Amherst College
Economics Department
Economics 66
Fall 2010

Discussion Questions for Week 9

Contracts II

1. Why may it not always be efficient to fulfill contractual obligations? Why would the required payment of "expectations damages" lead to efficient breach? Where does the term "expectations damages" come from?

2. The First Restatement of Contracts states that damage provisions in a contract are not enforceable unless they were a "reasonable forecast" of the harm of a breach. Suppose that such reasonable expectations turn out to be wrong. For example, in a famous case Bethlehem Steel agreed to a penalty clause in its contract to provide guns during the Spanish-American War. But the war ended before the delivery date and Bethlehem eventually delivered the guns late. Should the penalty clause be enforced?

3. The case of *Peevyhouse v. Garland Coal* concerns the damages that should be paid when a firm violates a contract to provide environmental cleanup. Explain how the various damage rules described in this course should be applied in this case. Which of these do you believe would yield the efficient result?

4. The contractual relationship between the Fisher Body Company and General Motors Corporation has been frequently discussed by economists. From 1919 until 1926 Fisher had a long-term contract to provide all the auto bodies needed by GM. But in 1926 the parties decided to merge and thereby absolve their long-term contract. This situation illustrates quite a bit about the choice between contractual relationships and integration of firms. The Fisher Body case is discussed in the paper by Andreas Roider on the website. After looking over this paper you should be able to describe some of the issues that contract theory poses for the theory of the firm.

5. McChesney's paper on "Tortious Interference" argues that this legal provision may be a first best solution to certain contracting situations rather than an "efficient breach" approach. How does the concept of "property rights in a contract" help to analyze which procedure would entail lower transactions costs? How do these various arguments play out in the 1984 case of *Texaco v. Pennzoil* ? (A more recent example is the 2008 dispute between Citicorp and Wells Fargo over the takeover of Wachovia bank).