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Introduction

Law should promote the wellbeing of people. Tort law, which deals with accidents, should reduce their cost and frequency—an important matter, as accidents cause approximately 42 million hospital visits and 182 thousand deaths per year in the United States.[1] Contract law, called upon in a range of activities from renting an apartment to buying an oil field, should lubricate these transactions. Transactions based on contract law generate approximately fifteen trillion dollars of national income annually in the United States.[2] Restitution law, which mostly discourages people from using what belongs to others without their consent, should encourage people to supply benefits for others that markets cannot provide.

In the law of torts, contracts, or restitution, the plaintiff in a suit is usually a private legal person such as a citizen or corporation, not the state as in a criminal trial. The defendant is often a private legal person as well. For these reasons, the law of torts, contracts, and restitution is called *private law*. By explaining how private law reduces accident costs, lubricates bargains, and encourages unrequested benefits, we will show three ways to improve the law of torts, contracts, and restitution. Before presenting our main claims, however, we briefly summarize the received economic analysis of torts, contracts, and restitution.

Tort law creates incentives for manufacturers to design safer products, injurers and victims to take precautions, insurance companies to adjust their coverage, governments to build safer roads, and so on. By imposing the cost of accidents on the parties who can best avoid them, tort law can reduce the cost of accidents to society. Unfortunately, when tort law or regulations fail to do so, much money, time, and effort spent on preventing accidents are wasted. Thus, investments in precaution are too high or too low when the negligent injurers' liability does not correspond to the social harm that injurers cause. Indeed, we spend too much money reducing a few small losses, as with some industrial chemicals, but we do not spend enough reducing numerous large losses, as with kerosene space heaters.[3] A better use of the same resources could provide more

[1] The three leading causes of accidental injury deaths are automobiles (more than 45,000 per year), poisoning (more than 29,000 per year), and falls (more than 22,000 per year). U.S. Department of Health and Human Services, Centers for Disease Control and Prevention, National Vital Statistics Reports, final data from 2007. Available at http://www.cdc.gov/nchs/data/nvsr/nvsr58/nvsr58_19.pdf.

[2] Economic Report of the President, Table B–1. Gross domestic product, 1963–2011, p. 316.

[3] *Id.*

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safety at no more cost. "Inefficient expenditures" on safety sounds like dull accounting, but it is a matter of life and death. To make the world safer without wasting money, judges, legislators, and regulators need to improve tort law.

Tort law has two pervasive rules that provide incentives for actors to reduce the cost of accidents: strict liability and negligence. Under a rule of strict liability the actor is liable for any harm caused by his behavior, as long as the victim was not negligent. Under a rule of negligence the actor is liable only for harms caused by his *negligent* behavior—again, assuming the victim is not negligent.[4] Both rules can provide actors with efficient incentives to minimize social costs, but in different ways.

We begin with strict liability. Suppose an employer has to decide whether to install a safety device in the workplace to reduce risks to his employees. Assume the installation costs $9, and it reduces risks to employees by $10. A strict liability rule provides incentives for the employer to install the safety device that costs him $9 and avoids liability of $10. Installing the safety device is also socially efficient since society benefits from reducing a risk of $10 at a cost of $9.

Alternatively, suppose that the cost of installing the safety device is $11, rather than $10. A strict liability rule provides incentives for the employer *not* to install the safety device, since installation costs $11 and avoids liability of $10. Not installing the safety device is also socially efficient, since society suffers from reducing a risk of $10 at a cost of $11.

Interestingly, a negligence rule would provide the employer with the same incentives as a strict liability rule. Under a negligence rule, an actor is negligent and bears liability for the resulting harm if he fails to take precaution that costs less than the risk reduced by it. In the first version of our example, in which precaution costs $9 and reduces risk of $10, the employer who fails to install the safety device is negligent ($9 < 10$) and bears liability of $10, exactly as under a strict liability rule. As a result, he will take the precaution that efficiency requires. Conversely, in the second version of our example—precaution costs $11 and reduces risk of $10—the employer who fails to install the safety device is *not* negligent ($11 > 10$) and bears *no* liability. As a result, and as efficiency requires, he will *not* take the precaution. So both rules provide potential injurers such as the employer with efficient incentives to minimize social costs.

Contract law is the second large body of private law. Whereas accidents are sometimes a matter of life and health, contracts are mostly a matter of cooperation and money. Contracts help people to cooperate with each other and to achieve their goals, especially economic goals. Thus contracts create incentives for manufacturers to make quality products, consumers to rely on sellers' representations, employees to work productively, innovators to improve technology, divorcing spouses to care for their children, governments to take bids

[4] If the victim is negligent, the rules become more complex, but to simplify the exposition we proceed with the assumption that the victim is not negligent.

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for procurement, and so on. Money pervades life more than accidents do, so contract disputes cause nine times more court filings than tort disputes in the state courts in the United States.[5]

To cooperate with each other, people should do what they say or compensate the victims of their broken promises. Contract law enables people to commit to keeping their promises by making them liable for breaking them. Whereas negligence is the dominant legal rule of tort law, the rule of strict liability dominates contract law. In case of a breach of contract, the promisor is typically liable for the promisee's losses regardless of whether or not the breach was negligent. While one liability rule dominates, contract law provides two fundamental remedies for broken contracts: damages and specific performance. With damages, the promisor who breaches the contract must compensate the promisee for the harm done. With specific performance, the promisee who suffers from a broken contract is entitled to a court order for the promisor to perform as promised. The Anglo-American legal systems describe damages as the primary remedy and specific performance as secondary, while the reverse is true in continental Europe. (In practice, the two legal systems provide similar remedies in similar situations.)

Here is how contract law achieves efficiency through the remedy of damages. Suppose that Builder promises to construct a house for Buyer. The house costs Builder $9 to construct, and it is worth $10 to Buyer. The price is $9.50, which Buyer pays Builder in advance. If Builder breaches the contract and fails to build the house, contract law allows Buyer to collect damages of $10, which is his value of the house. (We assume that Buyer suffers no additional losses.) Since Builder bears liability of $10 if she breaches the contract, she prefers to build the house at a cost of $9. This is socially efficient since performance increases social value by $1. Alternatively, suppose that performance costs $11, rather than $9. Since Builder bears liability of $10 if she breaches the contract, she prefers to breach instead of building the house at a cost of $11. This is socially efficient, since breaching saves social value of $1 that performance would destroy.

The remedy of damages for breach of contract creates incentives resembling strict liability in tort law. Contract law makes the promisor bear liability for losses ($10 in our example) and lets the promisor decide whether to breach (when performance costs are $11) or perform (when performance costs are $9). Similarly, strict liability in torts makes the injurer bear liability for losses ($10 in our example) and lets him decide whether to reduce the risk by taking precaution (when precaution costs $9) or not reduce the risk by omitting precaution (when precaution costs $11). Contract law aligns the promisor's incentives with the goal of promoting social efficiency, exactly as tort law does.

[5] Robert C. LaFountain and Shauna M. Strickland, Examining the Work of State Courts: An Analysis of 2008 State Court Caseloads. Available at http://www.courtstatistics.org/other-pages/~/media/microsites/files/csp/ewsc-2008-online.ashx.

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Unlike the remedy of damages for breach of contract, the remedy of specific performance can obstruct efficiency. Suppose the builder breaches the contract when construction costs $11 and the buyer is entitled to the remedy of specific performance. If the buyer insists that the builder construct the house, construction will destroy $1 in social value, because construction costs $11 and the house is worth $10. If builder and buyer are smart, however, they will renegotiate the contract. The builder will agree to pay, say, $10.50 to the buyer and the buyer will release the builder from the obligation to construct the house. Under this renegotiated contract, the builder and buyer each gain $.50 from not constructing the building. To gain $.50, the buyer will not insist on specific performance unless renegotiation fails with the breaching builder. Renegotiation is most likely to fail when negotiating is costly, in which case damages are a more efficient remedy than specific performance.

The law of restitution, which is also called the law of unjust enrichment, is the third body of private law. Whereas tort law allows victims to recover for harm that injurers caused them, the law of restitution allows benefactors to recover gains that their beneficiaries wrongfully obtained from them. Suppose that A digs and discovers a beautiful cave. The cave extends beneath both his land and B's land. A earns a great deal of money by charging tourists to tour the cave[6]—all without B knowing that part of the tour goes under her land. B is entitled to share the profits even though she suffered no harm from the unlawful use A has made of her land.

In this example, beneficiary A uses the property of benefactor B without the latter's consent. A most interesting part of restitution law concerns the opposite situation: benefactors can recover for benefits they voluntarily conferred upon beneficiaries without consent from the latter. Rescue cases are typical, as when a doctor gives first aid to an injured person in an emergency. Under restitution law, doctors can recover a modest amount of money for their services, even though their services were not "requested." It is easy to see how this rule promotes social welfare: it encourages benefactors (e.g., doctors) to create value for others (e.g., injured persons) when circumstances (e.g., emergencies) preclude a contractual transaction.

"Common fund" cases are another category in which restitution law allows benefactors to recover compensation for unrequested benefits. Take the case of an estate that is owed $100 by a recalcitrant debtor. Bringing a suit to recover $100 would cost $25. The net recovery of $75 would be split equally among the five heirs to the estate, so each heir would receive $15. Each heir's gain of $15 is less than the cost of $25 to bring suit. No heir will bring suit unless the other heirs share its costs. If the heirs cooperate, they may agree to share the suit's costs. However, one of the heirs may refuse to pay his share in the hope that the others will proceed without him and he can "free-ride" on

[6] *Edwards v. Lee* 96 S.W. 2d 1028 (1936).

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their efforts. Given the possibility of free-riding, the heirs may be unable to cooperate. Restitution law provides a solution by allowing an heir who brings suit to recover a share of its costs from the other heirs, even though the others never agreed to pay anything to him. Here too restitution law promotes social welfare by making the beneficiaries compensate the benefactor who provided an unrequested benefit.

This book makes three central claims, each developed in a separate part and each related to a different branch of private law. All three claims have a common denominator: the desire to reform private law and to make it more effective in promoting social welfare.

Torts and Misalignments

The first claim relates to tort law. As explained, an actor is negligent if the costs of precaution he failed to take are lower than the risk that it would have reduced. Thus, in our previous example, if precaution (installing a safety device in the workplace) costs \$9 and the risk of an accident to others (employees) is \$10, the injurer (the employer) who failed to take precaution would be considered negligent and bear liability for the resulting harm. Expected liability of \$10 would provide the injurer with efficient incentives to take precaution. In order to minimize social costs, the same risk of \$10 that is used by courts to set the standard of care should also be used to set damages when liability is imposed. This is the *alignment principle*.[7] Misalignment occurs when some risks that courts considered in setting the standard of care are disregarded when courts impose liability for damages, or vice versa. To illustrate using our previous example, assume the employer is negligent ($9 < 10$), but liability is imposed for only half of the resulting harm ($.5 \times 10 = 5$). The employer would prefer bearing liability of \$5 rather than taking precaution that costs \$9. Because of misalignment, the employer would not have efficient incentives.

So here is our first claim. *To achieve efficiency under negligence law, all foreseeable risks should be included when setting the standard of care and awarding damages* (unless there are compelling policy considerations to the contrary). In several important areas of law, however, *courts systematically misalign standards of care and liability for damages* by disregarding or miscalculating some risks. Courts either set the wrong standard of care or they award the wrong damages. Correcting misalignment would restore the law's social efficiency.

In part I of the book we identify misalignments in tort law that others have overlooked, and we explain how to eliminate them. Since these misalignments are embedded in the doctrines of negligence that most courts follow, these inefficiencies are systematic and endemic, not sporadic and episodic like other

[7] Ariel Porat, *Misalignments in Tort Law*, 121 Yale L.J. 82 (2011).

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inefficiencies in tort law. The effects of misalignment are large and they urgently need measurement and study.

Chapter 1 ("Prices, Sanctions, and Discontinuities") explains an important feature of negligence law—its discontinuity. Under a negligence rule, a negligent injurer often bears liability for harms that he did not cause. Imagine that a statute or a court sets a reasonable driving speed, a driver who exceeds it by just one mile per hour hits a pedestrian, and the court imposes liability on the speeding driver. If the driver had been driving one mile per hour slower, perhaps he would still have had the accident, but the court would *not* have imposed liability. If so, a small increase in speed over the speed limit creates a sudden jump or discontinuity in expected liability.

In this example, slowing down by one mile per hour eliminates liability but not the accident. Therefore, the speeding driver, if liability is imposed, is liable for more harm than his negligence caused. Thus the discontinuity misaligns liability and the standard of care. The standard of care is set according to the actual harm caused by negligence (speeding), and liability for damages exceeds the actual harm caused by negligence. This misalignment overdeters injurers, and courts should correct it when they can.

Chapter 2 ("The Injurer's Self-Risk Puzzle") explains that when courts set the standard of care, they consider the risks the injurer created toward others but not the risks he created for himself. The negligent injurer ideally bears all risks, but courts take into account only some risks (risks to others) when setting the standard of care. To illustrate, imagine a driver who creates risk of $7 for himself and $8 for others, which the driver can eliminate by taking precautions that cost $10. The cost of precaution exceeds the risk to others ($10 > 8$), so the court imposes no liability. This is a mistake by the court. Since precaution costs less than the driver's risk to himself and others ($10 < 7 + 8$), the driver should be considered negligent and bear liability. In so far as possible, *all* risks should count when courts set the standard of care. The RESTATEMENT (THIRD) OF TORTS recently adopted the principle that an injurer's self-risk should be included when setting legal standards. It remains to be seen whether future courts will continue to ignore self-risk when setting legal standards of care, or, alternatively, follow the recommendation of the RESTATEMENT and this book.

Chapter 3 ("Negligence Per Se and Unaccounted Risks") identifies another misalignment that occurs when courts apply the doctrine of negligence per se. Negligence law ordinarily requires the injurer to take reasonable care. If, however, a statute requires the injurer to take a specified level of care, then failing to do so is negligence per se—the injurer is liable for violating the statute regardless of whether his care was reasonable or unreasonable. In order to recover damages under negligence per se, the victim must belong to the class of people protected by the statute. Assume that a statute obliges employers to install special railings along the stairs to provide safe conditions for disabled employees. Further assume that an employer breaches the statute, and an able-bodied

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employee falls on the stairs. A railing would have prevented the victim's fall. Under current law, the employee, whose injury was caused by the railing's absence, apparently cannot recover damages from the employer. The injured employee cannot recover because she is able-bodied, and the statute is interpreted as protecting only disabled employees.

This interpretation creates misalignment and inefficiency. Absent explicit evidence to the contrary, the best interpretation of the statute assumes that the legislature took all risks into account when it set the standard of care. The obligation to install railings is justified by the additional protection to everyone. Once the presence of disabled employees makes installing railings mandatory under the statute, liability should be imposed for all harms that materialize from failing to install railings. Able-bodied employees should recover for injuries that railings would have averted. Otherwise the employer will have too little incentive to install railings.

Chapter 4 ("Lapses and Substitution") touches on a special case where there is an alignment between the standard of care and damages, but both are inefficient. The chapter concerns lapses in attention or judgment that cause many accidents, especially road and medical injuries. Everyone lapses from time to time. To reduce the frequency of lapses, people can monitor their own behavior more carefully. Lapses can be morally innocent, as when an actor self-monitors to the best of his ability and still has bad luck. Alternatively, lapses can be morally culpable, as when an actor negligently monitors his own behavior. Tort law often holds actors liable for the harm caused by their lapses, regardless of whether the lapses are morally innocent or culpable. It costs almost nothing to take a careful look at the road before crossing or to avoid leaving a sponge in the patient's body during a medical operation. Courts, consequently, consider lapses as negligence that triggers liability.

However, the result of this typical interpretation of negligence doctrine is that courts impose liability for risks that reasonable precautions could *not* avoid. We argue that liability should ideally be imposed only for those lapses avoided by reasonable precaution. Other lapses should not trigger liability. Reasonable precaution against lapses should be a defense against liability for accidents caused by lapses. With a lapse defense, legality would follow morality more closely. In addition, a lapse defense sometimes increases the efficiency of the law.

To close part I, chapter 5 ("Total Liability for Excessive Harm") deals with situations in which negligence by some wrongdoers causes harm, but the victim cannot prove which wrongdoers were negligent. To illustrate, assume that five firms discharge pollution into a lake. The socially efficient level of discharge is 10 per firm. To achieve efficiency, a lawmaker sets the legal standard at 10 for each firm. Obeying the legal standard would result in total discharge of 50. Unfortunately, the actual discharge totals 60. The courts know that the actual discharge of 60 exceeds the legal discharge of 50, but no one can prove how much

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each firm discharged. The courts cannot impose liability on any firm under the standard negligence rule, because the victim cannot prove that a specific injurer caused his harm. The standard of care is efficient, but liability of 0 for its violation is inefficient. Consequently, the standard of care misaligns with damages.

We analyze various solutions, such as proportionate liability, that seem appealing, and then show that they fail to provide efficient incentives. Instead, we propose a novel solution that will work, which we call *total liability for excessive harm*. If each polluter is liable for the total excess harm (10) caused by all polluters, then each polluter will respond by discharging at the efficient level. Excess harm will disappear, pollution will fall to the efficient level (50), and none of the five firms will have to pay damages.

Contracts and Victims' Incentives

Part II of the book turns to contracts, the area of law where we make our second claim. In a contract between two people, the law misaligns their incentives unless they make a novel contract that we call "anti-insurance" with a third party. Misalignment occurs because efficient incentives for the promisor undermine efficient incentives for the promisee. As explained above, the damages remedy incentivizes the promisor to breach the contract when performance is inefficient and to perform the contract when performance is efficient. As long as the promisor compensates the promisee for all the latter's losses, the promisor's incentives to breach and perform would be efficient and align with the goal of promoting social welfare. In contrast to these efficient incentives for the promisor, however, contract law provides inefficient incentives to the promisee. Once the promisee realizes that he will be fully compensated for all his losses from breach, he may over-rely on the promise and undercooperate with the promisor. This problem is acute when over-reliance and undercooperation are unverifiable in court.

As an illustration, suppose a builder contracts to construct an addition to a restaurant. The builder encounters difficulties in getting permits from the municipality, and the delay jeopardizes his chances of completing construction on time. The restaurateur could help to get the permits but fails to do so. The restaurateur could also postpone some orders of perishable food yet makes a large order for the scheduled opening of the addition anyway. In brief, the restaurateur undercooperates with the builder and over-relies on the builder's promise. After the fact, however, it is hard for courts to verify that the restaurateur's reliance and cooperation were unreasonable. When cooperation and reliance are unverifiable, contract terms promising efficient cooperation and reliance are unenforceable.

The second claim in this book is that contract law should respond more to the promisee's incentives, especially in regard to the problems of undercooperation

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and over-reliance. In three chapters, we explain the problem of promisee's incentives, and we offer possible solutions. Anti-insurance is a market innovation that clarifies the incentive problem and solves it in principle.

Chapter 6 ("Unity in the Law of Tort and Contracts") analyzes the problem of providing efficient incentives for the promisor and promisee simultaneously. This problem in contract law is much the same as the problem in tort law of providing efficient incentives for the injurer and victim in an accident. However, tort law often explicitly considers the victim's incentives, whereas contract law seldom explicitly considers the promisee's incentives. Perhaps the presence of a contract explains the difference. With a contract, the parties can attend to the victim's incentives through the contract's terms.

Chapter 7 ("Anti-Insurance") proposes novel terms that perfectly solve the incentive problem for promisor and promisee in a contract, even if their behavior is unverifiable.

Here is the basic idea. Breach of contract by the promisor poses a risk of loss to the promisee. The promisor can reduce this risk by taking precautions to avoid breaching, and the promisee can reduce this risk by cooperating more and relying less. Perfect incentives for the promisor and promisee require each of them to bear the cost of breach, so each of them balances the cost of breach against the cost of reducing it. In brief, perfect bilateral incentives require promisor's liability of 100 percent of the harm from breach and promisee's compensation of 0 percent. To achieve this result, promisee and promisor can sign a contract with a third party called the "anti-insurer," who buys the promisee's right to compensation for breach. The promisee gains the sale price of the liability right. If a breach materializes, promisor pays compensation of 100 percent to the anti-insurer. The promisee who assigned the right to the promisor receives no compensation for the promisor's breach. With anti-insurance, promisor's liability for breach is 100 percent and promisee's compensation is 0 percent, as required for efficient incentives. Anti-insurance, like most voluntary contracts, is attractive in principle to all parties because everyone benefits.

Anti-insurance is partly an explanatory device—by understanding anti-insurance, you understand the tension between the promisor's and promisee's incentives—and partly a practical proposal for future implementation in markets. However, markets currently generate few contracts resembling anti-insurance. As standard insurance too took a very long time to develop and come into widespread use, perhaps in time a functional market for anti-insurance will emerge. In the interim, because anti-insurance is so rare, the doctrines of contract law should provide some other solution to create efficient incentives for promisor and promisee.

Chapter 8 ("Decreasing Liability Contracts and the Assistant Interest") offers such a solution for a certain kind of contract. This chapter explains that reducing liability below full compensation improves the promisee's incentives and worsens the promisor's incentives. In certain kinds of contracts, reducing

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liability below full compensation improves the promisee's incentives by *more* than it worsens the promisor's incentives. In these contracts, reinterpreting legal doctrine to reduce damages or stipulating lower damages in the contract improves the contract overall.

This is typically true when the promisor performs a contract in phases, as in constructing a building or participating in a joint venture to develop a new product. In a decreasing liability contract, the promisor's liability decreases as he completes each successive phase of the contract. The promisor is liable for full compensation at the beginning of the contract, and he is subsequently liable for a lower and lower share of the loss. Specifically, the promisor is liable for full compensation minus his expenditure on the contract's phases up to the time of breach. This liability schedule allocates enough losses from breach—but not more than necessary—to make the promisor want to complete the contract and provides that the promisee shall bear the remaining losses. The remaining losses encourage the promisee to cooperate and restrain reliance. In phased contracts, decreasing liability with partial performance provides better incentives than retaining full liability until performance is complete.

Restitution and Positive Externalities

While parts I and II concern losses, part III concerns benefits. Arguably, just as injurers and promisors should pay for harming others, so benefactors should be paid for benefiting others. The law, however, treats benefactors very differently from injurers and promise-breakers. Tort law and contract law both require that injurers and promisors pay for the harms that they cause (or wrongfully cause) to others, whereas the law seldom entitles benefactors to be paid for benefits that they confer to others without a contract ("unrequested benefits").

The third claim in this book is that the law should compensate for unrequested benefits more often in order to induce people to provide more of them. The proposal in chapter 9 ("A Public Goods Theory of Restitution") requires recipients to compensate benefactors for unrequested benefits in more circumstances than under current law. Specifically, a duty of restitution should apply when benefactors cannot exclude beneficiaries from receiving benefits that are indisputable and measurable. When the benefactor cannot exclude others from benefiting, the beneficiaries often refuse to reimburse the benefactor for the cost of the good. They "free-ride" by enjoying benefits without paying the costs, so private markets undersupply the good. For example, removing pollution from a stream benefits all downstream property owners. In some circumstances, the upstream property owner who removes pollution from a stream should be able to collect a share of the costs from downstream property owners. Otherwise, the stream will remain polluted.

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In economics, "public goods" have the characteristic of "nonexclusion." Thus, when an upstream owner abates pollution, a downstream owner who refuses to share in the abatement costs cannot be excluded from the benefits of clean water. Nonexclusion and the related free-rider problem lead to a general undersupply of public goods. One remedy for the undersupply of public goods by private markets is for the state to collect taxes and supply public goods. The state supply of public goods, however, needs supplementing, especially for local public goods. According to chapter 9, the courts should expand the duty of restitution to encompass the unrequested supply of some local public goods.

Some activities convey both uncompensated benefits and risks of harm to others. If actors internalize negative externalities and not positive externalities, they will engage in too little of the activity. Tort liability can make actors internalize the risk of accidental harm that their activities impose on others, while at the same time the actors externalize some of the benefits. For instance, negligent medical treatment sometimes harms patients, and tort liability can make doctors internalize this risk. However, doctors usually convey greater benefits than the fees paid by their patients. Uncompensated benefits that doctors convey to patients are positive externalities. If doctors internalize the risk of negligent treatment and externalize much of the benefit from successful treatment, then doctors often have an incentive to take excessive care. They engage in "defensive medicine," such as favoring treatments with low liability risk for doctors even though the chosen treatments are worse for patients than alternative treatments with high liability risk.

Tort theorists often think that the ideal assignment of liability is to internalize the harm from accidents. Instead, chapter 10 ("Liability Externalities and Mandatory Choices") focuses on adjusting liability for accidents in light of effects on others besides the accidental harm to victims. Notably, doctoring brings patients much greater benefits than the fees that patients pay doctors. Therefore, if a doctor's negligence breaks a patient's leg, the ideal liability is less than the harm to the patient because a lower level of liability encourages more doctoring, which has external benefits. Conversely, driving causes pollution and congestion, which harms others aside from accidents. If a driver's negligence breaks a pedestrian's leg, the ideal liability is more than the harm to the pedestrian. A higher level of liability discourages driving, which has external costs. This contrast between doctoring and driving shows the difference between actual and ideal law. According to actual law, a doctor who negligently breaks a patient's leg has the same liability as a driver who negligently breaks a pedestrian's leg. Ideally, however, the doctor's liability should be less than the driver's liability.

The ideal liability for an accident is the *net* harm from the activity that caused the accident: the harm to victims minus the activity's external benefits. By following the net harm principle, courts would reduce liability for accidents from activities with beneficial externalities and increase liability for accidents with harmful

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externalities. Courts cannot, and should not, consider every type of benefit and harm when deciding a case in private law. In specific circumstances, however, courts can and should adjust damages in light of external effects. In particular, if a doctor negligently increased a particular risk to the patient and caused him harm, but at the same time decreased another risk for the same patient, liability should be reduced to account for both increased and decreased risk.

Chapter 11 ("The Relationship between Nonlegal Sanctions and Damages"), the book's last chapter, deals with positive externalities caused by nonlegal sanctions. The same act often triggers legal and nonlegal sanctions. For example, a judge finds a seller of televisions liable for breach of contract (legal sanction), and some buyers boycott the seller (nonlegal sanction). Or a judge finds the owner-operator of a limousine liable for an accident, and some customers transfer their business elsewhere. Chapter 11 asks whether courts should take nonlegal sanctions into account when awarding damages. Specifically, should courts deduct the nonlegal sanction from the damages that the defendant owes to the victim in a civil suit?

All benefits and costs to society count when creating efficient incentives. As explained, efficient incentives for injurers usually require setting liability equal to the net harm done to others. The net harm equals the actual harm minus the benefits to others. Nonlegal sanctions often transfer benefits from the injurer or the breaching party to its competitors, and nonlegal sanctions often create social benefits for the public by deterring injurers or telling potential victims whom to avoid. Thus, after the court finds breach of contract by the television seller or liability for an accident by the limousine owner-operator, some customers may transfer their business elsewhere. The court, when calculating liability for damages, should take into consideration the benefits transferred or created for others by the nonlegal sanction and deduct accordingly from the victim's actual harm. If the injurer causes harm of 100 and triggers a nonlegal sanction that benefits others by 40, the injurer's liability should equal 60. Deducting the benefits of nonlegal sanctions from compensatory damages typically improves incentives for both injurers and victims. Situations involving nonlegal sanctions arise frequently in a wide range of cases, and when deciding these cases, courts should ideally apply the net harm principle to set damages.

This book has three main claims: misalignments in tort law should be removed; in contract law, promisee's incentives should be improved; and the law should recognize some right of compensation for those who produce unrequested benefits. All three claims could be summarized in one short sentence: private law could, and should, promote social welfare better. To substantiate these three claims, we take the reader on a tour of economic analysis in private law. As with holidays, we hope that the journey is as attractive as its destination.

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