Preface

*The first principle of Economics is that every agent is actuated only by the self interest. The workings of this principle may be viewed under two aspects, according as the agent acts without, or with, the consent of others affected by his actions. In wide senses, the first species of action may be called war, the second, contract.*

– [Edgeworth (1881), pp. 16, 17]

Introduction

Contracts have traditionally been reckoned as means by which individuals/ firms (simply, economic agents) may commit themselves to specified courses of conduct. To an economist, a contract is an agreement through which the parties make reciprocal commitments in terms of their behaviour – a bilateral coordination arrangement. Characteristically, a contract is a specification of the actions that the parties are supposed to undertake at different times generally as a function of the conditions that hold good during the stipulated period. Thus any contract basically covers two broad aspects – actions and conditions. The actions typically relate to performance of services, delivery of goods, and monetary payments; and the conditions include uncertain contingencies, past actions of the parties, specialised information, and messages corresponded to by them. However, a contract is not an instrument by which the parties collectively may achieve such commitment. Rather, they are individual commitments, and perhaps explicit and implicit enforcement guarantees.

“*A chain is only as strong as its weakest link; and the longer the chain, the more weak links.*”¹ Similarly both the parties’ commitments are only as strong as their contracting part-

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¹ L. J. Peter, 1986
ners’ desire to hold them to their original promises. Without some forms of assertion that others will, when needed, uphold their commitments of a bargain, individuals will reasonably be averse to make investments, give up opportunities, or take other actions necessary to realise the full value of exchange. Consequently, the law – an obligation backed by the state sanction – that governs such agreements\(^2\) is critical to the functioning of free-market economies. This formulation not only touches the legal concept of contract as promises but also transcends it through extending remedies for any violation, disputes or breach of contract. While the law of property determines the boundaries of our lawful possessions (i.e. the configuration of entitlements that form the basis of production and exchange), the law of torts defends individuals against the violation of those boundaries as well as against the violations of their physical persons by protecting those entitlements from involuntary encroachment and expropriation. Where a contract is a single connection between the parties, the law of contract is the portion of Civil/ Common Laws that ratifies and enforces joint ventures beyond those boundaries through interpretation and enforcement of (written or verbally communicated) agreements between the parties and by resolving the disputes between them in general. It is contract law that sets the rules for exchanging individual claims to entitlements and determine the extent to which society is able to enjoy the gains from trade; and thereby, improve welfare for both the parties and for the society.

\(^2\) An agreement enforceable by law is a contract. Thus for the formation of a contract there must be – (1) an arrangement, and (2) the agreement should be enforceable by law.

Agreement is defined as “every promise and every set of promises forming the consideration for each other”. And a promise is defined as an accepted proposal. “A proposal, when accepted, becomes promise.”

Thus in a nutshell, a contract is an agreement; agreement is a promise and a promise is an accepted proposal. Every contract is an agreement, but every agreement is not a contract. An agreement becomes contract when the following conditions are satisfied – (i) there is some consideration for it, (ii) the parties are competent to contract, (iii) their consent is free, (iv) their object is lawful.

— Common Law. [See, Singh (2004), Law of Contract & Specific Relief. pp. 2-3]
The regime of contract law, which respects the dispositions that individuals make of their rights, carries to its natural conclusion on the liberal premise that individuals have rights. And, economic theory of contract, which sees contractual obligations as essentially self-imposed, is a fair implication of liberal individualism. Accordingly, economists interested in the welfare properties of specific institutions in particular, or the micro-foundations of exchange generally, have good reason to take account of the law of contracts.

Economic analysis of law, in principle, is concerned with two basic matters – (a) determination of the effects of the legal rules, and (b) evaluation of the desirability of the effects of legal rules with respect to well-specified definitions of social welfare. The orientation of economic analysis of contract law deals with enforcement of contractual agreements through damage payments\(^3\) by the party, which commits breach, to the victims

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3 Damages and specific performance are two broad types of court designed remedies for breach of contract.
A. Expectation damages: The breacher has to pay the amount that makes the victim equally well off as under contract performance.
B. Reliance damages: In this case, the harm that is caused by breach focuses on the costs the promisee has incurred as a result of relying on the contract. As such, perfect reliance damages are meant to leave the promisee indifferent between no contract and breach of the contract. The baseline is no contract. Damages then are equal to the net reliance costs of the promisee.
C. Opportunity cost damages: In this case, the harm that is caused by breach concentrates on the costs the promisee has incurred as a result of foregoing alternative contracts. As such, perfect opportunity cost damages are meant to leave the promisee indifferent between breach of the contract and performance of the next best contract. The baseline is value to promisee of the next best contract. Damages then are equal to difference between the net value of performance of the next best contract and no contract.
D. Restitution: Restitution simply requires that, in the event of breach, the promisor must give back anything the promisee gave the promisor in exchange for the promise.
E. Disgorgement: Disgorgement damages are intended to eliminate the injurer's profit from doing wrong. As such, if a promisor breaches a contract by doing something wrong and profits from the wrongdoing, perfect disgorgement damages would leave the promisor indifferent between performing the contract and breaching and paying damages equal to the gain from having breached.
F. Specific Performance: This remedy simply requires the promisor to perform the contract. In the event that the court orders specific performance, the parties to the contract can subsequently negotiate an alternative settlement, e.g., breach with damages paid to the promisee. An advantage it has over damages is that the court does not have to estimate the value of performance to the promisee. Specific performance is especially attractive in cases involving special/unique goods and services.
G. Party-designed remedies/Liquidated damages: The initial contract contains explicit terms specifying the remedy in the event of breach.
for harm. Economic approach can be counterpointed with the traditional analysis of law. Under the latter, damage payments for breaches tend not to be regarded as incentives toward performance or as an implicit escape hatch; and the effects of the legal rules are generally not consistently assessed. Damage payments are seen primarily as compensation for harm or as proper penalty for breaking a promise. But under the economic view, the breach of contract should not necessarily be identified with breaking a promise; the contracts that are written are not interpreted as detailed promises that parties truly want to be kept, but rather as incomplete promises that are only rough guides for behaviour, and that the parties do not want to govern when performance would be very difficult. One effect of the requirement to pay damages is that it induces contractual performance, which tends to raise the value of contracts to the parties and to the society. A less obvious advantage of damage payments is that they constitute an escape hatch that parties can use when contractual performance becomes difficult, for they can breach and pay damages rather than bear very high costs to perform. These points and others (notably, concerning risk allocation, and incentives to invest) about the virtues of payment of damages for breach have been analysed extensively in the economic literature on contracts.

The theory of contract ideates the fundamental link between contract design, on one hand, and contract enforcement, on the other; the choice of contract terms will depend in part on the legal rules and enforcement policies that parties expect courts to follow while the enforcement practices of efficiency-minded courts will depend on what courts perceive

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4 This escape hatch element of damage payments also raises the value of contracts, as it makes parties more willing to assume contractual obligations. The escape hatch feature of damages for breach is socially advantageous as well – it is not socially desirable for parties to perform when the cost of so doing outstrips the benefit to the recipient of performance.
as the purpose and impediments to contracting. In short, the analysis of contract law and its enforcement presupposes a theory of contracting behaviour, and vice versa. In spite of this interdependence, the literature on contract design and contract enforcement has been largely developed independent of each other. Economic theories of contracting give little explicit attention to enforcement issues, the presumption being that courts will see to it (and subject itself only to verifiability constraints) that whatever terms contracting parties arrive at are automatically satisfied. Indeed, in mainstream contract theory the court’s only function is to enforce contracts as written therein (Tirole, 1994). This judicial deference to contracts in economic theory contrasts with the far more intrusive role of courts in economic analyses of contract law, in which courts are called on to adjudicate disputes, fill gaps, and devise and implement default rules.

This thesis, accordingly, surveys the main issues arising in economic analysis of contract law with special attention given to the incomplete contracts. We discuss both the main features of contract law as they relate to the problem of economic exchange, and how the relevant legal rules and the institutions can be analysed from an economic perspective. In this introductory section, we set out the basic scope, background & motivation, research objective, methodology, and organisation of the discussion to follow.

**Background and Motivation:**
Comprehensive Vs. Incomplete Contracts

In recent years authors in both economics and law have recognised two basic segments in contracts – namely, completely specified (or complete or comprehensive contract) and incomplete contract. Each discipline has focused on different aspects of the contracting problem. Legal scholars consider a contract as incomplete if its obligations are not completely specified (Ayers and Gertner (1992)), e.g., a contract that fails to specify the price, quantity or time of delivery. From this perspective, even the “null contract” that states the parties have no obligations is a complete contract. Economists (for example, Hart and Moore, 1988), albeit, consider the contracts as incomplete – even if they fully specify the contracting parties’ obligations – if they are “insufficiently state contingent”, that is, it fails to make the specified exchange contingent on all the payoff-relevant information available to the contracting parties.

The former definition operates to define an incomplete contract in those circumstances in which an issue of "gap filling" can arise and thus is well suited to the lawyer’s purposes. The latter, in contrast, includes the contracts that poses no opportunity for the gap filling and thus give the parties an inducement to renegotiate or breach the original contractual terms to achieve the additional gains from trade. Hence, the economic analysis of incomplete contracts is virtually synonymous with the study of contract renegotiation and breach. Yet, from the lawyer’s perspective, this is the key issue raised by the incomplete contracting: what are the legal consequences that attach when disputes fall into the gaps in an incomplete contract?

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5 See, section 1.1.2 in the next chapter for more detailed discussion on the 'gaps' in incomplete contracts.
Reasons for Incompleteness and the Informational Asymmetry

The contracts, we observe in the real world, often fail to specify what happens in many important contingencies and they are not always crafted to provide each party with the optimal incentives (Stewart Macaulay, 1963); in such situations they said to have gaps.

Some contractual incompleteness can be explained easily enough. Important aspects of the agreement are unobservable to one of the parties or both (information is asymmetric) or too costly to prove in court (information is "unverifiable")\textsuperscript{1}. These things can then induce a "second-best" effect: the parties decide to omit from the contract certain of even the observable variables for fear of unduly concentrating incentives on just what is included. Or, it may be desirable to leave something out of the contract so it can be used as a threat by a party who would otherwise be vulnerable to opportunism by the other party (Bernheim

\textsuperscript{6} There are several types of reasons for the incompleteness of contracts, that is, for why parties find it in their mutual interest to leave contracts incomplete. One category of reasons concerns the effort and cost of anticipating possible contingencies, bargaining about their resolution (given that they are anticipated), and then describing them adequately in contracts. In particular, parties will tend not to specify terms for low probability events, because the expected loss from this type of exclusion will be minimal, whereas the cost of including the terms would be borne with certainty.

A second reason for incompleteness involves the subsequent cost of enforcing a contractual term. Notably, if the cost of providing evidence to the courts that a relevant contingency or condition has occurred is sufficiently large, then the term will not be worthwhile including.

A third important reason for incompleteness is that some contingencies or some variables cannot be verified by courts. If a contingency or the value of a variable cannot be verified by courts -- if there is an asymmetry of information between the parties and the courts -- then were the parties to include the contingency or variable in the contract, one of the parties would generally find it in his interest to make a claim about the contingency or the variable, causing problems.

A fourth factor is that the expected consequences of incompleteness may not be very harmful to contracting parties. To amplify, a court might interpret an incomplete contract in a desirable manner. In addition, the prospect of having to pay damages for breach of contract may serve as an implicit substitute for more detailed terms because it may lead parties to act as they would have under more detailed terms. Furthermore, the opportunity to renegotiate a contract often furnishes a way for parties to alter terms in the light of circumstances for which contractual provisions had not been made, and will lead them to do what they would have provided for had they written a more detailed contract in the first place.

\textsuperscript{7} If information is symmetric but unverifiable—observed by both parties to the contract but unobservable to the court—then it may still be useful to design an agreement around that information, as the mechanism design literature tells us. This possibility brings into question unverifiability as an explanation for contract incompleteness, a controversy discussed in Jean Tirole (1999).
Asymmetric information can also lead to incomplete contracts in a different way: Party A's fear that if he proposes an addition to the contract Party B will deduce that he has private information and either be more reluctant to trade or somehow use that information against him.

As Rasmusen (2006) put it, "we do have a number of explanations for why important variables are left out of contracts—unobservability, unverifiability, second-best incentives, fear of signalling undesirable characteristics, contract-writing costs, and the legal default rules. These explanations are far superior to the old phrases, "bounded rationality" and "transaction costs," in that they explain which contracts will be the most complete, but for that very reason they leave us with many contracts which ought to be complete but are not".

Here a clear relation between the asymmetrical information and the incompleteness is necessary. Although the asymmetrical information is a necessary condition to pass from non-contractual world to a comprehensive contractual world, it is not necessary to make sense of "incomplete" contracts. Put it differently, while the parties to a contract may have a symmetrical information, it is the asymmetry of information between the parties on one hand, and the outsiders (such as the courts) on the other hand, which is at the root of the problems. To use the jargon, the incompleteness arises "because the states of the world, quality, and actions are observable (to the contractual parties) but not verifiable (to the outsiders)." (Hart-Holmstrom, 1987)\textsuperscript{8}. The incomplete contractual world involves at least three agents and the third party represents an institution such as courts, custom, reputation, etc.

\textsuperscript{8} In these models whenever dispute arises in the post contractual execution scenario, parties tend to renegotiate the existing contract terms either before arriving to court or in front of a court appointed arbitrator once the suit is filed. In that case, the renegotiation process (if at all it is possible to design) agreed to by the parties along with the breach remedies enforced by the courts become critical determinants of contractual performance, and thereby effectively "completing" the contract.
The particular difficulties related to conveying the information to a third party is especially stressed in the theory of tacit knowledge (Hayek, 1968; Polanyi, 1967; Nelson and Winter, 1982). The other source of the asymmetric information is more crucial to the contractual incompleteness when it exists between the two contracting parties themselves (when the valuations and/or effort levels of one party cannot be observed by the other party). Needless to say, if the courts cannot observe these variables, then the contracts obviously cannot include them.

- Issues concerning Contractual Incompleteness, Informational Asymmetry and Specific Investments:

The goods and assets traded in the ‘thin’ markets (that is, those with few buyers and/or sellers) or those requiring transaction-specific investment, have weaker market sanctions. These may give rise to contractual difficulties particularly for the contracts involving specialised assets or those where one or both the parties have incurred significant transaction/relation specific investment or expenditure that enhance the value of performance but must be undertaken before the performance is due.9

In the real world, the presence of many types of transaction costs (viz. non-foreseeable uncertainty and asymmetric information) can prevent the achievement of optimal outcomes. The uncertainties of various types not only pose a challenge for the parties to design an optimal (complete) contract [that expressly controls all of the possible permutations of the

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9 Investments are specific in the sense that they have zero value outside the relationship. Following the work of Che & Hausch (1999), specific investments can be segregated in two ways – selfish and cooperative. A seller’s selfish investment would reduce her own costs; a buyer’s self investment would increase his value for the contractual performance. A cooperative investment, on the contrary, occurs when the seller takes an action that may increase the buyer’s valuation, and vice-versa.
risk of moral hazard, but also make it difficult for the parties to honour a binding contract. Market failure may occur due to the uncertainty, even though the transaction seems to be profitable. The uncertainty might make the profitability of the 'specific investments' so unsecured that the ex ante investments may not be undertaken (at all, or to the 'desired' level). This is the famous 'hold-up' problem.

On the other hand, the associated informational asymmetry (i.e. the parties' lack of knowledge about the other party, specifically about their valuations, characteristics and qualities, including their propensity to act opportunistically) not only aggravates the problem of moral hazard (i.e. hidden action) but can also lead to difficulty in execution of the contract due to the inefficient/opportunistic behaviour (adverse selection). Even though both the parties are aware of the investments being co-specific, they might not know the exact degree of relation-specificity of both their own and each others investments. This asymmetry or the lack of information creates uncertainty about the bargaining power, the size of the quasi-rents, the division of the return and the ex post hold-up potentials. The establishing of commitments might not give the required credibility if the parties do not have

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10 In legal literature it is called 'reliance'. We shall be using both the terms interchangeably throughout.

11 "Hold-up arises when part of the return on an agent's relationship-specific investments is ex-post expropriable by his trading partner. The hold-up problem has played an important role as a foundation of modern contract theory, ... as the associated inefficiencies have justified many contractual practices. One interpretation of the inefficiency is the failure of the Coase Theorem. Parties cannot achieve the efficient outcome since non-contractibility of the buyer's or the seller's investment-decisions prevents them from negotiating over that decision ex-ante." - Che and Sakovics (2004a). Also see, Klein, Crawford and Alchian (1978)

12 The case of moral hazard poses challenges to contract in many ways. Firstly, moral hazard is an ex post phenomenon - thus occurs after a contract was already made. Secondly, it derives from hidden action and is thus not foreseeable to other party in contract. Thirdly, hidden action in the case of moral hazard is mostly intentional so that the party undertaking it would surely not disclose this information to other party on any occasion.

13 The opportunistic behaviours (or breach) are essentially the 'bad-faith' re-negotiations of the contractual terms motivated by significant contract-specific investment or expenditure by one party induced by (in reliance on) a contractual promise.
the satisfactory information about the others' alternatives and their values. The asymmetric information also leads to the opportunistic exploitation of the 'valuable breach option'\(^{14}\) by the informed party (rent-seeking through hidden information). Thus the asymmetric information creates an incentive problem. It can also hamper the court's choice of the appropriate remedies (when it cannot verify these private informations ex post).

Both the adverse selection and the moral hazard are not mere phenomena but a result of the parties' economic decision making at the individual level. The ex post adverse selection hinders the parties from an efficient execution of the contract through a conflict in commitments, caused by the rational decision making under the imperfect information. The moral hazard, on the other hand, is the rational decision of a party to a contract towards an ex post re-adjustment of its position for its own advantage but to the detriment of the other party. The opportunism of these kinds may present itself either in the form of coerced variations of the contract or the termination of the business relation and the capture of an investment. We are thus precisely interested in checking how the existing contract laws respond to the problem of the opportunistic rent-seeking and the moral hazard.

\(^{14}\) Valuable breach options are the characteristics of executory contracts. The parties intend to breach a contract when production costs rise above the contract price or a better offer is received or valuation falls below the contract price or because a substitute has been found at a lower price. This makes honouring the contract either less profitable or totally loss making affair. The value of breach option particularly under asymmetric participation varies significantly with the riskiness of the underlying asset and dimension of private information. Breach option is significant as this not only governs the post contractual breach decision of the promisor but also affects the ex ante reliance behaviour of both the parties.
Specific Research Objectives:

The research topics of this dissertation are premised on the hypothesis that the party-designed liquidated damage remedy performs better (in protecting the ex ante reliance investments and attaining the ex post allocative efficiency) than the court-imposed damage remedies (precisely, the expectation damage) when one or both the parties hold ex post private information (thereby efficient post-breach bargaining is not possible) and the court cannot verify the relevant variables.

The specific objectives of this research are as follows:

1. Evaluate the welfare impacts (especially the issue of hold-ups) of the different modes of incomplete contracts when the relevant variables are observable by the parties but not verifiable in the court.
   
   i. which type of contract the parties would tend to put down in writing in case the parties do not use the sophisticated revelation mechanisms?

2. Analyzing the effects and the desirability of the different breach remedies, and providing plausible rationale in economic theory for every outcome.
   
   i. how the outcomes differ with the dimensions (one-sided and two-way) of informational asymmetry between the parties?

3. Theoretically examine the optimal incentive structure of the party-designed liquidated damages under the different dimensions of informational asymmetry —
   
   i. when the parties’ objective is to maximise the social welfare,

   ii. when the parties want to induce the efficient reliance investments.
4. Contribute to the legal debate over the adoption of the specific breach remedies when the breach victim's expectation interest is difficult to assess. Should a court ignore the ex post informational circumstances and

i. simply enforce the parties' contracts as written, or

ii. should the court craft a remedy that considers these circumstances?

5. Contribute to the debate over the court's reluctance to implement a large penalty designed by the parties in the event of breach, despite the court itself may threaten the promisor with a large penalty in order to induce the promisor either to perform or to make a supra-compensatory payment to the promisee.

i. Why can the courts do what the parties cannot? How far is it justified?

Methodology:

The theory of contracts and the Principal-Agent paradigm together play a central role in our economic analysis of the contract laws. The parties to a bilateral contract face a thin market; neither party competes with an outside "market" to set a price. Furthermore, each party usually possesses some private information about the state of the world. This combination of a thin market and the private information give rise to a strategic behaviour and impose a substantial costs on bargaining process. Because the outcomes of the bargaining games are often non-unique and process dependent, and because one can never be sure which bargaining "game" the parties would adopt, the robust predictions about the bargaining outcomes frequently prove elusive. This justifies the adoption of the Principal-Agent paradigm in our analysis as it recognises the conflicts of interest between the differ-
ent economic actors, formalising these conflicts through the inclusion of the observability constraints and the asymmetries of information. The analytical core of contract theory in general, and the agency theory in particular, is an optimisation problem, whereas in imperfect competition it is an equilibrium problem. Most of the contracting analyses consider a partial equilibrium by isolating the market for one good from the rest of the economy. Thus most contract theories are based on the assumption that the parties at some initial date (say, zero) design a Pareto-optimal long-term contract. The optimality is not to be understood in a first-best sense, but rather in a constrained or the second-best sense (the constraints imposed by the prevailing institutional setting through laws). It also simplifies the bargaining difficulties under the asymmetric information by allocating all the bargaining power to one party and thereby facilitates the realisation of the (constrained) Pareto-optima by maximising the utility of one party while fixing the other's utility to a given level.

In order to overcome these analytical dilemma, our analyses also take resort to a particular methodological approach from the game theory called "mechanism design". This approach enables us to analyse the outcomes of the bargaining processes (and the other allocation schemes) even when the precise bargaining procedures used by the parties are unclear. Although the mechanism design techniques have obvious relevance to the study of the legal institutions, and have had a revolutionary effect on the microeconomics, this methodological approach is still somewhat unfamiliar to the legal community. Of late it has been introduced in the literature of law and economics. Applying this technique to the bargaining problems, we can characterise the costs associated with the strategic behaviour for all the possible negotiation procedures that the parties might employ.
There is an incentive problem underlying each agency model, which is caused by the some form of asymmetric information. It is common to distinguish the models based on the particular type of informational asymmetry involved. All the models in which the agent has the pre-contractual information are dubbed as adverse selection. However certain models assume that agents have symmetrical information at the time of contracting. Within the models under this category, which we refer to as moral hazard, a further distinction is useful: the case where the agent undertakes unobservable actions, and the case where his actions (but not the contingencies under which they were taken) may be observed (Hart and Holmstrom, 1987). Arrow (1985) has suggested the informative names “Hidden Action Model” and “Hidden Information Model” for these two subcategories. Finally, when the information is symmetric between the parties at the time of contracting and they undertake unobservable actions – thus the moral hazard – but becomes asymmetric later at the performance stage – thus the hidden information, Rasmusen (2005) calls this as moral hazard with post-contractual adverse selection. Throughout our model analyses we would be using this last category of the agency models.

What makes the post-contractual hidden knowledge an ideal setting for the paradigm of mechanism design is that the problem is to set up a contract that (a) induces the agent to make a truthful report to the principal, and (b) is acceptable to both the principal and the agent. There is more hope for obtaining an efficient outcome than in adverse selection. The advantage here is that the information is symmetric at the time of contracting, so neither player can use the private information to extract surplus from the other by choosing the inefficient contractual terms.
Consequently our analysis examines the role of contracts between a buyer and a seller for the procurement of a good in the following situations – (i) either the buyer or the seller or both must engage in the selfish reliance expenditures before the date of exchange; (ii) the value of reliance to the buyer or to the seller is to some extent specific to the relationship between them; (iii) either the cost of production or the value of the good to the buyer or to the seller or to both are uncertain at the time of reliance and are ex post private information of the respective concerned party.

**Organisation of the thesis:**

The thesis consists of four chapters. The next chapter using a multi-task model presents an overview of the nature and the extent of the canonical hold-up problem under different modes incomplete contracting when the trade is always economically justified. We also encompass there the different issues surrounding the contracting for procurement under the symmetrical but non-verifiable information set-up. Chapter 2 attempts to set about the basic framework for the analysis of the effects of the different legal rules and rank them when the parties write simple fixed-price contract. We also search for an optimal contract in a situation when only one party undertakes the non-observable reliance investment and the other party holds some ex post private information and contemplates contract-breach. In Chapter 3 we extend our analysis from the previous chapter with a bilateral reliance and one-sided private information model. The effects of the various court-imposed damage remedies are again assessed systematically. Then we take our analysis further when either of the parties can breach irrespective of his holding private information.
in the backdrop of the expectation damage measure. In this regard we make an extensive use of the mechanism design to show that assessing the correct ex post expectation damage by the court is not only flawed in the face of private information but also comes at a cost through a loss of efficiency. Chapter 4 deals with a situation when both the parties undertake reliance investments as well as hold ex post private information. This bi-dimensional information asymmetry while poses great difficulties for the parties in writing a simple contract, it creates problems for the courts to settle the expectation interest of the victim of contract-breach. We encompass two methods of justifying the expectation interest by the courts – namely, subjective method and objective method. Finally, Chapter 5 presents general conclusions and reflections of this study.