

ESSAY

THE EXPECTATION REMEDY REVISITED

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INTRODUCTION

WE recently published an article in the *Virginia Law Review* that analyzed the standard contract remedies for breach and asked how those remedies relate to the theory of efficient breach.¹ The *Review* commissioned two responses to our article, and it generously offered to let us reply to those responses.² We are grateful to the two responders for taking our work as seriously as they did and for helping us to clarify our claims. Those claims, however, continue to hold.

Before discussing the responses, it is helpful to rehearse what we argued previously. Our formal analysis assumed:³

A1: Contracting parties are sophisticated and rational.

A2: Parties make the contractual choices that maximize their expected profits.

A3: The applicable legal system permits parties to contract for any remedy in the feasible set—expectation damages, specific performance, or disgorgement.

A4: Parties can verify all relevant economic variables to the court.

These four assumptions, we showed, implied that each of the possible remedies has the same efficiency and distributional prop-

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¹ Daniel Markovits & Alan Schwartz, *The Myth of Efficient Breach: New Defenses of the Expectation Interest*, 97 Va. L. Rev. 1939 (2011).

² Gregory Klass, *To Perform or Pay Damages*, 98 Va. L. Rev. 143 (2012); Seana Valentine Shiffrin, *Must I Mean What You Think I Should Have Said?*, 98 Va. L. Rev. 159 (2012).

³ The following list is a condensed version of our assumptions; for the full set, see Markovits & Schwartz, *supra* note 1, at 1955–56. We use the same assumptions generally made in academic literature about the expectation interest.

erties, gross of contracting and renegotiation costs. In particular, parties trade only when trade is efficient under all of the remedies and the parties' payoffs (in money), again gross of contracting and renegotiation costs, are the same under all of them. When those costs are taken into account, the parties' net payoffs under the expectation remedy (again in money) exceed the net payoffs that the other remedies yield. When *A4* fails to hold, however, specific performance yields the highest payoff.

Turning to contracting choices, *A3* permits parties in the model to choose the remedy that will apply to their transaction, and under *A1* parties are competent to make remedy choices that are in their best interests. When *A4* holds, a contract that delegates to the promisor the choice whether to perform the contract's substantive terms—the “action terms”—or to transfer to the promisee a sum that equals his expectation maximizes the parties' payoffs. *A2* then implies that the “model parties” would make this contract.

The formal analysis raises the question what contract regarding remedies actual parties would make, were they free to choose. All four assumptions are “domain assumptions”: that is, the conclusions they imply hold only in the domain they accurately describe. Hence, real parties would make the contract that “model parties” make only if, and to the extent that, real parties resemble the model parties and the other model assumptions hold.⁴ We claim that the set of real parties that resemble model parties is not trivial. *A4* sometimes obtains as well. Therefore, if the state permitted free contracting regarding remedies, the current damage rules would constitute a good default. Those rules permit the promisor either to perform the action terms or to pay the promisee's expectation; the typical promisee would not vary those rules if he could.⁵

⁴ When *A1* and *A2* accurately describe real parties, the real parties resemble model parties.

⁵ It may be helpful to explain more fully the method that yields our conclusions. A recent essay by four leading economic theorists sets this method out clearly:

[T]he analysis of a theoretical model can be viewed as the ‘observation’ of a new case. . . . [Consider] the claim ‘I have observed a case in which idealized agents, maximizing expected utility, with the following utility functions and the following information structure, behaved in such and such a way.’ The relevance of this observation for prediction will depend on the perceived similarity between the idealized agents and the real agents one is concerned with, the similarity between the situation of the former and that of the latter, and so forth. An economist who is interested in real agents would therefore have to

Our article then argued that the recent moral objections to the expectation remedy dissolve, at least as those objections apply to the parties that our model accurately characterizes.⁶ In particular, many real parties would *choose* contracts that contained the expectation remedy were the law to provide other remedies.⁷ It is the promisee's actual consent that insulates the expectation remedy from the concerns of its critics.

SHIFFRIN

Seana Shiffrin's response makes two methodological claims and two substantive claims.⁸ Beginning with methodology, Shiffrin rejects our moral arguments because, in her view, actual parties do not have the preferences we attribute to them (the "preference objection"). In particular, parties prefer the promisor to deliver the contract goods or perform the contract services—to perform "full stop"—rather than give the promisor the choice whether to perform or to pay. Further, she argues, we draw an impermissible inference from the contracts actual parties make to the contracts those parties would make if they were free to choose (the "infer-

judge to what extent the situation she studies resembles the idealized situation in the 'case' Judging the similarity of the model to the problem, one should ask, how similar are the agents in the model to the agents in reality? Are the people in the real problem expected utility maximizers like the players in the model? . . . [N]o general claim is made about economic agents. Rather, the economic theorist suggests certain theoretical cases in which agents who maximize a utility function behave in certain ways. These theoretical cases are to be judged according to their similarity to real prediction problems.

Itzhak Gilboa et al., *Economic Models as Analogies* 7, 8, 12, 14 (Penn Inst. for Econ. Research, PIER Working Paper 12-001, Dec. 27, 2011). Our claim is that many "agents in reality" are similar to "the agents in [our] model." The real agents are "expected utility maximizers like the players in the model" and function as such in similar situations.

⁶ See Markovits & Schwartz, *supra* note 1, at 1977–79.

⁷ See *id.* at 2005.

⁸ Shiffrin also argues that the dual performance hypothesis is incompatible with various more particular doctrines concerning contract remedies. See Shiffrin, *supra* note 2, at 168–70. We believe, to the contrary, that the dual performance hypothesis provides the best interpretation of the doctrinal edifice through which the law administers the expectation remedy. We support this view in an essay in honor of the thirtieth anniversary of the publication of Charles Fried's *Contract as Promise*, and so we do not repeat that argument here. See Daniel Markovits & Alan Schwartz, *The Expectation Remedy and the Promissory Basis of Contract*, 45 *Suffolk U. L. Rev.* 799, 824–25 (2012).

ence objection”). In particular, she contends that actual parties’ acceptance of the expectation remedy does not support the inference that parties in fact prefer the choices that this remedy permits the promisor to exercise. Regarding substance, Shiffrin argues that the mitigation rules, which support the expectation remedy, are unfair because the rules authorize the promisor to draft the promisee into her service (the “cover objection”). The rules, that is, require the promisee to purchase a substitute performance in order to reduce the promisor’s damages. Shiffrin adds, as a related but distinct argument, that while promisees prefer to “transfer, rather than hoard, discretionary power,”⁹ a dual performance promisor hoards that discretion. She thus indicts dual performance contracts for being “shabby and second-rate” (the “shabbiness objection”). We discuss these four objections in turn.

The Preference Objection. This objection reflects Shiffrin’s failure to appreciate how domain assumptions function. She concedes that our model, “if successful,”¹⁰ shows that parties would prefer the expectation remedy “if all they cared about were their individual financial interests.”¹¹ She also argues that actual parties “may reasonably” prefer specific performance to damages if they do “not conform to the highly narrow assumptions that they behave solely as rational profit maximizers and that they perform those roles well.”¹² And she apparently agrees that the liability rule contract, which is enforced with expectation damages, is an agreement that parties “*would have made* were they well-performing rational maximizers.”¹³ Shiffrin thus does not dispute the results of our formal analysis: that model parties would choose the expectation remedy, if given a choice, in the circumstances we postulate.

As the Introduction above shows, we model parties who do care only about their individual financial interests, at least partly because financial resources permit the parties to pursue their other concerns. These parties, we also assume, are competent to implement their financial preferences. As a consequence, Shiffrin’s preference objection would have bite only if very few actual parties re-

⁹ Shiffrin, *supra* note 2, at 176.

¹⁰ *Id.* at 167. Her response does not attempt to show that our model fails.

¹¹ *Id.*

¹² *Id.* at 170–71.

¹³ *Id.* at 174.

semble the model parties. Shiffrin does not make this seemingly implausible claim. Business firms, for example, commonly attempt to maximize expected profits, and it is widely assumed that many of them are capable of doing so. Consumers also maximize expected monetary returns to the extent that they use contract as a means for obtaining goods that may be otherwise acquired for money on the market, should the initial promisor fail to provide them. (It is a separate question how many consumers are competent to implement their commercial preferences.) However, we make no claim regarding the contracting preferences of parties like those made prominent in Shiffrin's analysis, who value trade intrinsically, and thus prefer the specific performance remedy.¹⁴ Shiffrin's preference objection is therefore not so much mistaken as it is overbroad.¹⁵

The Inference Objection. Shiffrin argues extensively that we cannot infer from the contracts actual parties make that parties, in a freedom-of-contract world, would choose the contracts that mirrored those actual contracts. That inference is false, she believes, because actual parties do not have freedom of contract. She thus remarks: "Remedies are not choices that individual contractors make prior to breach. A remedy has a social meaning. . . . That meaning would be undermined by its being . . . chosen by the very parties whose conduct is the object of the social reaction. . . . [R]emedies are not strictly speaking *our choices*."¹⁶ This reasoning leads her to ask, "why then think that the parties . . . incorporated [into their contract] the effect of the socially imposed remedy they should prefer . . . even though they do not, in fact, have the power to elect that remedy?"¹⁷ Again, "it seems difficult to impute actual (objective) intent where the parties have no clear mechanism to indicate an alternative intent and where they may just be reacting to an unchosen and un rebuttable feature of the legal environment."¹⁸

¹⁴ See, e.g., *id.* at 165, 176.

¹⁵ Shiffrin offers no evidence of how widespread the consumer preferences that she emphasizes are. Although we also offer no direct evidence on this point, we note that markets allow consumers to make an adequate expectation-based transfer that is functionally equivalent to trade.

¹⁶ Shiffrin, *supra* note 2, at 167–68.

¹⁷ *Id.* at 168.

¹⁸ *Id.* at 175.

The inference objection is misplaced because we do not reason from the contracting choices actual parties make to the choices parties would make in an unconstrained world. Rather, we model parties who are assumed to possess certain traits and to function in a specified institutional environment (one that includes remedies that we agree are socially imposed). We then exhibit the contracting choices these model parties make. Our results apply to that part of the actual world that resembles the model world. As indicated above, our claim, not addressed by Shiffrin, is that a substantial segment of the actual world, in particular its commercial part, resembles the model world. Hence, many real parties, in a freedom-of-contract environment, would choose liability rule contracts that protect the promisee's expectation, rather than property rule contracts.¹⁹

Shiffrin confusingly also makes an inference claim of her own. She argues that when the contract only says *p*—that is, it only describes what the promisor is to do—we mistakenly conclude that the parties have agreed to a disjunctive obligation: that the promisor is permitted to do either *p* or *q*—to pay. Rather, Shiffrin claims, the best inference from the parties' failure also to specify *q* is that the parties prefer *p*, full stop. In other words, parties that only write *p* prefer to obligate the promisor to deliver the goods or services if delivery is possible. For this reason, Shiffrin argues, the remedy term is not a default; defaults fill gaps in contracts. When the parties specify *p*, they intend the promisor to deliver *p*. She contends that “[i]n this case, the parties have specified a term, *p*; there is no need to gap-fill.”²⁰

¹⁹ Using a technical term, Shiffrin assumes that we are attempting to apply “revealed preference” theory. This theory holds that the analyst can predict the choice an agent will make in situation *B* if the analyst has already observed the choice the agent made in the relevantly similar situation *A*, and if the agent's choice behavior is stable over time and consistent. See Ken Binmore, *Rational Decisions* 7–12 (2011). We do not use revealed preference theory because the real world—situation *A*—is not relevantly similar to a world in which free contracting would obtain—situation *B*. Agents are constrained in today's world. Our method is instead subject to an external validity objection: that a real freedom-of-contract world would bear little resemblance to our model world. As argued above, this objection is without merit.

²⁰ Shiffrin, *supra* note 2, at 170. The inference she prefers is based on the possibility of specifying both options in the first place: “We could have said ‘*p* or *q*’ but we did not. That, perhaps, we should have said ‘*p* or *q*’ does not mean that we did say it, es-

There are two answers to this claim. First, Shiffrin also argues that parties are not free to specify remedies. Hence, parties could not agree to a disjunctive obligation.²¹ Nothing, then, can be inferred from their failure to do so. There is another way to put this point. Shiffrin argues that current restrictions on contracting for remedies prevent us from inferring a party preference for the expectation because actual parties do not contract in the alternative, but she draws an inference—parties prefer performance, full stop—because actual parties do not contract in the alternative. The analyst can have one of these arguments, but not both. The second answer to Shiffrin’s inference claim is that we do not infer party preferences from what actual parties do.²²

The Cover Objection. Shiffrin repeats an argument that she has made elsewhere,²³ that the dual performance hypothesis is objectionable because it permits a seller to impose a cover obligation on the buyer against the buyer’s will. According to Shiffrin, “the efficient breach argument permits the seller to . . . unilaterally shift to the promisee the task of securing a substitute performance.”²⁴ But, she asks, “[i]f the buyer cannot compel the seller to transfer when the seller chooses not to, . . . why should we allow the seller to com-

pecially because it would be relatively simple to designate alternative performances.” Id. at 169 (citation omitted).

²¹ For example, she mentions that contracting parties “could not have specified that failure to *p* . . . should yield a specific performance remedy.” Id. Parties today are formally free to specify in the contract that the promisor is to perform the action terms or pay the promisee’s expectation. There are two reasons why parties do not do this. First, the specification is unnecessary: the law today requires a promisor to pay if she does not perform the action terms. Second, the specification would be ineffective. A court would not be bound by it in an actual case if the court otherwise believed that specific performance was the appropriate remedy. Parties cannot contract out of specific performance just as they cannot contract into it.

²² Shiffrin asks: “why not think the better interpretative strategy is to look at what people actually said . . . rather than at what the model suggests they should have said.” Id. at 171–72. Our model does not “suggest” what actual people “should have said.” Rather, we show what contracts the agents in the model choose. We also do not use an interpretive “strategy.” Rather, we reason that real parties would choose as the model parties do to the extent that real parties resemble the model parties. See *supra* note 5.

²³ See Seana Shiffrin, *Could Breach of Contract Be Immoral?*, 107 Mich. L. Rev. 1551, 1564–66 (2009).

²⁴ Shiffrin, *supra* note 2, at 164.

pel the *buyer* to cover or suffer the losses associated with failure to do so?”²⁵

To see why this objection is mistaken, begin by observing the basic structure of cover. The law authorizes the cover remedy but does not require it. On the one hand, a buyer who does not cover can sue for market damages. On the other hand, the buyer cannot recover consequential damages—his actual expectation—if he could have covered but did not.²⁶ The cover remedy is feasible when parties contract for roughly homogeneous goods. If the seller fails to tender, the buyer may cover by making a purchase that substitutes for the seller’s performance. A buyer could do this only if other sellers offered goods that would fulfill the contract seller’s obligation. Buyers, that is, cover by reentering the market. As a consequence, a seller who eschews performance can always “cover” as well. She could purchase goods in the same market in which the buyer covered and perform by tendering those goods.

Parties *ex post* thus have a choice: to require the seller to cover or to require the buyer to cover. Ever since Llewellyn wrote, it has been plausibly believed that, in the usual case, it is less costly for buyers to repurchase than for sellers to become buyers and then, after purchase, to become sellers again.²⁷ Therefore, the incentives for buyers to cover that contract law creates reflect the task allocation that the buyers prefer. Expected cover costs are reflected in prices, and the cover remedy yields the buyer a lower price. The seller therefore does not draft the buyer into covering; instead, the buyer has volunteered.

This cover analysis implicitly incorporates the four domain assumptions set out above. Hence, our claim is that the real parties who resemble model parties would impose a cover obligation if the law did not create one. Many real parties bear this resemblance, including most commercial firms and those capable consumers who seek a contractual performance that they can readily acquire on

²⁵ *Id.*

²⁶ See U.C.C. §§ 2-711 to 2-715 (2001).

²⁷ See Alan Schwartz, Karl Llewellyn and the Origins of Contract Theory, in *The Jurisprudential Foundations of Corporate and Commercial Law* 12, 28 (Jody S. Kraus & Steven D. Walt eds., 2000). For a modern analysis of cover and the related market damages remedy, see Alan Schwartz & Robert E. Scott, *Market Damages, Efficient Contracting, and the Economic Waste Fallacy*, 108 *Colum. L. Rev.* 1610, 1613–17 (2008).

the market from third parties. And this leads to our conclusion: Shiffrin's response mistakes the methodology that supports the conclusions we reach. Consequently, her response seldom engages with our actual claims. To be clear, we take no position regarding Shiffrin's analyses of the contracting preferences of those who regard the particular performance for which they have contracted as irreplaceable. Our analysis applies elsewhere.²⁸

The Shabbiness Objection. Shiffrin adds to the cover objection that "promisors are responsible for respecting the boundaries of the right to decide otherwise (to choose something other than to perform the activity they have contracted to do) that they have transferred to the promisee."²⁹ This is the root of the shabbiness objection; dual performance promises are shabby, for Shiffrin, because the reservation of the right to transfer (while profiting from the diversion of trade) disrespects the promissory reallocation of the "right to decide otherwise" to the promisee.

There is a purely formal sense in which this objection *cannot* be well taken. As we have repeatedly said, a dual performance promise commits a promisor to performance just as surely as a promise of the form that Shiffrin prefers; it just changes what counts as performance. And a dual performance promisor therefore allocates the right to decide otherwise—that is, to decline both trade and transfer—to her promisee in just the manner that Shiffrin champions. We recognize, however, that this formal explanation, without more, might seem facile to those not already persuaded by our view. Surely, they will say, the purpose of the contractual promise was to facilitate trade, and by implying an option to transfer, the dual performance hypothesis merely builds the shabbiness Shiffrin asserts into contractual promises. Answering those who possess this sensibility requires a substantive argument.

²⁸ Shiffrin states: "It is unclear why all of contract law interpretation and damages should be structured around their specialized understanding." Shiffrin, *supra* note 2, at 172. We do not make this claim in our article. One of us has argued elsewhere that the optimal number of contract laws exceeds one: "Commercial law for centuries has drawn a distinction between mercantile contracts and others. Modern scholars have not systematically pursued the normative implications of this ancient distinction, however. We attempt to cure this neglect by setting out the theoretical foundations of a law merchant for our time." Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 *Yale L.J.* 541, 550 (2003) (citation omitted).

²⁹ Shiffrin, *supra* note 2, at 165 n.2.

The substantive argument shows that dual performance promises are not shabby at all. To appreciate the argument, imagine the attitudes and interactions that promisors and promisees would have when a property rights promisor of the sort Shiffrin celebrates is confronted by an opportunity to increase surplus *ex post* by diverting trade. A promisee who maximizes expected monetary returns prefers to receive his expectation plus a share of the surplus that diversion creates rather than to receive the contracted-for trade. The promisee is restricted to a share because if he asks for too much the promisor can deprive the promisee of any surplus by trading. Accordingly, the property rights contract induces an *ex post* renegotiation, in which the promisee releases the promisor from her trade obligation in exchange for a share of the gains that the release engenders.

Our discussions of this renegotiation have emphasized the transaction costs that it will involve. Turning to the deal itself, a profit-maximizing promisor, we show, will realize a share of the surplus that not trading creates by threatening to trade and thus eliminating that surplus altogether. Hence, if Shiffrin attributes a profit-maximizing motive to promisors, then her reconstruction of the contract relation involves no greater respect for promisee prerogatives than ours and is therefore no less shabby (although it is, for the reasons that we have explained, less efficient). Shiffrin can escape this conclusion only by supposing that promisors are other regarding. Attributing an other-regarding motive to promisors, however, is tantamount to requiring the promisor to administer the contract broadly, even in respect of new opportunities that arise over the course of its life, in the interests of her promisee, which is to say to behave as some form of fiduciary for her promisee. To require this behavior would undermine the moral point of contract, which is to establish a form of respectful coordination and joint action among parties who are not intrinsically motivated to promote each other's interests and who wish to remain, in spite of acting together, at arm's length. This is not a shabbier relation than fiduciary sharing, only a different one. We believe, for the reasons stated

in our earlier article, that this different type of relation is one appropriately fostered in the domain to which our argument applies.³⁰

KLASS

Gregory Klass uses our article to make several interesting suggestions about the functions that contract remedies serve. For example, he suggests that they may serve an expressive function or reflect the law's commitment to corrective justice. These suggestions, for the most part, are beyond the scope of our article, and we will not address them here. Klass does, however, raise several points that, in his view, our article does not satisfactorily address. We show here that it does.

Initially, Klass also doubts that parties have the preferences we attribute to them. He remarks:

If Markovits and Schwartz's moral argument is to succeed, the dual-performance hypothesis must be an empirical interpretive claim. . . . [S]ophisticated parties must in fact understand their contracts to commit them not to perform the action term *simpliciter*, but to perform the action or the transfer term. . . . Markovits and Schwartz do not explain why parties choose to express their contracts using language that does not correspond to their understanding of the commitment.³¹

As an example of his response, he writes that “[s]ophisticated parties know how to write take-or-pay or alternative-performance contracts when they want them, and in many industries they commonly do so.”³²

There are three difficulties with this objection. First, as Shiffrin shows, parties are not free to write alternative-performance contracts. Klass actually agrees. He remarks that “[t]he law . . . does

³⁰ Shiffrin expressly “contest[s] [the] interpretation of [her] view” according to which her conception of the promise relation is “tantamount to claiming the promisor is in a sharing relationship with the promisee or that the promisors become the general partner, agent or the fiduciary of the promisee” or even just tantamount to “claiming that the promisor should subordinate other interests of his in preference to the promisee’s.” *Id.* at 166 n.21. Notwithstanding these protestations, Shiffrin’s claim that her approach to contract remedies differs from ours necessarily implies that the law should require promisors to behave as fiduciaries toward their promisees.

³¹ Klass, *supra* note 2, at 145, 147.

³² *Id.* at 147.

not, however, permit [parties] to contract for remedies that run contrary to the social purpose of enforcing their agreements. The duty to perform is chosen; the duty to pay damages is not."³³ Thus, nothing can be inferred about the preferences of sophisticated parties from their failure to write alternative-performance contracts. Second, in our formal model, sellers/promisors breach. A take-or-pay clause governs the buyer breach case. More seriously, the take-or-pay clause is understood to substitute for market damages, an expectation remedy, when market prices are difficult to establish.³⁴ The contract specifies a minimum obligation, not the amount the parties expect to trade, and requires the buyer to pay the price on any units, less than the minimum, that the buyer does not take. The price, times those units (in the usual case), approximates what market damages would have been if the contract had required the buyer to take the (larger) expected trading quantity and the buyer only accepted the lesser amount. Take-or-pay clauses are attractive when it is less costly to prove the contract price than to prove the price in a relevant market. Parties who choose take-or-pay clauses thus expressly, though indirectly, contract for expectation damages. The third difficulty with Klass's objection is that our empirical claim, as said, rests on the resemblance of actual parties to model parties, not on the choices any actual parties make or could have made.

Klass also argues that we have not fully answered two questions: (1) why should courts grant specific performance of the transfer term rather than the action term (that is, require the promisor to pay, not perform)?;³⁵ and (2) why do we reject an implication of our analysis, that the appropriate remedy for breach is punitive damages?³⁶ Regarding question (1), a specific performance contract, were it enforceable, would have courts enforce the action term. We show that parties prefer liability rule contracts, under which courts

³³ *Id.* at 157–58.

³⁴ See Scott E. Masten & Keith J. Crocker, *Efficient Adaption in Long-Term Contracts: Take-or-Pay Provisions for Natural Gas*, 75 *Am. Econ. Rev.* 1083, 1084 (1985); Scott E. Masten, *Minimum Bill Contracts: Theory and Policy*, 37 *J. Indus. Econ.* 85, 86 (1988).

³⁵ Klass, *supra* note 2, at 148.

³⁶ *Id.* at 149–51.

enforce the transfer term. Courts that routinely enforce the action term would thus frustrate the parties' preferences.

A court could award punitive damages for two seller omissions: not to perform the action terms, and not to perform the transfer term. We show that every property rule contract—specific performance, disgorgement, and punitive damages—has the same efficiency and distributional properties. We also show that, when the assumptions we make hold, parties would make the liability rule contract rather than any of the property rule contracts. Punitive damages, then, should not be awarded for a promisor's failure to perform the action terms because, under the liability rule contract, that failure is not a breach. In contrast, the seller's failure to perform the transfer term is a breach. We do not address the case for punitive damages here, rather than specific performance, because U.S. contract law has decisively rejected the punitive damages remedy. Nothing in our analysis contests the case for reversing that decision.

Finally, Klass suggests that there are better justifications for contract law's moral properties than the justification we give.³⁷ This suggestion may prove correct when fully developed, but it is not germane to our project. We show that current moral objections to the expectation remedy dissolve once it is realized that parties commonly would contract for that same remedy were they free to do so. That there may be deeper justifications for the remedy, and for the law of which the remedy is a part, may be true, but it is a possibility we did not address.

CONCLUSION

The Shiffrin and Klass responses do not defeat our argument and in fact do not even engage it. This failure to engage the argument is the consequence of two methodological mistakes. First, Shiffrin and Klass believe that an economic model develops a covering law that explains the phenomena under its purview. A claim that one has developed a covering law can be refuted by exhibiting counterexamples. These authors thus informally argue that some

³⁷ *Id.* at 152.

contracting parties do not behave as we suppose.³⁸ Shiffrin and Klass are mistaken because economic models do not attempt to develop covering laws. Rather, a model is a theoretical case. The model's "solution" shows how the assumed parties behave in the case world. The model thus is predictive in a particular sense: to the extent that actual cases resemble the theoretical case, and actual agents possess the competence and have the preferences that the theoretical agents have, then actual agents should behave as the theoretical agents behave.

An economic model is unhelpful when only a trivial slice of reality plausibly resembles the theoretical case: the concern is not with counterexamples but with external validity. Our article claimed, to the contrary, that a large slice of reality plausibly resembles the world of our model. Many commercial parties—firms and sophisticated persons—seek to maximize expected returns and possess the capacity to do so. It is these agents who act like the agents in our model: real commercial parties, that is, would prefer the expectation remedy to other remedies in the circumstances we suppose. And real societies have reason to embrace markets in which agents have these preferences. Shiffrin and Klass could have met our arguments by showing that few actual commercial agents possess the ability and the objectives with which we endow our theoretical agents. Or they might have argued against the values immanent in our model of market exchange. Neither scholar attempts to make either claim, and we believe it unlikely that either claim could be persuasively maintained.

Shiffrin and Klass also misuse the law of revealed preference. This law holds that the analyst can predict how an agent will behave in situation *A* if the agent has stable and consistent preferences and behaves in a particular way in relevantly similar situation *B*. As applied to our claims, situation *B* is the current legal world in which free contracting about remedies does not exist, and situation *A* is a world in which contracting about remedies is unconstrained. Shiffrin and Klass observe that agents in situation *B* do not explicitly write the contracts we say they prefer; and they conclude from this observation that parties would not write those contracts were

³⁸ In science, a covering law is inducted from data and then tested on other data. The law is falsified if it cannot explain the new data.

they free to do so. This is a mistake because the situations are not relevantly similar. Agents are constrained in situation *B*—the real world—but are not constrained in situation *A*—a free contracting world. The analyst cannot predict how people who are in chains will behave when set free. To make that prediction requires a theoretical analysis of cases where those individuals have freedom. No such theory is investigated in either response.

These two mistakes stem from an even more fundamental problem. The claims that we advance are rooted in the methodology we use. That methodology has flaws, to be sure, as every methodology does. Shiffrin, Klass, and other critics may prefer to analyze the problems we address with other methods, and those methods may be productive. But to appreciate *our* argument—its weaknesses as well as its strengths—requires a sympathetic engagement with the method that generated it. Neither response attempted such an engagement. Rather, both responses wage a stealth war against our methodological commitments, and so take aim at the wrong thing. It is thus no surprise that they miss their mark.
