BOOK REVIEW: SUGATA BAG'S ECONOMIC ANALYSIS OF CONTRACT LAW

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Abstract

The economic analysis of law as it existed in the nineteenth century, and as it is apprehended in the twenty-first century, displays a few similarities but many differences. The fundamental similarity between these centuries is that the law comprises predominantly of contracts. The many disparities in this law influence the behaviour of its legal subjects in order to achieve particular ends. The economic analysis of Contract Law is often understood as a functional branch of Law and Economics. It is also recognized as an amalgamation of two individual and far-reaching branches, the Theories of Contract, and the Economics of Contract Law. Professor Bag in his book "The Economic Analysis of Contract Law" brings these emerging interpretations to light. In view of these constants and changes, this article reviews the position of contract law with regard to economics. It discusses the various illustrations and models mentioned by him in his book, and also brings to light the importance of his work in bringing intelligent

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and thought-provoking arguments to classroom discussion, thereby going a long way in bridging the gap between economics and law.

I. BOOK REVIEW

Emerging as the one of the most prominent perspectives in contemporary legal literature, the economic analysis of law is an instrumentalist theory of law which comprises two elements, namely, behaviour and ethics.[1] Under this theory, it is explained how law influences the behaviour of its legal subjects in order to achieve particular ends. Historically, economic analysis of law has assumed that law ought to seek effective means to maximize social welfare. When O. W. Holmes coined his "bad man" theory, he stated that reasonable, realistic, self-interested agents adhered with the law only insofar as noncompliance endangered them to the risk of sanctions.[2] However, the contemporary interpretations of the normative theories of law, employed by present-day analysts, have argued that certain legal institutions are designed to promote wealth maximization while others desire to achieve non-wealth maximizing objectives, such as distributive justice.[3]

The economic analysis of contract law is often understood as a functional branch of Law and Economics. It is also recognized as an amalgamation of two individual and far-reaching branches, the Theories of Contract and the Economics of Contract Law. Professor

[1]Rebecca Stone, Economic Analysis of Contract Law from the Internal Point of View, 116 Colum. L. Rev. 2005, 2006-07 (2016).
[2]*Id*. at 2006; *See also* Kevin Fleming, *An Economic Analysis of Contract Law: The Case of Efficient Reliance*, 10 U.S. A.F. Acad. J. Legal Stud. 159, 160 (2000).
[3]Sina Akbari, *Against the Reductionism of an Economic Analysis of Contract Law*, 28 Can. J. L. & Jurisprudence 245, 245-46 (2015).

Bag[4] in his book "the Economic Analysis of Contract Law"[5] brings these emerging interpretations to light. According to him, Contract Law and the Economics of Contract Law have developed independent identities from each other over the past few years. Through this book he intends to reconnect these two disciplines by explaining the correlation that exists between them. This book aims at drawing the attention of readers from both the undergraduate and post-graduate level, and while doing so, also appeals to scholars from both Economics and Law, particularly those who are interested in the economic foundation of law.

This book's central focus is on assessing the effect of damage remedies in contract law. Parties often enter into incomplete contracts. In that scenario, if either party breaches the contract, it is very difficult to ascertain the amount of damages that actually arises, as the damage may not always be in quantitative terms. It is therefore the duty of the contractor to understand the dangers of an incomplete contract as well as the remedies available in case of a negligent contract. In order to explain this, the book tries to convey the economic theory of contract, to provide for a framework to understand the legal concepts from an economic perspective. This has been achieved by drawing the reader's attention towards the latest developments in relation to law and economics by using vivid illustrations and real life day-to-day examples. After reading this book, both lawyers and economists will be able to apply the tools of economic analysis to understand the basic structure and function of the law, and in doing so, hone their approach towards legal issues.

This book consists of seven chapters. Additionally, these seven chapters can be divided into four parts. The first part is the

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[5]SUGATA BAG, ECONOMIC ANALYSIS OF CONTRACT LAW INCOMPLETE CONTRACTS AND ASYMMETRIC INFORMATION 3 (Springer, 2016) [hereinafter BAG].

introductory chapter that discusses the basic foundation of contracts and law; the second part explains the basics of contract law; the third and fourth parts provide detailed conceptual understanding of the damage remedies available in case of a breach between the contracting parties. The third part is intended for beginners while the latter for experts.

Part I of the book, which comprises an introductory chapter, offers a basic understanding of contracts and contract law. In this chapter, the author has correlated economics and law. In doing so, he has helped the reader familiarise himself with the two disciplines.[6] This chapter is crucial for those readers who have not acquainted themselves with either of the disciplines. The author further states that contract law plays a significant role in society as it acts as an enforcing mechanism. Throughout the chapter, both legal and economic views are considered by the author while highlighting issues concerning contractual incompleteness, informational asymmetry as well as specific investments. For readers outside the legal fraternity the concepts of welfare, efficiency and the principal-agent paradigm are explained, so as to build a strong base.[7]

Part II introduces the Economic Theory of Contract. In this part, the author explains the different market modes, the role incomplete information plays in markets, the kinds of parties that enter into a contract under different markets, and how these types of contracts help parties to benefit from trade. The author also lays stress on the incentives that are provided under numerous contracting scenarios. The author maintains throughout this part that trade is always profitable regardless of the uncertainty it offers. This chapter also seemingly illuminates how the incentives in a business relationship differ on the basis of the relationship between the parties. In order to

[6]BAG, *supra* note 5, at 2.
[7]*Id*. at 126.

demonstrate this, two types of transactions, viz. spot market and incomplete contracts are analysed and their further effect on the economy.

Part III consists of two chapters which provide great detail on the economics of damage remedies in cases of unilateral and bilateral reliance and one-sided information asymmetry. This part is targeted at amateur readers who do not have prior knowledge of essential economics and law concepts, such as breach of contracts, efficient breach, and efficient investments. In the course of this part, the reader at first acquaints himself with the present-day scenario of contract law, and then the general setup in which such contracts appear. Then moving on to the key concepts of contract breach and the remedies provided, the author explain these concepts with the use of complicated mathematical equations and comprehensive illustrations.

The first four chapters of the book are suitable for those who desire to create a foundation in Economics as well as Law. However, the last part is directed towards the advanced reader, who is accustomed to the complex concepts of Game Theory and mechanism design.[8] The author has continued to reflect on a trading environment which consists of two parties, where both parties decide to undertake a selfish reliance investment in their respective value functions. However, once the contract is binding, one of the two parties receives information about his or her valuation that remains hidden from the other party and to the courts. This part contributes to the legal debate over the adoption of specific breach remedies when the breach victim's expectation interest is difficult to evaluate. Finally, chapter seven presents the general conclusions and reflections of this study.

The chapter titled 'Mechanisms Under the Shadow of Expectation Damages', under this part, stands as one of the most educative chapters in the book, especially since the chapter deals with the

[8] *Id.* at 16.

various models developed for different kinds of valuations in inordinate detail. Professor Bag adopts a holistic and interdisciplinary approach to solving problems. When economic decisions involve groups, they are unlike those that comprise individual market transactions. Professor Bag's country-wide economic decisions and sound policymaking is one of the reasons why this book stands apart from the rest. This chapter also includes an extraordinary situation wherein two parties undertake a reliance investments while holding ex-post private information. This two-dimensional information asymmetry poses great difficulties for the parties in writing a simple contract. It also creates problems for the courts in settling the expectation interest of the victim of contract-breach. Two methods of justifying the expectation interest by the courts, namely, the subjective method and objective method, are used. To end with, the last chapter presents the general conclusions and reflections of this study.

The manner in which this book has been organized is consistent with that in an academic curriculum. The structure adopted by the author is a graded approach by building the models in consecutive chapters, so that the readers gradually get accustomed to the intricate mathematical requirements. While the chapters are created systematically, certain chapters seem forced, to conform to the seven-chapter plan. For instance, chapters five and six seem unnecessary. Some parts of chapter six are repetitive of the previous chapters. Ideally, the last two chapters could have been combined into one precise chapter. Since these two chapters are targeted at the advanced reader, the author should have skipped laying down the basic concepts of contract breach and damages again. As this book is aimed at the undergraduate and graduate level, the use of complex mathematical equations in the second and third chapter makes the concepts difficult to comprehend. Those readers who are not well-

versed with these mathematical concepts may find it difficult to grasp certain concepts even in the chapters that follow.

Keeping aside these two shortcomings, the author provides the readers with a detailed analysis of the law and economics, which is shown in a readable and interesting manner. The book brings to light many issues that had earlier been overlooked and this enables the reader to develop his financial and legal acumen in areas governed by contract law. Professor Bag's work presents broad analysis of an emerging concept of 'incomplete contracts and asymmetric information'. This area has not been worked upon extensively in the past and can be considered as a grey area with reference to contract law. Understanding the economic impact of contracts is as important as understanding the law that governs these contracts. The book has been able to convey the legal principles and economic concepts regarding contracts effortlessly.

Professor Bag's book is influenced by the works of Polinsky,[9] Miceli,[10] Cooter,[11] and Thomas Ulen.[12] Their works lay stress on how Law and Economics influence decision-making by providing extensive literature on this emerging discipline and its applicability to problems in tort law, contract law, property law, and litigation. In contrast, Professor Bag's book is limited to problems related to contract law, offering him the opportunity to provide his readers with exhaustive research and data on the economics of contract law. He reveals in his book thought-provoking and practical insights on how the trading environment together with laws structure the behavioural and contracting aspects of the concerned parties. The author examines

[9]MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS (3D ED., 2003).
[10]THOMAS MICELI, ECONOMICS OF THE LAW: TORTS, CONTRACTS, PROPERTY, LITIGATION (Oxford University Press, 1997).
[11]ROBERT COOTER, THOMAS ULEN, LAW & ECONOMICS (6th ED., 2012).
[12]*Id*.

contracts in light of economic realities, contemporary issues and the idea of justice.

The title of the book 'Economic Analysis of Contract Law' is an appropriate title for this book as it blends theories of economics and contract law in an intelligible manner and reclaims the importance of law in determining the economic position of the country. The force of the arguments put forth in his book is strong, and they convince the reader of his interpretation, with the added persuasive power of illustrations and models. Professor Bag's work searches wide for theoretical inspiration while suggesting that people not only adjust to economic conditions but also establish unique economic circumstances.

The unfeigned objective of this book lies in its dealing with the assessment of the effect of damage remedies of contract law on incomplete contracts under an asymmetrical information scenario. The book does not endeavour to cover a comprehensive arrangement of legal subjects; rather, it attempts to recount a brief yet intelligible relation about the law and how a financial investigation can be utilized to reveal more insight into the viability of different legal rules from both the Civil and the Common Laws of agreements.

In conclusion, this book is a compelling example of the reductionist approach of economic analysis of law. It provides numerous provocative arguments for why commercial contract law should be limited to helping firms maximize profit and how breaching and performing contracts varies with circumstances.[13] The book provides valuable contribution to the existing literature on this emerging discipline, and is strongly recommended to researchers, professors, students, economists, lawyers, and judges. This book has the potential to transform the legal education in Indian law schools by acquainting the reader with a legal background to how they can apply the tools of

[13]BAG, *supra* note 5, at 33.

economic analysis to understand the basic structure and function of the law, and thereby bringing intelligent and thought provoking arguments to classroom discourses and thereby bridging the gap between economics and law.