Avoiding Economic Waste in Contract Damages: Myths, Misunderstanding, and Malcontent

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History or custom or social utility or some compelling sentiment of justice or sometimes perhaps a semi-intuitive apprehension of the pervading spirit of our law, must come to the rescue of the anxious judge, and tell him where to go.1

Benjamin N. Cardozo

I. INTRODUCTION

In the realm of contractual remedies, there are two axioms upon which legal scholars and jurists have come to rely, to wit, the court will not make for the parties a better contract than they made for themselves,2 and the goal of awarding contract damages is to put the aggrieved party in as good of a position as he would have enjoyed upon full performance.3 These two basic principles were etched into con-

3. This is commonly referred to as the expectancy measure of damages. See E. ALAN FARNsworth, CONTRACTS § 12.1, at 730 (4th ed. 2004) (“How do courts encourage promises to rely on promises? Ordinarily they do so by protecting the expectation that the injured party had when making the contract by attempting to put that party in as good a position as it would have been had the contract been performed, that is, had there been no breach. The interest measured in this way is called the expectation interest and is said to give the injured party the ‘benefit of the bargain.’”); see also U.C.C. § 1-305(a) (2001) (“The remedies provided . . . must be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed . . . .”); RESTATEMENT (SECOND) OF CONTRACTS § 344(a) (1981) (“His ‘expectation interest’ . . . is his interest in having the benefit of his bargain by being put in as good
tract jurisprudence with the tools of justice and retribution in order to assure that contracting parties remain in complete control of their relations and that judicial involvement in contractual disputes is limited to fulfilling the intent of the parties. Thus, whenever a doctrine appears to run afoul of the underpinnings of contractual intent, it stands to reason that its veracity is called into question.

This Article calls into question one such doctrine, the doctrine of economic waste. As applied in the context of contractual rights and remedies, the doctrine of economic waste exemplifies the difficulties of utilizing a robust but misunderstood theoretical construct. While such a doctrine is best understood from an economic perspective, such a perspective has been virtually ignored in the doctrine’s jurisprudential application in contract law. Theoretical ignorance and a cavalier application of the economic waste doctrine is particularly problematic when it leads to confounding and incoherent remedial outcomes that defy the primary goal of contract damages—that is, to award the non-breaching party his expectation interests.

“Economic waste” is the label that courts have adopted as justification for not awarding an aggrieved party the cost of performance as damages for breach of a construction contract. Although it is widely accepted that cost of performance is generally the proper measure of damages to compensate for deficient performance under a construction contract, it is also widely regarded that such damages may be inappropriate when the increase in objective value to be achieved by finishing the task is grossly disproportionate to the cost involved. This gross disparity is commonly referred to as economic waste, which is frowned upon by the majority of courts, causing them to opt for an alternative measure of the loss of value in terms of the diminution in value—the difference in value with and without completion of the contract. Moreover, concerns about creating a windfall for the aggrieved party are used to bolster adoption of the alternative measure of damages because the court generally does not believe the aggrieved party

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4. See 11 Williston, supra note 2.
5. See 24 Williston, supra note 2, § 64:1, at 7–11.
6. The term “cost of performance” is used generically in this Article to refer to cost of remedying construction defects, as well as the cost of completing the construction.
7. See Farnsworth, supra note 3, § 12.13, at 790.
9. See Chomsky, supra note 8, at 1452, 1454.
will, in fact, use the damages awarded to finish a task that would result in little or no increase in market value.\footnote{10}{See Peevyhouse v. Garland Coal & Mining Co., 382 P.2d 109, 112 (Okla. 1962).}

However, it is difficult, if not impossible, to reconcile the justification for the use of this alternative measure of damages with the basic notions of economics and contractual intent. This difficulty stems from the misunderstanding of the economics of a bargained-for exchange, whereby both parties have weighed the pros and cons of entering into the transaction beforehand and have decided they are better off entering into the deal than not.\footnote{11}{For discussion of economic's equimarginal maximizing principle upon which rational actions and decisions are assumed to be premised, see infra note 83 and accompanying text.} The bargain between the parties is supposed to reflect their assessment of the costs and benefits of doing exactly what they agreed to do. Thus, when a court upsets this bargain after the fact by unilaterally deciding the parties' exchange is not worth what the parties agreed to pay or do, the court then creates a situation whereby the aggrieved party is not given the equivalent of the benefit of her bargain, and the breaching party is in a better position than he would have been had he fully performed. Thus, the windfall inures to the benefit of the breaching party. The result is an economically inefficient transaction, the very thing that the court ostensibly sought to prevent by resort to this alternative, albeit less desirable, measure of damages.

This Article explores the myths, misunderstanding, and malcontent generated by the judicial application of the economic waste doctrine. It specifically examines the doctrine of economic waste as it is commonly invoked as a justification for awarding diminution-in-value damages, ultimately revealing that the very condition (i.e., economic waste) the court seeks to avoid, ironically, is created when the court strays from its role of fulfilling the intent of the parties, alas the myth. This reverse phenomenon occurs because of a failure to understand the basic premise of economic waste from a microeconomics perspective, thus the misunderstanding. Given the myth and misunderstanding of the economic waste doctrine as applied in contract cases, as well as the litany of inconsistent and incoherent remedial outcomes revealed by a review of its judicial application, it can be of no surprise that the propriety of the current state of the law is suspect and in need of change, hence the malcontent.

Part II commences the following analysis with a discussion of the origin and development of the economic waste doctrine, as well as its modern application in renowned cases widely cited for discussion of the diminution-in-value alternative measure of damages. Part III explains economic waste from an economic perspective. Its discussion of the perfectly competitive model of microeconomics provides a back-
drop for a proper understanding of the economic waste doctrine. Part IV analyzes the expected strategic behavior of contracting parties utilizing conventional theoretical game models to further demonstrate problems with the courts' present application of the economic waste doctrine. Part V highlights the fallacies in the general assumption that this alternative measure of damages is needed to prevent economic waste, it explains how this alternative measure actually creates economic waste, and it suggests a simplified default rule for determining the proper measure of damages. Finally, Part VI concludes with a few thoughts about how the policies and premises discussed in this Article hold true in evaluating the propriety of other types of contractual remedies, thereby raising issues deserving of additional exploration.

II. THE ORIGIN AND DEVELOPMENT OF THE ECONOMIC WASTE DOCTRINE

A. Doctrinal Origins

The term "economic waste" has been bantered about since at least the early 1900s in many different contexts. The fact that it is seldom, if ever, defined by the user creates the appearance that it has no readily identifiable shared meaning. Instead, the term is commonly used to generally describe some undesirable result viewed as a waste of valuable resources. In contract law, the economic waste doctrine is often described as the jurisprudential justification for providing an alternative measure of damages (i.e., diminution in value) in connection with the breach of a contract when it is shown that the preferred measure of cost of performance has no rational relationship to the objective or market value such cost will achieve. This alternative mea-

16. See, e.g., 11 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 60.2, at 616 (2005).
sure of damages generally has been reserved for construction contracts.\textsuperscript{17}

It is commonly acknowledged that the economic waste doctrine originated in the opinion rendered in 	extit{Jacob & Youngs, Inc. v. Kent},\textsuperscript{18} penned by Justice Cardozo.\textsuperscript{19} In that case, a written residential construction contract called for the use of a specific brand of plumbing pipe (known as Reading pipe). After completion of construction, the owner discovered that the builder used an alternative brand of pipe (known as Cohoes pipe) for some of the plumbing work and thus refused to pay the builder the balance due under the contract. The court decried the harshness of a rule which would deprive a builder of compensation under the contract where he performed as promised except for a trivial and innocent omission.\textsuperscript{20} Where such is the case, the builder is deemed to have substantially performed, thereby entitling him to receive the promised compensation under the contract, less any amount of damages his deficient performance caused the aggrieved party to sustain.\textsuperscript{21} In determining whether less than full performance constitutes substantial performance, the court stated that the following factors must be considered and weighed: "[T]he purpose to be served, the desire to be gratified, the excuse for deviation from the letter, [and] the cruelty of enforced adherence."\textsuperscript{22}

In 	extit{Jacob & Youngs}, the court observed that the doctrine of substantial performance was created by the courts as an instrument of justice, and the damages that follow must likewise reflect that same goal.\textsuperscript{23} Noting that there was no difference in the objective value between the two brands of pipe, the court enunciated the following rule regarding the proper measure of damages: "The owner is entitled to the money which will permit him to complete, unless the cost of completion is grossly and unfairly out of proportion to the good to be attained. When that is true, the measure is the difference in value."\textsuperscript{24}

The difference in value, commonly referred to as the diminution in value, refers to the difference between the market value of the property had the contract been fully performed and the market value of the

\begin{enumerate}
\item See id. § 60.1, at 606; \textsc{Joseph M. Perillo, Calamari and Perillo on Contracts} § 14.29, at 606 (5th ed. 2003). Although the alternative measure of damages (i.e., diminution in value) is generally reserved for construction cases, its application is relevant to any contract in which a party's expectancy interest primarily relates to the performance of a construction-type service (e.g., repair and refurbishment services, painting services, etc.).
\item 129 N.E. 889 (N.Y. 1921).
\item See Marschall, \textit{supra} note 14, at 752 n.96.
\item \textit{Jacob & Youngs}, 129 N.E. at 891.
\item See \textsc{Farnsworth}, \textit{supra} note 3, § 8.12, at 548.
\item \textit{Jacob & Youngs}, 129 N.E. at 891.
\item \textit{Id.} at 892.
\item \textit{Id.} at 891.
\end{enumerate}
property in its defective or incomplete condition. 25 Although the court never used the term "economic waste," the exception crafted by the court setting forth a mandatory alternative measure of damages has since been dubbed the economic waste doctrine. 

As illustrated in Jacob & Youngs, substantial performance is aptly regarded as the counterpart of economic waste. 27 Without the benefit of the substantial performance doctrine, a deficiently performing contractor would never be able to earn a discharge of his duty to perform, thereby giving rise to the duty of the owner to pay the contract price. 28 This correlation is also insightful because in its discussion of the substantial performance doctrine in Jacob & Youngs, the court acknowledged that parties are free to make the fulfillment of each and every aspect of the contract an express condition of recovery of the contract price by the contractor, thereby closing the door on substantial performance. 29 In terms of avoiding operation of the economic waste doctrine, this would likewise seem to give the aggrieved owner leverage against the breaching contractor in requiring him to fully perform before he is entitled to be paid under the contract, including having him redo deficient portions of the work that may require substantial effort and resources despite yielding a low return in value.

In 1932, the Restatement of Contracts 30 was released with a provision giving the aggrieved party the choice between cost of completion

25. Chomsky, supra note 8, at 1446.

30. RESTATEMENT OF CONTRACTS, at vii–ix (1932) ("[The First] Restatement of Contracts mark[ed] the completion by The American Law Institute of its work on the
and diminution in value.\textsuperscript{31} Like the Jacob & Youngs court, this provision included a limitation on whether the aggrieved owner could recover his cost of completion.\textsuperscript{32} However, the drafters substituted the term "economic waste" for the disproportionality test referenced in Jacob & Youngs. Nevertheless, the first Restatement was viewed as consistent with Jacob & Youngs.\textsuperscript{33}

In the 1962 case of Peevyhouse v. Garland Coal & Mining Co.,\textsuperscript{34} farm owners entered into a written lease with a coal mining company that required the company to pay a stated sum to the farm owners for strip mining, as well as to perform restorative and remedial work on

first of a series of volumes designed to cover the restatement of the principal subjects of the law. . . . The Institute is composed of two classes of members—elected life members and official members. Official members are the justices of the Supreme Court of the United States, senior judges of the United States Circuit Courts of Appeals, the chief justices of the highest courts of the several States and the District of Columbia, the president and members of the Executive Committee of the American Bar Association, the presidents of the State Bar Associations, the president of the National Conference of Commissioners on Uniform State Laws, the presidents of certain learned legal societies . . . , and the deans of member schools of the Association of American Law Schools. . . . The American Law Institute was formed in the belief that in order to clarify and simplify the law and to render it more certain, the first step must be the preparation of an orderly restatement of the common law, including in that term not only the law developed solely by judicial decision but also the law which has grown from the application by the courts of generally and long adopted statutes." (emphasis added)).

\textsuperscript{31} See id. § 346(1)(a)(i)-(ii). This section explains that

\begin{enumerate}
\item For a breach by one who has contracted to construct a specified product, the other party can get judgment for compensatory damages for all unavoidable harm that the builder had reason to foresee when the contract was made, less such part of the contract price as has not been paid and is not still payable, determined as follows:
\begin{enumerate}
\item For defective or unfinished construction he can get judgment for either
\begin{enumerate}
\item the reasonable cost of construction and completion in accordance with the contract, if this is possible and does not involve unreasonable economic waste; or
\item the difference between the value that the product contracted for would have had and the value of the performance that has been received by the plaintiff, if construction and completion in accordance with the contract would involve unreasonable economic waste.
\end{enumerate}
\end{enumerate}
\end{enumerate}

\textit{Id.} (emphasis added).

\textsuperscript{32} See id.; see also id. § 346 cmt. b ("Sometimes defects in a completed structure cannot be physically remedied without tearing down and rebuilding, at a cost that would be imprudent and unreasonable. The law does not require damages to be measured by a method requiring such economic waste. If no such waste is involved, the cost of remedying the defect is the amount awarded as compensation for failure to render the promised performance." (emphasis added)).

\textsuperscript{33} See Chomsky, \textit{supra} note 8, at 1452.

\textsuperscript{34} 382 P.2d 109 (Okla. 1962).
the land at the end of the lease term. However, the coal mining company refused to restore the land at the end of the lease. The court cited with approval section 346(1)(a) of the first Restatement for its use of the term “economic waste,” as well as Jacob & Youngs for the disproportionality limitation on damages. Although the court was careful to distinguish a coal mining lease with a restoration provision from a building and construction contract, it nevertheless pointed to cases and other sources discussing damages for breach of building and construction contracts in support of its adoption of the diminution-in-value alternative measure of damages for breach of the land restoration provision. However, the Peevyhouse court then proceeded to alter the economic waste doctrine by stating that the breach must also relate to a provision that is merely incidental to the main purpose of the contract, in addition to the cost of performance being grossly disproportionate to the economic benefit which would result, in order for the aggrieved owner to be limited to diminution-in-value damages.

B. A Shift in Nomenclature

In 1981, the Restatement (Second) of Contracts was promulgated with significant changes to the economic waste doctrine as reflected in the first Restatement, as well as in longstanding case law. The most notable change in the second Restatement's approach was the elimination of the term “economic waste.” The comments to this revised sec-

35. Id. at 111.
36. Id. at 112.
39. Id. at 114.
40. See Restatement (Second) of Contracts § 348(2) (1981). This section explains that
tion indicate the drafters viewed this term as misleading since an aggrieved party was not likely to spend his cost of completion damages remedying defects if such were calculated to yield little or no return. Instead, the drafters opted to express concerns over giving the aggrieved owner a substantial windfall.

The second Restatement also appears to make significant changes to the disproportionality limitation on damages enunciated in Jacob & Youngs. First, the diminution-in-value versus reasonable-cost-of-performance choice only becomes relevant if the value of the loss to the injured party cannot be proved with sufficient certainty. Thus, the aggrieved party is presumptively entitled to recover damages measured by the loss in value to him, provided he can prove such loss with sufficient certainty. Second, if the aggrieved party is not able to prove his actual loss with sufficient certainty, the revision appears to give him the choice between diminution in value and reasonable cost.

If a breach results in defective or unfinished construction and the loss in value to the injured party is not proved with sufficient certainty, he may recover damages based on

(a) the diminution in the market price of the property caused by the breach, or

(b) the reasonable cost of completing performance or of remedying the defects if that cost is not clearly disproportionate to the probable loss in value to him.

Id.

41. See id. § 348 cmt. c ("Sometimes, however, such a large part of the cost to remedy the defects consists of the cost to undo what has been improperly done that the cost to remedy the defects will be clearly disproportionate to the probable loss in value to the injured party. Damages based on the cost to remedy the defects would then give the injured party a recovery greatly in excess of the loss in value to him and result in a substantial windfall. Such an award will not be made. It is sometimes said that the award would involve 'economic waste,' but this is a misleading expression since an injured party will not, even if awarded an excessive amount of damages, usually pay to have the defects remedied if to do so will cost him more than the resulting increase in value to him."). Comprehending the meaning of this comment is problematic. It is unclear as to why characterizing such an award as involving economic waste is "misleading" because an injured party may not use such an award to have the defects remedied. Whether the award is actually used to remedy defective performance or pocketed by the plaintiff, under the jurisprudential application of the economic waste doctrine, the award constitutes economic waste. This comment, however, demonstrates a very cavalier and ambiguous understanding of the economic waste doctrine as referenced and applied in construction contract cases.

42. See id.

43. See id. § 348(2); see also id. § 348 cmt. c ("Sometimes, especially if the performance is defective as distinguished from incomplete, it may not be possible to prove the loss in value to the injured party with reasonable certainty. In that case he can usually recover damages based on the cost to remedy the defects. Even if this gives him a recovery somewhat in excess of the loss in value to him, it is better that he receive a small windfall than that he be undercompensated by being limited to the resulting diminution in the market price of his property.").

44. See id. § 348(2).
of completion. However, the comments indicate that the aggrieved party's ability to recover under the diminution-in-value choice is actually limited by the provision disallowing recovery for loss the aggrieved party reasonably could have avoided. Thus, where the diminished value damages are larger but could have been avoided or mitigated by completion or correction of the defects, the aggrieved party would not be entitled to choose the higher diminished value damages. Lastly, where the aggrieved party cannot prove with sufficient certainty the loss in value to him, and thus gets to choose, he may not choose his cost of performance if such costs are clearly disproportionate to the probable loss in value to him.

The changes embodied in the second Restatement reflect a significant departure from both Jacob & Youngs and the first Restatement in that they begin the analysis of the propriety of damages with the inquiry of whether the aggrieved party can prove with sufficient certainty his actual damages, regardless of how they are measured. If he can, that appears to be the end of the analysis, and that is what he is entitled to recover. Only if he cannot do so is there a need to consider how damages should be measured.

C. The Generally Accepted Default Rule

Despite the changes to the text of the second Restatement, the comments indicate an intention to preserve the diminution-in-value alternative measure of damages in cases of clear disproportionality between the cost of performance and the actual loss of value to the aggrieved party. In any event, courts generally continue to analyze and decide matters under Jacob & Youngs and its progeny, using the terminology of the first Restatement but incorrectly citing to the second Restatement.

D. Confusion and Malcontent

To compound the confusion with respect to the application of the economic waste doctrine, many courts have strayed from the original

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45. Id.
46. See id. § 348 cmt. c ("Since the cost to complete is usually less than the loss in value to him, he is limited by the rule on avoidability to damages based on cost to complete. See § 350(1). If he has actually had the work completed, damages will be based on his expenditures if he comes within the rule stated in § 350(2).").
47. Id.
48. Id.
49. See Park Ave. Condo. Owners Ass'n v. Buchan Devs., L.L.C., 71 P.3d 692, 699–700 (Wash. Ct. App. 2003) (citing RESTATEMENT (SECOND) OF CONTRACTS § 348, but stating cost of repairs will not be awarded if they are grossly disproportionate to the value to the injured party of such repairs without inquiring whether the aggrieved party is capable of proving his actual loss of value with sufficient certainty); see also Chomsky, supra note 8, at 1453–54.
**Figure 1**

| Damages for Breach in Defective or Unfinished Construction Cases: |
|-------------|---------------|
| Breach      | Unfinished or defective construction |
| Damages     | Cost of completion or diminution in value, *unless* cost of completion results in economic waste as evidence by such cost being clearly disproportionate to the diminution in value, *then only* diminution in value. |

focus of the doctrine by introducing other matters for consideration when deciding whether to apply the general measure of cost of completion or the alternative measure of diminution in value. For example, in *Jacob & Youngs* the application of the economic waste doctrine was premised on a finding that the contractor's breach was not intentional. However, the court in *Peevyhouse* failed to address the willful nature of the breach at all in holding that an award of diminution in value was the proper measure of damages. Instead, the *Peevyhouse* court simply acknowledged that the contractor conceded not performing the remedial work.

In addition, courts have considered the extraneous matter of whether the deficiency in performance relates to an aesthetic aspect of the contract. For example, where the contractor failed to perform in accordance with aesthetic provisions of the contract, the court will

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51. *Jacob & Youngs, Inc. v. Kent*, 129 N.E. 889, 891 (N.Y. 1921) ("The willful transgressor must accept the penalty of his transgression."); *see also* Groves v. John Wunder Co., 286 N.W. 235, 236 (Minn. 1939) (discussing the willful nature of defendant's breach in light of the established rule that willful breaches cannot rise to the level of substantial performance).
52. *Peevyhouse v. Garland Coal & Mining Co.*, 382 P.2d 109, 111 (Okla. 1962). It merits noting that the *Peevyhouse* court was correct to dismissively ignore the *Jacob & Youngs* court's mention of "innocent" breach. A finding of "willful breach" should have no bearing on whether to award cost-of-completion or diminution-in-value damages because of the fact that all breaches are essentially willful. If not, then how can a trier of fact discern a willful breach from an innocent breach? Moreover, if a willful breach is the only type of breach for which higher cost-of-completion damages may be awarded, then such a doctrine effectively nullifies any notion of "efficient breach" which has long been acknowledged in the law of contracts by its refusal to award punitive damages or to recognize stipulated damage clauses that provide for the payment of penalty damages. *See also* Restatement (Second) of Contracts, ch. 16, at 100 intro. n. (1982) ("Willful breaches have not been distinguished from other breaches . . . . In general, therefore, a party may find it advantageous to refuse to perform a contract if he will still have a net gain after he has fully compensated the injured party for the resulting loss.").
generally find that the contract has not been substantially performed. Thus, requiring the contractor to correct or pay to correct the deficiencies, even at great cost, is not likely to be regarded as economic waste.

Simply put, courts are not consistent in their application of the current default rule dictating when cost of performance or diminution in value should be used. The second Restatement's provision is either misunderstood or blatantly ignored by courts purporting to adopt such a position. Most courts improperly start their analysis with the choice between cost of performance and diminution in value in light of the degree of disproportionality between the two. In misapplying the rule, they overlook the correct starting point of the analysis—whether the loss of value to the aggrieved party can be proved with sufficient certainty. This inquiry allows an aggrieved party to be compensated based on the utility of the transaction to him, provided that he is able to establish such value. Only if he is unable to do so does the diminution-in-value alternative come into play.

Another common misapplication relates to the market value considered by the court in assessing diminution in value. In some cases, the courts consider the relationship between the cost of performance and the total market value of the property, as opposed to the difference in the market value with and without complete performance under the contract.

In any event, improper considerations either stem from or contribute to the perception that courts are blinded by their own sense of what the underlying transaction is actually worth to them. Obviously, this is not a proper approach to a determination of loss of value since it circumvents the subjective inquiry into the nature and extent of the aggrieved party's actual loss as a result of less than full performance under the contract.

The Peevyhouse case is the classic example of courts being guided by their own perception of what the contractual exchange should have been worth. The cost of performing the promised restorative and remedial work on the Peevyhouses' farm at the end of the lease was established to be approximately $29,000. The decrease in the market

54. See Cope, 529 S.W.2d at 262.
56. See id.
58. See infra note 84 and accompanying text.
value of the property resulting from the nonperformance of the restorative work was approximately $300.00.\textsuperscript{61} Thus, the court determined that the proper measure of damages was the diminution in value and awarded the Peevyhouses only $300.00.\textsuperscript{62}

In its analysis, the court was obviously unconcerned with any subjective value or utility that the Peevyhouses may have had in wanting the property to be restored. In addition, the court ignored Garland Coal's admissions that the Peevyhouses insisted that the restoration provisions be added to the contract as a condition of them agreeing to the lease.\textsuperscript{63} Obviously, the utility that the parties attached to the transaction at the time of contracting was not attained due to the court's willingness to disregard the intent of the parties in the name of preventing economic waste.

To further illustrate the problem with the current approach, consider the following hypothetical: Owner and contractor enter into a written contract that requires contractor to build a house to certain specifications for owner in exchange for payment of $700,000. The specifications require installation of a hand-carved mahogany fireplace mantel, which is built to order in France. Due to an oversight, contractor neglected to order the hand-carved mahogany fireplace mantel. Contractor seeks the full contract price upon completing the house according to the specifications (with the exception of the hand-carved mahogany fireplace mantel). In order to have the fireplace mantel made, shipped and installed, it will cost $20,000. The market value of the house without the fireplace mantel is the same as it would be with it. Using the doctrine of substantial performance, contractor would be entitled to recover the full contract price, less any amount of damages owner has sustained as a result of contractor's relatively trivial incomplete performance. Under the current approach to the default rule, owner would not be entitled to a recoupment for the cost of having the mantel finished because it would be deemed grossly disproportionate to the increase in value that such cost would yield (in this case, $0). In addition, owner would only be entitled to recoup nominal damages due to the absence of any diminution in value. This absurdity highlights the need to dispense with the current default rule for determining the appropriate measure of damages.

E. The Economic Waste Doctrine—Misunderstood from Inception

The economic waste doctrine appears to have been doomed from inception, especially since it appears to have never been properly de-

\textsuperscript{61} Id. at 112.
\textsuperscript{62} Id. at 114.
\textsuperscript{63} Id. at 115 (Irwin, J., dissenting).
fined, and therefore, was incapable of being properly understood. To the extent the *Jacob & Youngs* court and its progeny applied the doctrine in an attempt to avoid an economic inefficiency, such an application necessarily required a more robust understanding of the economics. After all, economic waste has a definite meaning within in the field of microeconomics, and once properly understood, clarity can be gained with respect to the proper application of the economic waste doctrine.

Accordingly, an understanding of the economic waste doctrine necessitates an in-depth discussion of the economic constructs of wealth creation. In this regard, the following Part identifies and explains several operational conditions of the perfectly competitive market at risk as a result of an incoherent and superficial understanding, coupled with arbitrary jurisprudential application of a seemingly ambiguous economic waste doctrine. Specifically, the following discussion and analysis of the operational conditions of rationality, fully informed market participants, and unimpeded supply-and-demand forces demonstrates that the application of a misunderstood and ambiguous economic waste doctrine results in the very economic waste the doctrine was intended to prevent.

III. MICROECONOMICS AND ITS PERFECTLY COMPETITIVE MODEL—A PARADIGM FOR UNDERSTANDING AND IDENTIFYING ECONOMIC WASTE

Economic theory has long acknowledged that the given environment within which society functions is constrained by scarcity, and that such scarcity is the fundamental source of social and political conflict.64 Given such scarcity, all societies are confronted with the problem of determining (1) what, and how much, to produce; (2) how to produce; and (3) for whom to produce.65 The field of microeconomics has demonstrated that the adoption of the perfectly competitive model provides a remarkable social mechanism with which to address the social problems generated by scarcity.66 The perfectly competitive model ultimately nurtures, if not ensures, efficiencies in the allocation, production, and distribution of scarce resources.67

Proper instruction regarding the requisite antecedent conditions68 of the perfectly competitive model is essential for the jurist, practitioner, and the student engaged in the analysis of whether a contrac-

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65. *Id.* at 5.
66. *Id.* at 9.
68. The requisite antecedent conditions may also be referred to as fundamental assumptions or underlying assumptions.
tual remedy results in economic waste. Such instruction simplifies the task of understanding the contract doctrine of economic waste, as well as illustrates the ultimate inefficiencies created by its current application in construction cases.

A. The Operational Conditions and Efficiencies of the Perfectly Competitive Model

The requisite antecedent conditions of the perfectly competitive model consist essentially of the following:

1. The existence of numerous buyers and sellers, each acting independently and rationally;

2. Each buyer and seller consumes or produces such a negligible amount of the total output that no one buyer or seller can influence price by the amount they either consume or produce;

3. There are no barriers to entry or exit with respect to consumer or producer markets;

69. See Colander, supra note 64, at 242 (outlining the "necessary conditions for perfect competition" to thrive).

70. See Mansfield & Yohe, supra note 67, at 356–57 ("The firm in a perfectly competitive market has so many rivals that competition becomes impersonal in the extreme. . . . A competitive firm faces so little of the market demand curve that its effective demand curve is horizontal at whatever price the market will bear. A competitive firm can decide only the output that it would like to supply to the market given that price."); Pindyck & Rubinfeld, supra note 67, at 327 ("In a perfectly competitive market, the large number of sellers and buyers of a good ensures that no single seller or buyer can affect its price. The market forces of supply and demand determine price.").

71. See Mansfield & Yohe, supra note 67, at 426, 433–34 ("Unlike the case of monopolistic competition, the supply side of an oligopoly market is composed of a few firms. . . . Conditions in oligopolistic industries tend to promote collusion, since the number of firms is small and the firms recognize their interdependence. The advantages to the firms of collusion seem obvious: increased profits, decreased uncertainty, and a better opportunity to prevent others' entry."); Pindyck & Rubinfeld, supra note 67, at 430 ("In [competitive] markets, each firm could take price or market demand as given and largely ignore its competitors. In an oligopolistic market, however, a firm sets price or output based partly on strategic considerations regarding the behavior of its competitors.").

72. Steven E. Landsburg, Price Theory and Applications 634 (6th ed. 2005) ("[T]he economist assumes that people are rational."); see also infra note 83 (discussing rational choice as an equimarginal principle).

73. See Mansfield & Yohe, supra note 67, at 290 ("[P]erfect competition requires that each participant in the market, whether a buyer or a seller, be so small in relation to the entire market that he or she cannot affect the product's price."); Pindyck & Rubinfeld, supra note 67, at 252 ("Because each individual firm sells a sufficiently small proportion of total market output, its decisions have no impact on market price. . . . The assumption of price taking applies to consumers as well as firms.").

74. See Mansfield & Yohe, supra note 67, at 290 ("Perfect competition also requires that all resources be completely mobile. Each resource must, in other words, be able to enter or leave the market with ease and to switch from one use to another
4. All market participants (i.e., all buyers and sellers) are fully informed of all relevant economic and technological data;\(^\text{75}\)

5. All products are homogeneous, or rather, constitute interchangeable substitutes for each other;\(^\text{76}\) and

6. The forces of supply and demand are free to determine the quantity of output in a relevant market, as well as to determine a market-clearing, competitive price with respect to the same.\(^\text{77}\)

Microeconomic theory teaches that if these conditions are met, the perfectly competitive model will create efficiencies in consumption, production, and allocation.\(^\text{78}\) Further, it is through the creation of such efficiencies that a perfectly competitive market promises the greatest social opportunity for wealth creation\(^\text{79}\) in that it promises greater output at lower prices.\(^\text{80}\) It is within this social context that value-enhancing exchange transactions take place, thereby minimizing economic waste. In pure economic parlance, *pareto efficiencies* are without fuss or bother."); Pindyck & Rubinfeld, *supra* note 67, at 253 ("[F]ree entry (exit), means that there are no special costs that make it difficult for a new firm either to enter an industry and produce or to exit if it cannot make a profit. As a result, buyers can easily switch from one supplier to another, and suppliers can easily enter or exit a market.").

75. *See* Mansfield & Yohe, *supra* note 67, at 290–91 ("[P]erfect competition requires that consumers, firms, and resource owners have perfect knowledge of the relevant economic and technological data. Consumers must be aware of all prices. Laborers and owners of capital must be aware of how much their resources will bring in all possible uses. Firms must know the prices of all inputs and the characteristics of all relevant technologies. And in its purest sense, perfect competition requires that all of these economic decision-making units have an accurate knowledge of the past, the present, and the future."); Pindyck & Rubinfeld, *supra* note 67, at 595 ("[W]e have assumed that consumers and producers have complete information about the economic variables that are relevant for the choices they face.").

76. *See* Mansfield & Yohe, *supra* note 67, at 405 (noting that in perfectly competitive situations the goods sold are "completely homogeneous from one seller to another"); Pindyck & Rubinfeld, *supra* note 67, at 252–53 ("Price-taking behavior typically occurs in markets where firms produce identical, or nearly identical, products. When the products of all of the firms in a market are perfectly substitutable with one another—that is, when they are homogeneous—no firm can raise the price of its product above the price of other firms without losing most or all of its business.").

77. *See* Mansfield & Yohe, *supra* note 67, at 347–48 ("We have seen that a perfectly competitive economy maximizes the total net gain of consumers and producers. We then showed . . . how deadweight losses—reductions in economic efficiency—result if the government [obstructs the forces of supply and demand by imposing] a price ceiling[.] . . . a price floor[,] . . . a tariff, a quota, or an excise tax."); Pindyck & Rubinfeld, *supra* note 67, at 55 n.2 ("The market mechanism is the tendency for supply and demand to equilibrate (i.e., for price to move to the market-clearing level), so that there is neither excess demand nor excess supply.").


79. *See id.*

80. Colander, *supra* note 64, at 221.
achieved; that is, goods are efficiently allocated through exchange transactions such that "no one can be made better off without making someone else worse off."  

If the above operational conditions must be met in order for the perfectly competitive market to achieve the efficiencies for which it is so highly touted, then, from a purely economic perspective, the obstruction of one or more such conditions threatens the value-enhancing, wealth-producing attributes of a laissez faire market. Accordingly, the underlying conditions of the perfectly competitive economic model provide a powerful analytical paradigm for assessing the presence of economic waste in the contractual setting. If the conditions are met, economic theory indicates that there will be no waste. Through the interaction of buyers and sellers, the market forces of supply and demand will determine efficient output levels and prices such that resources will be directed to their highest valued uses.

B. Economics of Rationality and Utility Maximization

Central to the perfectly competitive model is the assumption that all market participants are rational, with rational action being defined by the principle of utility/profit maximization. Any act of con-

81. Pindyck & Rubinfeld, supra note 67, at 567.
82. See Melvin Aron Eisenberg, The Bargain Principle and Its Limits, 96 Harv. L. Rev. 741, 746 (1982) ("The contract price is normally the most efficient price, in the economist's sense of that term, because permitting the price of a commodity to be determined by the interaction of buyers and sellers will normally move the commodity to its highest-valued uses, as expressed by the amounts competing buyers are willing to pay, and will best allocate the factors necessary for the commodity's production."); see also Farnsworth, supra note 3, § 12.3, at 735–36 ("The basic notion is that an economy will operate 'efficiently' only to the extent that available goods and resources are utilized in their most productive manner. Ideally, each good must be consumed by the person who values it most highly, and each factor of production must be employed in the way that produces the most valued output. . . . A bargained-for exchange from which both parties benefit is socially desirable in the sense that it results in a gain in efficiency by moving the assets that are exchanged to higher valued uses.").
83. See Colander, supra note 64, at 242 (noting that "firms are profit-maximizing entrepreneurial firms"); id. at 181 ("The analysis of rational choice is the analysis of how individuals choose goods within their budget in order to maximize total utility, and how maximizing total utility can be accomplished by considering marginal utility. That analysis begins with the premise that rational individuals want as much satisfaction as they can get from their available resources. The term rational in economics means, specifically, that people prefer more to less and will make choices that give them as much satisfaction as possible."); Landesburg, supra note 72, at 634 ("The economist assumes that people act according to the principle of equimarginality. This is often expressed by saying that the economist assumes that people are rational. Indeed, it has been said that a student becomes a true economist on the day when he fully understands and accepts the principle that people equate costs and benefits at the margin."); Edwin Mansfield, Microeconomics: Theory and Applications 55 (6th ed. 1988) ("Given the
sumption or production that fails to maximize the utility or profit of an individual or firm is considered irrational economic behavior. Economic rationality necessarily requires that all costs and benefits be considered when exercising economic choices. Consequently, in order to act rationally, all market participants must be fully informed of all costs and benefits associated with their respective economic activities. Once informed of all activity costs and benefits, an economically rational actor will weigh his or her costs and benefits, and if the benefits exceed or equal the costs, he or she will engage in such activity. To the extent that all such costs and benefits are not considered—that is, they are external to the rational decisionmaking process—consumer's tastes, we assume that he or she is rational, in the sense that he or she tries to maximize utility.

84. See Colander, supra, note 64, at 179 ("Utility refers to the satisfaction one gets from consuming a good or service."); see also Pindyck & Rubinfeld, supra note 67, at 73 ("In the language of economics, the concept of utility refers to the numerical score representing the satisfaction that a consumer gets from a market basket. In other words, utility is a device used to simplify the ranking of market baskets. If buying three copies of this textbook makes you happier than buying one shirt, then we say that the books give you more utility than the shirt."); Mathis & Koscianski, supra note 83, at 45-46 ("Economists use the term utility to refer to the satisfaction an individual receives from consuming goods and services. Thus, we can express the level of utility that an individual derives from consuming various combinations of goods and services in terms of a relationship known as a utility function, defined as a function that expresses a consumer's level of utility in terms of the amounts of goods and services she consumes. Mathematically, we can express a utility function as \( U = U(X, Y, W, \ldots, Z) \), where \( U \) represents some measure of a consumer's utility and \( X, Y, W, \ldots, Z \) represent her consumption levels of various goods and services.").

85. See supra note 83 and accompanying text.

86. See Mansfield & Yohe, supra note 67, at 290–91 ("[P]erfect competition requires that consumers, firms, and resource owners have perfect knowledge of the relevant economic and technological data. . . . Firms must know the prices of all inputs and the characteristics of all relevant technologies. And in its purest sense, perfect competition requires that all of these economic decision-making units have an accurate knowledge of the past, the present, and the future.").

87. See Anthony E. Boardman et al., Cost-Benefit Analysis 31 (3d ed. 2006) ("Choose the combination of [goods and/or inputs] that maximizes net benefits." (emphasis omitted)).
process—non-utility/profit-maximizing choices will be made, resulting in unacceptable market inefficiencies.\textsuperscript{88}

The premise that market transactions are fueled and driven by the exercise of rational choice on behalf of market participants (i.e., “[m]uch of what people do reflects their rational self-interest”)\textsuperscript{89} is not new or novel in the field of economics. Rather, rational choice has long been acknowledged as the driving force of commercial and contractual activity. For example, Adam Smith observed, “[T]he propensity to truck, barter, and exchange one thing for another . . . is common to all men, and to be found in no other race of animals . . . .”\textsuperscript{90} And as Smith eloquently illustrates, this propensity to engage in contracts of exchange is driven principally by the human faculties of reason and speech:\textsuperscript{91}

But man has almost constant occasion for the help of his brethren, and it is in vain for him to expect it from their benevolence only. He will be more likely to prevail if he can interest their self-love in his favour, and show them that it is for their own advantage to do for him what he requires of them. Whoever offers to another a bargain of any kind, proposes to do this. Give me that which I want, and you shall have this which you want, is the meaning of every such offer; and it is in this manner that we obtain from one another the far greater part of those good offices which we stand in need of. It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves not to our humanity but to their self-love, and never talk to them of our own necessities but of their advantages.\textsuperscript{92}

The innate propensity to truck, barter, and exchange is ultimately facilitated by contractual instruments reflecting the rational choice of contracting parties. Assuming each party is rational at the time of contracting, seeking to maximize his or her utility by entering into an exchange transaction, their conduct will result in a value-enhancing, bargained-for exchange.\textsuperscript{93} Through the exchange process, each party seeks to gain value by offering value to the other. As conventional economic theory explains, each rational contracting participant “uses all prevailing information available to choose among various goods and services with the explicit goal of maximizing her utility.”\textsuperscript{94} It

\textsuperscript{88} MANSFIELD & YOHE, supra note 67, at 675 (“[P]roducers act in ways that cause harm to others without paying the full cost of the damage. In these and other, similar cases, the pursuit of private gain will not necessarily promote the social welfare.”).
\textsuperscript{89} COLANDER, supra note 64, at 178.
\textsuperscript{91} Id.
\textsuperscript{92} Id. at 15.
\textsuperscript{93} See FARNSWORTH, supra note 3, § 12.3, at 736 (“A bargained-for exchange from which both parties benefit is socially desirable in the sense that it results in a gain in efficiency by moving the assets that are exchanged to higher valued uses.”).
\textsuperscript{94} MATHIS & KOSCIANSKI, supra note 83, at 47.
then can be said that the two fundamental explanatory variables driving all contractual relationships are (1) each party's perceived gain in utility effectuated by their contract, and (2) the price to be paid for same.95

The principle of rational choice, as illustrated in Figure 2, posits that a market participant will choose to engage in a contract of exchange if his or her marginal utility of doing so exceeds his or her choice to the contrary. Rational economic action is thus defined as action taken for the purpose of maximizing the actor's marginal utility. Contracts effectuated by rational choice are encouraged and enforced as a matter of public policy because of their wealth-creating nature.96 Scarce resources are ultimately allocated to those who value them most through the process of voluntary, value-enhancing exchanges.97

The law of contracts, therefore, must not only honor the economic principles of rationality, but implement such principles in the formation of its remedies. The bargained-for exchange of interpersonal utility is the foundation of all rational exchange transactions, and this exchange of interpersonal utility must not be arbitrarily ignored when crafting a remedy for breach. This premise is particularly important with respect to whether the law of contracts should implement a remedy grounded on the cost of completing one's performance or the diminution in value resulting from one's failure to perform in accordance with contract terms. When the law of contracts mandates for the for-

95. COLANDER, supra note 64, at 179.
96. See FARNSWORTH, supra note 3, § 12.3, at 736 ("Through voluntary agreements, in which individuals exchange assets that they own for others that they value more, society progresses toward the goal of economic efficiency.").
97. See JOSEPH M. PERILLO, CALAMARI & PERILLO ON CONTRACTS 9–10 (5th ed. 2003) ("Neoclassical legal economists observe that people allocate society's scarce resources through the exchange process. Voluntary exchange occurs in a free-market setting because the parties, seeking to maximize their economic welfare, give up resources in return for more valuable resources. Such exchange is socially desirable because it moves resources to 'higher valued uses,' thereby increasing 'allocative efficiency.' By pursuing self-interest, then, people promote the interests of society. Skeptical of the capacity of lawmakers to improve on this 'private' method of economic organization, neoclassical legal economists believe that contract law appropriately enforces voluntary exchange." (quoting ROBERT A. HILLMAN, THE RICHNESS OF CONTRACT LAW: AN ANALYSIS AND CRITIQUE OF CONTEMPORARY THEORIES OF CONTRACT LAW 214 (1997))); see also RESTATEMENT (SECOND) OF CONTRACTS § 72 cmt. b (1981) ("Bargains are widely believed to be beneficial to the community in the provision of opportunities for freedom of individual action and exercise of judgment and as a means by which productive energy and product are apportioned in the economy. The enforcement of bargains rests in part on the common belief that enforcement enhances that utility. Where one party has performed, there are additional grounds for enforcement. Where, for example, one party has received goods from the other and has broken his promise to pay for them, enforcement of the promise . . . encourages the making of socially useful bargains . . . .").
The Principle of Rational Choice

If \( MU/K > MU_{\text{no}K}/P_{\text{no}K} \), rational market participant chooses to contract.

If \( MU/K < MU_{\text{no}K}/P_{\text{no}K} \), rational market participant chooses not to contract.

\( MU = \) Marginal Utility
\( P = \) Price
\( K = \) Contract

* Rational market participants engage in contract in which the incremental utility of doing so exceeds the incremental utility of refraining to contract.

C. Fully Informed Market Participants

Rationality requires that market participants be fully informed of all relevant economic and technological data.\(^{100}\) In fact, as noted above, having fully informed market participants is an essential operational condition of the perfectly competitive model. Without full information, distortions in output and price result. If at the time of contracting a party is ignorant of information relevant to the interpersonal utility he or she attaches to the other party's expected performance, such ignorance distorts the true value of the contract. To the extent such ignorance is relevant to the party's core expectations with respect to the transaction in question, the consummation and execution of a remedy grounded on diminution in value rather than cost of completing performance, such a remedy may ultimately nurture an inefficient outcome to the extent it ignores the aggrieved party's utility revealed at the time of contracting. Contract law's disproportionality test,\(^{98}\) if not understood within this context, will result in the imposition of an economically inefficient remedy generating the very economic waste the test was intended to discourage.\(^{99}\)

98. See Restatement (Second) of Contracts § 348(2) (1981).
99. See Farnsworth, supra note 3, § 12.13, at 790 (“The less generous measure of damages for partial breach, based on the diminution in market price, is sometimes defended on the ground that allowing the more generous measure, based on cost to remedy the defect, would result in 'economic waste.'”); see also County of Maricopa v. Walsh & Oberg Architects, Inc., 494 P.2d 44, 46-47 (Ariz. Ct. App. 1972) (“If economic waste is present, the effect is to award damages on the basis of the difference in value of the building had it been completed in accordance with the contract and the value of the building as erected, rather than on the basis of reasonable cost of completion to conform to the contract.” (emphasis added)); Restatement of Contracts § 346(1) cmt. b (1932) (“There are numerous cases . . . in which the value of the finished product is much less than the cost of producing it after the breach has occurred. Sometimes defects in a completed structure cannot be physically remedied without tearing down and rebuilding, at a cost that would be imprudent and unreasonable. The law does not require damages to be measured by a method requiring such economic waste.” (emphasis added)).
100. See supra note 75 and accompanying text.
tion of the transaction results in an inefficient allocation of resources, i.e., scarce resources will not be directed to those who value them most. The lack or inaccuracy of the available information relevant to the transaction at the time of contracting may likely cause a party to engage in an exchange transaction that he or she otherwise would choose to avoid. Such an exchange transaction is *pareto inefficient*;\(^{101}\) the party disadvantaged by incomplete or inaccurate information at the time of contracting may indeed be made worse off by engaging in the proposed exchange transaction.

If at the time of contracting a party reveals the interpersonal utility he or she attaches to a specific term relating to the other party's performance, the failure of that term will likewise result in an inefficient exchange transaction. But for the expected performance of the referenced term and utility attached thereto, the party would not engage in the transaction. Accordingly, knowledge regarding true value of the other party's performance is critical for a party to exercise rational choice with respect to an exchange transaction. For example, in *Peevyhouse v. Garland Coal & Mining Co.*,\(^ {102}\) had the nonbreaching parties known at the time of contracting that there was going to be a failure in performance of the restoration terms of the transaction by the coal and mining company, it is likely that the aggrieved party would have rejected the proposed exchange transaction. Similarly, a party's knowledge that upon breach of such performance the law of contracts might deny the recovery of a party's lost expected utility attached to the other party's performance, the aggrieved parties may likely choose to avoid the proposed exchange transaction.

The aggrieved parties in *Peevyhouse* placed significant interpersonal utility on having their farm restored to its pre-contract condition.\(^ {103}\) Such value directly influenced their negotiations with respect to the price terms of the leasehold, and therefore was a critical component of the proposed transaction.\(^ {104}\) At the time of consummation, the agreed exchange transaction was seemingly *pareto efficient*, provided the restoration terms were performed. However, Garland Coal's strategic decision not to perform ultimately rendered the exchange transaction to be *pareto inefficient*, especially in light of the court's decision denying the Peevyhouses' recovery of their lost expected utility measured in terms of cost-of-performance damages.

Remarkably and ironically, the consummated *pareto efficient* exchange transaction was subsequently rendered *pareto inefficient* by the Oklahoma Supreme Court on the grounds of economic effi-

\(^{101}\) See *supra* note 81 and accompanying text.


\(^{103}\) *Id.* at 115 (Irwin, J., dissenting).

\(^{104}\) *Id.*
ciency. Peevyhouse illustrates the illogical circularity inherent in the jurisprudential approach to such exchange transactions. The interpersonal utility attached by the Peevyhouses and acknowledged by Garland Coal with respect to the restoration performance term at the time of contracting created an efficient exchange transaction. And yet, the court refused to award cost-of-performance damages because it viewed such an award as economically inefficient. On the contrary, a pareto efficient outcome could have nonetheless been attained by awarding the aggrieved parties the cost-of-performance damages. Such an award, and only such an award, places the nonbreaching parties in the position in which they would have been had their farmland been restored by the coal mining company.

D. The Unfettered Forces of Supply and Demand Must Be Free to Determine Price and Output Levels

It has long been accepted in the field of microeconomics that the efficiency of the market mechanism necessarily depends on the tendency of supply and demand to equilibrate and determine an equilibrium market price and output level. As Professor Samuelson instructs, "By determining the equilibrium prices and quantities, the market allocates or rations... the scarce goods of... society among... possible uses." The unfettered forces of supply and demand efficiently determine the desired level or output, as well as a market-clearing competitive price with respect to same. Such equilibrating forces ultimately minimize, if not eliminate, any economic waste characterized by shortages and surpluses. Such

105. See id. at 113 ("In view of the unrealistic fact situation in the instant case, and certain Oklahoma statutes to be hereinafter noted, we are of the opinion that the 'relative economic benefit' is a proper consideration here. This in accord with the recent case of Mann v. Clowser, 190 Va. 887, 59 S.E.2d 78, where in applying the cost rule, the Virginia court specifically noted that 'the defects are remediable from a practical standpoint and the costs are not grossly disproportionate to the results to be obtained.'").

106. As the dissenting opinion to the case notes, Defendant had knowledge of the benefits that it would receive under the contract and the approximate cost of performing the contract. With this knowledge, it must be presumed that defendant thought that it would be to its economic advantage to enter into the contract with plaintiffs and that it would reap benefits from the contract, or it would have not entered into the contract. Id. at 115 (Irwin, J., dissenting).

107. See id. at 113–14 (majority opinion).

108. See id. at 114–16 (Irwin, J., dissenting).

109. See supra note 77 and accompanying text.

110. PAUL A. SAMUELSON & WILLIAM D. NORDHAUS, ECONOMICS 56 (17th ed. 2001) ("We find the market equilibrium by looking for the price at which quantity demanded equals quantity supplied.").

111. Id. at 60; see also Colander, supra note 64, at 96–98.
The market equilibrium price ($P_e$) and quantity ($Q_e$) is determined at point $E$, the intersection of supply and demand. At price $P_e$, market participants willingly supply what other market participants willingly demand. When the price is too low (e.g., $P_L$), quantity demanded exceeds quantity supplied, shortages result, and the price is driven up to equilibrium. When price is too high (e.g., $P_H$), quantity supplied exceeds quantity demanded, surpluses result, and the price is driven down to equilibrium.

An efficient outcome, however, is premised on supply-and-demand forces being free to equilibrate. To the extent these market forces are obstructed and therefore are not free to determine efficient output levels and prices, economic waste should reasonably be expected. For example, a legally imposed price control that either arbitrarily mandates a price below or above the equilibrium price ($P_e$) results in either inefficient surpluses or shortages as depicted in Figure 3.112

An inefficient default rule regarding the measure of damages can operate as a de facto price control; it can arbitrarily obstruct the equilibrating forces of supply and demand. By ignoring a contract price set by the supply-and-demand forces driving the consummation of an exchange transaction, an inefficient default rule will effectuate an inefficient surplus or shortage, depending on whether its implementation results in an actual price above or below the otherwise market price stated in the contract.

Figure 4 depicts the effect of inefficient default rules that ultimately work to obstruct the otherwise autonomous forces of supply and demand. If we assume that the contract price in Peevyhouse reflects the value attached by the Peevyhouses for agreeing to lease their land for strip mining purposes (i.e., rent, royalties, and restoration) as well as what Garland Coal is willing pay to lease such land

112. See Samuelson & Nordhaus, supra note 110, at 79–82; see also Colander, supra note 64, at 113–16; Pindyck & Rubinfeld, supra note 67, at 288–93; Mathis & Koscianski, supra note 83, at 326–31.
At price $P$, market participants willingly supply what other market participants willingly demand. When the default rule prohibits the recover of cost of completion damages in a contract in which completion of performance is an integral part of the supplier's contract price, such a rule effectively places a ceiling on the contract price of $P_L$ resulting in a shortage of supply. Similarly, a default rule that provides a supplier recovery in excess of the negotiated price $P_H$ (for a purchaser's breach) results in a surplus.

(i.e., rent, royalties, and restoration), then a default rule that prohibits the Peevyhouses from recovering restoration costs upon Garland Coal's nonperformance results in an effective price below that which would otherwise be determined by their individual supply and demand functions. Such a default rule operates to impose a price control with respect to the leasing of farmland for strip mining purposes.

E. An Incoherent Application of an Ambiguous Default Rule Regarding Cost of Completion Damages Threatens Several Operational Conditions Necessary for the Perfectly Competitive Model to Thrive

As discussed above, an incoherent application of an ambiguous default rule regarding the cost of completion damages threatens several of the operational conditions of the perfectly competitive model, i.e., rationality, fully informed market participants, and unimpeded supply-and-demand forces. The extent to which an incoherent application of the default rule arbitrarily results in the denial of cost-of-performance damages raises grave concerns regarding the efficiency in the marketplace. It ignores the aggrieved party's utility attached to the breaching party's performance that is likely to influence a rational decision with respect to whether the nonbreaching party should engage in an exchange transaction; it creates an environment of asymmetrical information regarding enhancement of the contracting parties' utility.
attached to the perceived (un)certainty of performance at the time of contract formation; and finally, an incoherent application of an ambiguous default rule may ultimately impede the capacity of supply and demand to determine an efficient, market-clearing price.

IV. GAME THEORY—AN ANALYSIS OF STRATEGIC BEHAVIOR

A. Extensive Form Games and the Need for Unambiguous and Certain Default Rule

Using a traditional game theory model (specifically, the "extensive form game"), the following analysis further demonstrates the inefficiencies resulting from a contract regime in which the recovery of cost-of-performance damages is influenced by an ambiguous doctrine of economic waste or its related disproportionality test. The following example incorporates the basic facts and circumstances addressed in 
Peevyhouse v. Garland Coal Mining Co.

Figure 5 summarizes a normal form game in which it is assumed the law of contracts will not hold a breaching party liable for cost-of-performance damages. As the first players in the game, the Peevyhouses must decide whether to engage in an exchange transaction and place their farm under the control of the Garland Coal Mining Co. If they decide to engage in a leasehold transaction with Garland Coal, as the second player in the game, Garland Coal must decide whether to cooperate in accordance with the terms of the parties' transaction or to appropriate (i.e., breach) by failing to restore the Peevyhouses' farmland. Cooperation is pareto efficient because both parties are made better off by an exchange transaction. At the time of contracting, the expected payoff of the transaction is allocated between the parties in the form of rent, royalties and profits (denoted above as \(\pi\)). The transaction is value-enhancing as evidenced by a

113. See Douglas G. Baird, Robert H. Gertner & Randal C. Picker, Game Theory and the Law 7 (1994) ("Game theory, like all economic modeling, works by simplifying a given social situation and stepping back from the many details that are irrelevant to the problem at hand. The test of the model is whether it can hone our intuition by illuminating the basic forces that are at work but not plainly visible when we look at an actual case in all its detail.").

114. Id. at 50 ("[T]he extensive form game, which models explicitly the actions that the players take, the sequence in which they take them, and the information they have when they take these actions. Because of its emphasis on actions, the sequence in which those actions are taken, and the information available to the players at each move, the extensive form game is often the appropriate way to model interactions between parties that take place over time.").

115. For a discussion and application of an agency game with and without contract enforcement from which the example in the above text was drawn, see Robert Cooter & Thomas Ulen, Law & Economics 196–201 (4th ed. 2004).

Normal Form Game—Ambiguous or Absence of Default Rule

**Peevyhouse v. Garland Coal Mining Co.**

<table>
<thead>
<tr>
<th>Willie &amp; Lucille Peevyhouse (First Players)</th>
<th>Garland Coal Mining Co. (Second Player)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Engage in Exchange Transaction</strong></td>
<td>Cooperate by Performing Promise to Restore Farmland</td>
</tr>
<tr>
<td></td>
<td>((\pi) - (x') &gt; 0) (shared payoff)</td>
</tr>
<tr>
<td></td>
<td>((\pi) + (u') &gt; 0) (shared payoff)</td>
</tr>
<tr>
<td><strong>Reject Exchange Transaction</strong></td>
<td>0</td>
</tr>
</tbody>
</table>

shared payoff; both parties benefit from the exchange transaction. The decision to appropriate is *pareto inefficient* because one party (Garland Coal) is made better off at the expense of the other party (Peevyhouse). The decision to appropriate redistributes all the benefits to Garland Coal, the second player.

If the Peevyhouses decide to engage in an exchange transaction, then Garland Coal receives more by appropriating than cooperating, e.g., \((\pi) + (x')\), where \((x')\) equals the cost of restoration, \((u')\) equals the Peevyhouses’ interpersonal utility attached to the restoration of their farmland, and \((x')\) approximates \((u')\). Thus, Garland Coal’s best move in the above game is to appropriate; appropriation is its dominant strategy.117 In anticipation of Garland Coal’s dominant strategy, the Peevyhouses best move is to reject an exchange transaction with Garland Coal. Consequently, in circumstances in which the law of contracts fails to enforce performance through the award of cost-of-performance damages, value-enhancing transactions are discouraged.

The above payoff matrix changes dramatically if a responsive law is assumed, a law that recognizes the availability of cost-of-performance damages in cases in which such performance is a material term of the exchange transaction. Figure 6 depicts a revised payoff of the normal form game involving the Peevyhouses (the first players) and Garland Coal (the second player). In this game, it is assumed that the law of contracts will hold the second player liable for cost-of-performance damages, regardless of the application of an economic waste doc-

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117. See Cooter & Ulen, supra note 115, at 197 n.4 (“Game theorists describe a move that is best against any possible move by the other side as a ‘dominant strategy’. . . . The first player does not have dominant strategy, but the first player has a best reply to the second player’s dominant strategy.”).
trine. If the Peevyhouses engage in an exchange transaction with Garland Coal, and Garland Coal performs, the parties experience a *pareto efficient* transaction with both parties sharing the surplus ($\pi$) created by their exchange. Similarly, a *pareto efficient* outcome is derived even in the event of Garland Coal's breach. The game assumes that an award of cost-of-performance damages places the Peevyhouses in the position they would have been in had Garland performed its obligation to restore the property to its pre-transaction condition.

**Figure 6**

<table>
<thead>
<tr>
<th>Normal Form Game—Default Rule Compensates Cost of Performance = ($x'$)</th>
<th>Peevyhouse v. Garland Coal Mining</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Garland Coal Mining Co. (Second Player)</td>
</tr>
<tr>
<td><strong>Willie &amp; Lucille Peevyhouse</strong> (First Players)</td>
<td>Cooperate by Performing Promise to Restore Farmland</td>
</tr>
<tr>
<td>Engage in Exchange Transaction</td>
<td>($\pi + (u') &gt; 0$) (shared payoff)</td>
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<td>Reject Exchange Transaction</td>
<td>0</td>
</tr>
</tbody>
</table>

If Garland Coal performs its obligation to restore the Peevyhouse farmland to its pre-transaction condition, the anticipated surplus ($\pi$) is shared by the parties in accordance with the terms of the transaction. Alternatively, the Peevyhouses can receive a payoff of zero by rejecting the proposed exchange transaction at inception. Faced with these two alternatives, engaging in an exchange transaction with Garland Coal is the Peevyhouses' best move.

In contrast, Garland Coal Mining Company's breach (appropriation) yields a payoff to Garland Coal of ($\pi$), from which Garland Coal must pay compensation of ($x'$) to the Peevyhouses equal to ($u'$), the utility the Peevyhouses expected from the restoration of their farmland. In this game, Garland Coal cannot be made better off by failing to perform, and may even find itself worse off to the extent that the value ($x'$) derived within the adversarial process, given the potential for measurement error, is greater than its expected payoff ($\pi$). Consequently, the best move for Garland Coal is to cooperate and perform its promise to restore the farmland. Because Garland Coal's best move is to cooperate by performance, the best move for the Peevyhouses is to engage in an exchange transaction which is ultimately value enhancing.
B. Asymmetrical Information and the Advantages of Repeat Players

Although game theory postulates that a repeatedly played game fosters ultimate cooperation,118 this only holds to the extent the repeated game includes the same players. Should the Peevyhouses and Garland Coal ever have the opportunity to engage in another exchange transaction, both parties will possess knowledge of each player's previous play; a subsequent transaction will be possible only if the parties indeed cooperate, especially given Garland Coal's previous breach. Such cooperation might be effectuated by the Peevyhouses insisting that their payoff include their anticipated cost restoration, or by securing Garland Coal's performance with a bond.

Repeated play, however, is highly improbable with respect to the parties in Peevyhouse, especially given the nature of the transaction. First, the subject matter of the transaction is not susceptible to repeated play. Once the farmland is mined and its resources depleted, it is unlikely that it will be mined again. While Garland Coal more than likely will play in other games with other parties by leasing land for strip mining purposes, it is less likely that the Peevyhouses will have similar opportunities. Thus, while the Peevyhouses are likely to be one-time players, Garland Coal is a repeat player to the extent that it repeatedly engages in similar exchange transactions. This difference is significant because it results in information asymmetries that further the potential of economic waste at the time of contract formation.

Given that Garland Coal is likely a repeat player, it may amortize the cost of obtaining knowledge of the existing legal rule over several, even hundreds of transactions. On the other hand, the Peevyhouses are likely to be one-time players, and as such they do not have the capability to amortize these costs over several transactions. The

118. Robert D. Cooter, Against Legal Centrism, 81 CAL. L. REV. 417, 422 (1993) (reviewing ROBERT C. ELLICKSON, ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES (1991)) ("When people are tied to each other in an enduring relationship, the game of cooperation is played over and over again. If a person 'cheats' in one round of the game, the victim will have the opportunity to retaliate in subsequent rounds. The future interest of the parties in the relationship may cause them to cooperate in each play of the game. In general, one-shot games with noncooperative solutions often have cooperative solutions when they are repeated."); see also Alan O. Sykes, "Mandatory" Retaliation for Breach of Trade Agreements: Some Thoughts on the Strategic Design of Section 301, 8 B.U. INT'L. L.J. 301, 307 (1990) ("The opportunity for players to punish one another in future periods for cheating, coupled with the fact that mutual compliance is better for everyone than mutual cheating, offers some hope that compliance can be sustained over time. But sustained compliance is by no means assured."); Eric Rasmusen, GAMES AND INFORMATION: AN INTRODUCTION TO GAME THEORY, chs. 4–5 (1989); DAVID M. KREPS, A COURSE IN MICROECONOMIC THEORY 505–15 (1990); Drew Fudenberg & Eric Maskin, The Folk Theorem in Repeated Games with Discounting or with Incomplete Information, 54 ECONOMETRICA 533 (1986).
Peevyhouses and others similarly situated are likely to rely on their common sense (i.e., uninformed legal advice) at the time of contracting. Accordingly, when repeat players contract with one-time players, "there is likely to be asymmetric information about the content of the contract law."119 In such situations, repeat players are in a position to leverage the asymmetrical information to their advantage, and one-time players are disadvantaged with respect to making a rationale choice at the time of contracting.

C. Determining an Appropriate Default Rule120

The anticipated strategic behavior of the parties discussed above demonstrates the need for a more appropriate default rule regarding the award of damages in construction cases. As it stands today, the generally accepted default rule regarding the award of damages in construction cases appears to be grounded on the court's assessment of what constitutes economic waste at the time of breach. Such an approach is erroneous from both an economic and a jurisprudential perspective. From an economic perspective, it is clear that the courts misunderstand the concept of economic waste. More importantly, from a jurisprudential perspective, it has long been acknowledged that the determination of an appropriate default rule should be grounded upon the expectations of the contracting parties at the time of formation and not at the time of breach.121 It should be derived by discern-

119. RANDY E. BARNETT, TEACHER'S MANUAL, CONTRACTS, CASES AND DOCTRINE 66 (3d ed. 2003). See also id. at 66–67 (wherein Professor Barnett formalizes the analysis with respect to jurisprudential determination of default rules); Timothy J. Muris, Cost of Completion or Diminution in Market Value: The Relevance of Subjective Value, 12 J. LEGAL STUD. 379, 390 (1983) ("If the law awards diminution, individuals likely to have subjective value might systematically underprotect themselves because they did not understand the law enough . . . .").


121. See, e.g., Ayres & Gertner, supra note 120, at 89 & n.18.
ing "how the parties would have provided for it had they sought to do so."122

V. THE CASE FOR A NEW DEFAULT RULE

A. Fallacies Under the Current Default Rule

In order to summarize the prior discussions, it is helpful to identify and dispel the fallacies of the justifications asserted by the courts for refusing to award an aggrieved party his cost of performance for breach of a construction contract.

First, the current approach to the award of contract damages in construction cases does not prevent economic waste. Despite the justification used by the courts for not awarding an aggrieved party his cost of performance, there is no economic waste created by simply fulfilling the intent of the parties. On the contrary, courts resorting to this alternative measure of damages under the current approach are, in fact, creating economic waste by not fulfilling the intent of the parties. Under the perfectly competitive model, the aggrieved party probably would not have entered into the transaction had he known beforehand that his expectation interests would not be satisfied by full performance or damages sufficient to substitute for full performance.

Moreover, awarding an aggrieved party his cost of performance does not create a windfall for such party. The fact that the aggrieved party may choose to spend his damages on something other than remedying the defect should be irrelevant to the determination of the proper measure of damages.123 This is routinely done in the context of casualty insurance in that the insured is compensated for the cost of repair or replacement of the property suffering the casualty. Generally, there is no requirement that the insured fix or replace the property with the insurance proceeds. Moreover, the threat of this happening is not factored into what the insurance company is required to pay. This is simply a reallocation of resources and cannot be properly classified as economic waste.124 If there is a windfall by an award of damages in construction cases, it is created in favor of the breaching party when the court allows him to keep the cost of performance that he presumably factored into his transaction costs, ironically catapulting the breacher into a better position than he would have had upon full performance.

123. See Emery v. Caledonia Sand & Gravel Co., 374 A.2d 929, 933 (N.H. 1977) ("If the plaintiffs choose to 'pocket' their recovery, they will have foregone the restoration of their land; they will not have been unjustly enriched."); see also Marschall, supra note 14, at 746, 758.
124. See Eisenberg, supra note 27, at 1158 ("An award of damages, however, merely redistributes wealth between the parties, and therefore cannot in itself involve waste.").
Lastly, the current approach does not account for the fact that the
avoidance doctrines are available to relieve one or both parties of du-
ties to perform under transactions in which perfect information is not
known to both parties or when the perfect information changes as a
result of unforeseeable and uncontrollable forces.125

B. An Efficient and More Appropriate Default Rule

The default rule regarding the proper measure of damages in
breach of a construction case should reflect certainty in that the con-
tracting parties should be able to rely on it at the time of contracting
as an essential part of their perfect information in weighing the costs
and benefits of entering into the transaction. In light of the need for
certainty, the default rule governing the proper determination of the
loss of value of performance upon breach of a construction contract
should be simply written as follows:

If the breach results in defective or unfinished construction and the loss in
value to the injured party is not proved with sufficient certainty, he may re-
cover damages based on the diminution in the market price of the property
day caused by the breach.126

Under this simply stated rule, an aggrieved party would receive
his cost of performance where he can establish the same with the de-
gree of certainty required by contract law jurisprudence.127 Observe
that this new and improved default rule eliminates any reference to
economic waste or a disproportionality test. As demonstrated above,
such doctrines have no relevance in the analysis and therefore should
play no role in assessing and awarding expectation damages in con-
struction cases. As Figure 7 illustrates, if the aggrieved party cannot
prove his cost of performance with sufficient evidence, then, and only
then, his loss of value is measured by the diminution in value caused
by the deficient performance. This comports with the general goal of
compensating the aggrieved party for the loss he sustains due to less
than full performance by the breaching party. In any case, the initial
inquiry should be whether the aggrieved party can adduce sufficient
evidence of the cost of substitute performance.

Generally, a party is entitled to such damages as he can prove were
caused by the breach and in the amount established with sufficient

125. See, e.g., Chomsky, supra note 8, at 1500 (discussing the availability of the doc-
trine of impracticability to relieve a party from contractual obligations where a
change in circumstances renders performance severely more burdensome than
originally contemplated).

126. This statement is simply an abbreviated version of the provision in the Restate-
ment (Second) of Contracts, recognizing that provable loss of value should be the
main focus and eliminating consideration of the disproportionality of the loss to
the cost of performance. See Restatement (Second) of Contracts § 348(2)

127. Id. § 352.
Damages for Breach in Defective or Unfinished Construction Cases—An Efficient and More Appropriate Default Rule

<table>
<thead>
<tr>
<th>Breach</th>
<th>Unfinished or defective construction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Damages</td>
<td>Cost of completion or cost to remedy, unless nonbreaching party attaches no values to completion or nondefective performance, then only diminution in value.</td>
</tr>
</tbody>
</table>

certainty. This limitation on the type and amount of damages recoverable by an aggrieved party ensures that the award is not based on mere speculation or conjecture. Thus, an aggrieved party would still be required to adduce competent evidence of the cause and amount of his actual loss as a condition of recovering his cost of performance.

This rule also preserves the long-standing procedure of determining the loss of value in terms of the actual worth of full performance to the aggrieved party, not to the “hypothetical reasonable person.” In the same vein, whether courts view the value of full performance in terms of what the parties agreed it would be worth is irrelevant for the purpose of determining the loss of value to the aggrieved party. This hands-off approach is consistent with the rationale for not inquiring into the adequacy of consideration in that the court normally will not substitute its judgment for that of the parties in determining the worth of the exchange. At the damages stage of the analysis, courts should not be engaged in a determination of whether the aggrieved party truly wanted the performance for which he contracted. Rules of construction and interpretation serve to establish the relevant terms of the contract early in the litigation so that the court will know what duties were relevant way before the matter reaches the damages phase. Thus, if the unfulfilled duty was included as a term of the contract, it is better to err on the side of regarding the duty as an essential term of the parties’ bargain, lest we upset the bargaining process by artificially assigning a pecking order of importance to terms that the parties presumably considered at great length prior to engaging in the transaction. On the other hand, if the breaching party has credible and competent evidence that the aggrieved party placed no value on the unfulfilled duty at the time of contracting, let him navigate the

129. See Farnsworth, supra note 3, § 12.15, at 799–800.
130. See id. § 12.8, at 758 (“Damages based on expectation should therefore take account of any circumstances peculiar to the situation of the injured party, including that party’s own needs and opportunities, personal values, and even idiosyncrasies.”).
131. See id. § 2.11, at 71.
maze of parol evidence rules in an effort to rebut the presumption of materiality.

Assuming the aggrieved party has no trouble establishing that he attached some value or utility in having the contract completed, the amount of money that would allow him to obtain substitute performance is the proper measure of damages. Generally, this will not be a problem where there is a market for the type of performance lacking under the contract. However, if there is no such market, the aggrieved party may not be able to establish with sufficient certainty his cost of obtaining substitute performance. In such rare situations, it would be proper to resort to the alternative measure of damages—diminution in value.

C. An Application of the New and Improved Default Rule

Let us return to the hypothetical regarding the missing hand-carved fireplace mantel discussed in Part II, analyzing it under the proposed default rule. Under the new and improved default rule, the inquiry starts with whether the owner is able to prove with sufficient certainty his loss of value caused by the contractor's failure to fully perform. Since there is a readily available market for substitute performance, the magnitude of cost-of-performance damages can be measured with reasonable certainty. Moreover, we know that the breach caused the owner to be deprived of the fireplace mantel. Thus, our analysis begins and ends with the cost of performance, and owner would be entitled to recover or recoup from the contract price $20,000 as his cost of performance.

It bears mentioning that the default rule is just that, a rule that applies in the absence of the parties' express agreement to be governed by another remedy. Thus, it allows the parties to opt out of its application should they have the foresight and need to do so. By the same token, it nurtures transaction efficiencies by requiring the parties to contract around the default rule to the extent they so desire. Such a clear and concise default rule would be a component of the information available to contracting parties when deciding whether to engage in the transaction; and they will be equipped and prepared to factor into their analysis any potential application of the default rule, as well as any other substitute remedy upon which they may agree. Thus, the underlying operational conditions of the perfectly competitive model are preserved.

VI. CONCLUSION

The doctrine of economic waste operates to interfere with contractual relationships by allowing the courts to second-guess the value of the exchange assigned and agreed to by the parties. This flies in the
face of the basic tenet of contract law of fulfilling the parties' intent. In order to preserve the autonomy of contracting parties to deal with each other as they see fit, it is essential that default rules governing damages for breach of contract reflect the goal of awarding an aggrieved party the benefit of his bargain. This generally requires an award of damages that will allow the aggrieved party to obtain substitute performance, lest the perfectly competitive model of economics be displaced by an altruistic judicial system. Moreover, when the justifications for depriving an aggrieved party of the benefit of his bargain are based on unfounded fears of encouraging the waste of valuable resources or providing a windfall to the aggrieved party, the need for judicial restraint in this area is magnified. In these cases, the role of the court should be limited to ensuring that the aggrieved party is compensated in such an amount as necessary to reflect the value he placed on the performance of which he has been deprived by the other party's breach, nothing more and nothing less. As observed in Professor Corbin's treatise on contracts:

We have a free market, under our common law, for the reason that the courts have left it free. They do not require that one person shall pay as much as others may be willing to pay, or that one person shall receive as little as others may be willing to receive for a like article. The contracting parties make their own contracts, agree upon their own exchanges, and fix their own values.132

The remarkable efficiencies of the free market have long been recognized both in theory and in practice, and it is imperative that our common law accommodate the continued existence of such a market by nurturing, maintaining, and promoting an environment within which it may thrive. While the current default rule regarding the awarding of damages in construction cases jeopardizes several of the operational conditions of the perfectly competitive model (as demonstrated in Part III above), the new and improved default rule as herein discussed accommodates the requisite operational conditions of laissez faire economics. By eliminating the misunderstood economic waste doctrine and the disproportionality test from the analysis of expectancy damages, the new and improved default rule constrains the court's authority to arbitrarily interfere with one of the essential components of perfect competition—the freedom of contract. The new and improved default rule proposed herein endows contracting parties with the right to make their own contracts, to agree upon their own exchanges, and to fix their own values such that scarce resources may be directed to those who value them most, thereby ultimately (and ironically) minimizing the social evil of economic waste.

Of course, the policy reflected in the above-cited passage is not limited to defining a new and workable default rule for determining dam-

ages in the breach of a construction case; this policy transcends every aspect of contract damages. To this end, the current climate of invalidating liquidated damages clauses when the court regards them as penalties is yet another area that suffers from hasty disregard of the parties' intent by courts with altruistic notions of saving the parties from themselves.\textsuperscript{133} Perhaps, this issue deserves a closer look as well.

\textit{Judges are apt to be naïf, simple-minded men, and they need something of Mephistopheles. We too need education in the obvious—to learn to transcend our own convictions and to leave room for much that we hold dear to be done away with short of revolution by the orderly change of the law.} \textsuperscript{134}

\textit{Oliver Wendell Holmes, Jr.}

\textsuperscript{133} See U.C.C. § 2-718 (2002); Restatement (Second) of Contracts § 356 (1981).

\textsuperscript{134} Justice Oliver Wendell Holmes, Jr., Law and the Court, Speech at a Dinner of the Harvard Law School Association of New York (February 15, 1913), in \textit{The Occasional Speeches of Justice Oliver Wendell Holmes} 172 (Mark DeWolfe Howe ed. 1962).