

## *Introduction: The Relationship between Contract Law and Commercial Expectations*

A RECURRING THEME within some branches of socio-legal and relational contract scholarship has been the divergence between the practice of making and performing commercial agreements and the law of contract that may notionally apply to those agreements. It may be accepted that contracting is an important part of commercial activity, but the precise role of legally enforceable contracts and contract law in this activity is often hard to identify. At its simplest level of expression, the core of the socio-legal critique of contract law is that there is often a significant gap between the ‘paper deal’, that is, the formal written expression of the parties’ contractual obligations, and the ‘real deal’, which is that diffuse collection of informal norms, implicit understandings<sup>1</sup> and flexible commitments that surround a contractual agreement and will impinge upon how the parties view their obligations.<sup>2</sup> Given contract law’s undoubted preference for determining obligations according to the paper statement of express terms, this misalignment may be problematic. In short, commercial contract law does not match commercial expectations. Empirical studies of contracting behaviour, emanating from a wide range of disciplines and sources, have alerted contract law scholars to the limited emphasis placed on legally enforceable agreements by contracting parties and the richness of the normative and institutional structures, such as trust, reasonable expectations and informal sanctioning, that support contract making and

<sup>1</sup> J Wightman provides a useful definition of the elusive notion of ‘implicit understandings’ in contracts: ‘the knowledge, practices and or norms pertaining to contracting in general (or an individual transaction) of which the parties to a particular contract are actually aware, (or can in the circumstances, reasonably be expected to be aware) but which are not typically rendered express in their contracting activity’: ‘Beyond Custom: Contract, Contexts, and the Recognition of Implicit Understandings’ in D Campbell, H Collins and J Wightman (eds), *Implicit Dimensions of Contract* (Oxford, Hart Publishing, 2003) 143, 147.

<sup>2</sup> S Macaulay, ‘The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules’ in Campbell, Collins and Wightman (eds), above n 1, 51.

## 2 Introduction

performance.<sup>3</sup> In the face of this evidence, contract law has been criticised as failing to comprehend the parties' agreement as they understand it, seeking instead to impose on the parties a legal structure based on an acontextual and highly abstract model of contracting behaviour. This perceived dissonance between the experiences of commercial contractors and the legal world is in turn taken to be the principal indicator of the law's failure to accord with commercial expectations. Given this, contract law, or at least the classical version of it expounded in textbooks and doctrinal scholarly articles, has often been dismissed as largely irrelevant to commercial transactors, since it rarely impinges on their day-to-day experience of managing their productive and exchange activity. The law only becomes relevant when the business relationship is in trouble.<sup>4</sup>

This critique of contract law is not universally accepted however. Other strands of contract scholarship have accepted that all contracts are socially embedded but have questioned the implications of this for the rules of contract law as applied by judges resolving contract disputes in courts. There is plenty of scepticism that 'what business people do', while arguably of some relevance, should carry determinative weight in the legal regulation of commercial activity.<sup>5</sup> Disagreement centres over whether norms constituting the 'real deal' exist, how they are to be identified, what justifies their use and the circumstances in which legal recognition and enforcement of these is appropriate.<sup>6</sup> Some argue that the complex reality of business dealing vindicates a formal and classical style of contract law where close alignment between law and 'immanent business norms'<sup>7</sup> should be rejected. Instead, the 'neoformalist' argues against the incorporation of the standards and expectations of business people into an agreement in favour of bright-line rules of enforcement, plain-meaning interpretation, legally sanctioned

<sup>3</sup> See, eg, S Macaulay, 'Non-Contractual Relations in Business: A Preliminary Study' (1963) 28 *American Sociological Review* 55; H Beale and T Dugdale, 'Contracts Between Businessmen: Planning and the Use of Contractual Remedies' (1975) 2 *British Journal of Law and Society* 45; L Bernstein, 'Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms' (1996) 144 *University of Pennsylvania Law Review* 1765; L Bernstein, 'The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study' (1999) 66 *University of Chicago Law Review* 710; L Bernstein, 'Private Commercial Law in the Cotton Industry: Creating Co-operation Through Rules, Norms and Institutions' (2001) 99 *Michigan Law Review* 1724. For a review of these studies, and more recent empirical work on commercial contracting practice, see C Mitchell, 'Contracts and Contract Law: Challenging the Distinction between the "Real" and "Paper" Deal' (2009) 29 *OJLS* 675.

<sup>4</sup> H Collins, *Regulating Contracts* (Oxford, OUP, 1999) 136–37.

<sup>5</sup> '[T]he rules that parties follow when they play among themselves are not those that a court should attempt to apply': D Charny, 'Illusions of Spontaneous Order: "Norms" in Contractual Relationships' (1996) 144 *University of Pennsylvania Law Review* 1841, 1854.

<sup>6</sup> J Gava, 'False Lessons from the Real Deal: Campbell, Collins and Wightman on Implicit Dimensions of Contract—Discrete, Relational, and Network Contracts?' (2005) 21 *Journal of Contract Law* 182.

<sup>7</sup> This terminology is attributable to Bernstein, 'Merchant Law in a Merchant Court' above n 3.

standard terms and gap-filling defaults, and a strict parol evidence rule.<sup>8</sup> The justificatory framework for such an approach is usually efficiency. For this branch of contract scholarship, the design of contracts and contract law should reflect instrumental goals such as wealth maximisation. Such theorists may not see themselves as opposed to the socio-legal and relational contract movement, but rather as working within it. Naturally, this is a matter of some controversy.<sup>9</sup>

From the brief outline given here it is apparent that the argument that commercial contract law should track the expectations and practices of commercial people is both complex and disputed. The claim of misalignment, and its consequences for the law, cannot be assessed without considering larger questions concerning how contract law best facilitates commerce, whether it is possible to identify immanent business norms and, where they do exist, the precise role of such norms in legal reasoning. It is the investigation of these particular issues, and the debates that surround them within contract law, that forms the subject matter of this book. The work explores aspects of the general relationship between contract law and commercial activity and considers whether contract law should proceed on the basis of a more enriched understanding and appreciation of the actual practices, norms and expectations that commercial contractors bring to bear on their business relationships or that are generated within these relationships. These matters will not be examined in isolation however, but within the context of other related debates that surround modern contract law. While the concerns emanating from the socio-legal critique of the classical law may appear isolated and remote from other scholarly endeavours within contract, such as the attempt to impart doctrinal coherence to the law, or to explore its normative foundations, they are related since doubts concerning contract law's coherence and fitness for purpose are manifest throughout contract scholarship. Socio-legal and empirical work on contract has brought into question the relationship between law and commercial dealing, but similar disquiet is also manifest in more traditional

<sup>8</sup> See especially RE Scott, 'The Case for Formalism in Relational Contract' (2000) 94 *Northwestern University Law Review* 847. Also D Charny, 'The New Formalism in Contract' (1999) 66 *University of Chicago Law Review* 842; O Ben-Shahar, 'The Tentative Case Against Flexibility in Commercial Law' (1999) 66 *University of Chicago Law Review* 781; R Epstein, 'Confusion about Custom: Disentangling Informal Customs from Standard Contractual Provisions' (1999) 66 *University of Chicago Law Review* 821; W Woodward, 'Neoformalism in a Real World of Forms' (2001) *Wisconsin Law Review* 971; J Murray, 'Contract Theories and the Rise of Neoformalism' (2002) 71 *Fordham Law Review* 869; H Hunter, 'The Growing Uncertainty about Good Faith in American Contract Law' (2002) 20 *Journal of Contract Law* 31; WC Whitford, 'Relational Contracts and the New Formalism' (2004) *Wisconsin Law Review* 631.

<sup>9</sup> RE Scott, 'The Promise and the Peril of Relational Contract Theory' in J Braucher, J Kidwell and WC Whitford (eds), *Revisiting the Contracts Scholarship of Stewart Macaulay* (Oxford, Hart Publishing, 2013) 105, 106.

## 4 Introduction

doctrinal work that has examined whether commercial law is aligned with the practices and expectations of commercial actors.<sup>10</sup> Further, the claim that the function of (commercial) contract law is to facilitate commercial transactions invites consideration of the fit between this aspiration and the need for a system of general law to display certain normative and institutional commitments. Is alignment between contract law and commercial expectations required by a rights-based theory of contract law, an efficiency theory or some other kind of theory? Or does the function of facilitating commerce, if believed to be important, require surrendering these normative commitments in favour of a pragmatic contract law that is not fully assimilated within any of the current normative explanations? This latter position certainly appears implausible. Whatever the precise role of contract law in commercial dealing, it must involve more than simply arbitrarily bestowing legal validity on whatever actions or decisions the community of commercial contractors take in the pursuit of their business interests. Although some scholars would wish to see a stronger instrumental connection between law and commercial practice, at the expense of any deeper normative commitments within commercial contract law,<sup>11</sup> it cannot be the case that what is commercially expedient is thereby legally permitted. Yet it is also clear that the legal regulation of commercial contractual relationships raises complex problems with which the relatively simplistic formula of agreement making and performance assumed by the classical law seems poorly equipped to deal. The question of the balance to be struck between legality and the fulfilment of commercial expectation is a difficult one that does not admit a simple response. This book seeks to make a modest contribution to answering this question by drawing out and exploring some of the various connections, possibilities, problems and tensions raised by the relationship between contract law and commercial contracting practice.

As well as assessing whether the socio-legal criticisms of contract law are apposite and whether change is both necessary and desirable, there

<sup>10</sup> See, eg, the essays in S Worthington (ed), *Commercial Law and Commercial Practice* (Oxford, Hart Publishing, 2003), especially R Bradgate, 'Contracts, Contract Law and Reasonable Expectations', 651 and AJ Duggan, 'Commercial Law and the Limits of the Black Letter Approach', 595. See also C Twigg-Flesner and G Villalta Puig, 'Introduction: The Boundaries of Commercial Law' in C Twigg-Flesner and G Villalta Puig (eds), *Boundaries of Commercial and Trade Law* (Munich, Sellier, 2011), 1.

<sup>11</sup> '[t]he legal structure should support the commercial structure of civil society and not the other way around ... Commercial law, it follows, should do no more than restate commercial practice': G Villalta Puig, 'The Misalignment of Commercial Law and Commercial Practice' [2012] *Lloyd's Maritime & Commercial Law Quarterly* 317, 319. For Villalta Puig such an approach is justified on economic grounds, *ibid*, 331–32. Against, see D Lawton, previously Director of Markets, Financial Services Authority: '[I]t is important that market participants and investors have confidence in the fairness of UK markets, because bluntly, no one wants to operate in a market where they cannot trust the other side', 'Four Building Blocks of Efficient Capital Markets', address at the Practising Law Institute on 1 February 2013: <http://www.fsa.gov.uk/library/communication/speeches/2013/0201-dl>.

are other reasons to examine the relationship between contract law and commercial activity. It was mentioned above that it is a recurring theme in contract scholarship that a good *commercial* contract law will meet the needs and expectations of commercial contractors. There are probably very few scholars who would defend an application of contract rules that proceeded without any reference at all to the expectations, practices, behaviours and norms of the commercial community, at least insofar as the law seeks to retain legitimacy amongst such contractors.<sup>12</sup> Of course whether this claim is supportable depends very much on what reference to ‘commercial expectations’ is taken to signify. This matters since it is clear that the belief that contract law (or the parts of it that are pertinent to business contracting) should uphold ‘commercial expectations’ is not confined to contract scholars, but also forms an important part of the self-understandings of the judiciary concerning their role in resolving contract disputes, enforcing agreements and developing commercial contract law. There are many judicial proclamations to the effect that the function of commercial contract law is to uphold commercial purposes, support the expectations of business people<sup>13</sup> and incorporate business practice.<sup>14</sup> Certainly in specific areas of commerce, such as obtaining adequate security, transferring title and ensuring payment, the law has upheld the legality of tools designed chiefly by business people. The retention of title clause, the bill of lading and the documentary credit all provide examples of measures developed within the commercial sphere to facilitate trade, particularly at the international level, and mitigate its risks. However, many of these measures did not originate from within contract law, but were rather circumventions of it. That agreements have the security of legal enforcement may matter to business, but the common law of contract, encumbered with an attachment to doctrines such as privity and consideration, could not easily afford recognition to measures designed to facilitate business dealing, such as negotiability and transferability of financial instruments, or the creation and protection of third-party interests. Instead, other areas of law such as property, tort, restitution and, in particular, equity, have been called upon to mitigate the effects of the rigid structures of contract law.

<sup>12</sup> Although J Gava comes close. See J Gava and J Greene, ‘Do We Need a Hybrid Law of Contract? Why Hugh Collins is Wrong and Why it Matters’ (2004) 63 *CLJ* 605; J Gava, ‘Dixonian Strict Legalism: *Wilson v Darling Island Stevedoring* and Contracting in the Real World’ (2010) 30 *OJLS* 519; ‘How Should Judges Decide Commercial Contract Cases?’ (2013) 30 *Journal of Contract Law* 133.

<sup>13</sup> For examples of this in extra-judicial writings see Lord Devlin, ‘The Relation Between Commercial Law and Commercial Practice’ (1951) 14 *MLR* 249; Lord Goff, ‘Commercial Contracts and the Commercial Court’ [1984] *Lloyd’s Maritime & Commercial Law Quarterly* 382; Lord Irvine, ‘The Law: An Engine for Trade’ (2001) 64 *MLR* 333.

<sup>14</sup> Lord Irvine, above n 13, 333.

## 6 Introduction

Given its doctrinal commitments, it is not apparent why any supposed lack of fit with commercial expectation should matter to contract law, although it is clear that it does since congruence with commercial interests, reasonableness and practices is often a reference point for articulating and choosing between alternative outcomes in a contract dispute. In the interpretation of contracts, for example, judges have been counselled by the Supreme Court to uphold commercial purposes and pursue commercially reasonable outcomes over absurd ones when interpreting commercial agreements.<sup>15</sup> Despite this surface engagement with the idea of commercial expectations, it is not clear whether the appeal to commercial considerations here entails a set of determinate and readily identifiable values that can genuinely inform legal reasoning,<sup>16</sup> or is just a rhetorical gloss to obscure an exercise of judicial discretion. Certainly there is nothing to suggest that judges are relying on any socio-legal or ‘real deal’-derived appreciation of these expectations and outcomes. Lawyers and judges are not unaware of the wider contract context beyond documents and rules, but there is lacking any real penetration of the socio-legal findings into the law, despite indications that occasionally suggest otherwise.<sup>17</sup> It can be doubted then that judicial edicts concerning the importance of ‘commercial expectations’ should be understood as motivated by a desire to develop a contract law that better reflects the reality of business relationships. Rather, appeals to commercial concerns in judgments will continue to appear to many as a cloaking device that hides, and not particularly subtly, unwarranted judicial interventions into economically driven bargains on ‘fair and reasonable’ grounds.<sup>18</sup> Given this, it is worth investigating whether the judicial appeal to commercial expectations could be an invocation of a genuine and meaningful standard, thereby rendering the commitments and values it expresses more transparent. Failure to do this only makes more attractive the sceptical position that such expectations are irrelevant to law, particularly since it lends credence to a common criticism of the incorporationist argument—that judges are politically and institutionally limited in their capacity to engage with the internal norms of the business relationship.

<sup>15</sup> See Lord Clarke in *Rainy Sky S A and others v Kookmin Bank* [2011] UKSC 50; [2011] 1 WLR 2900.

<sup>16</sup> For doubts over this see R Barnes, ‘Commerciality and the Construction of Commercial Contracts: Some Observations on the Use of Legal Reasoning’ in Twigg-Flesner and Villalta Puig (eds), *Boundaries of Commercial and Trade Law*, above n 10, 179.

<sup>17</sup> Some judicial recognition of the contrast between the real and paper deal appears in *Balmoral Group Ltd v Borealis (UK) Ltd* [2006] EWHC 1900 [339]; and *Total Gas Marketing v Arco British* [1998] 2 Lloyd’s Law Rep 209. More recently a reference to ‘relational contracts’ was made by Leggatt J in *Yam Seng Pte Ltd v International Trade Corporation Ltd* [2013] EWHC 111 (QB), [142].

<sup>18</sup> See, eg, Gava, ‘Dixonian Strict Legalism’, above n 12; M Hogg, ‘Fundamental Issues for the Reform of the Law of Contractual Interpretation’ (2011) 15 *Edinburgh Law Review* 406, 419.

Ultimately, this work aims to fill a gap in contract law scholarship and to contribute to understanding the relationship between contract law and commercial contracting practice by exploring a point that appears inadequately covered in the literature concerning the existence of the ‘real deal’ and its effect in the ‘non-use’ of contract law. While much attention has been devoted to the question of whether the law should track commercial expectations, rather less attention has been devoted to how it could do so, at least insofar as it is reckoned such expectations must be sourced in part from the implicit norms and dimensions that constitute the parties’ real deal. This issue is important since if lack of legal engagement with commercial norms and expectations is made out then a case for reform will be easier to establish, although identifying exactly what reforms are necessary, and implementing them, may not be straightforward. Alternatively if it is demonstrated that there is no mismatch between commercial behaviour and contract law, or that there are good reasons why law should not track the norms and behaviours of contracting parties, then the criticisms made by socio-legal and relational scholars, however important and enlightening in other respects, will have minimal relevance for legal development.<sup>19</sup> Examination of the idea of commercial expectation and its role in contract law may also shed light on what judges are doing when they appeal to ‘commercial’ factors during the course of their judgments and whether the appeal could be made more meaningful and robust. The remainder of this chapter sets out in more detail some background and context to these debates and the specific lines of enquiry that will be pursued in the book. This will give some indication of the structure of the book and the content of the chapters that follow.

## CONTEXTS AND BACKGROUND

### **The Deficiencies of Classical Contract Law**

The questions that surround the relationship between English contract law and commercial activity can be perceived as the manifestation of a more general anxiety concerning the relevance of the domestic common law of contract in a modern global economy. While the significance of contracts and contract law can be perceived in broad strokes, it has been evident for many years that the legal principles, or at least those promulgated by judicial development through case law, have been subjected to a wide variety of pressures.<sup>20</sup> Chief amongst these is the reduced scope of operation for

<sup>19</sup> See the conclusions reached by Beale and Dugdale from their study, above n 3, 59–60.

<sup>20</sup> See generally E McKendrick, ‘English Contract Law: A Rich Past, an Uncertain Future?’ (1997) 50 *Current Legal Problems* 25.

the common law principles of contract. As is often noted, many contractual relationships (for example, employer and employee, landlord and tenant) are subject to their own specially formulated rules and statute-based regulatory schemes. Most contracts between businesses and consumers are likewise subject to significant legislative intervention and separate regulation.<sup>21</sup> Many of these legislative interventions were required precisely because of the deficiencies of classical contract law in addressing substantive unfairness in contract terms or inequality manifest in the contracting relationship. In championing the virtues of freedom and sanctity of contract, voluntariness and consent, the common law of contract lacked the doctrinal tools to deal effectively with contractual relationships characterised by stark inequality in economic power and potential for abuse. The common law contract rules have been rendered largely irrelevant to these contractual arrangements.

The hiving off of a significant number of contractual relationships into separate spheres of regulation could be regarded as an opportunity for the common law of contract, since what remains for the classical law is that branch of contracting that in many respects represents the natural place for the operation of its principles—commercial agreements. But even here the historical and doctrinal difficulties that classical contract law placed in the way of contractors seeking to pursue certain outcomes or create certain interests through contracts—third-party rights for example—are well known. The adherence to doctrine rendered the common law of contract ineffective at upholding contractual arrangements agreed between parties which were clearly intended to have legal effect. Such measures could only be made effective after some imaginative manipulation of the concepts.<sup>22</sup> While not abolished entirely, many of the classic doctrines of the common law of contract have been undermined by statute (for example, the Contracts (Rights of Third Parties) Act 1999) or by the development of numerous exceptions to classical law precepts. These ‘exceptions’ have often relied on principles derived from other areas of law such as equity (as with promissory estoppel) and restitution, or other hybrid forms of liability, such as misrepresentation, which lie on the boundary between contract and tort. In the commercial sphere the domestic rules of contract law also appear to have dwindling significance in the face of the burgeoning availability of ‘private legal systems’<sup>23</sup> and alternative dispute resolution processes, some of these promulgated within domestic courts.<sup>24</sup> Commercial contractors have

<sup>21</sup> H Collins, *The Law of Contract*, 4th edn (London, LexisNexis, 2003) 37–39; R Brownsword, *Contract Law: Themes for the Twenty-First Century*, 2nd edn (Oxford, OUP, 2006) ch 4.

<sup>22</sup> See, eg, *New Zealand Shipping Co Ltd v AM Satterthwaite & Co Ltd*, *The Eurymedon* [1975] AC 154, per Lord Wilberforce.

<sup>23</sup> See generally R Canavan, ‘English Commercial Law and Private Legal Systems’ in Twigg-Flesner and Villalta Puig (eds), *Boundaries of Commercial and Trade Law*, above n 10, 153.

<sup>24</sup> A new mediation scheme was introduced in the Court of Appeal in April 2012 for personal injury and contract claims up to £100,000. The scheme was due to run for a

a choice between various systems within which to frame their agreement and resolve disputes. Suites of terms and conditions and private dispute resolution regimes may be provided either within specific trades<sup>25</sup> or within the international commercial community more generally.<sup>26</sup> These alternatives may seek to cater to a demand for contract governance according to an international scheme that is reflective of the global nature of the trade and its participants, rather than the local law of a particular nation state, even for parties based within a single jurisdiction. Thus the line of modern contracts scholarship that has called into question the assumption that contracts and contract law contribute in any significant way to the process of commercial dealing can be regarded as just a part of a more general attack on the significance and relevance of classical contract law.

Despite these various pressures, some scholars remain sanguine over the judicial capacity to incorporate elements of the real deal into legal reasoning, arguing that contract law contains methods and techniques that are sufficiently adaptable to recognise such norms and in this way stay connected to commercial expectations.<sup>27</sup> Others are less optimistic. David Campbell and Hugh Collins have argued that the classical-law model of economic relationships is built upon a flawed foundation of discrete contracts and self-interested contracting parties that is at variance with the reality of co-operative commercial dealing. For them, isolated departures from the classical rules that attempt to give effect to an agreement's implicit dimensions only serve to compound a lack of coherence in the law.<sup>28</sup> While making inroads into the classical law, the counternorms' status as 'limited exceptions' to the rules have not led to a sustained challenge to that model's central place in the organisation and understanding of contract law. It has

year: [www.judiciary.gov.uk/media/media-releases/2012/news-release-mediation-pilot-court-of-appeal](http://www.judiciary.gov.uk/media/media-releases/2012/news-release-mediation-pilot-court-of-appeal). On the social cost of the 'vanishing trial' see generally L Mulcahy, 'The Collective Interest in Private Dispute Resolution' (2013) 33 *OJLS* 59, 59–63.

<sup>25</sup> W Konradi, 'The Role of *Lex Mercatoria* in Supporting Globalized Transactions: An Empirical Insight into the Governance Structure of the Timber Industry' in V Gessner (ed), *Contractual Certainty in International Trade* (Oxford, Hart Publishing, 2009) 49; Bernstein, 'Private Commercial Law in the Cotton Industry', above n 3; L Bernstein, 'Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry' (1992) 21 *Journal of Legal Studies* 115.

<sup>26</sup> Eg, the UNIDROIT Principles of International Commercial Contracts (2010). Dispute resolution procedures are provided by the likes of the International Chamber of Commerce under their own arbitration rules.

<sup>27</sup> Brownsword, above n 21, 139ff. See also R Austen-Baker, who argues that 'much of existing contract jurisprudence copes well with the reality of the contract relation, as seen through the lens of relational contract theory': 'Comprehensive Contract Theory: A Four-norm Model of Contract Relations' (2009) 25 *Journal of Contract Law* 216, 219.

<sup>28</sup> D Campbell and H Collins, 'Discovering the Implicit Dimensions of Contracts' in Campbell, Collins and Wightman (eds), above n 1, 25–27. See also D Campbell, 'The Relational Constitution of the Discrete Contract' in D Campbell and P Vincent-Jones (eds), *Contract and Economic Organisation* (Aldershot, Dartmouth, 1996) 40, 43–45.

simply heralded a system of ‘rules + standards’ labelled ‘neoclassical’ law.<sup>29</sup> This manner of organisation and understanding of the law serves to diminish our appreciation that what are presented as exceptions to freedom of contract (illegality or contracts contrary to public policy, duress and misrepresentation) are in fact constitutive of contracts and thus fundamental to any conception of what a contract is. Other socio-legal scholars point to a distinct lack of engagement between the law and socio-legal findings concerning the important role of ‘relational norms’ in functioning business relationships, and regard this deficiency as setting an important future agenda for contract law development: ‘The need to reform contract law doctrine better to reflect and therefore support relational norms [trust, cooperation, reciprocity, flexibility and contractual solidarity] in commercial practice is widely accepted as a central task of contemporary socio-legal scholarship’.<sup>30</sup>

Even when contract law appears to take on board the implicit dimensions of an agreement and commercial expectations—through a flexible, contextual approach to doctrine and contract interpretation for example—this is only in a pseudo-sense, a superficial veneer on an approach which resolutely remains confined within classical and neoclassical traditions. A case in point which can be used to illustrate these distinctions is the legal approach to contract interpretation. A classical-law approach to contract interpretation might privilege a literal or plain meaning method to understanding the words of the contract. This statement of express terms, recorded in a document and containing manifestations of objective consent (usually signatures) *is* the contract. It is the supreme statement of the parties’ obligations and assumed to be relatively complete. A literal method of interpretation upholds these parties’ intentions and cuts down considerably the scope for a judge to substitute their own view of what the contract means for that assumed to be held by the parties. While it can be doubted that the classical law invariably adopted such an approach towards interpretation, this outline is in keeping with the characteristics of the classical law and its underpinning assumptions concerning freedom of contract, party consent and the *possibility* of positing a complete statement of contractual obligations, at the precise moment of formation, to govern even long-term performance. A neoclassical approach to contract interpretation would differ in that it might permit enquiries outside the documents to decide what the parties meant by the words they have used, although

<sup>29</sup> J Feinman, ‘Relational Contract Theory in Context’ (2000) 94 *Northwestern University Law Review* 737, 748. See also O Williamson, *The Economic Institutions of Capitalism* (New York, Free Press, 1985) 68–72.

<sup>30</sup> P Vincent-Jones, *The New Public Contracting* (Oxford, OUP, 2006) 8.

this might achieve the same result as literal method.<sup>31</sup> Troublesome words or phrases are read within a wider context of the matrix of fact or other relevant background information available to the reasonable contractor.<sup>32</sup> Congruence with standards such as ‘commercial reasonableness’ and ‘business common sense’ may decide what interpretation is to be adopted in the face of plausible alternatives.<sup>33</sup> This contextual interpretation exercise, while arguably an improvement on the plain-meaning method, still manifests its classical commitments by assuming the object to be interpreted is the express terms. A ‘real deal’ or fully contextual approach to the agreement differs again since it would not begin the interpretative task by attention to the documents at all, but would examine other aspects of the contractual relationship. The use of contextualism in such a method may reveal that the written documents were not that important to the parties at all and may be manifestly unreliable as a statement of their understandings about their agreement. Such a conclusion simply cannot be countenanced within classical and neoclassical contract law, unless one of the exceptional doctrines can be brought into play.

### The Wider Debate: A Contextual and Relational Approach to Contracts

If commercial expectations are taken to denote the extra-legal or social sphere of contractual relationships, the issue about dissonance between contract law and commercial expectations is part of a larger debate concerning the limitations of the legal understanding of the social embeddedness of contracting. Sheinman has written that contracts are, first and foremost, ‘social norms recognized by law, not legal norms. The legal intervention is designed to support the pre-existing practice, not create a new one’.<sup>34</sup> The argument advanced by some scholars is that the law should develop a better understanding of the ‘pre-existing practice’ of commercial dealing and utilise it as part of commercial contract law method. At present the classical law generally isolates the express terms of the agreement and places them at the centre of the analysis. For some this approach is incorrect, since the

<sup>31</sup> Eg, consider the different approaches of Lord Mance and Lord Collins in *Belmont Park Investments PTY Limited v BNY Corporate Trustee Services Limited and Lehman Brothers Special Financing Inc* [2011] 3 WLR 521; [2011] UKSC 38, concerning whether there had been an evasion of the anti-deprivation rule of insolvency. For Lord Collins the parties’ contractual motive and the overall commercial sense of the provision were important. Lord Mance preferred to base his decision on a close reading of the contract whereby Lehmans were not ‘deprived’ of any property, thus falling outside the scope of the rule.

<sup>32</sup> Lord Hoffmann, *Investors Compensation Scheme v West Bromwich Building Society* [1998] 1 WLR 896, 912–13.

<sup>33</sup> *Rainy Sky v Kookmin Bank*, above n 15.

<sup>34</sup> H Sheinman, ‘Contractual Liability and Voluntary Undertakings’ (2000) 20 *OJLS* 205, 219.

express terms can only be understood as a part, and sometimes a relatively insignificant part, of the entire business relationship and the transaction.<sup>35</sup> Ian Macneil is most closely associated with this criticism of the classical law, and the development of an alternative relational theory of contract that attempted to capture the complexity of contract as a social phenomenon. For Macneil the legal construct of ‘the contract’ is embedded within a wider network of social norms and expectations, which will, to a greater or lesser degree, determine how any formal statements of obligations should be read and understood.<sup>36</sup> While relational theory, at least as envisioned by Macneil, is multifaceted and reflective of the complexity of the contractual relationship itself, it is the importance attached to social context that lies at its heart.<sup>37</sup> Contract law has traditionally sought to ignore this complexity, emphasising the discreteness of the transaction by its assumptions concerning the parties and their agreement—objectivity, arm’s-length dealings, party autonomy and self-interestedness, rather than trust, co-operation and interdependence. Of course the parties might choose to downgrade the role of relational factors in their contract, creating an ‘as-if-discrete’ contract which they expect to be regulated according to formal legal norms.<sup>38</sup> In this way, classical contract law has become synonymous with the impersonal market transaction, enforced through litigation in courts of law. The commercial expectations argument can be understood as part of this debate, and the call for the law to align itself with commercial expectations understood as an appeal to develop a relational contract law in the sense of one that responds to the findings of relational theory and in particular that version advanced by Ian Macneil.

#### SPECIFIC LINES OF ENQUIRY

##### Defining and Identifying ‘Commercial Expectations’

If the above outlines the contours of the debate and part of its context, what specific lines of enquiry are pursued in this book? First, the concern is with how the notion of ‘commercial expectations’ should be understood. The appeal for law to reflect ‘commercial expectations’ or ‘the

<sup>35</sup> Collins, above n 4, 271.

<sup>36</sup> See generally I Macneil, ‘Reflections on Relational Contract Theory after a Neo-Classical Seminar’ in Campbell, Collins and Wightman (eds), above n 1, 207.

<sup>37</sup> *Ibid.*

<sup>38</sup> The discrete norms controlling this choice are ‘effectuation of consent’ and ‘implementation of planning’: I Macneil, *The Relational Theory of Contract: Selected Works of Ian Macneil*, D Campbell (ed) (London, Sweet and Maxwell, 2001) 154, 158.

reasonable expectations of honest [commercial] men'<sup>39</sup> is usually advanced as a justificatory argument for contract law to incorporate such matters as shared commercial practices and implicit understandings into contract legal reasoning.<sup>40</sup> Currently these often vital elements in a business relationship have only an attenuated role in legal analysis, the law preferring to confine its attention to the documented agreement wherever possible. Evidently expectations have a substantive element concerning what, exactly, is expected by commercial contractors, both from their contracting partners and the law. Such substantive expectations must be infinitely variable and could be derived from a variety of sources.<sup>41</sup> Here there is a problem of over-inclusiveness since not all, or even any, of these expectations may be intended by the parties to be legally enforceable, nor should they be. The appeal that contract law should be better aligned with commercial expectations must mean something more specific than this, even accepting that commercial expectations is a mutable concept. In a more general sense, and in the context of reaching and performing agreements, commercial expectations generally refers to the collection of beliefs that surround the commercial contracting process, which are derived from outside the parties' legal statement of the express terms and conditions, but may impinge on that legal statement. Assuming for the moment that greater incorporation of these alternative norms is required, then how are these to be identified and why are they compelling? While commercial expectations may be used to refer to the subjective beliefs commercial contractors bring to bear on their agreements and business relationships, the claim that contract law should be better aligned with commercial expectations contains a normative dimension. It is an appeal for contract law to assess its effectiveness by reference not just to coherence with its internal principles and rules, but to an external vantage point that seeks to 'import non-legal values into a legal judgement'.<sup>42</sup> In this sense the commercial expectations concept seeks to add to the judge's arsenal of justificatory arguments that can be drawn upon in decision making. While this might be readily understood as the general idea, teasing out the specifics of what sensitivity to commercial expectations requires in each particular case or from the law more generally is difficult. For example, does it require (i) an incorporationist strategy, that takes account of implicit dimensions of agreements as well as, or instead of,

<sup>39</sup> Lord Steyn, 'Contract Law: Fulfilling the Reasonable Expectations of Honest Men' (1997) 113 *LQR* 433.

<sup>40</sup> Campbell and Collins, 'Discovering the Implicit Dimensions of Contracts', above n 28, 28.

<sup>41</sup> Thus, commercial expectations mirror the idea of 'reasonable expectations', which can also be derived from various sources: see R Brownsword, 'After *Investors*: Interpretation, Expectation and the Implicit Dimension of the "New Contextualism"' in Campbell, Collins and Wightman (eds), above n 1, 103, 105–08; and C Mitchell, 'Leading a Life of its Own? The Roles of Reasonable Expectation in Contract Law' (2003) 23 *OJLS* 639.

<sup>42</sup> Barnes, above n 16, 185.

express and formal contract terms; or (ii) that contract law should become more relationally constituted; or (iii) that contract law should routinely seek to legalise the practices or devices that commercial people use in their contracting activity, or seek inventive ways of overcoming legal barriers (as with, historically, privity of contract); or (iv) that judges become more commercially active, using ‘commercial reasonableness’ (however this is determined) as a touchstone for reaching decisions in commercial contract cases; or (v) that judges should pay more attention to the effects or consequences of their rulings for the commercial community? It might be thought that any or all of these could be countenanced and pursued within a contract law that is attuned with commercial expectations, but they are not necessarily compatible and they may encounter different levels of resistance. The claim that contract law should be better aligned with commercial practice and expectations could be interpreted as a more general appeal to the law to recognise the social values and behavioural norms that almost *all* commercial contractors, to a greater or lesser degree, bring to bear on their trading relationships. This entails a much wider brief for law than simply enforcing a norm, practice or custom on the isolated basis that it reflects the internal understanding of participants about the way things are invariably done in a particular industry. The law frequently implies ‘trade customs’ into contracts in particular cases, usually without controversy, but the notion that law must recognise that certain values such as trust and co-operation inform a contractual relationship, and to reorient its reasoning processes appropriately across all contract cases (including identifying the situations in which such norms should *not* be applied), may encounter considerable resistance. The difficulties of explanation and identification are considered further in Chapter 2.

### **Descriptive Accuracy of the Mismatch Claim**

The suggestion that contract law should be better aligned with commercial expectations is often followed by the different claim that the present law, or some aspect of it, does not support these expectations or commercial practices. This issue concerns the accuracy of descriptive claims about the existence and extent of discrepancies between contract law and commercial expectations. What evidence is there to suggest that there is some mismatch between law and commercial expectations? This question in itself could lead to several sub-enquiries, such as what substantive expectations contractors may have, and the organising criteria or theoretical framework by which lack of fit between law and commercial expectations is established. This enquiry could demonstrate that English contract law already does an adequate job of meeting such expectations. In other words, the claim about a mismatch may be descriptively false. The English classical law of

contract is often perceived as highly formal, both in what it requires from commercial contracting parties (relatively complete contractual documents) and in its rules and doctrines.<sup>43</sup> Yet it is clear to anyone with more than a cursory appreciation of the law that the rigid classical model of contract law has been undermined in many different ways and that contract law is not completely isolated from commercial expectations and practices. Some statutory reforms within contract law have specifically sought to address commercial concerns over the rigidity of doctrine<sup>44</sup> and judges frequently assert that the aim of commercial contract law is to facilitate commerce, or that law and legal concepts are the servants of commerce not the master.<sup>45</sup> It is clear that courts do not simply apply express terms at face value, but take context into account when interpreting agreements, implying terms or policing one party's exercise of contractual rights, such as termination,<sup>46</sup> as well as displaying a willingness to look behind contractual labels to the reality of the parties agreement.<sup>47</sup> That contract law can respond adequately to the expectations created by different commercial contracting contexts is supported by some scholars. Roger Brownsword has written that commercial contract law has long exhibited a tension between the ideologies of static and dynamic market-individualism. Static market-individualism broadly reflects the concerns of classical contract law—the imposition of bright-line ground rules for trading that are generally known by the participants and that effectively constitute the market. Dynamic market-individualism, on the other hand, is displayed by a law more reliant on norms and expectations created by the parties and their situation. These norms might arise from the parties' economic and social relationship, from within the industry in which their trading takes place, or from moral requirements of fair dealing. The latter norms may often qualify the operation of the classical ground rules, even if they do not fully substitute for them, and even if they can only be rendered effective through some other branch of the law. There may be a more open engagement with values such as fairness, justice and reasonableness in contract outcomes when such an approach is adopted.

<sup>43</sup> Lord Steyn, 'Does Legal Formalism Hold Sway in England?' (1996) 49 *Current Legal Problems* 43, 58; C Sunstein and A Vermeule, 'Interpretation and Institutions' (2003) 101 *Michigan Law Review* 885, 924–25; AW Katz, 'The Relative Costs of Incorporating Trade Usage into Domestic versus International Sales Contracts' (2004) 5 *Chicago Journal of International Law* 181, 187.

<sup>44</sup> The Contracts (Rights of Third Parties) Act 1999 is perhaps the most obvious recent example. The Law Commission highlighted the difficulties caused to commerce by the third-party rule in their proposals for reform: Law Commission, *Privity of Contract: Contracts for the Benefit of Third Parties* (Law Com no 242, Cm 3329) (London, HMSO, 1996), paras 3.9–3.27.

<sup>45</sup> Goff LJ in *Clough Mill v Martin* [1984] 3 All ER 982, 987.

<sup>46</sup> *Schuler AG v Wickman Machine Tool Sales Ltd* [1974] AC 235; *Rice v Great Yarmouth Borough Council* [2000] All ER (D) 902.

<sup>47</sup> Eg, *Schuler (L) AG v Wickman Machine Tool Sales Ltd* [1974] AC 235; *Re Spectrum Plus Ltd* [2005] UKHL 41; [2005] 2 AC 680.

Thus Brownsword argues that contract law is already partly constituted by norms that limit the operation of untrammelled self-interest characteristic of the classical-law approach.<sup>48</sup> On this basis, there may not be much more for the law to do to align itself with expectations. The issue of descriptive accuracy is assessed in Chapters 3 and 4.

### **Theoretical Difficulties Posed by the Commercial Expectations Argument**

#### *(i) Efficiency and Rights-based Theories*

Problems of definition and identification encountered in aligning contract law with commercial expectations are matched by the theoretical difficulties. Neither efficiency- nor rights-based theories of contract law immediately suggest themselves as the underpinning foundation from which the claim that contract law should better support commercial practices and expectations can straightforwardly be derived. In part this is because the claim that the law does not support such expectations is advanced on empirical rather than theoretical grounds. In addition, the argument about the role of commercial norms and expectations in contract law engages the debate about the relative merits of intersystemic and extrasystemic factors in legal reasoning, or the legitimacy of policy-based and principle-based arguments in the law. Some of the difficulty here relates to the lack of precision in the claim that a good commercial contract law will meet the expectations of the contracting parties. As has been seen, this could be a specific entreaty for the courts to uphold particular commercial practices or a more general appeal for the law to engage more fully with relational norms of flexibility and co-operation in commercial dealing. Justification for such a position could be based on grounds either of efficiency (legal incorporation of norms or certain contextual interpretative methods might cheapen the contracting process for the parties); or upholding contracting parties' rights (upholding the rights and obligations of the agreement, whether based on formal terms or informal norms, is to enforce the agreement created and intended by the parties). Here it is important to keep separate the justification for contracting, that is, for the parties to seek to create a relatively comprehensive, legally enforceable contract, and the justification for contract law that is applicable to that agreement. The parties may enter into contracts to maximise wealth and may write a complete contract for reasons of efficiency, but this does not mean the law applied to that contract must track these values, although many efficiency theorists would subscribe to the view that contract law does or should commit to efficiency (wealth maximisation)

<sup>48</sup> Brownsword, above n 21, 139ff.

as a social goal. In the contract literature, the efficiency position usually manifests as a preference for an anti-incorporationist and formalist reasoning strategy in contract law, although there is no immediate reason to think an incorporationist strategy could not be shown to be efficient or wealth maximising for the parties, or superior in some other way.<sup>49</sup> Locating the commercial expectations argument within a specific normative framework underpinning contract is difficult, although some of these difficulties are largely the result of problems emanating from within the normative positions themselves. For example, in relation to the efficiency of incorporating business norms, do we assess the efficiency of the individual transaction before the courts, which might demand an expansive enquiry into contractual context to determine the optimal outcome for these parties? Or do we assess efficiency of the resulting ruling for the general body of commercial contractors to whom the ruling may be applicable? A decision that promotes individual wealth maximisation between the parties may not be optimal for other contracting parties. Further, the process costs of an expansive approach to contract interpretation may also create inefficiencies in itself, as would litigating the problem. These inefficiencies may largely undercut whatever benefits might be derived from seeking the optimal outcome in the individual case. Similarly the parties may rely on norms of trust in their business dealings, but it may not be appropriate for the law to enforce such arrangements in all circumstances. These issues concerning the normative foundation for a commercial expectations argument are considered further in Chapter 5.

*(ii) Relational Contract Theory*

It could be argued that the claim about misalignment between contract law and commercial expectations is a response to a social, rather than philosophical, component of contracts. In essence, then, the claim that contract law reflects commercial expectations may be fundamentally different to one concerning the efficiency of contract law or its commitment to upholding the rights and autonomy of contracting parties, although arguments on such grounds could undoubtedly be built. Thus it may be relational theory that provides the prime justification for addressing the misalignment between commercial contract law and commercial expectations.<sup>50</sup> Relational theory and Ian Macneil's work seeks to bring to the fore the complexity of

<sup>49</sup> Ian Macneil argues that a relational approach to contracts that tracks the internal norms of the business relationship is likely to be more efficient than classical contract law: 'Reflections on Relational Contract Theory after a Neo-classical Seminar' in Campbell, Collins and Wightman (eds), above n 1, 207, 208. These claims are difficult to establish however: see further Ch 5.

<sup>50</sup> See generally Macneil, above n 38.

contracting behaviour in the real world, including the self-understandings of the parties about their contractual relationship, and social norms and institutions (apart from law) that impinge on and direct the conduct of their exchange activity. Of course a law that reflects and incorporates these understandings may be justified by an appeal to party autonomy, but this higher theoretical justification may not be of much importance to the broad thrust of the relational project, which rests on a combination of authenticity and legitimacy in the law's approach to the parties' agreement. But here again the retort may be that while contracts may be relational, contract law is not,<sup>51</sup> and thus relational theory can yield no particular insight that can inform the development of the common law of contract. Macneil's relational theory is considered further in Chapter 6.

### The Capacity of Contract Law

It has already been mentioned that the impetus for the claim about misalignment between contract law and commercial practice and expectations derives not from traditional contracts jurisprudence but from empirical studies demonstrating the attitudes of business people towards contracts and contract law. Early empirical studies found that the law was marginal, although not entirely irrelevant, to the conduct of commercial dealing. Other studies emanating from a wide range of sources and with an increasingly wide array of agendas, such as to defend formalism,<sup>52</sup> or to examine the law's role in economic development, or the place of legally enforceable contracts in functioning business relationships,<sup>53</sup> have added to the knowledge gained from these early studies. If one concentrates on the findings themselves, rather than the normative conclusions that the scholar may attempt to draw from the findings, then the studies are relatively consistent in demonstrating that commercial contracting activity is varied, complex and underpinned by a wide variety of normative structures. The legal framework for the agreement, associated with express terms and legally enforceable agreements, insofar as it exists at all, may play a more or less enhanced role in this scheme. Although the academic literature generated by these studies has been rich and detailed, on the whole contract law has appeared to be relatively immune to the issues revealed by these empirical studies and the ensuing scholarly debate. Given the evidence, some of which is explored in greater depth in Chapter 3, it might be wondered why the findings of empirical studies and broadly relational theory appear to have had such little impact on the law, beyond occasional recognition amongst

<sup>51</sup> RE Scott, above n 8, 852.

<sup>52</sup> In this context see the studies conducted by Lisa Bernstein, above n 3.

<sup>53</sup> For an overview of some of this literature see Mitchell, above n 3.

the judiciary that a contract may have relational features, or that the paperwork does not provide the whole story about a contractual agreement.<sup>54</sup> The reasons for this seeming lack of engagement are complex, but two particular factors may have been significant.

(i) *The Character and Limits of Legal Regulation*

The first limitation relates to the capacity of law itself. Collins has described the classical law of contract as having two particular characteristics—self-reference and closure.<sup>55</sup> Law presents itself as formal in the sense of being neutral, autonomous and external to the phenomena it seeks to regulate, facilitate or control. Law is a certain kind of technique, backed by a particular institutional framework and distinct methodology.<sup>56</sup> Within the common law, this is reflected partly in a set of institutional constraints operating on judges. New rulings have to be brought within an existing body of law or its justifying principles and this is not always readily achieved without either distorting the legal categories or excessive abstraction in isolating the relevant facts.<sup>57</sup> Justification for those principles is usually sought within broadly normative criteria, rather than pragmatic considerations concerning their congruence with what commercial parties expect or demand—although these considerations are certainly not ignored. In contrast with the tenacity of classical contract law, with its relatively simple model of the single seller and buyer involved in a discrete exchange, business practice, in particular the way that commercial entities organise themselves and their productive activities, is increasingly complex. In addition, contracts have lost none of their resonance, both as a matter of practical importance in the facilitation of trade, as a mechanism by which voluntary obligations can be assumed and given substance, and as a repository of normative value and symbolism.<sup>58</sup> The stability of law in the face of great change and developments in economic activity, commercial practices and commercial contracting could be regarded as one of its prime virtues, reflective of commercial contract law's character as *common law* and one of the hallmarks of specifically the *legal* regulation of commerce.<sup>59</sup> On this

<sup>54</sup> A recent notable example is Leggatt J's comments on relational agreements in the High Court in *Yam Seng Pte Ltd v International Trade Corporation Ltd* [2013] EWHC 111.

<sup>55</sup> Collins, above n 4, 37.

<sup>56</sup> E Weinrib, *The Idea of Private Law* (Cambridge MA, Harvard University Press, 1995) 4–5.

<sup>57</sup> *Ibid* 38.

<sup>58</sup> T Roxenhall and P Ghauri, 'Use of the Written Contract in Long-Lasting Business Relationships' (2004) 33 *Industrial Marketing Management* 261, 267; Lord Devlin, above n 13, 266.

<sup>59</sup> Gava, 'Dixonian Strict Legalism', above n 12, 521–24. See also 'How Should Judges Decide Commercial Contract Cases?', above n 12.

basis contract law is a scheme of *general rules* that cannot be expected to function as descriptions of commercial behaviour.

A related difficulty is that a commercial contract law informed by relational factors or commercial expectations and practices may be associated with a degree of commercial activism that would not sit well with the traditional approach of contract law to the commercial agreement. It might be doubted whether in practical terms generalist judges have the expertise and experience within a litigation setting to make accurate and workable judgments about commercial practice and commercial expectations.<sup>60</sup> The empirical studies reveal a range of implicit social norms and behaviours that govern a relationship, not all of which can even be apprehended by the law, still less given the badge of legal enforceability. The commercial settings generating such norms are likely to be heterogeneous and too fragmented to form the basis of a coherent law. Law by its nature may not be able to reflect commercial practices and expectations without fundamentally transforming them in significant and possibly unpredictable ways, rendering the legal understanding of them quite different to the parties' understanding.<sup>61</sup> It may therefore be entirely right that there are elements of commercial dealing that should be left to the self-regulation of the parties through social and informal norms. These are cogent arguments, but while the general scepticism concerning whether evidence of actual business behaviour yields any insights for legal reasoning about contracts is understandable, it will nevertheless be misplaced if strong justificatory arguments can be raised in support of developing a more relational contract law. These issues concerning the capacity of contract law to reflect commercial expectations are considered further in Chapter 7.

(ii) *The Limits of the Socio-legal and Empirical Scholarship*

The second reason for the lack of impact of socio-legal work has been the lack of attention to this issue amongst socio-legal scholars themselves.<sup>62</sup> Some socio-legal and relational studies emanating mostly from the US have concentrated on critiquing the classical and neoclassical law, arguing that classical contract law is not fit for purpose in regulating complex commercial agreements. Socio-legal scholars themselves have not been forthcoming over whether they are simply pointing out an under-appreciated element of contracting behaviour or seeking to reform and develop contract law in the

<sup>60</sup> Gava and Greene, above n 12, 616ff.

<sup>61</sup> R Cranston, 'What Do Courts Do?' (1986) 5 *Civil Justice Quarterly* 123, 130–32.

<sup>62</sup> Although see Feinman, above n 29, 737. Other theorists have considered the move to a more substantive and contextual version of contract law as either appropriate, or already existing. See especially, M Eisenberg, 'The Emergence of Dynamic Contract Law' (2000) 88 *California Law Review* 1743. In the UK noteworthy contributions to this question about contract law design are Collins, above n 4; Brownsword, above n 21; Campbell, Collins and Wightman (eds), above n 1.

light of the 'real' behaviour they have identified. If the latter, then it is not always made clear whether and how contract law can be reformed in the light of the empirical findings.<sup>63</sup> The crux of the debate between formalists and contextualists/relationalists is whether commercial contract law should be expanded to encompass the internally generated norms of the business relationship or reduced to a set of predictable formal rules, whose justification arises externally to any specific contractual agreement to which they might be applied.<sup>64</sup> This debate might be thought to be highly relevant to the issue of the design of contract law, yet it has remained frustratingly theoretical and abstract in nature. Questions concerning whether these two alternatives exhaust the possibilities for legal reasoning about contracts, what each approach precisely requires and how a judge chooses between these approaches in an individual case have not had satisfactory answers. While this polarised theoretical debate appears destined to continue indefinitely, it offers scant guidance to lawmakers, particularly within the English legal system, on how contract law might be designed to overcome the limitations identified. This will be examined further in Chapters 6 and 7. More specifically, the lack of a fully worked-out version of what might be called relational legal reasoning has arguably impeded the reception of relational theory into the law. Ian Macneil's 'essential contract theory', for example, did not include a comprehensive account of legal reasoning about contracts under dispute, although his work includes many relevant insights and suggestions concerning how a relational contract law might be modelled and the commitments that it would display. While Macneil's particular contribution is examined in Chapter 6, the issue of what a broadly relational legal reasoning method may look like, and why this is better attuned with commercial expectations, is addressed in the final chapter.

## COMMERCIAL AGREEMENTS, CONTRACTS AND CONTRACT LAW

Before leaving these introductory matters, a few remarks about the confines of the book. The book is not intended to be a complete exposition of the

<sup>63</sup> Some general guidance is provided by RE Speidel, 'The Characteristics and Challenges of Relational Theory' (2000) 94 *Northwestern University Law Review* 823. Some scholars doubt that findings from social theory and empiricism can simply be absorbed into legal theory, rather they must be reconstructed in legal terms: G Teubner, 'Coincidentia Oppositorum: Hybrid Networks Beyond Contract and Organisation' in M Amstutz and G Teubner (eds), *Networks: Legal Issues of Multilateral Co-operation* (Oxford, Hart Publishing, 2009) 3, 9–10.

<sup>64</sup> For general outlines of the positions see Macaulay, above n 2; and the works cited above n 8. For a sceptical view about whether contract law can better facilitate market transactions by incorporating commercial practice, see J Gava, 'Can Contract Law Be Justified on Economic Grounds?' [2006] *University of Queensland Law Journal* 253 and 'False Lessons from the Real Deal', above n 6.

rules of classical contract law that have particular relevance to commercial contracting, nor is it concerned with commercial law in its entirety, nor even particular aspects of it. Rather it is concerned with contract law's general approach towards commercial contracting and its own role within it. Given its specific focus, it concentrates on the various debates that surround the relationship between the common law of contract and the commercial community whose dealings it seeks to facilitate and regulate. But even in relation to contract law, the work's engagement with specific doctrines will be minimal. The work may appear frustratingly limited to some readers, particularly in its concentration on the domestic law of contract, and in particular the judicially created rules. But there is a long-standing debate here, which impinges on how contract law should at least be perceived and understood, and which may also have implications for its future direction and reform. Thus further attention to these issues seems warranted.

The book is concerned with the general law of contract as it is applied to commercial dealings. To explain this in a little more detail, commercial agreements are taken to be those where participants do not act as consumers, but in the course of a business.<sup>65</sup> To confine examination to contracts made as part of business activities is hardly to impose a radically limiting criterion, given that 'commercial contracting' covers a wide variety of agreements made by different types of contractor operating within vastly different contexts, generating their own expectations and understandings. The sheer breadth of contracting behaviour caught by such a criterion is a major source of difficulty for this work, since it might be thought that there is little to be gained by examining the issue of commercial expectations and their connection to contract law in a general and abstract sense, particularly since this book is necessarily selective over the areas of contract law examined, and the aspects of commercial expectation and practice that it explores. So, one limitation is that it is not part of this work to make any extended comment on the legal controls that should apply to agreements which, while notionally made between commercial contractors, occur within business relationships characterised by stark inequalities in bargaining power. The relative lack of attention to this issue here might be regarded as a serious omission, since one important commercial expectation may be that a weaker commercial party will be given some protection by the law from an economically stronger party.<sup>66</sup> One reason for the omission is that some protection already exists for commercial contracting parties

<sup>65</sup> This is intended as a general definition here, rather than any specifically legal one as, eg, the definition of consumer under the Unfair Contract Terms Act 1977, s 12, or acting in the 'course of a business' under the Sale of Goods Act 1979.

<sup>66</sup> The problem of inequality of bargaining power between businesses was recognised in the Law Commission's 2005 report *Unfair Terms in Contracts* (Law Com No 292, Cm 6464). They recommended extending further protection to businesses with fewer than nine employees: see generally Part 5 of the report.

through doctrines such as economic duress, misrepresentation and certain provisions of the Unfair Contract Terms Act 1977.<sup>67</sup> These measures may be criticised as wanting in various respects, but the focus of this work is narrower. It has less to say about the general expectations of fairness that contractors might have and more about the norms of practice and behaviour that may operate within commercial contracting relationships and the relevance of these for contract law and legal development. Contract law has long grappled with considerations of fairness in contractual bargains, and while contractors may have certain expectations of the law in this respect, the primary analysis here concerns expectations that might arise out of business relationships and contractual contexts, rather than moral considerations attaching to contractual obligations more generally. While much evidence is available of the mismatch between law and commercial dealing, it appears an underdeveloped area within scholarship to tease out the implications of this for the common law of contract. Issues about fairness and inequality cannot be entirely ignored however, since they impinge upon matters which are relevant to this work, such as the role of good faith in business relationships, and how the balance of power between the parties may be an important part of contractual context which explains, at least in part, the choice of contractual arrangements. Neither is this work an exposition of the areas of contract law that have special relevance to commercial dealing. It might be thought that abstraction is a weakness here, but if the argument is that the law must tap into the context of all contractual relationships of whatever type, then what this requires can be considered in general, as well as specific, terms.

By the general law of contract is meant that set of rules developed and applied by courts to voluntarily assumed obligations, as well as relevant legislative provisions of contract law that have general scope and are not confined to any particular trade or industry. Given the increasing complexity of business dealing, it is not certain that the non-use-of-contract claim can be maintained without qualification. Contracts and the law may be largely invisible in functioning commercial dealings, but this does not mean they are entirely irrelevant, as the early empirical studies themselves demonstrate. The rules promulgated by judges and legislators continue to set the conditions of legal enforceability for contracts, vitiating factors, remedies for breach and so on, providing guidance to other contractors on these issues, irrespective of whether the legal requirements are essential or only marginal to the individual contracting arrangements. Whatever the level of scepticism that may exist, commercial contractors continue to bring their claims before the courts. This suggests that contract law still matters and

<sup>67</sup> Most notably under parts of ss 3, 6 and 7. These allow the courts to assess the reasonableness of some types of excluding and limiting terms in commercial contracts.

that there is more to say concerning the role of contract law in regulating commercial activity, not least how the institution of contract law can appear at once both central and peripheral to the practice of commercial contracting.<sup>68</sup>

While it might be relatively easy to identify what commercial contract law looks like, deciding what is meant by ‘a contract’ is not straightforward. Legal identification of the contract with the documented agreement is common but has been questioned.<sup>69</sup> Insights gained from a socio-legal appreciation of contractual obligations suggest that whilst the legal framework to the contract is important, the extent of its importance—particularly to the contracting parties, as opposed to their lawyers—should not be overemphasised. In *Regulating Contracts* for example, Collins takes a sceptical view about the relevance of the legal contract and contract law rules to the agreement the parties make. In his view, the legal rules and decisions in cases frequently undermine the reasonable expectations of the parties which, in the commercial context, are based on ‘considerations of the long term business relation, the customs of the trade, and the success of the deal’<sup>70</sup> rather than the contractual planning documents. It is this social framework, or context, of agreements that gives rise to most of the contracting parties’ intentions and expectations, not the legal regulation. Some judges are aware of the limitations of the written contract in this regard, often revealing anecdotally that contracting parties seem to care little about the legal documents.<sup>71</sup>

The issue of how one understands ‘the contract’ is an important one to the socio-legal critique, since one strategy for upholding commercial expectations (but also possibly undermining them) is for the law to attempt to incorporate more of these social and relational norms into an agreement. Faced with the criticism that the law is simply irrelevant to most transactions, it seems the effectiveness of contract law can no longer be measured by its certainty in promulgating and enforcing a strict body of doctrinal rules, but by its success in supporting and upholding the more elusive ‘reasonable expectations of the parties’.<sup>72</sup> The view of many notionally ‘commercial contractors’ may be that legal contracts and contract law get in the way of doing business.<sup>73</sup> The increasing sensitivity to the issue of whether the documents really capture all the parties’ understandings about their agreement is one aspect of the question of whether contract law reflects and upholds ‘commercial expectations’. It may be that the genuine agreement

<sup>68</sup> Collins, above n 4, 5.

<sup>69</sup> P Linzer, ‘The Comfort of Certainty: Plain Meaning and the Parol Evidence Rule’ (2002) 71 *Fordham Law Review* 799, 822; Macaulay, above n 2, 53–56; Collins, above n 4, ch 6.

<sup>70</sup> Collins, above n 4, 271.

<sup>71</sup> Lord Devlin, above n 13, 252.

<sup>72</sup> Lord Steyn, above n 39.

<sup>73</sup> Lord Devlin, above n 13, 252; Beale and Dugdale, above n 3, 47–48.

cannot be yielded from the documents at all, although contracting parties may be compelled to draft express terms in order to give legal certainty to their agreements. In identifying ‘the contract’ it is possible to rely on the definition that would appeal to the law, which is simply an agreement that the law will enforce. This could be interpreted as agreements that meet strict legal requirements for enforceability—coincidence of offer and acceptance, consideration and intention to create legal obligations. It is well known that in practice these requirements are malleable and the courts will attempt to enforce agreements when it is tolerably clear that the parties both intended to be legally bound and there is some identifiable content to the obligation.<sup>74</sup> In part though, this study is precisely concerned with what ‘contracts’ and ‘contractual obligations’ are taken to be more generally, and particularly within the commercial contracting community. Some participants within such a community may have a legalistic view of what a contract is, others a more flexible view of what a ‘contractual commitment’ to a contracting partner entails. The latter may not make much of a distinction between legal obligations and obligations of a more nebulous or moral kind. Since this is one of the concerns of this book, there is little more to be said about this within the introduction. Suffice to say that it should be clear when a distinction is made between contract law and contracts, and in relation to the latter, when the legal meaning is relied upon or some other more flexible understanding.

Finally, some cautionary words. It is very far from straightforward to reach determinate conclusions about the relationship between contract law and commercial activity, still less about how contract law could display relational concerns and commitments within its scheme of rules and dispute resolution processes. At best this work will make only a modest contribution to these issues. Most of its conclusions are tentative. The claim that contract law should track or uphold commercial expectations cannot be assumed to be self-evident, but neither is it the case that the debates in this area can be defined out of existence by maintaining that contract law is only concerned with formal and legally enforceable commitments. The findings from empirical studies are arguably inconclusive about the role of law in commerce, and they certainly do not suggest the law plays no role in regulating and facilitating commercial dealing.<sup>75</sup> If anything, the studies tend to suggest that the law has a greater role to play in certain kinds of commercial relationship. But these empirical findings do give rise to more

<sup>74</sup> A recent example is provided by the Supreme Court decision in *RTS Flexible Systems Ltd v Molkerei Alois Müller GmbH & Co KG (UK Productions)* [2010] UKSC 14; [2010] 1 WLR 753.

<sup>75</sup> D Campbell, eg, once referred to the ‘devastating empirical finding of non-use’ of contract law in business relationships: ‘Reflexivity and Welfarism in the Modern Law of Contract’ (2000) 20 *OJLS* 477, 480.

basic issues about the rules of contract law that appear only obliquely addressed by unpacking the normative commitments of contract law or by tracing the analytical contours of a contractual obligation. These are important endeavours, but they arguably have little impact on the practical reality of many commercial agreements. The reverse is also true of the socio-legal critique of contract law. Evidence about the practical reality of contracting appears to have had remarkably little impact on contract law, at least insofar as the identification of its main doctrines goes. In short then, this book attempts to pick up the story where other accounts end. These other accounts and judicial views assert that serving commercial expectations, purposes and so on is an end point in the analysis of what contract law is for and how its success is to be judged. Here, the attempt is made to understand better what this claim might mean, whether and how it should be pursued and what reforms to contract law might be necessary to render these claims more than merely rhetorical. The work attempts to provide an overview of the issues, problems and potential for developing greater alignment between commercial expectations and contract law through the broad understandings that are presented by relational theory. Relational scholars may regard the application of the theory to law as immaterial or going beyond their concerns or even impossible, but if so, they can then hardly be surprised or disappointed if a lawyer (or even a business person) greets their claims with a sceptical 'So what?'.<sup>76</sup> Since so many claims of relational theory are critical of the classical law it is hard to believe such theories have, or should have, no reforming aims whatsoever. Similarly, if the law relating to commercial contracts must be based on some assumptions about the contracting parties, it is necessary to ask what justifies its current set of assumptions and whether an alternative set of assumptions based on different criteria, including the real behaviour of contractors, might not be preferable.

<sup>76</sup> Campbell remarks that Macneil evinced disappointment with the reception of his work: 'Ian Macneil and the Relational Theory of Contract' in Macneil, above n 38, 5.