A BARGAINING POWER THEORY OF GAP-FILLING

Omri Ben-Shahar[*]

Very Preliminary Draft
Spring 2007

Abstract

This article explores the merits of a new criterion for default rules in incomplete contracts: fill the gaps with terms that are favorable to the party with the greater bargaining power. It argues that some of the more common gaps in contracts involve purely distributive issues, for which it is impossible to choose a unique, "most efficient" term. Rather, the term that mimics the bargain in these settings must be sensitive to the bargaining power of the parties. The article explores the justifications for such a bargain-mimicking principle, the ways it can be implemented by courts, and the subtle ways it is already in place.

Note to Workshop participants:
This is still a very early version of an idea. I am currently working on splitting this article into two separate pieces, one dealing with the general criterion of "bargain-mimicking gap-fillers" (currently introduced in section I) and another dealing with the principle of "maximal tolerable terms" (in section II.) In the current version, however, they are still treated in a unified manner, with the latter explored as an application of the former.

-- O.B.S

[*] Kirkland & Ellis Professor of Law and Economics, University of Michigan, Ann Arbor, MI 48109 (omri@umich.edu).

I am grateful to Ian Ayres, Richard Brooks, Clay Gillette, Bob Hillman, Barak Medina, Ariel Porat, Peter Siegelman, Eyal Zamir, Kathy Zeiler, and workshop participants at University of Chicago, Cornell, Duke, Michigan, and NYU for helpful suggestions. Financial support from the Olin Center at the University of Michigan Law School is gratefully acknowledged.

INTRODUCTION

How to fill gaps in incomplete agreements is perhaps the most important question in contract law. It is important because interpreting and supplementing contracts is what courts often do, but also because the default rules set by law determine how contracts will be written. Providing a coherent answer to this question of how to fill gaps is also where the economic approach to contracts had its greatest success.

The most broadly accepted principle of gap filling is 'mimic the parties' will.' Only gap-fillers that mimic what the parties themselves would have chosen would be allowed by the parties to remain in place and survive opt-out; and they will reduce the unnecessary costs of drafting.[1] Of course, the notion of the parties' will is hypothetical. Because the contract contains a gap, we don't know what they would have consented to. It is here that the economic approach provides another, very powerful, insight: the parties' will is to have the most efficient arrangement. Thus they are best served by default rules that maximize the contractual surplus.[2]

The idea that gap-fillers should be the surplus maximizing terms is based on the following well-known logic. If the parties are rational—so goes the argument—they would have agreed upon terms that maximize their joint surplus, irrespective of the distributive impact of such terms. Further, they would have corrected for the distributive effects of the surplus maximizing terms by an appropriate adjustment of the contractual price or of another purely distributive term. But notice that

[1] Richard Craswell, *Contract Law: General Theories* in III ENCYCLOPEDIA OF LAW AND ECONOMICS 1, 3-4 (2000).

[2] RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 98 (6th ed. 2003) ("[C]ontract law cannot readily be used to achieve goals other than efficiency. A ruling that fails to interpolate the efficient term will not affect future conduct; it will be reversed by the parties in their subsequent dealings. It will only impose additional—and avoidable—transaction costs."). See also FRANK EASTERBROOK AND DANIEL FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 17-22 (1991); Alan Schwartz and Robert Scott, *Contract Theory and the Limits of Contract Law*, 113 Yale L. J. 541, 554-5 (2004); FARNSWORTH, CONTRACTS 486 (4th Ed. 2004) (courts are to provide terms "that an economist would describe as maximizing the expected value of the transaction".)

for this theory to be valid, it must assume that there is at least one term in the contract to which the theory does not apply—the term that the parties use to make the appropriate distributive adjustments—usually, the price term. The content of the purely distributive terms is not determined by the surplus maximizing criterion; it is surplus-neutral. Rather, the content of the purely distributive term it is determined by the bargaining power of the parties. In other words, the surplus maximizing conception of gap-filling is, by definition, insufficient to resolve all gaps: it does not resolve gaps in the price term or in any other term in the contract that is purely distributive.

Thus, there is a troubling paradox surrounding the basic criterion of gap filling. It assumes that the parties' joint will exists—that there is a single term such that, if only the parties spent the time and attention dealing with the gap, they would have jointly desired the surplus-maximizing term. Yet the existence of a gap in a contract is often an indication that a consensus could be reached—that a single jointly preferable term does not exist. That is, the gap in the contract is often surrounding a purely distributive issue—the one over which the parties interests diverge. Ironically, many of the cases in contracts casebooks that introduce the topic of indefiniteness and gap-filling involve purely distributive gaps over issues such as price, for which the prescription "choose the terms that maximize the total surplus" does not provide a definite solution. To fill such gaps, a criterion different than 'surplus-maximization' is needed to identify the hypothetical consent of the parties.

The purpose of this paper is to begin developing this additional criterion, one that would fill gaps in purely distributive terms, where the traditional criterion of surplus maximization is unhelpful. The proposed criterion is consistent with the fundamental norm of mimic-the-the-parties'-will. In the case of purely distributive terms, I argue, we need more information about the joint will—about the way the parties would have resolved the a-priori conflict of their wills. Namely, what the court needs is information to mimic the *bargain*: the division of the surplus that would have been struck between these parties, given the allocation of bargaining power. Accordingly, the paper develops a "bargain-mimicking" conception of gap-filling, which requires courts to fill gaps with terms favorable to the party with the greater bargaining power.

Part I of this paper introduces the idea of bargain-mimicking gap-fillers. It explores the conceptual basis for this idea, how it relates to other criteria of gap-filling, and when it may be regarded as the natural substitute for the otherwise compelling, but indeterminate principle of maximize-the-joint-surplus. Part II then expands the scope of the analysis by introducing the problem posed by excessive terms—terms that go beyond a mandatory bar. When such excessive terms are struck down and need to be replaced, courts may view the problem as one of gap-filling. Here, it is generally clear that one party holds greater bargaining power. To maintain maximal loyalty to the bargain struck between the parties, the substitute term should equal the "maximally tolerable" term.

If Parts I and II focuses more on a conceptual introduction of the ideas of bargain mimicking default rules and of maximal tolerable terms, Part III of the paper examines some normative aspects. It is not an easy task. Admittedly, there is something objectionable about a legal rule that favors the strong party, the party with the greater bargaining power. Bargaining power is hardly a compelling conception of distributive fairness. Legal rules that favor the weak party, that level the playing field, are usually more appealing. But in the law of gap-filling, I argue in Part III, bargaining power trumps this normative predisposition. Default rules that try to upset the potential bargaining outcome are undesirable—they are a futile effort—and I provide examples from actual drafting of contracts to highlight this point. Part III also examines the possible bad incentives that bargain mimicking terms generate (e.g., the incentive to draft excessive terms, knowing that at most courts will only strike down the excrescence) and difficulties in implementing a standard that is based on something so abstract as bargaining power.

Part IV of the paper explores the doctrinal grounding of the bargain-mimicking thesis of gap-filling. It demonstrates that this principle is already embedded in the law, although its adoption is far from universal, and in fact some interesting debates in contract law can be understood as debates over whether this norm should be further accepted. One doctrine I focus on is *partial enforcement* (and its archaic predecessor, the *Blue Pencil Rule*), with special attention to partial enforcement of covenants-

not-to-compete. Another doctrine is *unconscionability*: what do courts do when a term is struck as unconscionable? Is it replaced with the maximal tolerable term, most favorable to the strong party? Part IV also examines several issues relating to remedies. It demonstrates that the bargain-mimicking criterion can prescribe (and explain) the choice between different ways to measure expectation damages. It also rationalizes a compelling solution to the problem of punitive liquidated damages.

I. BARGAIN-MIMICKING TERMS

A. No Joint Will

There is a troubling paradox surrounding one of the most basic tenets of contract law, that gaps in contracts should be filled with term that mimic the will of the parties—terms that most parties would have jointly chosen. On the one hand, this conception of gap-filling makes basic sense: it minimizes the need of the parties to contract around the default rule and it spells out performance provisions that maximize the parties' joint well being. But on the other hand, the mimic-the-parties'-will principle assumes that the parties' joint will exists. It assumes that there is a single term such that, if only the parties spent the time and attention dealing with the gap, they would have jointly supported the drafting of this term. Yet the existence of a gap in a contract is often an indication that a consensus could be reached—that a single jointly preferable term does not exist. The claim from which the analysis in this paper begins is that there are situations in which more than one term satisfies the standard conception of the joint will of the parties. If so, absent a more powerful prescription, the mimicking principle would be indeterminate.

The problem with the joint will principle of gap-filling, and the reason it is indeterminate, comes from the fact that the conception of joint will that is normally articulated is one of maximization of surplus. If the parties didn't specify explicitly what they want, it is safe to assume that they would have wanted the terms that maximize their joint surplus.[3] Or

[3] This intuitive proposition was developed in the early work of Goetz and Scott. *See, e.g.*, Charles J. Goetz & Robert E. Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and a Theory of Efficient Breach*, 77 COLUM. L. REV. 554 (1977); Robert E. Scott, *Rethinking the*

else, it is sometimes said, they would have left "money on the table." This, irrespective of the distributive impact of such terms, because the parties are able to (and probably did) correct for the distributive effects of the surplus maximizing terms by an appropriate adjustment of the contractual price or of another purely distributive term.[4] But notice that for this theory to be valid, it must assume that there is at least one term in the contract to which the theory does not apply, one term that is purely distributive—the price term. The existence of such term is necessary for the surplus-maximization criterion: it guarantees that gap-filling according to this criterion will not undermine the distributive consequences of the deal.

Put differently, contract design involves two tasks: creating the pie, and dividing it (many terms affect both aspects). In creating the pie, surplus maximization is normally the dominant norm. Once the pie is created, through the combination of express terms and surplus maximizing gap-fillers, it has to be divided and the term that accomplishes this aspect has no bearing on the size of the pie. If one of the distributive terms is missing from the agreement, the surplus maximizing conception of gap-filling would, by definition, be indeterminate in supplementing it. So what do we do if the gap involves one of these distributive aspects?

The basic reason to doubt whether there is one joint will that can potentially be mimicked when the gap involves a distributive issue is that the parties have opposite interests in resolving this issue. In these settings, it is impossible to articulate solely on the basis of economic efficiency what term the parties would have chosen. The process of reaching agreement over distributive elements is resolved by bargaining, and is thus determined by ad-hoc factors that affect the parties' bargaining power and how this power was applied with respect to other

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Default Rule Project, 6 VA. J. 84, 94 n.4 (2003) ("[C]hoosing a default rule on the basis of some normative conception of fairness would be wrong, in the sense that it would not increase the amount of fair contracts in the world, but it would increase the amount of contracting costs.").

[4] RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 96-97 (7th ed. 2007) ("Each party wants to maximize his gain from the transaction, and that is usually best done by agreeing to terms that maximize the surplus created by the transaction – the excess of benefits over costs, the excess being divided between the parties.")

elements of the deal. Filling distributive gaps, then, is not an exercise in maximization of surplus or in figuring out the optimal design of the transaction, but in guessing out how the surplus would have been divided.

Consider for example, a sale contract that does not specify payment terms. There are many ways to supplement this gap but it can hardly be said that they affect the "size of the pie." In many cases, whether payment is made before, during, or after delivery, is merely a matter of the time value of money and would affect the well-being of the parties in a zero-sum fashion. There is no more or no less efficient arrangement; the only effect is distributive. There is no joint will to mimic: earlier payment is usually preferable to the seller to the same extent that it is detrimental to the buyer. The seller has one will, the buyer has another.

Ironically, some of the most prominent cases on contractual indefiniteness are ones in which the gaps in the agreement involved price terms—the one term that by definition has purely distributive effect. For example, one leading case discusses a lease of commercial property with an option to renew that contains a gap—the renewal price is missing (needs "to be agreed upon").[5] Another classic case, *Sun Printing v. Remington Paper*, involves a sale contract that contains an indefinite price formula.[6] Yet another well-known case deals with a contract in which the price was deliberately left out and yet the court was more than ready to supplement it.[7] Another casebook teaches gap-filling through a case is in which the payment and credit terms—elements that are purely distributive—are not fully specified.[8] There might be—in fact, there is—a debate whether such distributive gaps render the contracts too

[5] Joseph Martin, Jr., Delicatessen, Inc. v. Schumacher, 417 N.E. 2d 541 (N.Y., 1981). In that case, the court refused to fill the gap and held that the contract was too indefinite to be enforced. But the growing trend is to enforce such contracts. See, e.g., *Validity and Enforceability of Provision for Renewal of Lease at Rental to Be Fixed By Subsequent Agreement of the Parties*, 58 A.L.R.3d 500 (1974)

[6] Sun Printing & Publishing Assn. v. Remington Paper & Power Co., 139 N.E. 470 (NY 1923) (reprinted in BARNETT, CONTRACTS CASES AND DOCTRINE 404 (3d Ed. 2003).)

[7] Mantell v. International Plastic Harmonica Corp., 55 A.2d 250 (NJ 1947) (quoted in FARNSWORTH, CONTRACTS 209-210 (4th Ed. 2004).)

[8] Southwest Engineering Co. v. Martin Tractor Co., 473 P.2d 18 (Kan. 1970) (reprinted in SUMMERS AND HILLMAN, CONTRACT AND RELATED OBLIGATION 735 (4th Ed. 2001).)

indefinite to be enforced. But if the contract is enforceable—as modern contract law tends to conclude[9]—the gap-filler cannot be determined by reference to the price that maximizes the total surplus. Every price, at least within a fairly broad interval, satisfies this criterion.

The observation that the surplus-maximization conception is potentially indeterminate can be reinforced by understanding why contracts are indefinite. Negotiations—the bargaining and haggling over the terms—require time, effort, strategy, and often fail, not because parties are under-trained in solving maximization exercises. The failure to reach agreement and to conclude the negotiations is not a reflection of some difficulty in cracking a mathematical equation. Rather, negotiations are hard precisely where the issue is distributive, when there is no single maximizing term over which an agreement would naturally arise. Again, the irony is that negotiations are harder and more likely to fail—and most likely to leave gaps in the eventual agreement that the law would set out to fill—when the issues are purely distributive.

True, many aspects of the contract that are primarily distributive also have effect on total surplus. But it is false to conclude that gap fillers for all these aspects can be set to maximize the surplus. As I mentioned at the outset, the only reason that a sub-set of the gap fillers can indisputably be surplus-maximizing is that there are other aspects of the deal—at least one—that are purely distributive, which can be used to achieve the bargained-for distribution of value.

B. Mimic One Party's Will

As a mechanism for gap filling, the surplus-maximization principle is easy to justify. It improves the well being of both parties; it gives them what they would rationally have chosen, ex-ante. If a distributive gap cannot be filled with a surplus maximizing term, it may nevertheless be possible to provide a similarly justified gap-filler, one that solves the problem of what the parties would have chosen ex-ante.

[9] UCC 2-305; FARNSWORTH, CONTRACTS 207-211 (4th Ed. 2004).

In the case of distributive terms, the parties do no have a joint interest, ex ante. To be sure, consensus over distributive issues can emerge, but it would be a result of bargaining and maneuvering, in the shadow of market conditions. The argument, therefore, is that the central conception of what the joint will is—the term that maximizes the surplus from the transaction—must be supplemented by a criterion that would apply to settings that are purely distributive. Luckily, courts often have information that can help them tease out what the parties would have agreed upon: information about the relative bargaining power.

When the interests of the parties concerning a particular term are conflicting, the term that the parties would have agreed upon depends on *the allocation of bargaining power*. If one party had a significant bargaining power advantage, he would have been able to dictate a one-sided term, and thus the gap-filler should favor that party. If, instead, the parties have equal bargaining power, the gap-filler should resemble the split-the-difference, mid-range term. Generally, a gap-filler that depends on any information the court has regarding the relative bargaining power at the time the contract is a superior proxy for the missing term. Call this gap-filler a 'bargain-mimicking' default rule. Unlike standard mimicking terms—the familiar surplus maximizers—the key feature of bargain-mimicking terms is their sensitivity to bargaining power factors, namely, factors that affect the division of the contractual surplus.

Thus, for example, in the context of a missing payment term, the bargain-mimicking gap-filler would potentially favor the party that was in a bargaining position to force the other to acquiesce and surrender to her dictates. Unlike mid-range, split-the-difference default terms that reflect, say, the average interest rate or the most common credit arrangement, the bargain mimicking term could fall anywhere within a broad interval and could be significantly different than the mid-range solution. The greater the seller's bargaining power, the higher the interest rate and that would be supplied by the gap-filler. And conversely, the greater the buyer's bargaining power, the more lenient the credit terms.

Notice that the content of the bargain-mimicking gap-filler is "tailored"—it depends on factors that are specific to the parties. The same contract, with the same gap, can be filled with a pro-seller term in

one case and a pro-buyer term in another, depending on the relative bargaining power in each case. For example, a lease with an option to renew under a price to be agreed upon would be supplemented with a high, pro-landlord price if the landlord happens to enjoy greater bargaining power (say, because of migration of many tenants into the region). The same lease would be supplement with a low, pro-tenant price if the tenant is the party with the greater bargaining power (say, because of the presence of many vacant sites in the area.)

In an interesting way, bargain-mimicking gap fillers share the same empirical premise, and also can be contrasted with, the *contra proferentum* principle. Both principles envision situations in which one of the two parties has the bargaining power to dictate the language of the terms and yet this party left some element ambiguous or unspecified. That is, both principles require a determination of relative bargaining power. But at the same time, the bargain-mimicking principle provides the opposite prescription relative to contra proferentum. When a contract is ambiguous or indefinite, the contra proferentum principle prescribes the term that is *least favorable* (within reason) to the party who drafted the contract. The bargain-mimicking principle does the opposite: it supplies the term that is *most favorable* to the drafter, the term that resembles the deal that the drafter was able to dictate. While the contra proferentum doctrine relies on the notion that the strong party should by "punished" for leaving ambiguity or indefiniteness in the contract,[10] the bargain-mimicking principle gives the strong party what she could have gotten explicitly through bargaining. The normative case for the contra proferentum rule is well known. Part II of the paper examines the normative case for the bargaining mimicking approach.

C. Majoritarian versus Bargain-Mimicking Terms

The bargain-mimicking conception of gap-filling breaks a discontinuity that is otherwise created by mid-range, majoritarian gap-fillers. If all gaps are filled with mid-range terms, a decision by the strong party to leave a gap in the contract as opposed to filling it with a bargained-over

[10] See, e.g., Kenneth S. Abraham, *A Theory of Insurance Policy Interpretation*, 95 Mich. L.Rev. 531, 545 (1996); Ayres & Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 Yale L.J. 87, 91 (1989).

express term would result in an expected forfeiture of a discrete chunk of the private payoff. For this party, the choice to leave the contract with a gap might well save some transactions costs, but would at the same time cost her the opportunity to exploit her bargaining advantage and to appropriate a favorable slice of the surplus. The agreement that results from mid-range gap-filling is distinctly different from that which she would have expressly negotiated; the more gaps she leaves, the greater the wedge between the hypothetical agreement and the legally supplemented contract. It is this discontinuity—the divergence between the hypothetically negotiated deal and the legally-implied deal—that the proposed conception of gap-filling resolves. The closer the gap-fillers are to the hypothetical bargain, the smaller the divergence.

It is clear that in many distributive contexts the bargain mimicking criterion would prescribe terms that are generically different from the majoritarian, mid-range reasonable terms. The majoritarian criterion recognizes that different parties could have perhaps reached different reasonable terms; namely, that there is a distribution of bargained-for terms. It chooses a term that measures a "center" of this distribution. Unlike the majoritarian criterion, the bargain-mimicking criterion relies on specific information indicating the deal that *these* parties would have struck, reflecting the division of bargaining power.

Still, it would be a mistake to conclude from this discussion that the bargain-mimicking gap-fillers would always diverge from the majoritarian, mid range, gap-fillers. The two gap-filling criteria may be reconciled—they may prescribe the same content of gap filler—in situations in which the bargaining positions of the parties are the common positions that similar parties in similar situations have. These are situations in which information about the specific parties' bargaining does not change the inference about the hypothetical bargain. For example, if the parties are "price-takers"—if they are dealing in matters for which there is a thick market and neither of them is in a unique position within this market—it is likely that the term they would agreed upon is the same term most parties in the market adopt. If, say, bargaining power is determined by outside options, and if there is a thick market of alternative partners for each party, the terms of that bargain are influenced by the terms in that market. Here, the bargain-mimicking

principle would prescribe a term that reflects the market term—the same term prescribed by the majoritarian criterion. But it would do so, not because this term best reflects some statistical regularity regarding the market, but rather because it is the best guess as to each parties' share of purchasing power. Put differently, majoritarian gap fillers that refer to "reasonable market prices" can be viewed as consistent with the bargain-mimicking criterion, applied to specific situations in which the bargaining power of the parties is determined by the market.[11]

To illustrate, consider one of the well-known cases in which parties left the price term open.[12] This was a long-term distribution agreement between a wholesaler and a distributor. The agreement did not fix the price. It made reference to the prices charged to other distributors, but as it turned out there were no other distributors. The court decided to fill the gap with a reasonable price term, but explained that what constitutes a reasonable price depends on the price that the seller can get from other dealers, competition between wholesalers as well as between dealers, the uniqueness of the product, the quantity produced, and more.[13] These are precisely the factors that determine the bargaining power of the parties.

D. Can Courts Identify the Bargain-Mimicking Terms?

There is something admittedly deceptive about the idea of bargain-mimicking gap fillers. It is assumed that the division of bargaining power between the parties is a measurable parameter that can be verified by the court. Bargaining power is, of course, a real factor in negotiations, and economic theory demonstrates that it depends on relative risk preferences, outside options, discount factors, negotiation protocol, and the like.[14] It reflects, in short, the relative facility of each party to say "no" to the deal. But it is one thing to recognize the theoretical existence and role of this parameter; it is another thing to measure it and base legal policy on its measurement.

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[11] James Gordley, Foundations of Private Law 363 (2006) ("the market price preserves (so far as possible) each party's share of purchasing power.")
[12] Mantell v. International Plastic harmonica Corp., 55 A.2d 250 (NJ 1947).
[13] *Id.*, at 256.
[14] See, e.g., Martin Osborne and Ariel Rubinstein, *Bargaining and Markets* (1990).

It is probably naïve to expect that courts would be able to measure bargaining power with precision. Still, implementing a regime with error, or only in those cases where the parameter *is* verifiable, is better than nothing. There are situations in which some crude approximations of relative bargaining power are likely to be correct, even if not perfect. A seller of a good for which demand is inelastic is known to have bargaining power. Or, when many bidders compete for a single job, the party inviting the bids has bargaining power. While it is hard, even in these situations to quantify a party's bargaining strength on a scale of 0 to 1, is it harder than adjudicating other parameters that courts ordinarily scale, such as comparative fault in torts?

In fact, courts already (and quite regularly) refer to bargaining power as a factor that justifies case outcomes. Under unconscionability doctrine, the presence of one-sided bargaining power is often identified and invoked for the purpose of reforming some explicit term.[15] Under the duress doctrine, weak bargaining power is often identified and invoked for the purpose of relieving the weak party from a coerced deal.[16] Under the *contra proferentum* doctrine courts have to figure out which party had the power to dictate a term, and rule *against* this party. The Restatement recognizes that *contra proferentum* is "often invoked in cases of standardized contracts and in cases where the drafting party *has the stronger bargaining position*."[17] While courts at times misjudge the relative bargaining positions (there is a misguided tendency to view a take-it-or-leave-it offer as a sign of bargaining power[18]), a substantial doctrinal tradition is nevertheless founded on the belief that courts can identify bargaining power.

And yet, existing doctrines that refer to bargaining power usually favor the weaker bargainer, whereas the approach discussed here favors the strong bargainer. This difference might be more crucial than initially

[15] See, e.g., Carboni v. Arrospide, 2 Cal.Rptr.2d 845 (1991) ("there was inequality of bargaining power which effectively robbed [promisor] of any meaningful choice.") See also UNIDROIT principles of International Commercial Contracts art. 3.10(1) ("lack of bargaining skill" is a factor relevant to determination of unconscionability.)
[16] Rubenstein v. Rubenstein [cite]
[17] Restatement (Second) of Contracts §206 cmt a (*emphasis* added).
[18] See, e.g., Circuit City Stores v. Adams, 279 F.3d 889, 892 (9th Cir. 2002)

seems. For a weak party, there is no danger in arguing that the other side had all the bargaining power. For a strong party, on the other hand, arguing that she herself had all the bargaining power may be risky. For example, if she were to argue that her bargaining power is due to a monopoly position, she might face antitrust consequences. If she were to argue that her bargaining power is due to information advantage, she might face heightened disclosure requirements, or simply lose the sympathy of the court. In other words, one's superior bargaining power might be a trait that one prefers to keep secret, rather than prove in court.[19] A legal regime that relies on litigants demonstrating their own superior bargaining strength faces this difficulty.

Moreover, and adding to the difficulty, even in the clear presence of verifiable uneven bargaining power, identifying the bargain-mimicking term may be tricky. Gaps in the contract may result from the parties' inability to agree. Or, they may result from the strong party's strategic calculation to leave an issue open, recognizing that on this specific issue the weak party would not acquiesce to a one-sided term, or would be alerted to some hidden aspect of the deal. If she suppressed a specific issue and left a gap deliberately, the bargain-mimicking term is not necessarily favorable to her. In an explicit agreement, the strong party might not have been able to secure a one-side term. Granting her a favorable gap-filler would only encourage her to leave gaps in areas in which she cannot bargain for an advantage.

Thus, the craft of filling gaps with bargain mimicking terms is more nuanced than merely identifying the party with the greater overall bargaining power. It requires attention the specific issue left open and the parties' special concerns regarding this issue. Recognizing that a bargain usually involves some concessions even by the overall stronger party, the court has to figure out how the parties would have used their bargaining power over *this* specific term, given that some leverage was already spent on other, expressly drafted, terms.

[19] *See* Omri Ben-Shahar and Lisa Bernstein, *The Secrecy Interest in Contract Law*, 109 Yale Law Journal 1885 (2000).

Daunting as this task might appear upon first reflection, it is probably not more complicated than other gap-filling principles. For example, under the surplus-maximizing principle, figuring out which term is most efficient requires a sophisticated account of costs and benefits, an understanding how different terms and issues interact, what each party values more, all with an eye to idiosyncratic preferences. Still, the surplus-maximization criterion has broad appeal because it makes normative sense, despite the fact that it is harder to implement than other, simpler default rules. It is the right thing to ask courts to make the effort to figure out—it is worth the cost. In Section III below, I will propose a normative defense of the bargain-mimicking criterion, suggesting that here too it is a worthy effort to trace the bargain that parties would have struck. And, at the very least, if it so happens that courts have good information about the bargain-mimicking term, it ought not be ignored.

E. Examples for Bargain Mimicking Terms

While the bargain-mimicking criterion can at times prescribe terms that are identical to the majoritarian, mid-range, gap-fillers, there are situations in which the two conceptions diverge. When the bargaining position of one party is superior, the bargain-mimicking gap filler would be more favorable to this party than the majoritarian term.

Consider, for example, a hypothetical setting in which many suppliers bid for a contract issued by a single buyer. The auto manufacturing market epitomizes this setting. Several "tier-1" suppliers often compete through a bidding process to produce auto parts to be assembled into a car model manufacturered by the automaker. Because there are only a few automakers but many suppliers, the buyer has all the bargaining power, and indeed once the supplier is selected and the price is set, the buyer dictates all the remaining terms of the contract.[20] The standard form contracts, however, are short and contain many gaps. For example, they often leave unspecified the price under which "service parts" will be sold. Service parts (which are repair parts sold to dealers and car owners in the retail market) are a significant source of profits, but how should

[20] See Omri Ben-Shahar and James J. White, *Boilerplate and Economic Power in Auto Manufacturing Contracts*, 104 Mich. L. Rev. 953 (2006).

this premium be divided between the parties in the absence of specific agreement?[21] Here, there is no "market" term to refer to. A mid-range, split-the-profit price, is one way to fill the gap. Of course, it does not reflect the true bargaining power of the parties and does not come close to mimicking the express deal they would have reached (the deal the buyer would have dictated, and that some automakers do in fact dictate.) The bargain-mimicking gap filler would supply a price that accords the greater share of profits to the buyer.

Another example where a bargain-mimicking criterion might tilt the gap-filler in favor of the stronger party is an incomplete prenuptial agreement. A millionaire who is about to marry a fortuneless person often has a greater bargaining power regarding the financial consequences of divorce. If divorce occurs, a gap-filler that tracks this bargaining advantage would significantly differ from a gap-filler that provides a more generous distribution to the less affluent spouse. True, in this setting the notion of bargaining power could be more elusive than in commercial settings. Bargaining power is not equivalent to financial prowess; there are less tangible factors that affect the power of a party to say "no" to the relationship. And yet, bargaining power surely exists, it is often played out in express prenuptial bargains, and identifying it ex-post might relieve the parties from the costly need to punctuate it, ex-ante.

II. MAXIMALLY TOLERABLE TERMS

When bargaining power is unevenly distributed, the strong party would naturally use its bargaining leverage to draft one-sided, self serving terms. Even when there is explicit contracting into one-sided terms, though, the strong party cannot overreach. Several doctrines of contract law set limits to the one-sidedness of terms. A party who reaches beyond those limits may face the consequence of having a court strike down the term. The doctrines of unconscionability and duress (as well as other rules) grant courts the power to invalidate excessively one-sided term.

[21] *See, e.g.*, Toyota Motors Manufacturing N.A., Inc. Term and Conditions § 4.2 (Oct. 1988) (leaving the price for service parts to be determined later).

When the excessive term is struck down, a gap is created in the contract. How should this gap be filled? This question is raised here for two reasons. First, this is a clear situation in which a new provision has to be supplied; usually over a distributive matter such as the price; and there is also a clear indication that one party has the bargaining power. Thus, this situation provides ground for application of the proposed gap-filling theory. Second, if a workable conception of a bargain-mimicking term can be developed for this kind of gap, it could be applied more generally to gap filling even when the gaps are not the result of struck-down offensive terms, but rather of failure to contract.

When a one-sided term is invalidated the court can fill the gap with a majoritarian-reasonable term. This, however, would deprive the strong party of both the legitimate and the excessive advantages it acquired in the contract. Alternatively, the court can fill the gap with a bargain-mimicking term: a term that is still one-sided, favorable to the strong party. Admittedly, there is something paradoxical about a bargain-mimicking principle in this context. The term that best reflects the division of bargaining power was in fact written in the contract, and yet it was found unenforceable under a policy aimed at limiting the reach of bargaining power. A pure bargain-mimicking term would be equivalent to that offensive term; surely, the court would not reinstate the same term it has just struck down!

The practical effect of the bargain-mimicking principle in this setting is to prescribe a term that is still one-sided, still favorable to the same party who dictated the original one-sided term, but moderated sufficiently so that it would be *tolerable*. Instead of substituting the offensive term with a more balanced majoritarian term, the court would reduce it only so much as to fit it within the range that is considered legitimate. The court would mimic the hypothetical bargain that parties *negotiating over a truncated domain* would reach. This would be a "constrained bargain mimicking" gap-filler, or the "maximally tolerable" term.

To illustrate, consider a situation in which a service can be purchased for a price ranging between $200 and $600, with the most common price being the mid-range, $400. Any price within that range is reasonable. If a service provider exploits her bargaining power to charge an unreasonable

price of $1000, the court would strike it down. The majoritarian gap-filler would be $400; the "constrained bargain mimicking" gap-filler would be $600—the maximal price within the tolerable range.

To be sure, maximally tolerable terms respond to a different problem than pure gap-fillers. The latter resolve the problem of failure to contract for any term, whereas the former address the problem of explicit contracting above a mandatory ceiling. But the two problems converge at the stage in which the court is asked to supply the actual term. Whether the need for supplementation arises from a lacuna or from an aborted term, courts usually apply the same standard for picking the gap-filler. Thus, uniting the two problems for the purpose of gap-filling is not a novel methodology. The novelty is in replacing the majoritarian solution to the unified problem with a bargaining power oriented solution..

Before turning to discuss why such approach might be desirable, let me sketch a conceptual underpinning for such a rule. The point to emphasize is that under doctrines like unconscionability, which are intended to provide relief from extreme terms, there are no clear grounds for courts to provide more than the minimum necessary relief. The court's authority to intervene in the contract and to police its terms arises from the fact that an express term lies beyond society's tolerable range. The further out this term relative to what is tolerable, the greater the justification for intervention. Once the offensive term has been pushed into the tolerable range, even if only minimally so, there is no remaining justification for intervention.

One way to reinforce this idea filling the gap with maximally tolerable term is by considering the following synthetic illustration. Imagine again the case in which the contract contains an excessive price, $1000, and suppose that the process of adjusting the price involves a gradual examination of successively lower prices. That is, after deciding that $1000 is too high, the court considers one price lower, say $990. If that price is also unconscionable, the court considers a further incremental reduction, to $980. It continues similarly step-by-incremental-step until it reaches a price which is no longer considered intolerable. Once that price is reached, the process of adjusting the price downwards would then stop. There will be no remaining justification—at least not under direct

policy grounds that give rise to the unconscionability redress—for further adjustments of the price beyond this threshold.

Put differently, if we analogize the process of judicial intervention in the contract to a force that pulls the price from its current intolerable level towards the permissible region, the force gradually weakens as the price gets closer to the tolerable level, and vanishes completely as soon as this level is hit. The point where this adjustment process runs out of justification is not the mid-range, majoritarian, most-balanced term. Rather, it is the maximally tolerable price: it is still a one-sided term, albeit not as bad as the original term.

This argument goes some distance towards justifying bargain-mimicking gap-fillers. It is based on the logic that if legal intervention in the contract is justified by a particular distributive concern, it is also limited by this very concern. There are several equivalent ways to articulate this claim. One is to compare a contract that contains the maximally tolerable price term with a contract that is all else equal, but contains an even worse price term. Under the bargaining power theory of contract-policing developed here, if there is no good reason to intervene in the former, is there a reason to intervene in the latter beyond fixing it to look like the former? We shall see later, there may be incentive-based reasons for a more aggressive intervention in the latter contract. But those are different than the distributive concerns justifying the intervention in the first place. Another equivalent way of saying this is to focus on the complaint of the weak party. This party has no reasonable grounds to demand more than the minimal redress tailored by the maximally tolerable term. Once accorded this adjustment, what basis does he have for demanding additional relief?[22]

This conceptual defense of the idea of minimum-necessary-relief accords with other deep-rooted practices of the law in general, and contract law in particular, which entitle a party to *concede* a greater contested claim in order to secure a smaller uncontested claim. For example, the doctrine of

[22] This rationale is recognized by Corbin: "The line [representing the enforceable term] must be drawn somewhere, and it is drawn at the point where the protection to which the buyer is justly entitled ends." *See* Arthur L. Corbin, *On the Doctrine of Beit v. Beit: A Comment*, 23 Conn.B.J. 40, 46 (1949).

remittitur deals with excessive jury verdicts in civil trials. The judge determines the portion of the verdict that is excessive and gives the plaintiff the option to remit—*to concede*—this increment, or face a new trial. The verdict is not entirely voided, nor is it replaced with the most reasonable amount. Rather, only the excrescence—the sum which exceeds "the highest amount which the jury properly could have awarded"—is lopped off.[23] Many courts have specifically rejected the more intrusive approach, which reduces the excessive judgment to the level that is most fair. Instead, they prefer the least intrusive approach, reducing the judgment "to the maximum that would be upheld by the trial court as not excessive."[24] This practice is analogous to the idea of replacing excessive contract terms with the maximum tolerable terms.

Within contract law too, one can find the roots of the idea that excessive provisions can be cured by incremental, rather than total, invalidation. A party may concede a gap in the contract in favor of the other party in order to cure indefiniteness and enforce the conceded contract.[25] More generally, the idea of minimum necessary relief can be embedded in the doctrine of *waiver*. The drafting party is treated as accepting a reduction of the self-serving term, waiving her right to insist on full unlimited enforcement of that term. With the waiver in place, there is no remaining ground for intervention. As the Supreme Court of Texas recognized in this context:

> "Even thought the contract may be illegal and unenforceable as written, one of the parties may make it legal and enforceable by offering to take out of it the offending provision that makes it illegal…[26]

Moreover, using maximally tolerable terms to fix instances of overreaching is consistent with another common practice in contracts: the severability of terms. A party who drafts a self-serving standard form often adds a boilerplate severability clause, stating:

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[23] Dick v. Watonwan Co., 562 F. Supp. 1083, 1108 (1983); *See, generally,* 11 WRIGHT, MILLER, AND KANE, FEDERAL PRACTICE AND PROCEDURE 167 (2d ed. 1995).
[24] Earl v. Bouchard Transportation Co., Inc., 917 F.2d 1320, 1328 (2d Cir., 1990)
[25] 1 Farnsworth on Contracts §3.29 (3rdEd. 1999); Ben-Shahar, *Agreeing to Disagree: Filling Gaps in Deliberately Incomplete Contracts*, 2004 Wisc. L.Rev. 389, 421.
[26] *Lewis v. Krueger, Hutchinson and Overton Clinic*, 269 S.W.2d 798, 800 (Tex. 1954).

> If any provision in the contract is not permitted by governing law, such provision shall not be construed to be null and of no effect, but court shall construe the agreement to provide for the maximum enforceable application.[27]

Many provisions contain similar language, rendering a term enforceable "to the maximal extent permitted by law." For example, a usury term may stipulate that the creditor is entitled to the "maximum rate" and that if the charged interest exceeds the maximal permissible rate, the creditor should refund only the amount of such excess.[28] Or, a warranty/liability term can disclaim all warranties or damages to the maximum extent permitted by law.[29] These are situations in which the parties anticipate the possibility that a one-sided term might be struck, and instruct the courts specifically how to fill gaps in the agreement. The instruction is for the court to follow a one-sided methodology, picking terms that are equivalent to the constrained bargain-mimicking provisions.

III. ARE BARGAIN-MIMICKING TERMS DESIRABLE?

The purpose of this article is not to advocate for the general use of bargain mimicking gap-fillers, but to identify it as a conceptual and practical possibility and explore arguments in support of such a regime. Before turning, in section IV, to examine incidents of actual implementation of this regime, let us explore some normative aspects.

A. Transactions Costs

[27] See, e.g., Laurence H. Pretty, Patent Litigation, ex. 15-24, pp. 15-41 to 15-42.

[28] See, e.g., J Robert Brown and Herbert B. Max, Raising Capital: Private Placement Forms & Techniques ("payee shall never be deemed to have contracted for, or be entitled to receive as interest on this note, interest ….or any amount in excess of the Maximum rate. […] if the interest received … exceeds the maximum rate, then payee shall refund the amount of such excess.") See also Richard T Williamson, Selling Real Estate Without Paying Taxes: A Guide to Capital Gains Tax Alternatives 173 ("no payment or interest shall exceed the maximum amount permitted by law. Any payment in excess of the maximum amount shall be [disbursed to the payor]."

[29] See, e.g., Napster's Terms and Conditions, available at www.napster.com/terms.html ("To the Extent that in a particular circumstance any disclaim or limitation on damages or liability set forth herein is prohibited by applicable law, then instead of the provision hereof […] Napster shall be entitled to the *maximum disclaimers and/or limitations on damage and liability available at law or in equity*…") (*emphasis* added)

When the gap in the contract involves an issue that affects the size of the surplus, a well-rehearsed argument explains why the gap-filler ought to be the surplus-maximizing provision. It is an argument of exceptional appeal, because it side-steps any distributive implications. Surplus-maximizing gap-fillers increase the well-being of both parties to the contract, indiscriminately. If the law were to provide off-the-shelf terms that are anything but the surplus-maximizing arrangements, it would have the effect of inducing the parties to write explicit provisions instead, and other than occasional indirect benefits (say, in the form of exposing private information), this would merely increase transactions costs.[30] And once the price or another distributive term is adjusted appropriately to divide the saving in transactions costs—each party ends up with a greater net payoff.

It might be perceived, though, that in the context of bargain-mimicking terms this same distributive-neutral defense is inapplicable. If the law provides a gap-filler that is more favorable to one of the parties, without affecting the size of the surplus, how can it be said that this term accords both parties a greater surplus to divide? If it is a term that mimics one party's will, against the will of the other party, how could the other party benefit from it?

Moreover, upon first reflection, bargain mimicking terms might seem to encounter an objection that surplus-maximizing terms avoid, namely, that they conflict with social concerns and intuitions regarding the fairness of distribution. While surplus-maximizing terms need not have any distributive effect—they merely secure more value to divide—bargain-mimicking terms do not create a greater surplus and do have a clear distributive effect in favor of the strong party. Why, it might be asked, should it be the objective of the law to resolve ambiguities and gaps in distributive aspects in favor of the strong party? Surely, this party can take good care of herself and secure advantages by bargaining; If at all, it is the weak transactor that should be protected by the law and enjoy a distributive bias. A prescription of distributive fairness, so goes

[30] Richard Craswell, *Contract Law: General Theories*, in 3 ENCYCLOPEDIA OF LAW AND ECONOMICS 1, 2-4 (Bouckaert & De Geest, Eds., 2000).

the objection, can hardly be based on bargaining power as the conception of merit. It should aim to undo the unfairness that unfettered bargaining might generate, not mimic it.

Compelling as this argument might be, it is unfortunately beside the point. The benchmark argument in favor of bargain mimicking terms is not that these terms are fair or that they otherwise conform to an attractive conception of distributive desert. They probably do not. Bargain mimicking is a principle of gap-filling, not of redistribution. The reason why bargain mimicking terms may be desirable as gap-fillers is that, *very much like surplus-maximizing terms, they save transactions costs*. If the law accords her the same terms that she can secure by explicit (and harsh) bargaining, the party with the bargaining power need not spend the cost of specifying the same terms in an explicit fashion. If gap fillers tried to do anything other than mimic the term that this party were able to dictate, they would have the ex ante effect of inducing this party to dictate the term, to preempt any adverse allocation that would otherwise be brought upon by the gap filler. Perhaps even more than in other contexts, it is very likely that when the distribution is at stake the strong party will insist on contracting around a non-mimicking gap filler.

In the context of surplus maximizing gap-fillers, it is commonly noted that both parties enjoy the saving of transactions costs afforded by such terms.[31] Thus, by similar logic, it must also be true that when one party has the bargaining advantage, both parties enjoy the saving of transactions costs achieved by bargain mimicking terms, and prefer them over majoritarian gap-fillers. The only difference in the current context is that the saving achieved by the mimicking terms is, like other sources of value in the contract, enjoyed disproportionately by the party with the greater bargaining power. Her leverage enables her to dictate a division of the salvaged transactions cost that is favorable to her.

What, exactly, are these transactions costs that are saved by a bargain-mimicking term? Beyond the obvious category of drafting costs, in the context of unequal bargaining power there might be additional "psychic" burdens that may be saved. There are settings in which weak parties

[31] POSNER, ECONOMICS ANALYSIS OF LAW 96 (6th Ed. 2003).

endure humiliation when the strong party openly dictates a one-sided term. While this cost of punctuating one's powerlessness owes to emotional and behavioral (that is to say, irrational) grounds, it is recognized as important in the negotiation literature.[32] Strong parties are advised to accord their counterparts the sense that the pie is equally divided, even when it is not, to make it easier for them to acquiesce. A default rule that eases the need of strong parties to openly "stick it" to the weaker parties, has this cost-mitigating effect.

B. Drafting of One-Sided Contracts

The argument that bargain mimicking terms save transactions costs without affecting the substance of the transaction applies to situations in which the parties left a gap in the contract. But when the contract contained an excessive term that was invalidated by court, the parties already spent the drafting cost. What, then, is the saving that they enjoy when that term is substituted by the maximally tolerable term? Moreover, the concern grows, if a party with the bargaining power expects that the court would only strike the excessive increment, there is no incentive to draft reasonable terms.[33] At best, the express term will stand; at worst, it will be replaced with the most favorable term permitted by law. Why draft a term that reflects this maximal permissible standard if you can get away with—in fact, benefit from—drafting a more excessive term? In contrast, if the law were to replace the excessive term with a mid-range balanced term, or perhaps even with a *contra-proferentum* provision, the drafter has more to lose from overreaching and would have an incentive to draft less extreme terms.

This incentive argument, however, overlooks two additional factors that, if jointly accounted for, would detract from its validity. One factor has to do with uncertainty over what constitutes the maximal permissible term. The other factor has to do with spillover effects on other terms in the contract. Together, they also explain why maximally-tolerable gap-fillers are also consistent with the saving-of-transactions-costs justification.

[32] CITE Lax and Sibenius, The Manager as Negotiator; Mnookin et al. ….
[33] See *Central Adjustment Bureau v. Ingram*, 678 S.W.2d 28, 37 (Tenn. 1984) (noting the adverse incentive problem)

Uncertainty. The legal standards that determine the boundaries between permissible and unconscionable terms are not always obvious to the drafting party. For example, arbitration clauses in employment contract that were traditionally enforceable and still are in the majority of jurisdictions are occasionally held to be unconscionable by some courts.[34] For one, parties are not always informed about the legal standards. Moreover, terms that might be considered reasonable when applied to a particular context might become excessive in a different context.[35] If the drafting party is "punished" for overreaching, say, by replacing the excessive term with one significantly below the maximal permissible level, she faces a familiar dilemma. Any additional sliver of the surplus she tries to appropriate trough an incrementally more self-favorable term has a small upside equal to this increment if the term is enforced, but a downside of potentially significant magnitude if the term is held to be excessive and replaced. In fact, when the replacement term is a mid-range reasonable term, the downside is one order of magnitude greater than the upside.

This asymmetry between the benefit and the risk of one-sided terms could have two effects on the drafting party. First, it could lead her to draft more cautiously to assure that she does not bump against the maximal permissible boundary.[36] She will maintain a safety cushion against bumping into the legal standard by forgoing part of the surplus that she would otherwise extract. This effect alone is not a social cost, but it may be inefficient once we examine (below) the effect of such extra caution on other terms of the deal. Second, the drafting party would have added incentive to invest in information that would enable her to assess the exact location of the boundary. Such investment has a private value because it can help the drafting party avoid the need for an overly

[34] Compare Szetela v. Discover Bank, 118 Cal.Rptr.2d 862 (2002) (California court holding a credit card arbitration clause unconscionable because it forbids class actions) with Hutcherson v. Sears Roebuck & Co., 793 N.E.2d 886 (Ill. 2003) (Illinois court holding same clause not unconscionable).

[35] For example, in Carboni v. Arrospide, , 2 Cal.Rptr.2d 845 (1991), a 200% interest rate would have been tolerable for a very short term credit transaction, operating more as a closing fee; it was unconscionable when the credit duration extended to two years.

[36] Craswell & Calfee, Deterrence and Uncertain Legal Standards, *2 J. L., Econ. & Org.* 279 (1986).

cautious safety cushion. This investment is largely a social waste: it has no social value.[37]

Spillover. The incentive to moderate the drafting of a term to avoid bumping against the ceiling of the permissible domain may also induce the drafting party to shift her leverage to other terms of the contract. In extreme cases, the party with the bargaining power might not enter the contract in the first place unless she can secure a very favorable term (e.g., a harsh interest payment in the face of high risk). In less extreme cases, she might force the other party to surrender to bad terms that are permissible, but more costly to that party. For example, if the law were to use maximal tolerable terms, an employer who is interested in favorable arbitration clause or a non-compete restraint would experiment with drafting such terms, knowing that at worst, if she overreaches, the term would be corrected only incrementally. But if the law replaces an excessive term with one that is unfavorable to the employer (say, no arbitration at all; or eliminating the non-compete restraint entirely), the employer might be reluctant to draft such terms in the first place, and would use her bargaining power to insist on lower wages or some other costly burden on the employee. Thus, from the employee's perspective, such a rule might backfire. As long as the law does not resolve the underlying imbalance of bargaining power, the employer would still be able to dictate one sided terms. But he may have to do so in areas of contracting that affect the total surplus, or that require a more costly drafting and transaction procedure, to the employee's disadvantage.

How, then, do we reconcile these competing concerns? On the one hand, maximal tolerable terms give no incentive for moderation. On the other hand, an aggressive legal intervention in one area of the contract can shift bargain dominance to other areas, affording no relief to the weak party. A possible solution would apply the proposed maximal tolerable terms, but only when the strong party did not knowingly and deliberately overreach. If the boundary of permissible terms is known and nevertheless crossed, the term would be invalid and replaced by a reasonable mid-range provision, or by some term that is less then what

[37] Kaplow and Shavell, Private Versus Socially Optimal Provision of Ex Ante Legal Advice, 8 *J. L., Econ. & Org.* 306 (1992); Kaplow and Shavell, Accuracy in the Assessment of Damages, 39 *J.L. & Econ*. 191 (1996).

the parties are allowed to fix in the agreement. But if the boundary is fuzzy and was violated without bad faith, the law would only reduce the excessive term back to the boundary—to the maximal tolerable level. This regime would not lead to overly cautious drafting; and at the same time, it would give the drafting party something to lose in cases in which the unreasonable term was knowingly inserted.[38]

C. Ex Ante Investment

The analysis so far assumed that the relative bargaining power of the parties is an exogenous factor, determined before the parties enter the negotiations. Many features may affect bargaining power—outside options, impatience to reach a deal, reputation, financial distress, negotiation savvy, and more—but until now it was implicitly assumed that non of these factors depend on the gap-filling methodology. Thus, the premise was that bargain mimicking gap fillers can be a function of the relative bargaining power of the parties, but not vice versa.

Theoretically, though, a bargain mimicking regime can create incentives for the parties to make investments that affect their bargaining power. Of course, parties already have the motive to invest in strengthening, or to refrain from actions that weaken, their bargaining power. Such actions help them secure better express terms in the deal. But in the shadow of bargain-mimicking gap-fillers, the incentive to manipulate the bargaining positions would be bolstered. Investing in stronger bargaining power would now affect not only the explicit provisions, but also the gap fillers.

It is not clear what to make of these potential effects. Prima facie, much of the investment in bargaining leverage is a social waste—it is a social cost that only redistributes value without creating a corresponding social benefit. This may suggest that the bargain-mimicking regime has the undesirable effect of further distorting already excessive investments.

But the picture is more complex. There are other types of precontractual investments—investments that have an effect on the total surplus of the

[38] See FARNSWORTH, CONTRACTS 347 (4th Ed. 2004) ("absent a showing that [the excessive clause] was drafted in good faith…, the court may fix a lesser restraint that it would allowed the parties themselves to fix in their agreement.")

potential bargain, not on the relative bargaining power—that are often set at a level that is *too low*, due to the hold-up problem (the anticipation that some of the fruit of this investment will be appropriated by the other party).[39] If the party who makes the surplus-enhancing investment is also the one who is in a position to make the bargaining-leverage investment, it is no longer clear that the latter investment is a social waste. Investing in greater bargaining leverage would have an indirect positive effect: it would diminish the ability of the other party to engage in hold-up and would thus lead to a more efficient level of surplus-creating investments. For example, a builder who successfully acquired an exclusive position in a specific market can now afford, in the course of negotiating a project with a client, to make precontractual investments in plans and materials, knowing that his bargaining leverage would shield him from hold up.

Moreover, sometimes the same investment has both a surplus-enhancing effect and a bargaining leverage effect. For example, learning a special skill would make a potential employee more valuable (that is, increase the surplus) but also accords the employee more leverage in negotiating her wages. The incentive to make *too much* of this investment to enhance the bargaining leverage is now a counterforce to the incentive to make *too little* of this investment in light of the hold up problem. The bargain-mimicking legal regime, which amplifies the "too much" side of this trade off, is not necessarily bad.

In the end, though, whatever effect the bargain-mimicking gap-filling regime has on ex-ante investment, one should doubt whether this effect is significant. Parties have strong incentives to make investments that increase their bargaining power even in the absence of this gap-filling regime. Such investments secure greater payoffs through the more favorable express terms that the investing party can draft. Ex ante, the incremental effect of the gap-filling regime is probably negligible.

A less negligible effect might arise from the social policy regarding excessive terms. In a variety of situations, parties draft extraordinary terms as a cushion to protect their relationship-specific investments. For

[39] See, e.g., Lucian Bebchuk and Omri Ben-Shahar, *Precontractual Reliance*, 30 Journal of Legal Studies 423 (2001).

example, covenants not-to-compete in employment agreements are necessary for the employers to invest the relationship. Or, high liquidated damages, high prices, and even arbitration terms are often the protection that a party with bargaining power drafts into a contract in order to secure her reliance investment in future contingencies in which she might become more vulnerable. If the law were to reform these terms by eliminating the entire advantage, it might chill some reliance investments. The minimal intervention embodied in the bargain-mimicking approach minimizes such distortion.

IV. IMPLEMENTING BARGAIN MIMICKING TERMS

This section examines some existing practices that are consistent with the bargain-mimicking criterion of gap-filling. It also identifies some instances in which this criterion was expressly rejected and questions the wisdom of such outright rejection.

A general principle of bargain-mimicking gap-fillers was never explicitly endorsed by the law. Notably, Section 204 of the Restatement instructs courts to supply gap fillers that are "reasonable in the circumstances," expressly rejecting the bargain mimicking approach:

> "Where there is in fact no agreement, the court should supply a term which comports with community standards of fairness and policy *rather than analyze a hypothetical model of the bargaining process.*" (*Empahasis* added)[40]

Despite this abstract mandate, I hope to show that in many subtle ways contract law applies gap fillers that reflect relative bargaining power.

Before turning to legal rules that supply gap-fillers, it is important to note that principles of gap-filling can be enacted in the contracts themselves. Bargain-mimicking gap-fillers can emerge in practice as a result of contractual drafting that instructs courts to apply such a criterion. Contracts often include terms that, while ambiguous and in

[40] Restatement (Second) of Contracts §204 cmt d.

need of interpretation or supplementation, nevertheless point in the direction of one-sided, bargain-mimicking arrangements. As mentioned in Part I, there are various terms in contracts that refer to enforcement *to the maximal extent permitted by law*. If a provision that is otherwise drafted vaguely is appended by this *maximal extent* boilerplate, the ambiguity is resolved in a one-sided manner. Such drafting technique may apply to a single provision, as in warranty disclaimer clauses,[41] or it may apply to the entire contract.[42] Effectively, by including such provisions, the drafting party opts out of the "fair community standards" gap-filling approach of Section 204 and opts into a bargain-mimicking, one-sided gap-filling regime. The incentive to draft such terms is particularly strong when applied to distributive issues, where the one-sidedness does not come at the expense of the overall surplus.

A. The Doctrine of Partial Enforcement

The doctrine of partial performance is a method that enables courts to enforce a term that is otherwise unreasonable or extreme in a partial, tolerable manner. The archaic "Blue Pencil Rule" was the origin of this method. Under this rule, when a contract contained an invalid term, the invalid portion would be literally crossed out (by the metaphoric blue pencil). If the language that remained was grammatically meaningful, it would be enforced. Otherwise, if the remainder was not coherent without some affirmative rewriting, it was entirely invalid. This, to be sure, was not a regime of gap-filling but rather of selective enforcement. And given the mechanical nature of the procedure, there was no general way to characterize the terms that were, if at all, enforced. They could happen to be equivalent to the maximal tolerable terms, or they could be more lenient. The outcome had an arbitrary, inconsistent, aspect.

Yet there was an appealing feature to the Blue Pencil rule that the more modern approach to partial enforcement sought to preserve. It was a

[41] See, e.g., RealNetworks EULA ("To the maximum extent permitted by applicable law, RealNetworks further disclaims all warranties.")

[42] See, e.g., Charles Sennewald, *Security Consulting* ("If the scope of any of the provisions of the agreement is too broad in any respect whatsoever to permit enforcement to its full extent, then such provisions shall be enforced to the maximum extent permitted by law...")

technique that allowed courts to depart from the older and even more rigid all-or-nothing regime, which simply voided any unreasonable provision in its entirety. If the provision were divisible, why not sever only the offensive part—the minimally necessary part—and enforce the remainder? While such divisibility was the policy underlying the Blue Pencil rule, the mechanical procedure of the rule significantly limited its effectiveness. A better rule for partial enforcement could implement the divisibility policy without constraining courts by a grammatical criterion.

Under the modern partial enforcement doctrine, a court is authorized to reform an unreasonable term in a contract and enforce it to extent necessary to avoid the unreasonableness. The court does not have to use the blue pencil method. It can do more than just cross out some language and enforce the remainder. It can, in addition, substitute the offensive language with a different provision. The underlying goal is to give maximal effect to the parties' agreement, subject to the constraint of avoiding unreasonableness.[43] This goal can be implemented by replacing the excessive term with the maximal tolerable term.

Perhaps the most striking (and most common) application of this partial performance technique involves covenants not to compete. When an employee enters and employment contract, he often signs a non-compete clause with the employer, applicable in the event that the employment ends. Similarly, when a business is sold with its good will, the seller often promises to not compete with the buyer. These restraints are at times too harsh, either by setting too long a duration of the non-compete period, or by defining the geographical boundaries of the non-compete region too broadly. Old decisions in the all-or-nothing tradition used to void these as unreasonable restraints altogether, and leave the parties free of any restraint.[44] Blue Pencil decisions—somewhat less strict—granted relief by partially enforcing the restraints if they were grammatically meaningful after the crossing out the offensive words. But most courts

[43] Williston and Corbin, *On the Doctrine of Beit v. Beit*, 23 Conn.B.J. 40, 49-50 (1949).
[44] The earliest case is Mitchel v. Reynolds (1711) 1 P Wms 181, 24 Eng Reprint 347. This rule remained in force in England and in the U.S till the end of the 19th century. See C.T. Drechsler, *Enforceability of Restrictive Covenant, Ancillary to Employment Contract, as Affected by Territorial Extent of Restriction*, 43 A.L.R2d 94, §6(a).

nowadays follow the practice of substituting the offensive term with the maximally tolerable term.[45]

At times, the maximal tolerable level is defined explicitly be statutes. Some states have enacted bright line rules stating the maximal duration of non-compete clauses in employment contracts. In these states, when the contract contains a non-compete term that is longer than the statutory cap, it is normally truncated to be equal to that cap.[46] That is, only the increment of the restraint that is socially intolerable is eliminated; the rest stands. In other states there is no bright line statute. There, too, courts reduce the non-compete term, bringing it down to a level that is maximally tolerable. The restraint "is not enforceable beyond the time or area considered reasonable by the court."[47] The permissible duration varies across circumstances and jurisdictions. Case law provides numerous examples for the cap being set between 6 months to 7 years.[48]

The stated aim of this jurisprudence is to protect the employer's interest without unreasonable hardship upon the employee. While this is a cost-benefit test, it would be wrong to conclude that the courts are enforcing the most efficient gap-filler. Rather, courts view their role as securing the bargain that the parties struck, recognizing the superior bargaining power of the employer. The cost-benefit efficiency test is used, not to identify the surplus maximizing term, but rather to characterize what is excessive. A limitation that burdens the employee without according benefit to the employer is deemed unreasonable. Thus, in eliminating the unreasonable portion of the restraint, the court is setting not the most reasonable or common term, nor a majoritarian or average provision, but rather the maximally tolerable one.

Moreover, in this area of the law, courts have developed an interesting practice that purports to address the drafting incentive problem discussed

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[45] See, e.g., Harlan M. Blake, *Employee Agreements Not to Compete*, 73 Harv. L.Rev. 625, 646-651 (1960)

[46] See, e.g., Section 542.335(1)(d)1, Florida Statutes (1997) ("a court… shall presume unreasonable in time any restraint more than 2 years in duration"), enforced in Flickenger v. Fitzgerald & Co., 732 So.2d 33 (Fl. 1999)

[47] *See, e.g.*, Justin Belt Co. v. Yost, 502 S.W.2d 681, 685 (Tex. 1974).

[48] Cite

in Section III. Recognizing that the doctrine of partial enforcement might give drafters incentives to dictate overly oppressive restraints, expecting to lose at worst only the excessive increment but to keep it anytime it is not challenged, courts have responded by invalidating the entire non-compete clause if there is evidence of deliberate overreaching.[49]

B. Unconscionability Doctrine

Much of the commentary and case law on the unconscionability doctrine address the question "what constitutes unconscionability?" Less attention is devoted to inquire how to repair unconscionable contracts. What happens when a term is adjudged unconscionable?

It would be inaccurate to say that the law uses maximal tolerable terms to substitute those that are deemed unconscionable. There are ample instances in which this criterion was followed, but there are other examples for the contrary. Corbin seems to have endorsed this criterion when he explained, in the context of a loan of money, that "a contract that requires a payment of a very high interest will be enforced, *up to the point at which 'unconscionability' becomes and operative factor*."[50] In many cases courts have replaced an unconscionable term with something that resembles the maximal tolerable term. For example, in the classic door-to-door sale case, *Toker v. Westerman*,[51] the buyer agreed to pay over $1200 for a refrigerator that normally sells for $400. After the buyer paid more than $650, he sought relief from the oppressive price. The

[49] See, e.g., Central Adjustment Bureau v. Ingram, 678 S.W.2d 28, 37 (Tenn.1984), where the court notes:

> "We recognize the force of the objection that judicial modification could permit an employer to insert oppressive and unnecessary restrictions into a contract knowing that the courts can modify and enforce the covenant on reasonable terms. […] the employer may have nothing to lose by going to court, thereby provoking needless litigation. If there is credible evidence to sustain a finding that a contract is deliberately unreasonable and oppressive, then the covenant is invalid."

See also Jenkins v. Jenkins Irrigation, 259 S.E.2d 47, 51 (Ga. 1979).

[50] 1 Corbin, Contracts § 129, p. 556 (1963) (*emphasis* added).

[51] 274 A.2d 78 (NJ, 1970). See also *Jones v. Star Credit Corp.*, 298 N.Y.S.2d 264 (N.Y.Sup.Ct. 1969) (a $300 freezer was purchased for a price that exceeds $1400; the court allowed the buyers to stop payments after $620 were paid).

court indeed struck down the price as unconscionable, but allowed the seller to keep the money already paid. True, the court did not directly hold the seller is entitled to the maximal tolerable price. The $650 figure happened to be the amount already paid when the case was initiated. The buyer only asked for the remainder to be unenforceable; he did not seek restitution of some of the money previously paid. But in another case, in which the price was not yet paid, the court specifically reversed a lower court's stipulation of a low market price, and allowed the seller to collect a high-end price that includes reasonable profit and various charges.[52]

Another example comes from the decision of the district court in the famous *Batsakis v. Demotsis* case. Recall that this case involved a loan in Greek currency made in Greece during the war, which, in nominal terms, amounted to the equivalent of $25. In return, the debtor promised to pay $2000 plus interest after the war. When the time to pay the debt came, the debtor reneged. The District Court in Texas found that the promise to pay $2000 for a loan of $25 was not enforceable, for lack of consideration. Sympathizing with the debtor, but recognizing also that the contract cannot simply be voided and undone, the court ordered the debtor to pay $750 to satisfy the debt. This result, we know, was overturned by the Court of Appeals, which reinstated the obligation to pay $2000.[53] For our purpose, however, it is the lower court's decision that is of interest. That court effectively invalidated the $2000 price and thus needed to fill a gap. It did not turn to the most reasonable and balanced term, nor to a term that comports with community standards of fairness. Rather, it used a one-sided term, just within what it perceived to be the tolerable range.[54]

Courts do not always resort to this principle of striking down only the minimum necessary to bring the unconscionable term within the tolerable region. For example, in a landmark case on unconscionable arbitration terms, the court found some elements to be unconscionable

[52] *Frostifress v. Reynoso*, 274 NYS2d 757 (Sup. Ct. 1966), rev'd as to damages, 281 NYS2d 964 (App. 1967).
[53] Batsakis v. Demotsis, 226 S.W.2d 673 (Tex. 1949)
[54] A similar principle underlies another landmark usury case, Carboni v. Arrospide, 2 Cal.Rptr.2d 845 (1991). There, the court struck the agreed upon interest rate of 200%, and replaced it with a 24% rate, which was higher than the market rates of 18-21%.

and struck down the entire arbitration clauses, effectively filling the gap with a no-arbitration term.[55] The employer argued in vain for a different result, of severing the unlawful elements in the arbitration clause and eliminating only those elements, leaving the rest of the arbitration term in tact. The employer was, effectively, asking for the maximal tolerable term. The court rejected this, explaining that it has no vested power to "reform" a contractual term; if some elements are unconscionable, the court's only choice is to void the entire term.[56] The no-arbitration gap-filler was regarded by the court as fair.

Parenthetically, it might be argued that there was something artificial about the *Armendariz* court's reasoning. The court explained that it has no authority to sever parts of a contract and to cure the gap by "augmenting" the contract, that is, by adding a non bargained-for term. But was this not what the court was doing anyway? By striking the entire arbitration arrangement, the court severed this part of the employment bargain and "augmented" the bargain by adding a non bargained-for term—a no-arbitration term. The question, then, is not whether the court has the power to reform the contract—it surely does.[57] The question is how much of the bargain needs to be eliminated: only the minimum, rendering the remainder tolerable, or more than the minimum, rendering the remainder fair and balanced? Indeed, in other cases the severability principle was invoked and only the offensive elements of the arbitration clause were eliminated.[58] For example, in *Brower v. Gateway*—another leading unconscionability decision—the court held that a term mandating arbitration under the ICC forum is unconscionable because of the excessive filing fee of $4000.[59] It held, though, that Gateway can cure this defect by agreeing to arbitrate in another forum, if it entails filing fees that are not unconscionable. This is another example of an unconscionable term repaired by the 'maximally tolerable' criterion.

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[55] See, e.g., Armendariz v. Foundation Health Psychcare

[56] *Id.*, at 125 ("Because a court is unable to cure this unconscionability through severance or restriction, and is not permitted to cure it through reformation and augmentation, it must void the entire agreement")

[57] UCC 2-302, cmt 2. CITE

[58] See, e.g., Little v. Auto Stiegler, 63 P.3d 979 (Cal. 2002); Anders v. Hometown Mortgage Services, 346 F.3d 1024 (11th Cir. 2003) (severability clause prevents any invalid provisions from destroying the entire agreement to arbitrate.)

[59] Brower v. Gateway 2000, 246 A.D.2d 246 (N.Y.A.D 1998).

C. Remedies

Most remedies for breach of contract are default rules. The parties can opt out of the legally-supplied remedies and, subject to several well-known limitations, stipulate their own remedies. If the legally supplied remedies are gap-fillers that kick in only when the contract is silent, are there instances in which they are tilted in favor of the party with the ex ante bargaining power?

1. *Liquidated Damages.* One potential application of the bargain-mimicking idea concerns liquidated damages. It is well-known that courts do not enforce liquidated damage terms that are clearly excessive and punitive. But what is the damage term that courts supply instead? While the text-book answer is "compensatory" damages, it is often the case that compensatory damages can be assessed with more or less accuracy, thus lie within a fairly broad range of reasonableness, from the low estimates (that rule out consequential damages and types of avoidable harm) to high estimates (that include generous measures of potential lost profit). A bargain-mimicking term would replace the unenforceable liquidated measure, not with the average or most reasonable compensatory measure, but rather with the high end estimate of expectation damages.

There are some statements in American case law that reject this notion. When an excessive liquidated damages clause is held unenforceable, it is wholly invalidated. In these situations, the most that courts are willing to award is the ex-post proven expectation damages. Courts refuse to apply a method of reducing the liquidated damages to bring them within the reasonable range.[60] Effectively, then, courts reject the maximal-tolerable-term formula.

But other legal traditions deal differently with penalty clauses. Under Israeli contract law, for example, courts are instructed merely to reduce excessive damages to the level reflecting the magnitude of loss

[60] For an explicit rejection of the reduce-and-enforce methodology in penalty clauses, see Cad Cam, Inc. v. Underwood, 521 N.E.2d 498 (Oh. 1987)

reasonably expected at the time of contracting.[61] In one case, a liquidated damages clause required the seller of a business to pay $700 per day of delay in fulfilling his obligations. The seller was late by 100 days. The court found the liquidated amount to be excessive, and held that actual damages were probably zero or close to it, because the business was running at a loss. Still, the court decided to reduce the damages, not to the actual harm of $0, but instead to $200 per day, explaining that "$200 per day is *the maximal amount that the parties could have anticipated* as possible harm from delay."[62] A leading commentary states that excessive liquidated damages should be reduced "to the *highest level* that the court regards as reasonably related the harm anticipated at the time of contracting…; that is, reduced to the measure *closest to the agreed sum, such that if that measure were the one agreed upon in the first place, the court would not have been justified in reducing it*."[63] This, in other words, is the maximally tolerable level.

2. *Damages for Defective Performance.* The bargain-mimicking idea can help explain case outcomes in another important area: the selective application of the cost-of-completion measure of damages in cases of defective performance. In classic case of *Peevyhouse v. Garland Coal*[64] the court had to decide what damages apply when the stripmining company breached its promise to restore the mined farm land to its original condition. The case provides a dramatic illustration of the choice between two measures of expectation damages: cost-of-completion, which would have been $29,000, and diminution-in-market-value, which was only $300. It was a hard choice, and the Supreme Court of Oklahoma ruled 5-to-4 in favor of the diminution in value measure. Other courts in other states held differently. Authorities are still split.

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[61] Contract Law (Remedies for Breach of Contract) 1970, Sec. 15(a), Sefer Ha-Chukkim No. 609. p. 13.

[62] Zaken v. Ziva, Civil Appeal No. 539/92 (Unpublished), p. 4.

[63] U. Yadin, CONTRACT LAW (REMEDIES FOR BREACH OF CONTRACT) 1970, p. 132 (2d Ed. 1979) (in Hebrew). *See also* Eyal Zamir et. al, BRIEF COMMENTARY ON LAW RELATING TO PRIVATE LAW 302 (1996) (in Hebrew) ("the measure of reduction of liquidated damages ought to be to the level for which the element of excessiveness no longer applies…[such that] if that level was set in the first place, it would not have been reduced by the court.")

[64] Peevyhouse v. Garland Coal & Mining Co., 382 P.2d 109 (Ok. 1962).

For the purpose of our discussion here, it is interesting to note what the trial court did in that case. Rather than granting one of the two competing measures of recovery, the trial court awarded the plaintiffs $5000. This, it turns out, is not merely a split-the-difference compromise; it is the remedy that closely resembles the bargain-mimicking outcome. It is well-documented that when the contract between the plaintiffs and Garland Coal was signed, the plaintiffs had strong bargaining leverage.[65] They were not particularly eager to enter the contract, but when they eventually agreed, they leveraged their bargaining strength and insisted on including a restoration clause. In fact, they waived their right to receive an upfront restoration allowance of $3000—close to the entire value of the farm—in order to secure that restoration clause. Thus, if instead of a restoration clause the plaintiffs would have bargained for an explicit liquidated allowance to be used to fund self-managed restoration, it would have been roughly $3000—the sum they traded away for the restoration clause. Not $29,000, nor $300. The jury award of $5000, it turns out, comes close to mimicking that bargained-for remedy of $3000 (augmented by incidental costs arising from breach, delay, and trial).

The choice of cost-of-completion versus diminution-in-value is a fundamental and controversial one, leading to seemingly conflicting outcomes across cases. It is an ongoing struggle for contracts scholars to provide a descriptive theory of the result reached by courts. Why do some plaintiffs get the former, usually higher measure, whereas others receive the latter, stingier recovery? Criteria such as the willfulness of the breach and the disproportionality of the cost-of-completion are only partial and ad-hoc organizing factors. The bargain-mimicking principle, I argue, can bolster our understanding of case outcomes. Promisees, like the Peevyhouses, who had the superior bargaining power to insist on a completed performance, are entitled to the more generous measure. It mimics the high-end liquidated damages clause they would have bargained for. This idea, focusing on the ex-ante bargaining power of the transactors, underlies Cardozo's famous but cryptic distinction between "common chattel" versus "a mansion or a skyscraper."[66] Why does Cardozo think that courts should allow the margin of non-completion to

[65] See Judith L. Maute, Peevyhouse v. Garland Coal and Mining Co. *Revisited: the Ballad of Willie and Lucille*, 89 Nw.U.L.Rev 1341 (1995).
[66] Jacob & Youngs v. Kent, 129 N.E. 889 (N.Y. 1921)

be greater (and the remedy to be smaller) in the case of common chattels or when the client purchased a stock floor plan house,[67] but require stricter compliance and award the higher cost-of-completion measure for mansions? Plausibly, clients who purchase common chattel and stock floor homes have less bargaining power against sellers and little ex ante leverage to demand the cost-of-completion remedy. But when mansions and skyscrapers are designed, the client is often in a strong bargaining position. Hence, when the aggrieved party had the ex ante bargaining power to insist of precise completion of performance that courts award the more generous measure.[68]

To be sure, remedies for breach of contracts are not the kind of gap-fillers that have solely distributive effects. A long and distinguished literature has shown that, through their effect on performance and reliance decisions, remedies have significant influence on the overall surplus.[69] Thus, there is a strong argument suggesting that gaps in the contract concerning remedies ought to be filled with surplus maximizing terms rather than bargain-mimicking terms. Indeed, in the context of *Peevyhouse*, commentators have expressed concerns how the cost-of-completion measure would affect the incentive to breach-or-perform.[70] And yet, despite this fundamental concern, it is quite plausible that the damage measure chosen in cases like *Peevyhouse* would have only a distributive effect. If damages are too high, inducing inefficient performance, the parties would likely renegotiate them. And if damages are too low, inducing inefficient breach, again the parties would have an incentive to renegotiate.[71] Thus, to the extent that the damages merely

[67] Plante v. Jacobs, 103 N.W.2d 296 (Wis. 1960)

[68] *See also* Groves v. John Wunder Co., 286 N.W. 235 (Min, 1939) (awarding $60,000 cost-of-restoration when the diminution in value was no more than $12,000), and case commentary by Robert Hillman, Principals of Contract Law 140 (2004) (arguing that the factor that should determine the outcome is the bargaining power when restoration clause was drafted), and Marvin A. Chirelstein, Concepts and Case Analysis in the Law of Contracts 174 (4th Ed. 2001) (arguing that the recovery should equal the amount the promisee could have bargained for at the agreement stage.)

[69] Shavell, Foundations of Economic Analysis of Law 304-312 (2004).

[70] Posner, Economic Analysis of law 121 (6th Ed. 2003).

[71] Ian Ayres & Krisin Madison, *Threatening Inefficient Performance of Injunctions and Contracts*, 148 U.of Pa. L.Rev. 45 (1999) discuss the effect of the damage measure on

affect the bargaining position of the parties in the renegotiation phase, but not the performance outcome, the argument is all the more compelling that such damages should reflect the ex ante bargaining power of the parties, to save them the trouble of explicitly stipulating these damages in the contract.

Conclusion
[to be written]

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the subsequent rounds of bargaining over release from inefficient performance and inefficient breach.