

Passed solution review

2. Consider a contractual setting in which the technology of the relationship is given by the following partnership game:

		2	
		I	N
1	I	4, 4	-4, 9
	N	2, -4	0, 0

Suppose the players contract in a setting of court-imposed breach remedies. The players can write a formal contract specifying the strategy profile they intend to play; the court observes their behavior in the underlying game and, if one or both of them cheated, imposes a breach transfer. The players wish to support the investment outcome (I, I).

- (a) Write the matrix representing the induced game under the assumption that the court imposes *expectation damages*. Can a contract specifying (I, I) be enforced? Explain your answer.
- (b) Write the matrix representing the induced game under the assumption that the court imposes *restitution damages*. Can a contract specifying (I, I) be enforced?
- (c) Write the matrix representing the induced game under the assumption that the court imposes *reliance damages*. Can a contract specifying (I, I) be enforced with reliance transfers? Explain your answer.
- (d) Suppose litigation is costly. When a contract is breached, each player has to pay a court fee of  $c$  in addition to the *reliance* transfer imposed by the court. What is the induced game in this case?
- (e) Under what condition on  $c$  can (I, I) be enforced with reliance transfers and court costs?
- (f) Continue to assume the setting of part (d). Suppose the court intervenes after a breach only if the plaintiff brings suit. For what values of  $c$  does the plaintiff have the incentive to sue?
- (g) How does your answer to part (e) change if the court forces the losing party to pay all court costs?

a) Yes because there's no incentive to deviate from I, I

1\2	I	N
I	4, 4	4, 1
N	-6, 4	0, 0

b) Yes

1\2	I	N
I	4, 4	5, 0
N	0, -2	0, 0

c) No. Player 2 could still deviate

1\2	I	N
I	4, 4	0, 5
N	-2, 0	0, 0

d) OneNote sucks ass and won't let me insert a table into a list unless I type something first

1\2	I	N
I	4, 4	-c, 5 - c
N	-2 - c, -c	0, 0

e)  $c \geq 1$

f) Player 1 sues if  $c \leq 4$   
Player 2 sues if  $c \leq 4$   
Therefore a suit occurs if  $c \leq 4$

g)  $c \geq .5$