative, but will leave the injured party to his legal remedy of recovering the money specified in the second.[53]

Finally, courts use terms that acknowledge the dual performance hypothesis even when they hold that a promisee's right to specific performance of trade survives a liquidated damages clause. For example, a Florida case holding that "[a] provision for liquidated damages in a contract does not necessarily bar injunctive relief against its breach" adds, in the next sentence, "If, however, it appears that the liquidated damages clause was intended to furnish a party the alternative of performance or payment or was to be an exclusive remedy, an injunction will not be issued."[54] Observations such as these illustrate that the law adopts the dual performance hypothesis's understanding of the expectation remedy as a conceptual matter even where the law concludes, with respect to a particular contract, that a promisor is not entitled to transfer in lieu of trade.

The only open question therefore is not conceptual but interpretive: Does the law *generally* interpret contracts that do not contain liquidated damages clauses as making an appropriate transfer into an alternative performance? This Article argues that the answer is "yes."

Doctrine clearly announces that transfer as well as trade *may* count as performance. The law thus treats contracts that expressly make transfer an

51. Duckwall v. Rees, 86 N.E.2d 460, 462 (Ind. App. 1949) (en banc).

52. *See, e.g.*, Davis v. Isenstein, 100 N.E. 940 (Ill. 1913); O'Shield v. Lakeside Bank, 781 N.E.2d 1114 (Ill. App. Ct. 2002); Moss & Raley v. Wren, 120 S.W. 847 (Tex. 1909).

53. JOHN NORTON POMEROY, A TREATISE ON THE SPECIFIC PERFORMANCE OF CONTRACTS 68 (1879) (emphasis added); *see also Duckwall*, 86 N.E.2d at 462.

54. Beery v. Plastridge Agency, Inc., 142 So. 2d 332, 334 (Fla. Dist. Ct. App. 1962). The court cites, among other authorities, to RESTATEMENT (FIRST) OF CONTRACTS § 378, which is the predecessor to RESTATEMENT (SECOND) OF CONTRACTS § 361. *Id.*

alternative to trade on the dual performance model. But what of cases in which the parties do not expressly give transfer this status? Rational parties commonly *intend* a transfer, in the amount of the promisee's expectation, to count as performance. This circumstance suggests that the law ought to treat even contracts that fall short of expressly treating transfer as performance on the dual performance model nevertheless.

One important class of such contracts involves liquidated damages clauses. The dispute between the conventional, substitutionary view of contract damages and the dual performance hypothesis makes a real difference when a contract fails explicitly to make a stipulated remedy exclusive, the promisor volunteers transfer under the remedy, and the promisee seeks more. Accordingly, a showing that the law treats such cases as the dual performance hypothesis recommends—and denies the promisee's request—goes a long way towards showing that the hypothesis is consistent with contract law generally.

The required showing begins by taking up the U.C.C.'s liquidated damage rules, which are consistent with the account of contract embodied in the dual performance hypothesis.[55] The U.C.C. addresses the relevant cases in two provisions: Section 2-718 directs courts to enforce liquidated damage clauses and Section 2-719 directs courts to enforce clauses that limit remedies, though it adds, in Section 2-719(1)(b), that "resort to a remedy as provided [by the

55. Other sections of the U.C.C. also support this Article's view, at least in some measure. This Article confines discussion of these sections to the margin because they do not go directly to the dual performance hypothesis, in its core application, so much as reveal that law decides peripheral matters in ways that are consistent with the dual performance approach. Section 2-508 (which governs cure by sellers whose performance has failed to satisfy the perfect tender requirement of Section 2-601) allows the parties to "reach an agreement as to the type of cure provided . . . and . . . [to] agree that a money allowance against the price is to be given by the seller to compensate for defects in the goods." RICHARD A. LORD, 18 WILLISTON ON CONTRACTS § 52.28 (4th ed. 2010) ("Nature of Cure"). Moreover, some courts have observed that this money allowance may be established not only by express agreement but also by trade usage. *See* N. Am. Steel Corp. v. Siderius, Inc., 254 N.W.2d 899, 904 (Mich. Ct. App. 1977). These rules adopt a version of the dual performance hypothesis, in effect making transfer of part of the value of trade (coupled with imperfect trade) into an alternative form of performance. Admittedly, no cases were found in which transfer of the full value of the trade was treated as a "cure" for the "imperfect tender" of not tendering trade at all. In addition, the dual performance hypothesis receives support from doctrines that make it easier for sellers to recover the price than for buyers to receive specific performance of trade terms. *Compare* U.C.C. § 2-709 (2011), *with id.* § 2-716. If contracts contained only simple promises to trade, and expectation damages were merely substitutionary, then this difference would find no justification in the basic structure of contract law but would appear, rather, to reflect a special privilege for sellers (justified, perhaps, because it is cheaper to enforce promises to pay money than to do other things). In the context of a dual performance promise, by contrast, the seller's "action for the price" under § 2-709 and the buyer's "right to specific performance" under § 2-716 are not perfect analogs. *Compare* U.C.C. § 2-709, *with id.* § 2-716. Whereas sellers promise to trade or to transfer money equal to the buyer's value of trade, buyers promise to pay the money price or to transfer money equal to the seller's value of receiving the price in exchange for the goods. The money to be transferred under the second prong of the buyer's promise will—for example, where the buyer has accepted the goods—often be simply the price. Giving sellers the right to receive the price therefore does not reflect any preference for sellers or give sellers greater access than buyers to direct relief. Rather, the difference between these provisions reflects an asymmetry in the content of the parties' substantive entitlements under their dual performance contracts.

contracting parties] is optional unless the remedy is expressly agreed to be exclusive."[56]

This language raises the question whether Section 2-719(1)(b)'s requirement of an express exclusivity agreement for remedy limitations also applies to the liquidated damage clauses that Section 2-718 regulates. The answer is that it does not: liquidated damages clauses adopted under Section 2-718 are interpreted to exclude other remedies in the absence of an express statement. In taking this approach, the law adopts the interpretive regime associated with the dual performance hypothesis, at least with respect to these clauses. Moreover, the law's attraction to the dual performance hypothesis in this area makes it natural to understand the general legal treatment of the expectation remedy in terms of an implied-in-fact liquidated damages clause (fixed by the price term), along the lines that this Article suggests.

To see why, begin with the language of the statute, which recites that liquidated damages are not subject to the express exclusivity requirement that governs remedy limitations. Section 2-719(1) makes its exclusivity requirement "subject to . . . the preceding section on liquidation and limitation of damages."[57] Courts have taken this direction seriously; a prominent opinion observes that a liquidated damage clause is "not a limitation on a remedy."[58] Rather, "the concepts are separate and distinct," so that liquidated damage clauses are governed not by Section 2-719(1)(b) but rather by Section 2-718, which does not "impose the additional restraints" attached to limitations of remedy.[59] A liquidated damage clause, the court concluded, is the promisee's sole remedy against a promisor who rejects trade even when the clause is not made expressly exclusive. Indeed, the court reached this broad conclusion although, in the case at hand, the liquidated damages transfer constituted less than ten percent of the value the promisee would have realized from trade. Hence, the clause had the same practical effect as a limitation of remedy.[60] As another court observed, "a liquidated damages clause, without evidence to the contrary, is so inconsistent with any other [d]amage remedy as to require a conclusion that it contemplates exclusiveness."[61]

56. U.C.C. §2-719(1)(b) (2004).

57. *Id.* § 2-719(1).

58. N. Ill. Gas Co. v. Energy Coop., Inc., 461 N.E.2d 1049, 1056 (Ill. App. Ct. 1984). The court's view is correct. A remedy limitation attempts to allocate efficiently between sellers and buyers the duty to repair and preserve the goods. The remedy aspect requires the seller to repair or replace when she can do this most efficiently; the limitation aspect puts risks on the buyer that he can best reduce by careful use. A liquidated damages clause has a different function.

59. *Id.*

60. *Id.*

61. Ray Farmers Union Elevator Co. v. Weyrauch, 238 N.W.2d 47, 50 (N.D. 1975). The inclusion of the phrase "without evidence to the contrary" signals that the parties may, of course, create a contract that identifies a sum of money as merely substitutionary relief if they so choose. *See id.* And some courts, latching on to the specifics of contractual language in particular cases, have given particular provisions this effect. *See* Beck v.

This approach—and in particular, its insistence on the formal distinction between remedy limitations and liquidated damages clauses even in the face of the two provisions' substantially identical practical effects—would be nonsensical if contract damages provided only substitutionary relief. The comment to U.C.C. Section 2-719 observes: "Subsection (1)(b) creates a presumption that clauses prescribing remedies are cumulative rather than exclusive."[62] Accordingly, if a liquidated damages clause were understood merely to identify a substitutionary remedy for the promisor's refusal to trade, then this remedy would naturally fall under the U.C.C.'s presumption in favor of cumulation and against exclusivity. That the remedy does not fall under this presumption, but instead is held to be exclusive even if the contract does not so state, could reflect rational drafting only if the U.C.C. understands liquidated damages clauses to be different things from remedy limitations. In the Code's view, parties do not write liquidated damage clauses merely to identify substitutes for a promisor's failure to perform the contract's trade terms; rather, as the dual performance hypothesis proposes, parties intend compliance with these clauses to be an alternative means of performance. Consequently, a court that orders a transfer pursuant to a liquidated damage clause is directing specific relief of an obligation in the alternative.

This is the basic insight achieved by courts when they observe that U.C.C. Section 2-718, which governs liquidated damages provisions, takes precedence over Section 2-719's rules concerning limitations of remedies. As another court explained, it is a "valid argument generally . . . that if a liquidated damage clause [is] created under Section 2.718, it . . . logically self operate[s]" so that the other remedies generally contemplated by the law are no longer available.[63] The turn to the idea of "self-operating" is instructive; it suggests, as under the dual performance hypothesis, that the liquidated damages clause in itself identifies the content of the promisor's contractual obligation. There is no need to feed the clause through the conventional substitutionary logic of the law of remedies in order to fix its legal effect. Indeed, there are opinions that adopt the language in which the dual performance hypothesis is cast, saying that an appropriate "provision for liquidated damages limits the non-breaching party to a suit for specific performance *of the liquidated-damages provision*."[64]

Mason, 580 N.E.2d 290, 293 (Ind. Ct. App. 1991). This possibility is, of course, entirely consistent with the dual performance hypothesis, which does not make the rule that transfer can count as performance *mandatory*.

62. U.C.C. § 2-719 cmt. 2 (2004).

63. McFadden v. Fuentes, 790 S.W.2d 736, 738 (Tex. Ct. App. 1990). The edits in the quotation reflect the fact that the court's statement was counterfactual because the court found that the liquidated damages clause at issue in that case was, for independent reasons, not valid.

64. Mkt. Place P'ship v. Hollywood Hangar, LLC, No. CA 06-749, 2007 WL 1086573 (Ark. Ct. App. Apr. 11, 2007) (emphasis added). Note that it is commonplace for courts to hold that a liquidated damages clause forecloses not just claims for the money value of trade as substitutionary relief but also claims for specific performance of the promise to trade. *See* Gilman Yacht Sales, Inc. v. FMB Invs., Inc., 766 So. 2d 294, 296 (Fla. Dist. Ct. App. 2000).

The U.C.C.'s treatment of liquidated damage provisions is neither a narrow technicality nor an outlier (that is, a departure from the common law). Instead, it tracks the interpretive presumptions associated with the expectation remedy quite generally. The U.C.C. is striking merely because it recapitulates these presumptions in a somewhat surprising arena—surprising because of the contrast between the treatment of liquidated damage provisions under Section 2-718 and remedy limitations under Section 2-719(1)(b), a contrast that lays bare what would otherwise remain hidden.

These observations naturally carry over to contracts without express liquidated damages provisions, supporting this Article's view that the expectation remedy is not a form of substitutionary relief provided by the law but is adopted by the parties as a liquidated damage clause, whose textual expression appears through the price term and that term's implications for surplus sharing.[65] The law's preference for the expectation remedy over specific performance, conventionally understood, is now revealed to be a direct analog to the U.C.C.'s treatment of more ordinary liquidated damages clauses: just as the U.C.C. treats conventional liquidated damages clauses as presumptively exclusive, so the common law treats the expectation remedy as presumptively exclusive, that is, as precluding specific performance of trade terms. And just as with respect to the U.C.C.'s rules, the common law's approach would be inexplicable if the expectation remedy merely gave promisees access to a form of substitutionary relief. The same intuition that underlies U.C.C. Section 2-719(2)—that contract remedies should be cumulative—would apply to the common law also, to reject the interpretive presumption that the expectation remedy is a promisee's exclusive recourse when a promisor refuses to transfer. Just as with respect to U.C.C. Section 2-718, the common-law rule that makes expectation the preferred remedy for breach of contract thus implies that contracts should be interpreted, pursuing the logic of our model, to make transfer of a sum equal to the promisee's expectation an alternative form of performance.

Courts implicitly acknowledge this understanding of the expectation remedy even in the unusual cases when they interpret contracts so that specific performance requires, exclusively, trade. As an example, although agreements to sell land are specifically enforceable, courts have adopted a flexible approach to the question how a promisor may comply with a land contract.[66]

65. A liquidated damages clause states a number. The expectation-interest remedy is a formula for creating a number (that is, value less price). Parties have an incentive to use the number when the formula cannot be applied because the buyer's value is unverifiable. The parties' goal does not change with the choice between a number and a formula, however. In both cases, the parties usually prefer to permit the promisor to choose between trade and transfer.

66. *See* E. ALLAN FARNSWORTH, 2 FARNSWORTH ON CONTRACTS § 12.6 (1990); RESTATEMENT (SECOND) OF CONTRACTS § 360 cmt. e (1981) ("A specific tract of land has long been regarded as unique and impossible of duplication by the use of any amount of money.").

Courts apply Pomeroy's principle—that parties may agree to treat an appropriate transfer as an alternative performance—to strikingly thin contract text and with strikingly little interpretive investigation. One court found it sufficient to observe: "The contract before us provides that in the event the vendor fails to convey the real estate described in accordance with its terms, he shall return the down payment of $500 together with an additional $500 as liquidated damages," explaining that "[i]n our opinion this provision definitely characterizes the contract as one which contemplates the payment of the stipulated damages as an alternative to specific performance."[67] Although the contract might have been read to shore up the disappointed buyer's common-law right to a supracompensatory remedy, the court did not inquire into the parties' actual intent to depart from the common-law default. Instead, the court inferred from the presence of a liquidated damages clause that the parties intended a monetary transfer to count as performance.[68]

The specific performance rule is less firmly entrenched still when sellers sue for the expectation while their buyers assert that forfeiting a deposit is an alternative performance of the obligation in the contract. In this context, some courts interpret ordinary liquidated damages clauses along the lines Pomeroy identifies, as establishing that the sacrifice of earnest money is compliance with the contract. Indeed, some courts have adopted this approach without tying it to peculiarities in the text or party-understandings of the contracts at issue. For these courts, a clause saying that a seller may retain a buyer's deposit if the sale is not consummated renders the payment of the deposit an alternative performance.[69] This comes close to abandoning the traditional rule for real estate contracts that a buyer complies only by paying the full price.

Moreover, the dual performance hypothesis explains not just the doctrinal preference for the expectation remedy, but also the cases in which this preference is *abandoned*. The law rejects the expectation remedy in favor of specific performance (as conventionally understood) when it rejects the

67. Duckwall v. Rees, 86 N.E.2d 460, 462-63 (Ind. App. 1949) (en banc).

68. *Id.* at 463.

69. For chattels, restricting the seller to the down payment is the second-best efficient contract. *See generally* Alan Schwartz, *Price Discrimination with Contract Terms: The Lost-Volume Problem*, 12 AM. L. & ECON. REV. 394 (2010). Courts have decided many cases regarding real estate transactions. *See* Suchan v. Rutherford, 410 P.2d 434, 438 (Idaho 1966); Centex Homes Corp. v. Boag, 320 A.2d 194, 198 (N.J. Super. Ct. Ch. Div. 1974) (denying specific performance of condominium sale contract because condominium not unique and could be resold). The clearest statement of this approach comes out of Louisiana, where a court held, "The giving of earnest money [in connection with a contract to purchase real estate] is related to a stipulation for liquidated damages which bars specific performance by either party should the intended contract of sale not be consummated." Sunbelt One v. Melian, 509 So. 2d 705, 707 (La. Ct. App. 1987). The court added, "[t]here is a judicial presumption that any deposit made pursuant to a contract to sell is earnest money unless the contracting parties have expressly stipulated to the contrary." *Id.* So in Louisiana, at least, the dual performance hypothesis provides a sticky default rule of interpretation for *any* real estate contract in which a buyer pays a deposit. Louisiana, of course, is an outlier among American jurisdictions because of the civilian influence on the state's law.

interpretive presumption that a transfer equal to a promisee's value of trade counts as an alternative performance. To illustrate, let a contract be interpreted to require the seller to perform the trade terms unless performance is physically impossible. When the seller fails to perform those terms, a court will not order the seller to pay damages as a substitute. Rather, the court will order the seller to trade. Thus, when transfer would involve breach, and "expectation damages" do not directly vindicate an alternative promise to transfer but are instead unavoidably substitutionary, such expectation damages are not awarded.

A typical case is *Gassner v. Lockett*.[70] The defendant seller in *Gassner* conveyed a parcel of real property to the plaintiff (who did not record the sale) and later reconveyed the same parcel to a second buyer (who did record) for a higher price. The initial buyer sued for specific performance, which was unavailable in light of the second buyer's good title to the land.

The *Gassner* court believed that the parties intended to create a property right contract. It thus refused to limit the plaintiff's recovery to "expectation damages": substitutionary relief based on the plaintiff's valuation of the land. When a seller under a property right contract cannot trade, she becomes a constructive trustee of any proceeds that the subject of sale produced. The *Gassner* seller could not satisfy this obligation by tendering *less* than those proceeds. The court thus awarded the initial buyer damages that included any profit the seller realized from resale. Structurally, this was a direct rather than a substitutionary remedy (the damages were the proceeds from the first buyer's beneficial ownership of the trust, and the core remedy was granting the first buyer such beneficial ownership). In this Article's terms, the *Gassner* plaintiff prevailed because his claim was for specific performance of a contract that did not permit transfer in place of trade.

Gassner thus illustrates that when the law rejects the default transfer term associated with the expectation remedy in favor of an interpretation that makes trade the only form of performance (or, equivalently, sets the transfer term at ∞), then the law abandons expectation damages, which now could *only* be substitutionary relief, and awards whatever direct relief is possible. The law requires literal trade where it can, as when it orders specific performance of real estate contracts (which do not provide for forfeiture of a deposit as an alternative performance). And where literal trade is impossible, as in *Gassner*, the law requires a seller to pay money damages that function as the structural analog to trade, treating conduct by the breaching promisor with respect to the contract's trade terms as undertaken on the promisee's behalf.[71]

This Article's earlier claims that voluntary transfer does not involve breach

70. 101 So. 2d 33 (Fla. 1958). *See generally* Markovits, *supra* note 11.

71. Although this approach is required by the logical structure of the doctrine, it is not always followed. *See generally* Bander v. Grossman, 611 N.Y.S.2d 985 (Sup. Ct. 1994).

and that expectation damages are best understood as the specific enforcement of a contract's transfer term therefore receives further support from the courts' practice—when voluntary transfer is not permitted and expectation damages cannot be so understood—to reject these damages in favor of requiring a promisor to trade. The positive argument that the doctrinal preference for the expectation remedy is best understood in terms of the dual performance hypothesis is thus backed up by a negative argument that the cases in which the doctrine abandons this preference in favor of specific performance (traditionally understood) are also best understood in terms of that hypothesis.

This Article's account of contract remedies is now complete. To be sure, decision makers and commentators sometimes *characterize* the expectation remedy as providing substitutionary relief (damages) for breach of a contractual obligation to trade. But both what courts *do* in administering the expectation remedy and *the rules under which they do these things* are best explained (indeed, understood at all) only if this remedy is seen to provide direct relief for breach of the transfer prong of a promise in the alternative.

The standard approach to the expectation remedy and the approach of this Article come apart when promisors volunteer transfers that would count as performance on the dual performance hypothesis while promisees seek more valuable remedies. The law, in such cases, uniformly adopts the conceptual structure associated with the dual performance hypothesis; it allows the parties to treat transfer as an alternative form of performance, as that hypothesis recommends. Moreover, the law commonly adopts the interpretive presumption associated with the dual performance hypothesis: the rule that a liquidated damage clause is the promisee's exclusive remedy (even though not expressly made exclusive) is understandable only if the clause establishes the transfer it specifies as an alternative form of performance; and the law's underlying preference for the expectation remedy over specific performance makes doctrinal sense only if this remedy is understood through the model of liquidated damages. Finally, the cases in which the law rejects the expectation remedy also lend doctrinal support to the dual performance hypothesis. The expectation remedy is not awarded, in these cases, because transfer is not understood as an alternative form of performance, and the rejection of this Article's interpretive presumption in these cases only confirms its conceptual claim.

In a sense, this is a natural conclusion. In defending the expectation remedy, this Article is defending the law as it stands; it is critics of the expectation remedy who are revisionists. And so this Article's doctrinal reflections merely show that the theoretical argument marshaled in support of the expectation remedy—the dual performance hypothesis—supports not only the *outcome* that the expectation remedy should be the standard response to breach of contract but also the *doctrinal edifice* through which this outcome is achieved. This Article's doctrinal arguments remain important, however, even when viewed in

this modest light. The criticisms of the expectation remedy that the dual performance hypothesis answers propose that the bottom line preference for the expectation remedy over specific performance is inconsistent with the rest of the doctrinal structure of contract law. Accordingly, rendering the two consistent takes much of the wind out of the critics' sails.

IV. CONCLUSION

The relation between prescription and description in legal argument is complex, and the interaction between normative and positive accounts of the law can be maddening. Lon Fuller once observed, "There is indeed no frustration greater than to be confronted by a theory which purports merely to describe, when it not only plainly prescribes, but owes its special prescriptive powers precisely to the fact that it disclaims prescriptive intentions."[72] The frustration Fuller described owes much to the conservative character of law, that finding an ideal immanent in the law for many lawyers presents, in itself, a reason to admire that ideal.

This Article acknowledges that lawyerly instinct but does not limit itself to conservative reconstruction of existing doctrine. Rather, this Article follows the example set by Fried's *Contract as Promise* and seeks to marry reconstructions of existing doctrine with arguments based on first principles. The Article thus seeks to characterize the positive law of contract remedies as elaborating the conception of contractual promises—associated with the dual performance hypothesis—that appears best when assessed in terms of moral and economic principles that stand outside the law.

72. Lon L. Fuller, *Positivism and Fidelity to Law—A Reply to Professor Hart*, 71 HARV. L. REV. 630, 632 (1958).