

**1. Econ 276a, "Law and Economics of Contracts I" (Yale Econ/Law/Business)**

**2. Brief Description (about 3 lines) and state prerequisite if any.**

Parties engaging in economic exchange often organize their relationships through written contracts. We study how the design of these contracts and the body of law which governs and influences their economic efficiency.

Prerequisite: Basic Calculus, Intermediate Microeconomics or permission of instructors

**3. Expanded Description (Do not repeat the brief description) include the following in one or two paragraphs:**

While contract theory devises incentives schemes from scratch in search for efficient solutions given a certain economic environment, the Law & Economics literature takes institutions as given and asks how they facilitate efficient trade (e.g. by showing that standard breach remedies of contract law interact with simple contracts to provide efficient mechanisms in economically relevant situations). This course is situated at the intersection of those two literatures. It takes institutions of contract law seriously but operates on the premise that the study of contract theory exposes the basic effects behind efficiency result of the Law & Economics literature and favors a more rigorous approach, in particular with respect to informational assumptions.

The main subject of the course will be to study contractual solutions to the hold-up problem. Starting from seminal articles in the bilateral trade literature and the literature on breach remedies, the course introduces students to the most recent developments of the field using a uniform notional apparatus. Students will be provided with handouts but are strongly encouraged to read the original articles (see below).

**4. Number of pages of reading each week**

40 (though there will be optional readings for students who want to go more into depth). There will also be problemsets to prepare students for the exam.

**5. Midterm exam or Paper?**

Midterm exam

**6. Any research paper due by midterm and number of pages**

Optional paper (as an alternative to taking the final examination): students who choose this option will be asked to write on a paper to builds on insights gained the optional reading. Topic must be chosen by date of midterm examination.

15 Pages (not including references and appendix).

**7. Final exam or final paper**

Final Exam

## 8. Syllabus of the course.

### I. Introduction

- 1) The Role of Institutions: Law as an Institution
  - 1) North, D. C. (1991): "Institutions" *The Journal of Economic Perspectives*, Vol. 5, No. 1. (Winter, 1991), pp. 97-112.
  - 2) Coase, R. (1998): "The New Institutional Economics" *The American Economic Review*, Vol. 88, No. 2, Papers and Proceedings of the Hundred and Tenth Annual Meeting of the American Economic Association. (May, 1998), pp. 72-74.
  - 3) Williamson, O. E. (2000): "The New Institutional Economics: Taking Stocks, Looking Ahead" *Journal of Economic Literature*, Vol. 38, No. 3. (Sep., 2000), pp. 595-613.
  - 4) Handout
- 2) Economic Motives for Contracts
  - 1) Hermalin, B.E.; Katz A.W.; Craswell, R. (2007): Contract Law, in: Handbook of Law and Economics, Vol 1., Polinsky, A. M.; Shavell, S. (Hrsg.), North-Holland, 1-12.
- 3) The Hold-up problem.
  - 1) Handout
- 4) Math Refresher (Partial Integration, Implicit Differentiation, Differentiation with respect the bounds of an Integral, &c.)
  - 1) Handout

### II. Simple Contracts and Breach Remedies inducing Selfish Investments

- 5) Binary Breach without Renegotiation
  - 1) Shavell, S. (1980): "Damage Measures for Breach of Contract", *Bell Journal of Economics*, 1980, 11 (2), 466-490.
  - 2) Shavell (1994): "The Design of Contracts and Remedies for Breach", *Quarterly Journal of Economics*, February, 1984, 99 (1), 121-148.
  - 3) Handout.
- 6) Binary Breach with Renegotiation
  - 1) Rogerson, W. P. (1984): "Efficient Reliance and Damage Measures for Breach of Contract", *Rand Journal of Economics*, 1984, 15 (1), 39-53.
  - 2) Handout.
- 7) Continuous Breach
  - 1) Edlin, A.; Reichelstein, S. (1994): "Holdups, Standard Breach Remedies, and Optimal Investments", *American Economic Review*, 1996, 86 (3), 478-501.
  - 2) Edlin, A. (1996), "Cadillac Contracts and Up-Front Payments: Efficient Investment Under Expectation Damages", *Journal of Law, Economics and Organization*

- 3) Ohlendorf, S. (forthcoming): "Expectation Damages, Divisible Contracts, and Bilateral Investment", *American Economic Review*
- 4) Handout.

### III. Simple Contracts and Breach Remedies inducing Cooperative Investments

#### 8) Without Quality Thresholds

- 1) Che, Y-K. and Chung, T. Y. (1999): "Contract Damages and Cooperative Investments," *RAND Journal of Economics*, 30(1), 84—105.
- 2) Schweizer, U. (2006): "Cooperative Investments Induced by Contract Law," *RAND Journal of Economics*, Spring 37-1, 134—145.
- 3) Handout.

#### 9) Quality Thresholds

- 1) Stremitzer, A. (2008): "Standard Breach Remedies, Quality Thresholds, and Cooperative Investments", *mimeo*.
- 2) Brooks, R. and Stremitzer, A. (2009a): "Remdies if Non-Performance is Excused", *mimeo*.
- 3) Handout.

#### 10) Expectation Damages and Efficient Breach (revisited)

- 1) Brooks, R. and Stremitzer, A. (2009b): "The Myth of Efficient Breach", *mimeo*.
- 2) Handout.

#### 11) Breach Remedies inducing Hybrid Investments

- 1) Handout.

### IV. Additional Topics

#### 12) Incomplete Contracts: Selfish Investments Information Observable but Unverifiable (Manipulating Bargaining Power, Option Contracts, Balancing)

- 1) Chung, T. Y. (1991): "Incomplete Contracts, Specific Investments, and Risk Sharing," *Review of Economic Studies*, 58(5), 1031—1042.
- 2) Aghion, P.; Dewatripont, M.; Rey, P. (1994): "Renegotiation Design with Unverifiable Information," *Econometrica*, 62(2), 257—282.
- 3) Nöldeke, G.; Schmidt, K. (1995): "Option Contracts and Renegotiation – a Solution to the Hold-Up Problem," *RAND Journal of Economics*, 26(2), 163—179.
- 4) Edlin, A.; Reichelstein, S. (1994): "Holdups, Standard Breach Remedies, and Optimal Investments", *American Economic Review*, 1996, 86 (3), 478-501.
- 5) Handout.

#### 13) Incomplete Contracts v. Hidden Action: Cooperative Investments, Hidden Action and Sequential Investments

- 1) Che, Y.-K.; Hausch, D. B. (1999): "Cooperative Investments and the Value of Contracting", *American Economic Review*, 1999, 89 (1), 125-147.
- 2) Demski, J. S. ; Sappington, D.: "Resolving Double Moral Hazard Problems with Buyout Agreements", *RAND Journal of Economics*, 1991, 22 (2), 232-240.