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TABLE OF STATUTES

AUSTRALIAN CAPITAL TERRITORY

NEW SOUTH WALES

INTRODUCTION

PART I

CHAPTER 1

The nature of contract

THE IDEA OF CONTRACT

[1.05] A contract is commonly defined as an agreement or set of promises that the law will enforce (ie, for breach of which the law will provide a remedy).[1] There are, however, many different ways of understanding what a contract is, and what contract law is about. This chapter explores some ideas about the nature of contract and the role of contract law. Given the range and complexity of the different approaches covered in this chapter, it is necessary to begin with an overview of the different perspectives.

According to the classical understanding, a contract is an expression of the joint will of parties engaged in a transaction. On this view, contractual obligations are voluntarily assumed

1 Coote, "The Essence of Contract – Part I" (1988) 1 *Journal of Contract Law* 91, 94-7.

and sharply distinguishable from obligations imposed by the law of tort. The role of contract law, according to the classical understanding, is to facilitate the freedom of the parties to create their own private law. This set of ideas, known as "classical contract theory", exerted a significant influence over the development of English contract law in the 19th century. Although these ideas have been the subject of sustained criticism over a considerable period of time, their influence can still be seen in many principles of Australian contract law and in the outcomes of contemporary Australian contract cases.

The classical theory of contract was a unifying theory that attempted to capture the essence of contract in a single idea. Some contemporary scholars have offered alternative unifying theories that are related to classical theory, but avoid some of its inconsistencies and deficiencies. Two prominent contemporary unifying theories of contract law are Charles Fried's theory that contractual obligation is based on promise and Randy Barnett's idea that contract is based on consent to the transfer of entitlements.

A second way of understanding contract, then, is to see it as based on the moral obligation to keep a promise. Charles Fried argues that a moral obligation arises from the making of a promise, because the promisor has invoked a convention that gives the promisee moral grounds to expect the promised performance. From this liberal individualist perspective, promise is the core of contract.

Thirdly, contract can be seen to be based on consent. Randy Barnett suggests that it is consent to a transfer of entitlements rather than promise that gives contract law its moral force. A person who manifests an intention to assume a legal obligation invokes the institution of contract and thereby incurs a moral obligation to perform that promise. The legal enforcement of a contractual promise is justified because the parties have consented to legal enforcement or have at least behaved in such a way as to indicate that they have so consented.

Fourthly, contract can be seen as a mechanism that facilitates economically efficient exchanges. Michael Trebilcock has suggested that, from an economic viewpoint, the functions of contract law are: first, to prevent opportunistic behaviour by enforcing contractual obligations; secondly, to provide a set of default rules and thus save parties the effort and expense of negotiating all of the terms of their transactions; thirdly, to fill gaps in contracts; and, fourthly, to address market failures, such as misinformation and improper pressure. [2] The economic approach to contract law can be seen as another unifying theory: it attempts to explain and justify all of contract law by reference to a single idea and a single goal, namely economic efficiency.

Not all writers on contract law share the desire to explain the subject by reference to a single principle or unifying theory. Most contract scholars accept that contract law draws on a diverse range of ideas and is shaped by a number of goals, which often point in different directions. This fifth view of contract law sees it as "a rich combination of normative approaches and theories of obligation" which draws on a complex mixture of values and influences. [3] The leading exponent of this view is Robert Hillman. [4]

A sixth way of understanding contract law is to see it as a set of contradictory formal rules that serve an ideological function. That function is to mask the political and social issues

2 Trebilcock, *The Limits of Freedom of Contract* (1993), pp 15-7.

3 Hillman, *The Richness of Contract Law* (1998), pp 6-7.

4 See Hillman, *The Richness of Contract Law* (1998). See also Trakman, "Pluralism in Contract Law" (2010) 58 *Buffalo Law Review* 1031.

underlying particular disputes and to perpetuate a legal order that protects the interests of the powerful. This understanding of contract law is associated with the Critical Legal Studies movement.

Seventhly, contract law can be analysed from the point of view of gender. Its doctrines, its ideology and its representations of women can be seen as having negative effects on women. Contract law can also be seen as reflecting a masculine viewpoint, with its emphasis on abstract rules and its disregard of values such as co-operation and respect for others. It can also be criticised for its failure to address issues of substantive gender inequality. These views can all be described as feminist perspectives on contract law.

Eighthly, contract can be viewed as a social relationship. The behaviour of parties to contracts is affected by the social relations between the parties and by the broader social context in which the contract is made. These social relations may be more important to the parties than their legal rights. Empirical evidence shows that even business people in some contexts plan transactions on the basis of trust, rather than the availability of legal sanctions, and routinely modify exchange transactions without regard to their legal rights. In many cases this is because the relationship between the parties, which may form part of a broader web of social relations, is more important than the particular transaction. Ian Macneil and other relational contract theorists argue that contract law suffers from too strong a focus on discrete exchange transactions. Some suggest that the principles of contract law should to a greater extent reflect the relational aspects of contracting (eg, by accepting that contractual obligations can evolve over time and that parties do not always attempt complete planning at the beginning of the relationship).

Ninthly, contract can be seen as a form of regulation. Jean Braucher points out that contract law plays a significant regulatory role in determining the validity of contracts, interpreting the language and conduct of the parties and filling substantial gaps in agreements. Hugh Collins characterises the law of contract as a particular form of regulation of markets and exchanges, which he calls "private law" regulation. The "private law of contract" gives rights to the parties themselves and allows them to enforce those rights through the courts. This private form of regulation can be contrasted with the public regulation of exchanges, through legislation that sets standards and establishes government agencies to enforce compliance with those standards.

A tenth way of understanding contract is to see it in its doctrinal context, as part of the law of obligations. The common law recognises three fundamental obligations owed by individuals to each other: the obligation to perform certain promises (the law of contract), the obligation to avoid causing harm to others in certain situations (the law of tort) and the obligation to restore certain unjust gains (the law of restitution or unjust enrichment). Alongside these legal obligations are numerous equitable and statutory obligations, which cannot be so neatly categorised. Contract law can be understood as part of a web of obligations created by the common law, equity and statute. This way of understanding contract is considered in Chapter 2.

The final section of this chapter is concerned with the internationalisation of contract law. There are many ways in which the principles of contract law in different jurisdictions are converging. There are both formal and informal moves to harmonise and standardise the principles of contract law, particularly in relation to international transactions. From a practical point of view, it is important to understand the different ways in which contract law is becoming internationalised. It is also useful to compare the approaches taken in different

jurisdictions to particular contract problems. Such comparisons give us a better understanding of the nature of Australian contract law and help us to consider why a particular approach is adopted and whether it is desirable.

CLASSICAL CONTRACT THEORY

The philosophy underlying classical contract law

[1.10] Classical contract theory is the set of ideas and assumptions that underpinned the development of contract law in England and the United States during the 19th century. The latter half of the 19th century is often described as the classical age of English contract law. There are two reasons for this: first, because of the extensive development of contract principles that took place during that period; and secondly, because the prevailing political and economic views of the time elevated contract to a position of central importance in the law. [5] Classical theory remains important to us today because significant areas of Australian contract law are still based on the classical principles developed in England in the 19th century. Moreover, the classical understanding of contract continues to influence the development of contract law in the Australian and English courts.

The law of contract that developed in the 19th century was influenced by the will theory of contract. [6] According to the will theory, a contract represents an expression of the will of the contracting parties and, for that reason, should be respected and enforced by the courts. At the heart of the will theory is the notion that a contract involves self-imposed liability. The will theory and the principle of freedom of contract were connected with economic, philosophical and political views of the late 19th century. [7] The prevailing ideology was the liberal individualist philosophy of laissez faire, and the courts developed principles of contract law that were consistent with that philosophy. [8] The parties to a contract were regarded as self-interested individuals who created their own private law through agreement. It was thought that individuals should be free to enter into whatever bargains they considered would benefit them and the courts should facilitate that freedom by enforcing whatever bargains individuals chose to make. Otherwise, the courts should interfere as little as possible. [9] Freedom of contract was the starting point for the determination of all contract law issues. [10] These ideas are reflected in the famous statement by Sir George Jessel MR in *Printing and Numerical Registering Co v Sampson* that: [11]

> if there is one thing which more than another public policy requires, it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of justice.

The political and social context in which modern contract law developed thus favoured individualism, self-reliance and the exercise of free will over government intervention and

5 Atiyah, *An Introduction to the Law of Contract* (5th ed, 1995), p 10.
6 See Atiyah, *The Rise and Fall of Freedom of Contract* (1979), pp 405-8.
7 Atiyah, *The Rise and Fall of Freedom of Contract* (1979), Chs 1-5.
8 Atiyah, *An Introduction to the Law of Contract* (5th ed, 1995), pp 7-9.
9 Atiyah, *An Introduction to the Law of Contract* (5th ed, 1995), p 8.
10 Atiyah, *The Rise and Fall of Freedom of Contract* (1979), p 666.
11 (1875) LR 19 Eq 462 at 465.

paternalism. [12] The principles of modern contract law were founded on those concepts, [13] which were encapsulated in a political theory labelled "contractualism" by Morris Cohen:

> Contractualism in the law, that is, the view that in an ideally desirable system of law all obligation would arise only out of the will of the individual contracting freely, rests not only on the will theory of contract, but also on the political doctrine that all restraint is evil and that the government is best which governs least. This in turn is connected with the classic economic optimism that there is a sort of pre-established harmony between the good of all and the pursuit by each of his own selfish economic gain. [14]

This approach had two principal effects. First, the courts were reluctant to recognise the existence of non-contractual obligations. The law of tort and restitution went largely undeveloped during the latter half of the 19th century, [15] and the courts imposed stifling constraints on the enforcement of promises that had been relied upon, but did not form part of, a bargain or exchange between the parties. [16] Hugh Collins has observed that the courts tended to perceive social relations in contractual terms. This is illustrated by the famous case of *Carlill v Carbolic Smoke Ball Co*. [17] When a manufacturer's advertisement for a device designed to prevent colds proved to be misleading, Mrs Carlill was able to obtain a remedy against the manufacturer by establishing a contract between them. A contract was found to have been made despite the fact that the parties had never communicated with each other or exchanged money or goods. [18] Collins points out that, rather than recognising the misleading advertising as a civil wrong in itself, the court used the law of contract to discourage misleading claims in advertising and to deter the marketing of unproven pharmaceutical devices. [19]

Secondly, the principles of contract law were developed and justified by reference to an overriding concern with giving effect to the intentions of the parties. The courts "felt that they were not imposing legal rules on the parties, but were merely working out the implications of what the parties had themselves chosen to do". [20] The principles were seen as objective and neutral, and based on a respect for voluntary choices. [21] There could therefore be no room for any requirement of fairness in contractual exchanges or for the imposition of contractual obligations without the consent of the parties. [22]

An important factor in the development of contract as a distinct body of law was that textbooks on English contract law began to be written in the 19th century. Textbooks such as those by Chitty, Pollock and Anson played an important role in the development of the

12 Atiyah, *The Rise and Fall of Freedom of Contract* (1979), esp Chs 1-2.

13 Atiyah, *The Rise and Fall of Freedom of Contract* (1979), esp Chs 13-6. Atiyah's detailed account argues that free market principles influenced the judges and filtered into the content of contract doctrine. Cf Gordley, *The Philosophical Origins of Modern Contract Doctrine* (1991), who argues that Atiyah and others have exaggerated the influence of liberal theories.

14 Cohen, "The Basis of Contract" (1933) 46 *Harvard Law Review* 553, 558.

15 Atiyah, *An Introduction to the Law of Contract* (5th ed, 1995), p 10.

16 See Robertson, "Situating Equitable Estoppel within the Law of Obligations" (1997) 19 *Sydney Law Review* 32, 33-7.

17 [1893] 1 QB 256. See further [3.10].

18 Collins, *The Law of Contract* (4th ed, 2003), p 4.

19 Collins, *The Law of Contract* (4th ed, 2003), p 4.

20 Atiyah, *An Introduction to the Law of Contract* (5th ed, 1995), p 10.

21 Collins, *The Law of Contract* (4th ed, 2003), pp 6-7.

22 Collins, *The Law of Contract* (4th ed, 2003), pp 6-7.

classical idea of contract law by describing in systematic form a set of abstract general principles which applied to all types of contract. [23] The textbooks helped to carve out contract as an independent body of law, which was separate from property law, the law of tort and the law of restitution. [24] Contract could therefore be seen as a branch of law that was exclusively concerned with voluntarily assumed obligations. [25] Contract was sharply distinguished from the law of tort, in which obligations were imposed on individuals. This separation was and remains artificial, since obligations are routinely imposed by the law of contract, while intention and voluntary conduct play a role in shaping obligations in tort. [26] Moreover, property, tort and restitution play an important role in the regulation of market transactions [27] and in the determination of the rights and obligations of contracting parties in particular cases. [28]

Criticism of the classical approach

[1.15] The will theory and the classical approach to contract have been comprehensively criticised. The first point is that the rights and obligations arising from a contract do not necessarily represent the will of the parties. Many problems the courts must deal with arise as a result of what the parties *have not* expressly agreed upon, rather than what they *have* agreed upon. As Morris Cohen has pointed out, litigation almost invariably reveals the absence of agreement between the parties. [29] Problems arising from miscommunication or a lack of agreement cannot be resolved by treating the agreement as an expression of the will of the parties. The courts resolve such problems by determining the rights and obligations of the parties on an objective basis.

In determining whether a contract has been formed, the courts are not concerned with whether the parties actually intended to enter into a contract, but with whether a reasonable person would believe they intended to do so, based on their words and behaviour. [30] This approach requires the court to make policy decisions as to whether contractual obligations should be recognised in particular circumstances. Liability for breach of contract can therefore be seen as tort-like liability for negligent conduct or careless use of language, rather than as self-imposed liability that has emanated from the will of the parties. [31]

The content of a contract is also determined objectively: statements made during negotiations may form part of a contract if a reasonable bystander would think that a contractual promise was intended, [32] and unsigned written terms form part of a contract if

23 Simpson, "Innovations in Nineteenth Century Contract Law" (1975) 91 *Law Quarterly Review* 242, 247; Atiyah, *The Rise and Fall of Freedom of Contract* (1979), pp 388-90.

24 Collins, *The Law of Contract* (4th ed, 2003), p 5.

25 This view remains influential; see, eg, *Transfield Shipping Inc v Mercator Shipping Inc ("The Achilleas")* [2008] UKHL 48; [2009] 1 AC 61, esp at para [12]: "It seems to me logical to found liability for damages upon the intention of the parties (objectively ascertained) because all contractual liability is voluntarily undertaken". See also *Astley v Austrust Ltd* (1999) 197 CLR 1, 36: "Tort obligations are imposed on the parties; contractual obligations are voluntarily assumed".

26 Atiyah, "Contracts, Promises and the Law of Obligations" (1978) 94 *Law Quarterly Review* 193, 221.

27 Collins, *The Law of Contract* (4th ed, 2003), p 6.

28 See Chapter 2 and [3.150].

29 Cohen, "The Basis of Contract" (1933) 46 *Harvard Law Review* 553, 577.

30 See Chapters 3 and 5.

31 Mensch, "Freedom of Contract as Ideology" (1981) 33 *Stanford Law Review* 753, 763.

32 Subject to the parol evidence rule: see Chapter 12.

reasonable notice of the terms was given by one party to the other. [33] The contractual terms are then interpreted according to what a reasonable person would think was meant by the language used. [34] The courts routinely imply terms to fill gaps and deal with contingencies not provided for in the contract. Other contract doctrines, such as the doctrine of frustration and the remoteness rule require the courts to fill gaps in the contractual allocation of risk. [35] Contracting parties routinely leave it to the courts to decide what should happen in the event that one of the parties should fail to fulfil their obligations. Thus, in many respects, contract law operates in a similar way to the law of tort: the state, through the courts, imposes obligations on the parties based on norms of reasonable behaviour. Contractual obligations derived from an objective interpretation of behaviour can be seen as obligations that are imposed by the state in order to protect persons who rely on promises. This serves the broader policy goal of facilitating commercial transactions and other valuable exchanges by ensuring that individuals can rely on serious commitments made by others.

A second problem with the classical approach to contract is that it assumes that contracts are fully negotiated between the parties. Today, most written contracts are made on the basis of standard form terms which are generally not negotiable and typically not read, and the implications of which are commonly not understood by the non-drafting party. [36] The widespread use of standard forms, which began in the 19th century, undermines the idea that a contract necessarily represents a consensus between the parties. If the bargaining power in a given situation is sufficiently unequal that one party is able to impose his or her own standard terms on the other, then the resulting contract is unlikely to represent the will of both parties. [37] The classical notion of individuals freely bargaining in relation to contract terms does not take account of the dominance of standard form contracts or the unequal distribution of economic power. [38]

A third problem with the notion that contract law is fundamentally concerned with individual autonomy is the role played by the state in enforcing contracts and in establishing the legal framework in which bargaining takes place. Freedom of contract is not a matter of leaving parties to do their own thing, as the philosophy of laissez faire might suggest, because the state plays a decisive role in both the enforcement and formation of contracts. A contract is only "binding" because the state, through the courts, will enforce it. Morris Cohen has observed that the role played by the state in the enforcement of contracts allows the law of contract to be viewed as a branch of public law. [39] The state also plays a decisive role in the making of a contractual bargain. In a market economy in which labour is specialised, individuals have no choice but to make contracts in order to obtain food, clothing and shelter,

33 See Chapter 12.

34 See Chapter 13.

35 See Chapters 15 (on the doctrine of frustration) and 27 (on the remoteness rule).

36 See Kessler, "Contracts of Adhesion – Some Thoughts About Freedom of Contract" (1943) 43 *Columbia Law Review* 629; Slawson, "Standard Form Contracts and Democratic Control of Lawmaking Power" (1971) 84 *Harvard Law Review* 529; Rakoff, "Contracts of Adhesion: An Essay in Reconstruction" (1983) 96 *Harvard Law Review* 1173; Hillman and Rachlinski, "Standard-Form Contracts in the Electronic Age" (2002) 77 *New York University Law Review* 429.

37 See Robertson, "The Limits of Voluntariness in Contract" (2005) 29 *Melbourne University Law Review* 179, 187-202.

38 Dawson, "Economic Duress – An Essay in Perspective" (1947) 45 *Michigan Law Review* 253; Cohen, "The Basis of Contract" (1933) 46 *Harvard Law Review* 553.

39 Cohen, "The Basis of Contract" (1933) 46 *Harvard Law Review* 553, 586.

to acquire skills and to work.[40] Coercion is "at the heart of every bargain" because it is "inherent in each party's legally protected threat to withhold what is owned".[41] It is the right to withhold property that allows a party to force another to submit to his or her terms, provided they are no worse than the alternative.[42]

The power to bargain is founded on property rights that are conferred and enforced by the state. As Betty Mensch has explained, ownership, or the right to withhold property, is a function of legal entitlement.[43] If we can say that ownership is at the heart of every bargain and ownership is a function of the legal order, then every contract is a function of the legal order, rather than a function of the will of the parties. This conclusion demonstrates the falsity of the distinction between public and private in contract law, and the distinction between free and regulated markets.[44]

The validity of the first and second criticisms of classical contract theory set out in this section have become matters of debate in recent years. Scholars such as Charles Fried, Randy Barnett and Stephen Smith, whose work is discussed below, defend theories of contract that are based on the core classical idea that contractual obligations can in general be regarded as voluntary or self-imposed. There is also a broader movement in the contract law literature that seeks to show that there are fewer gaps in contracts than is commonly thought, and that judges play a less significant role in shaping contractual obligations than is commonly thought.[45]

PROMISE THEORY

Charles Fried

[1.20] One of the most prominent contemporary unifying theories of contract law is that proposed by Charles Fried in his book *Contract as Promise: A Theory of Contractual Obligation*.[46] Fried believes that the law of contract has an underlying, unifying structure and that that structure is founded on moral principles. He argues that the moral basis of contract law is the promise principle – the principle by which people may impose on themselves obligations that previously did not exist. Contract is often defined in terms of promise and "contract as promise" is a prominent mainstream concept. Fried's basic point is that a person who makes a promise is morally bound to keep it because that person has "intentionally invoked a convention whose function it is to give grounds – moral grounds – for another to expect the promised performance".[47] A contract is, he says, first of all a promise, and a contract must be kept because a promise must be kept.

Fried's theory is essentially a restatement of the classical will theory of contract. We have seen that, according to that theory, a contract involves self-imposed duties. It is a theory that

40 Radin, "Contract Obligation and the Human Will" (1943) 43 *Columbia Law Review* 575, 580; Hale, "Bargaining, Duress, and Economic Liberty" (1943) 43 *Columbia Law Review* 603.

41 Mensch, "Freedom of Contract as Ideology" (1981) 33 *Stanford Law Review* 753, 764.

42 Hale, "Coercion and Distribution in a Supposedly Non-coercive State" (1923) 38 *Political Science Quarterly* 470, 472-3; Hale, "Bargaining, Duress, and Economic Liberty" (1943) 43 *Columbia Law Review* 603, 604.

43 Mensch, "Freedom of Contract as Ideology" (1981) 33 *Stanford Law Review* 753, 764.

44 Mensch, "Freedom of Contract as Ideology" (1981) 33 *Stanford Law Review* 753, 764.

45 See [1.22].

46 Fried, *Contract as Promise: A Theory of Contractual Obligation* (1981). A second edition published in 2015 retains the original text but includes a new essay responding to subsequent scholarship.

47 Fried, *Contract as Promise: A Theory of Contractual Obligation* (1981), p 16.

fits comfortably with the liberal individualist philosophy of allowing individuals free choice and respecting their decisions – the ideology of laissez faire. Fried's endorsement of this ideology underlies his view that judges should not interfere with contracts in order to redistribute wealth. Such redistribution should not be effected on an ad hoc basis. Rather, redistribution should be effected by the legislature through general taxation and the provision of welfare benefits.[48] On this view presumably courts should not have the power they currently enjoy to strike down clauses, such as penalty clauses, unreasonable restraint of trade clauses and certain exemption clauses.[49] However, Fried does reject some of the extremes of the classical approach and acknowledges that there are aspects of contract law that do not rest on the promise principle. For example, when a contract is frustrated by subsequent events, he sees that there is no point in insisting that the legal consequences are somehow promise related.[50] Rather, it should be admitted that this contingency was not provided for by the contract and the courts must fill the gap by applying non-promissory principles of fairness. Fried sees no threat to the promise principle in "gap-filling" by the courts, as a gap is only filled when the parties have omitted to make a promise.

In evaluating Fried's theory, a number of issues arise. The first is that the theory does not tell us which particular promises the law should enforce. If there is a moral duty to keep promises, why are only some promises given legal force? The principal way in which the law distinguishes between legally enforceable and non-enforceable promises is through the doctrine of consideration. A promise is only enforceable under the law of contract if something is given or promised in exchange for it. Gratuitous promises are generally not enforceable. This does not accord with Fried's promise theory. He argues, however, that the concept of consideration is incoherent and inconsistently applied by the courts. Moreover, it is being undermined by developments such as the recognition of equitable or promissory estoppel, a principle of reliance-based liability which Fried sees as an attempt to "plug a gap" left in the general regime of promise enforcement by the doctrine of consideration.[51] Given that the adequacy of consideration is entirely up to the contracting parties, and that even nominal consideration is sufficient, it is no doubt arguable that the law should allow individuals to make gratuitous promises that are legally binding.

But what of social and domestic promises, such as a promise to come to dinner or to help a friend fix his car? The law denies enforceability to such promises through the requirement of an intention to enter legal relations.[52] Fried accepts the need for a similar principle. He states that the promisor "must have been serious enough that subsequent legal enforcement was an aspect of what (the promisor) should have contemplated" at the time the promise was made.[53] This represents a qualification on the promise theory, since a promise is not of itself seen as sufficient to give rise to a contractual obligation.

Courts regularly interpret contracts and imply terms in them. Generally, an objective approach is taken so the actual intention of a promisor is not to the point. Does this process fit

48 Fried, *Contract as Promise: A Theory of Contractual Obligation* (1981), p 106.

49 See, respectively, Chapters 28, 41, 13.

50 But see Morris, "Practical Reasoning and Contract as Promise: Extending Contract-Based Criteria to Decide Excuse Cases" (1997) 56 *Cambridge Law Journal* 147; Langille and Ripstein, "Strictly Speaking – It Went Without Saying" (1996) 2 *Legal Theory* 63.

51 Fried, *Contract as Promise: A Theory of Contractual Obligation* (1981), p 25.

52 See Chapter 5.

53 Fried, *Contract as Promise: A Theory of Contractual Obligation* (1981), p 38.

comfortably with the promise theory? Fried takes the view that the courts "flesh out" what the promisor has accepted as a contractual duty because promises "are made against a background of shared purposes, experiences, and even a shared theory of the world". [54] He says "there is always some deeper, more general level of shared experience and striving to which appeal can be made in order to make the particular project mutually intelligible". [55] If this is so, then objective and subjective intention will coincide. But is Fried's rationalisation realistic, given that terms are often implied or interpreted against the will of a promisor? [56] The implication of terms and the process of interpretation can be seen as "gap-filling" by the courts. [57] The greater the extent of judicial gap-filling, the less persuasive the argument that the promise principle is dominant. On the other hand, many contracts may not receive judicial scrutiny because through careful drafting the potential gaps have already been filled by the parties themselves.

On the question of damages, Fried sees the promise principle as providing a good explanation for the awarding of expectation damages to the disappointed promisee. The principal remedy for breach of contract is an award of damages calculated to put the promisee in the position he or she would have been in had the promisor's promise been performed (expectation damages). Such a measure of damages is often compared with reliance damages (covering losses incurred in reliance on the promise) and restitutionary damages (covering the return of benefits received by the promisor). Fried makes the point that if a person makes a promise to another and fails to keep that promise, then it is only fair that the equivalent of the promised performance should be handed over. [58] Note, however, that the promisee will not always receive in damages what was promised, because in some cases the promisee will be awarded reliance damages, and in all cases the promisee is under a duty to mitigate the loss which flows from the promisor's breach. Moreover, the promise principle does not explain why an award of damages, rather than specific performance, is the normal remedy available to disappointed promisees. [59]

The legal enforcement of a contractual promise necessarily restricts the autonomy of the promisor because it deprives the promisor of the ability to choose to break the promise. However, Fried contends that the legal enforcement of promises enhances, rather than restricts, individual autonomy because the existence of the contractual mechanism gives individuals the power to bind themselves. "In order that I be free as possible … it is necessary that there be a way in which I may commit myself … By doing this I can facilitate the projects of others, because I can make it possible for others to count on my future conduct". [60] As we saw, Fried is a critic of the legal requirement of consideration as that requirement restricts the ability of the individual to make a legally binding gift-promise. Once a legally binding promise is made, a promisor is not permitted a change of heart. Autonomy of the individual does not extend that far, on the Fried view, even though the promisee may not have relied on the

54 Fried, *Contract as Promise: A Theory of Contractual Obligation* (1981), p 88.

55 Fried, *Contract as Promise: A Theory of Contractual Obligation* (1981), p 88.

56 See, eg, *Brambles Holdings Ltd v Bathurst City Council* [2001] NSWCA 61; (2001) 53 NSWLR 153, discussed in [PtV.10].

57 See Chapter 14.

58 Fried, *Contract as Promise: A Theory of Contractual Obligation* (1981), p 17.

59 See Craswell, "Contract Law, Default Rules and the Philosophy of Promising" (1989) 88 *Michigan Law Review* 489, 517-20.

60 Fried, *Contract as Promise: A Theory of Contractual Obligation* (1981), p 13.

promise in a detrimental way nor conferred any benefit on the promisor. This suggests that an absolutist morality lies at the base of Fried's promise theory.

Stephen Smith

[1.22] A promise-based understanding of contract has also been defended by Stephen Smith. Smith describes his account of contract law as "interpretive": it aims to enhance our understanding of contract law by identifying connections between different features of contract law and thereby revealing an "intelligible order" in it.[61] Smith argues the essence of contact law is best captured by promise theory, which is the idea that a contractual duty is "created by communicating an intention to undertake an obligation."[62] Contract law is therefore essentially concerned with self-imposed obligations. On this view of contract, exchanges that are truly simultaneous are not contracts because they do not involve the creation of any self-imposed obligations.

Smith differs from Fried on how best to answer arguments about the apparent lack of "fit" between contract law doctrines and the idea that contractual obligations are created by the parties through the making of promises. Smith accepts that the idea that contractual obligations are created by promises cannot explain the doctrine of consideration. But Smith notes that no other plausible theory about the nature of contractual obligation can account for the doctrine of consideration either.

Smith argues that the doctrine of consideration essentially operates as a requirement of form. By requiring a promisor to take an additional step to make a valid contract, it promotes caution and provides a means by which the parties can signal their intention to create legal obligations.[63] The doctrine of consideration "facilitates the expression and proof of contracting parties' intentions" and is therefore not inconsistent with the promise theory of contract.[64] He accepts that an objective approach to contract formation causes some discomfort for a promise theory because "promises can only be *made* intentionally – and a search for intention is necessarily subjective".[65] But Smith questions whether the courts do in fact approach the question of intention to make a contract from an objective viewpoint and claims that the literature on this point is inconclusive.[66] Moreover, he says, the objective approach can be justified on the basis that it provides the most reliable evidence that is available of a promisor's subjective intentions.

Smith argues that the objective approach to contractual *interpretation*, on the other hand, does not undermine the promissory view of contract because the *content* of a promise is always determined objectively: the content of a promise is not what the promisor intended, but what the promise itself actually meant.[67]

It was noted that Charles Fried accepted that certain contract doctrines, such as the doctrine of frustration, are instances in which the courts fill gaps in the contractual allocation of risk and therefore fall outside the promise principle. Smith, in contrast, seeks to bring these doctrines within the promise principle on the basis that the courts in these cases are not

61 Smith, *Contract Theory* (2004), p 5.
62 Smith, *Contract Theory* (2004), p 57.
63 See further [7.05].
64 Smith, *Contract Theory* (2004), p 65.
65 Smith, *Contract Theory* (2004), p 174.
66 This question is considered at [3.140].
67 Smith, *Contract Theory* (2004), p 62.

imposing a solution on the parties, but are in fact interpreting and implementing the parties' intentions. Smith's argument is based on a body of recent work which seeks to show that contract doctrines that are commonly thought to be concerned with the filling of gaps in fact involve an interpretation of what was agreed by the parties. [68] This is based on the idea that contracting parties can intend things they do not mention, or even think about, during negotiations. "[A] great deal of the content of a contract therefore goes without saying." [69] Most importantly, however, this view depends on the idea that judges can identify exactly what has gone without saying; that is, what has been tacitly agreed between the parties. It depends on the notion that, by examining the nature of the contract and the context in which it was made, judges are able to identify an implicit allocation by the contracting parties of the risk in question. For Smith and others, this is what the courts do in the application of doctrines such as mistake, frustration and remoteness.

Promise theory is considered in relation to implied terms in Chapter 14 and in relation to duress in Chapter 34.

CONSENT THEORY

[1.25] Consent theory is another unifying theory of contract law. This theory has been proposed and elaborated by Randy Barnett. [70] The theory posits that contractual obligations can only be fully understood if they are seen as dependent on an underlying system of *legal entitlements*. This system of entitlements specifies the rights which people may acquire and transfer and prescribes how such acquisitions and transfers may be effected.

Contract law is that part of a system of entitlements that identifies the circumstances in which entitlements are validly transferred from one person to another. [71] It concerns enforceable obligations arising from the valid transfer of *existing* entitlements, ie, those entitlements that are already vested in the parties. A transfer requires the *consent* of the rights holder, ie, consent to be legally obligated. The legal enforcement of an obligation requires moral justification, and it is consent that provides the moral justification in this instance.

One of the primary functions of an entitlements theory is to specify the boundaries within which people may operate freely in order to pursue their purposes and thereby provide the basis for co-operative activity with others. The boundaries must be ascertainable so that rights may be respected and disputes avoided. In contract law this means that consent to the alienation of rights must be *manifested*. Without such manifestation, parties to a transaction cannot ascertain what is rightful conduct and what constitutes a commitment upon which they can rely. Whether a person has consented does not depend on that person's subjective opinion about the significance of his or her words or conduct, but rather on the meaning that would ordinarily be attached to them. Only through general reliance on objectively ascertainable

68 See, eg, Langille and Ripstein, "Strictly Speaking – It Went Without Saying" (1996) 2 *Legal Theory* 63; Morris, "Practical Reasoning and Contract as Promise: Extending Contract-Based Criteria to Decide Excuse Cases" (1997) 56 *Cambridge Law Journal* 147; Kramer, "Implication in Fact as an Instance of Contract Interpretation" (2004) 63 *Cambridge Law Journal* 384; Kramer, "An Agreement-Centred Approach to Remoteness and Contract Damages" in McKendrick and Cohen (eds), *Comparative Remedies for Breach of Contract* (2005), p 25.

69 Smith, *Contract Theory* (2004), p 314.

70 Barnett, "A Consent Theory of Contract" (1986) 86 *Columbia Law Review* 269.

71 Barnett's theory of contract is therefore sometimes classed as a "transfer theory"; see, eg, Smith, *Contract Theory* (2004), pp 44-5. Another prominent transfer theory of contract is that of Peter Benson, "The Unity of Contract Law" in Benson (ed), *The Theory of Contract Law* (2001), p 118.

assertive conduct can a system of entitlements function coherently, minimise conflicting claims and respect the interests of those who take the conduct of others at face value. Accordingly, "a consent theory specifies that a promisor incurs a contractual obligation the legal enforcement of which is morally justified by manifesting assent to legal enforcement and thereby invoking the institution of contract". [72] A promise does not itself give rise to a contractual obligation; there must be a manifest consent to legal enforcement.

Barnett does not see anything paradoxical in adhering to an objective notion of consent, even though this consent may conflict with actual or subjective intention. He points out that the objective notion of consent is based on words and conduct of people that are commonly understood to reflect their subjective assent. Moreover, a person never has direct access to another person's subjective mental state. [73] A person must learn what other people intend to communicate by evidence of their conduct and words and, in the context of contract, this must be limited to evidence available to the other party at the time of the transaction.

A consent theory, because it is based on fundamental notions of entitlements, explains why an objective manifestation of consent must prevail over a subjective intent in the (unusual) event of a conflict. Such a theory also explains exceptional cases where evidence of subjective intent will prevail. [74] For example, there may be proof of a special meaning that the parties held in common or proof that the promisee did not actually understand the ordinary meaning to be the intended meaning. In such cases the normal boundary-defining functions of the entitlements analysis would not be served by an objective approach. The main purpose of the objective approach is to enable people to rely on the appearances created by others because the subjective intentions of others are generally inaccessible. This purpose is satisfied when a person has actual knowledge that appearances in a particular case are, in fact, deceptive.

Barnett's view then is that the objective manifestation of consent to a transfer of alienable rights is binding:

> because of its usual connection with subjective assent (thereby protecting the reliance interest of the promisor) and because people usually have access only to the manifested intentions of others (thereby protecting the reliance interest of the promisee and others as well as the "security of transactions"). [75]

Consent may be manifested formally or informally. Formal consent is manifested in a document under seal (ie, a deed). Informal consent may be manifested in various ways, such as bargained-for consideration, non bargained-for detrimental reliance by the promisee or an unambiguous verbal commitment. Although this would go beyond the current understanding of which promises are binding (at least in Australia), Barnett believes that consent theory encourages informed action by providing a clearer criterion of enforceability that is available to the parties, namely the criterion of consent to obligation. He says that:

> A consent theory provides a focus for contemporary dissatisfaction with the doctrine of consideration, while putting into better perspective the recognised need to enforce some gratuitous commitments and to protect some acts of reliance that were not bargained for. [76]

72 Barnett, "A Consent Theory of Contract" (1986) 86 *Columbia Law Review* 269, 305.

73 See further [3.140].

74 See [3.80] and [5.05].

75 Barnett, "A Consent Theory of Contract" (1986) 86 *Columbia Law Review* 269, 309-10.

76 Barnett, "A Consent Theory of Contract" (1986) 86 *Columbia Law Review* 269, 319.

The traditional defences to contractual liability are seen in the context of consent theory as depriving the manifestation of consent of its normal moral and therefore legal significance. [77] The objective manifestation of consent must have been "voluntary". This will not be the case if, for example, the consent was improperly coerced by the promisee (duress) or was based on misinformation for which the promisor was responsible (misrepresentation). The defence of frustration of a contract is rationalised by inferring a tacit assumption on which the consent was based that certain types of events would not occur and that the promisee should bear the risk of their occurrence.

A difficulty that must be overcome if consent is to be regarded as the basis of contractual obligation is the judicial and legislative practice of implying terms. Some implied terms are commonly understood to be imposed by the legal system for reasons of policy, rather than consented to by the parties to the contract. However, Barnett takes the view that the set of implied terms which represent a genuine imposition on the parties is much smaller than is commonly thought. [78] He distinguishes three categories of terms: [79]

1. terms that are the product of "direct consent" (express or implied-in-fact terms);
2. terms that are the product of "indirect consent" (implied-in-law default rules); and
3. terms that are imposed on the parties without any consent (implied-in-law immutable terms).

Category (1) terms are based on the parties' consent. Category (2) terms are the kind that are incorporated into the contract by the courts or legislatures unless the parties agree to oust or vary them, so a manifest assent by the parties to the contrary will displace or vary the term. Category (3) terms are mandatory and cannot be displaced by a manifest assent to the contrary. The requirement of consent to be legally bound, the basis of consent theory, necessarily implies consent to the application of *some* set of default (and immutable) rules when a gap arises in a contract. Barnett argues that in certain circumstances silence by parties in the face of category (2) default rules can constitute consent to the imposition of those *particular* default rules. He believes that default rules are often indirectly consented to by the parties who could have "contracted around" the rules but did not do so. If the parties are informed and can be counted on to know the law and to vary any default rule that did not reflect their subjective intentions, such parties by their silence have indirectly consented to the default rule. "So long as the costs of learning the content of default rules and of contracting around them are sufficiently low, silence by the parties in the face of a default rule can constitute consent to its imposition". [80] If, on the other hand, the parties are not in this situation, the default rule is only likely to reflect the parties' consent if the law has adopted a "conventionalist" default rule (ie, one that reflects the conventional or common sense understanding of the community) as this is likely to accord with the parties' subjective intentions. [81]

77 Barnett, "A Consent Theory of Contract" (1986) 86 *Columbia Law Review* 269, 318.

78 Barnett, "The Sound of Silence: Default Rules and Contractual Consent" (1992) 78 *Virginia Law Review* 821.

79 Barnett, "The Sound of Silence: Default Rules and Contractual Consent" (1992) 78 *Virginia Law Review* 821, 827-8.

80 Barnett, "The Sound of Silence: Default Rules and Contractual Consent" (1992) 78 *Virginia Law Review* 821, 897.

81 For criticism of Barnett's analysis of default rules, see Robertson, "The Limits of Voluntariness in Contract" (2005) 29 *Melbourne University Law Review* 179, 211-3.

Another potential problem for a consent theory is that contractual obligations routinely arise from standard form contractual documents that are signed without being read. Barnett argues that a person who signs a standard form contract (or clicks "I agree" on a website displaying contractual terms) manifests an intention to be legally bound by whatever is contained in the document, even if he or she does not know what those contents are. [82] Barnett explains that a person can accept an unknown obligation because contract law facilitates the assumption of risk. A person who agrees to contractual terms without having read them is simply accepting the risk that she may regret the transaction at some later time when she learns of the content of the agreement. There is, however, an implicit limit, according to Barnett. A person who signs an unread document manifests an intention to be bound only by terms of a kind one would expect to find in such a document; accordingly, there is no manifested consent to terms that are "radically unexpected". [83]

Those who believe that subjective consent is the only "real" consent may regard Barnett's consent theory of contract as harbouring a misnomer. If consent is not real then the resultant contractual duties appear to be imposed in much the same way as torts duties. For Barnett, however, a manifested consent can be real even when it is not accompanied by subjective assent. As he says:

> This is because the concept of consent that is at the root of contract theory is *communicated* consent, though one reason for the centrality of communicated consent is its close empirical correspondence with subjective assent. [84]

ECONOMIC ANALYSIS OF CONTRACT LAW

[1.30] Economic analysis has been a significant force in the field of contract law in North America in the last 30-40 years. [85] Economic analysis of law involves analysing legal rules by reference to their ability to promote efficient market outcomes. A transaction enhances economic efficiency if it results in the transfer of goods or services to a person who values them more highly. Economic analysis places a high value on voluntary exchanges. Individuals are assumed to be the persons best placed to assess their own welfare. Voluntary exchanges move resources to their most valued uses because an individual will only exchange a thing (such as money, goods or services) for another thing that he or she values more highly. This analysis assumes the individual to be a "self-interested egoist who maximises utility". [86] It is not assumed that all individuals are rational, but that the utility-maximising individual represents a "weighted average of the individuals under study in which the non-uniformities and extremes in behaviour are evened out". [87]

82 Barnett, "Consenting to Form Contracts" (2002) 71 *Fordham Law Review* 627, 635-6.

83 Barnett, "Consenting to Form Contracts" (2002) 71 *Fordham Law Review* 627, 637. For criticism of Barnett's analysis of standard form contracting, see Robertson, "The Limits of Voluntariness in Contract" (2005) 29 *Melbourne University Law Review* 179, 190-3.

84 Barnett, "The Sound of Silence: Default Rules and Contractual Consent" (1992) 78 *Virginia Law Review* 821, 859 (fn 81).

85 For a recent overview and discussion, see Katz, "Economic Foundations of Contract Law", in Klass, Letsas and Saprai, *Philosophical Foundations of Contract Law* (2014), p 171.

86 Veljanovski, "The Economic Approach to Law: A Critical Introduction" (1980) 7 *British Journal of Law and Society* 158, 162.

87 Veljanovski, "The Economic Approach to Law: A Critical Introduction" (1980) 7 *British Journal of Law and Society* 158, 162.

Economic functions of contract law

[1.35] Given its emphasis on voluntary exchanges, it is not surprising that the neo-classical economic analysis of contract law, like classical contract theory, favours a principle of freedom of contract and discourages state intervention. Nonetheless most adherents of an economic analysis of law would accept that contract law fulfils a number of important functions in regulating voluntary exchange. Richard Posner has argued that voluntary exchanges would still take place without contract law, but the system would be much less efficient because contracting parties would need to implement costly measures to protect themselves against opportunistic behaviour. [88]

Michael Trebilcock identifies four functions of contract law in promoting economic efficiency. [89]

"Containing opportunism in non-simultaneous exchanges"

[1.40] A first economic function of contract law is to contain opportunistic conduct. Where parties do not perform their contractual obligations at the same time, the party performing second may engage in opportunistic behaviour. The incentive for such conduct will occur where, after the contract is made and one party has performed, something causes the other party to regret making the commitment. The contract might, for example, prove to have been a bad deal because the market price has changed or a better opportunity has arisen. The party who has not performed may then seek to renege on the contract, despite the expectations of the other party and his or her reliance in performing. As we shall see, contract law enforces contracts by requiring a party who refuses to perform in breach of contract to pay damages to the other party and, in some cases, may order specific performance of the contract. Proponents of an economic analysis of law stress that these rules provide important protection for contracting parties against such opportunistic advantage-taking. There are also many non-legal incentives for parties to perform contracts, such as the value of a good reputation, which may in fact prove a more significant incentive for loyalty to a contract than the law. [90]

"Reducing transaction costs"

[1.45] A second economic function of contract law is to reduce transaction costs. Contract law reduces transaction costs by supplying *default rules*. Default rules are rules that will apply to all contracts, or to all contracts of a certain type, unless the parties have excluded their application. As we shall see, contract law recognises numerous terms that are routinely implied in certain types of contracts. [91] Moreover, many of the general rules of contract law, such as those governing termination, may be seen as default rules. [92] Default rules save the parties the expense of having to negotiate and draft provisions dealing with particular contingencies. Proponents of the economic approach argue that the default rules of contract law should encourage or facilitate efficiency-enhancing behaviour. This can be done in one of two ways. First, default rules might attempt to provide outcomes that best approximate what the parties

88 Posner, *Economic Analysis of Law* (9th ed, 2014), §4.1.

89 Trebilcock, *The Limits of Freedom of Contract* (1993), pp 15-7; Trebilcock, "The Value and Limits of Law and Economics" in Richardson and Hadfield (eds), *The Second Wave of Law and Economics* (1999), p 12.

90 See [26.135].

91 See Chapter 14.

92 See Chapter 21.

themselves would have agreed on had they had the opportunity. Secondly, default rules can be formulated in such a way that they provide incentives or disincentives that encourage parties to behave efficiently.

"Filling gaps in incomplete contracts"

[1.50] A third function of contract law, which is closely related to the provision of default rules, is to fill gaps in incomplete contracts by dealing with those matters on which the parties have not expressly reached agreement. A contract may prove incomplete where the parties fail to foresee or provide for a particular contingency affecting performance of their contract. As we shall see, where a contingency for which the parties have not provided occurs, courts are in some cases prepared to imply terms in contracts on a one-off basis. [93] The doctrine of frustration, which relieves parties from their obligations where performance becomes impossible or radically different from what they intended, may also be seen as a gap-filling rule. [94]

"Distinguishing welfare-enhancing and welfare-reducing exchanges"

[1.55] A fourth economic function of contract law is to provide excuses for non-performance. Contract law thus discourages exchanges that are inefficient because of a market failure. As we shall see, the law of contract recognises a range of factors as vitiating a contract and justifying non-performance, such as where a party has been misled, has entered into a contract on the basis of a mistake or has been subjected to illegitimate pressure to enter into a contract. These vitiating factors may be seen in economic terms as regulating cases of market failure, such as information failure [95] and lack of voluntariness. [96]

Emphasis on consequences

[1.60] Much legal analysis is confined to considering the effect of a particular rule in resolving a dispute that has occurred between the parties in a particular case. By contrast, economic analysis directs our attention to the broader consequences of a rule. Economic analysis considers the broader functions of contract law rules and analyses how well those rules fulfil their functions. Adherents of an economic analysis of law ask: what sort of incentives will the rule provide to contracting parties in the future? Economic analysis is concerned with the overall effect of the rule in either encouraging or discouraging efficient outcomes, rather than with the results in a particular case. [97]

Criticism of economic analysis

[1.65] One criticism of the economic analysis of law is that its emphasis on individual autonomy reflects an "impoverished, pre-social conception of human life". [98] As noted earlier in this chapter, adherents of an economic analysis of law presume a contracting party to be a

93 See Chapter 14.

94 See Chapter 15.

95 See Part XIA, Chapters 31-33, "Misinformation".

96 See Part XIB, Chapters 34-38, "Abuse of Power".

97 Craswell, "Against Fuller and Perdue" (2000) 67 *University of Chicago Law Review* 99.

98 Trebilcock, *The Limits of Freedom of Contract* (1993), p 18.

"self-interested egoist who maximises utility". [99] By contrast, as discussed below, relational contract theorists argue that human behaviour is not merely influenced by self-interest but also by social bonds, such as those between families and communities, and also by values such as loyalty and altruism. An account of contracting behaviour that does not take account of these social influences on human behaviour will, on this view, be incomplete.

Another criticism of law and economics is that the concepts deployed are indeterminate and commonly rely on unexpressed value judgments. [100] For example, a person's decision in a particular situation will be optimal in an economic sense only if it is voluntary and informed. These are abstract concepts and there can be much argument about what they require. As Trebilcock argues, in the real world, few choices are made with perfect information or free from pressures of any kind. [101] Accordingly, value judgments will be required to determine what amount of pressure should invalidate a transaction and what degree of information imperfection should be tolerated. [102]

A third criticism of economic analysis of contract law concerns its neglect of the issue of distributive justice. [103] Economic analysis focuses on the question whether an exchange is efficient, rather than on whether the allocation of resources between the parties involved was fair to begin with. Trebilcock explains that proponents of economic analysis of law assume that contracting parties have equal opportunities, but ignore the fact that individuals do not "start out equal, if only because of the effects of the genetic lottery or early family circumstances, which are morally arbitrary". [104] Trebilcock gives the following example:

> Suppose a starving painter or artist agrees to sell for "a song" a book or painting he or she has been working on for years to raise a couple of dollars to buy a loaf of bread. Does this transaction meet the Pareto criterion? The answer is yes in the sense that the seller of the book or painting prefers two dollars to the book or painting and the buyer of the latter prefers it to the two dollars he agrees to pay for it. Similarly in the case of the bread transaction. Everybody seems to be better off, but we may wish we lived in a society where people did not find themselves in such desperate circumstances that they have to sell their life's work to buy a loaf of bread. The Pareto criterion provides no purchase on this problem, implying that economics has no theory of distributive justice. [105]

A fourth criticism of law and economics is that it emphasises the desirability of giving effect to parties' choices or preferences without applying any ethical criteria to the value of those preferences. [106] We may consider that some choices are not worthy of recognition. For example, we may consider that choices should not be sanctioned where they would cause harm to other people. We may also consider that some people do not have the capacity to decide what is in their own best interests, such as children or persons who are mentally incapacitated. Only value judgments can tell us what limits should be imposed on individual autonomy.

99 Veljanovski, "The Economic Approach to Law: A Critical Introduction" (1980) 7 *British Journal of Law and Society* 158, 162.

100 Trebilcock, *The Limits of Freedom of Contract* (1993), p 19.

101 Trebilcock, *The Limits of Freedom of Contract* (1993), p 20.

102 See generally Trebilcock, *The Limits of Freedom of Contract* (1993).

103 Trebilcock, *The Limits of Freedom of Contract* (1993), p 20.

104 Trebilcock, *The Limits of Freedom of Contract* (1993), p 20. See also Duggan, *The Economics of Consumer Protection: A Critique of the Chicago School Case against Intervention* (1982), pp 98-100.

105 Trebilcock, "The Value and Limits of Law and Economics" in Richardson and Hadfield (eds), *The Second Wave of Law and Economics* (1999), p 20.

106 Trebilcock, *The Limits of Freedom of Contract* (1993), p 21.

Although economic analysis continues to play a dominant role in contract law literature in the United States, Eric Posner has judged economic analysis of contract law a failure in terms of explaining contract doctrine and in terms of generating ideal contract law rules. [107] Posner notes that, despite its dominance, economic analysis has had very little influence on US contract law. Simple economic models are unhelpful because they "exclude relevant variables", while complex models are unable to justify reform because "the optimal rule depends on empirical conditions that cannot be observed." [108] The literature is becoming increasingly sophisticated as more complex models are developed, but no more helpful for understanding or reforming contract law.

Some proponents of economic analysis of contract law have tried to respond to some of these criticisms of the economic approach. They have tried to adopt a less dogmatic approach to the economic analysis of contract law than that which is often associated with the neo-classical approach. Scholars such as Michael Trebilcock and Gillian Hadfield have tried to combine the rigour of an economic analysis, in particular its emphasis on assessing the consequences of legal rules, with the insights of other theoretical perspectives in order to enrich those provided by an economic analysis. [109]

Economic perspectives are considered in relation to estoppel in Chapter 9, implied terms in Chapter 14, contract remedies in Chapters 26, 27, 28 and 30 and vitiating factors in Chapters 31, 34 and 39.

CRITICAL LEGAL SCHOLARSHIP

[1.70] The Critical Legal Studies (CLS) movement has attempted to expose the ideology of contract law and the contradictions within contract doctrine. [110] CLS literature on contract law is extremely rich and diverse and draws on a number of different philosophical traditions. Broadly speaking, it involves a critique of legal formalism in contract law: the notion of contract law as a set of value-free, abstract rules that can be applied to any fact situation with predictable results. The CLS movement has sought to expose the way in which contract doctrine conceals the political choices made by judges. Contract law has been a central focus of the CLS movement, because it provides such a clear example of the formalist model and has an identifiable ideological agenda. That agenda is to support the existing economic and social order and to suppress communitarian values and collective interests. [111]

Drawing on the technique of deconstruction, some CLS writing on contract law has been concerned to expose the unquestioned assumptions and inconsistencies of contract law. [112] This begins with exposing the dualities that exist in contract law, the most important of which are: market versus community, individualism versus altruism, self versus other, form versus substance. Contract law is generally thought to favour the first of each of those poles: markets

107 Posner, "Economic Analysis of Contract Law after Three Decades: Success or Failure?" (2003) 112 *Yale Law Journal* 829.

108 Posner, "Economic Analysis of Contract Law after Three Decades: Success or Failure?" (2003) 112 *Yale Law Journal* 829, 854.

109 Trebilcock, *The Limits of Freedom of Contract* (1993); Hadfield, "The Second Wave of Law and Economics: Learning to Surf" in Richardson and Hadfield (eds), *The Second Wave of Law and Economics* (1999), p 50ff.

110 See Hillman, *The Richness of Contract Law* (1998), Ch 10.

111 See Feinman, "The Significance of Contract Theory" (1990) 58 *Cincinnati Law Review* 1283, 1308-13.

112 A good example of this is Dalton, "An Essay in the Deconstruction of Contract Doctrine" (1985) 94 *Yale Law Journal* 997.

over community, individualism over altruism, self over other and form over substance. It is clear that the disfavoured poles play a role in contract law, although there are different interpretations of what that role is. Jay Feinman argues that the dichotomies between the favoured and disfavoured poles make contract law incoherent, because it relies on contradictory principles and flips from one side to another. [113] Duncan Kennedy, on the other hand, argues that the occasional forays into altruism, substance and community values (through doctrines such as estoppel, unconscionable dealing and economic duress) preserve the existing structure by pre-empting more comprehensive reform. [114] Roberto Unger also argues that the less favoured poles are used to prop up the system. [115] He argues that they are given effect as vague slogans, such as unconscionability and good faith, which have a very limited impact on contract law. Unger also argues that the vagueness of contract doctrine is used to confine the disfavoured poles.

Given the broad range of approaches to contract law falling within the CLS movement, attempts to criticise the entire movement may be viewed as misguided. Nevertheless, general criticisms have been made. [116] Critical Legal Scholars have been criticised for their focus on appellate cases and legal doctrine, rather than empirical evidence concerning "the social 'impact' of law or the behaviour of legal actors". [117] Robert Hillman has argued that CLS writers overstate the indeterminacy of contract doctrine. Hillman argues that contract law is sufficiently determinate that the results of most cases can be predicted. [118] Moreover, he suggests that such incoherence or malleability as exists in contract law need not necessarily be used to preserve and legitimise the status quo, but could be exploited as a means of effecting social change. [119] John Murray has gone further, suggesting that the CLS movement is "irrelevant and counterproductive" to the task of refining and enhancing legal doctrine because CLS scholars eschew doctrine and fail to offer an "alternative design" other than "an ambiguous 'communitarian' notion of a vague utopia". [120]

Some critical perspectives on the formation of contracts are provided in Chapter 3. [121]

FEMINIST ANALYSIS OF CONTRACT LAW

[1.75] Feminist analyses of the law have often concentrated on areas of the law that raise issues of specific concern to women, such as parts of criminal law, employment law and family law. Some feminists have also considered areas of the law that do not deal specifically with women but clearly affect them, such as the law of contracts. While those analysing the law

113 Feinman, "Critical Approaches to Contract Law" (1983) 30 *UCLA Law Review* 829, 836.

114 Kennedy, "Form and Substance in Private Law Adjudication" (1976) 89 *Harvard Law Review* 1685.

115 Unger, "The Critical Legal Studies Movement" (1983) 96 *Harvard Law Review* 561.

116 For a defence of CLS writing on contract law against these criticisms, see Feinman, "The Significance of Contract Theory" (1990) 58 *Cincinnati Law Review* 1283, 1308-13.

117 Trubek, "Where the Action Is: Critical Legal Studies and Empiricism" (1984) 36 *Stanford Law Review* 575, 576.

118 Hillman, "The Crisis in Modern Contract Theory" (1988) 67 *Texas Law Review* 103, 107-10.

119 Hillman, "The Crisis in Modern Contract Theory" (1988) 67 *Texas Law Review* 103, 112.

120 Murray, "Contract Theories and the Rise of Neoformalism" (2002) 71 *Fordham Law Review* 869, 875. See also Fried, "The Ambitions of Contract as Promise" in Klass, Letsas and Saprai, *Philosophical Foundations of Contract Law* (2014), pp 17, 18-20.

121 At [3.140] and [3.150].

from a feminist perspective generally share a concern to reveal and redress inequalities between men and women, feminist analyses of contract law reflect a range of political and theoretical perspectives. [122]

Three approaches

[1.80] It is possible to identify three different feminist approaches to contract law based on ideas of identical treatment, difference and subordination. [123] The second and third approaches involve different, rather than opposing, types of inquiry and therefore overlap.

The identical treatment approach

[1.82] The identical treatment approach denies that there are any significant differences between women and men. Accordingly the approach "[c]alls for the elimination of legal or other distinctions between the sexes and promotes gender-neutral, strictly identical treatment of women and men". [124] The identical treatment approach has little to say about the modern law of contract, which generally does not purport to treat men and women differently.

The difference approach

[1.85] The difference approach is based on the idea that women are physically, socially, psychologically and politically different from men. [125] Substantive equality for women can only be achieved if the law takes those differences into account. [126] One version of the difference approach has been influenced by the work of Carol Gilligan. [127] Gilligan argues that, typically, men and women view life differently. Feminists influenced by Gilligan's work criticise the law as reflecting a masculine viewpoint and neglecting a feminine perspective. In relation to contract law, such feminists criticise the almost exclusive use of an abstract, rule-orientated and apparently neutral style of analysis. Feminists argue that this style of analysis relies on characteristics associated with the cultural stereotype of men. [128] A more contextualised approach to contract law would give voice to a "feminine" viewpoint. [129] Such a viewpoint might be subjective and context-specific. It might emphasise the role of values

122 See Mulcahy (ed), *Feminist Perspectives on Contract Law* (2005).

123 See Sheehy, Background Paper, "Personal Autonomy and the Criminal Law: Emerging Issues for Women", reproduced in Graycar and Morgan, *The Hidden Gender of Law* (1990), p 40.

124 Sheehy, Background Paper, "Personal Autonomy and the Criminal Law: Emerging Issues for Women", reproduced in Graycar and Morgan, *The Hidden Gender of Law* (1990), p 40.

125 Sheehy, Background Paper, "Personal Autonomy and the Criminal Law: Emerging Issues for Women", reproduced in Graycar and Morgan, *The Hidden Gender of Law* (1990), p 41.

126 Sheehy, Background Paper, "Personal Autonomy and the Criminal Law: Emerging Issues for Women", reproduced in Graycar and Morgan, *The Hidden Gender of Law* (1990), p 41.

127 See, eg, Gilligan, *In a Different Voice* (1982). See also Shaughnessy, "Gilligan's Travels" (1988) 7 *Law and Inequality Journal* 1, 9.

128 See, eg, Frug, "Re-Reading Contracts: A Feminist Analysis of Contracts Casebook" (1985) 34 *American University Law Review* 1065; Frug, "Rescuing Impossibility Doctrine: A Post-modern Feminist Analysis of Contract Law" (1992) 140 *University of Pennsylvania Law Review* 1029; Tilwell and Linzer, "The Flesh Coloured Band Aid" (1991) 28 *Houston Law Review* 791; Shultz, "The Gendered Curriculum: Of Contracts and Careers" (1991) 77 *Iowa Law Review* 55; Wightman, "Intimate Relationships, Relational Contract Theory, and the Reach of Contract" (2000) *Feminist Legal Studies* 93, 99-100.

129 Morgan, "Feminist Theory as Legal Theory" (1988) 16 *Melbourne University Law Review* 743, 756, discussing the work of Boyle, "Book Review" (1985) 63 *Canadian Bar Review* 427.

such as reliance, co-operation, respect for the other and compromise in contract law. [130] For some feminists applying a difference approach, relational contract theory [131] is seen as providing what they regard as a "feminine voice" in contract law. [132] This is because relational contract theory emphasises the importance of "relationships" in contract and the role of norms such as trust and co-operation. [133]

A closely related, and overlapping, approach comes from feminists influenced by postmodern literary theory. Postmodern feminism is also closely associated with the CLS movement. Some postmodern feminists focus on the dichotomies in legal discourse. [134] These scholars then explore the ways in which the dichotomies in legal discourse mirror cultural stereotypes of women and men. [135] Mary Joe Frug explains that through this process "[p]ostmodern feminists attempt to overcome the male/female opposition by accepting it and at the same time disrupting it". [136]

The difference approach might be criticised as perpetuating undesirable stereotypes about masculine and feminine characteristics. [137] Proponents might respond that by drawing attention to the gender implications of contract law doctrine and analysis, they are mounting a radical challenge to legal thought. Indeed if, as these feminists argue, contract law is premised on a masculine viewpoint, then gender reform may not merely be a case of introducing a feminine voice. Rather the entire legal system might have to be rethought. Alternatively, we might need to recognise that certain values remain outside the law. [138]

The subordination approach

[1.90] The subordination approach is associated with the work of Catherine MacKinnon. [139] This approach sees women's inequality in terms of subordination to men, rather than differences between women and men. Scholars adopting this approach evaluate particular legal practices and policies in order to "assess whether they operate to maintain women in a subordinate position". [140] If those policies and practices are justified on the basis of differences

130 See, eg, Tilwell and Linzer, "The Flesh Coloured Band Aid" (1991) 28 *Houston Law Review* 791.

131 See [1.100]-[1.170].

132 See, eg, Threedy, "Feminists and Contract Doctrine" (1999) 32 *Indiana Law Review* 1247, 1258; Tilwell and Linzer, "The Flesh Coloured Band Aid" (1991) 28 *Houston Law Review* 791; Wightman, "Intimate Relationships, Relational Contract Theory, and the Reach of Contract" (2000) *Feminist Legal Studies* 93, 100. But cf Dow, "Law School Feminist Chic and Respect for Persons: Comments on Contract Theory and Feminism in the Flesh Coloured Band Aid" (1991) 28 *Houston Law Review* 819.

133 See Mulcahy, "The Limitations of Love and Altruism" in Mulcahy (ed), *Feminist Perspectives on Contract Law* (2005), p 1.

134 See [1.70].

135 Frug, "Rescuing Impossibility Doctrine: A Post-modern Feminist Analysis of Contract Law" (1992) 140 *University of Pennsylvania Law Review* 1029, 1031.

136 Frug, "Rescuing Impossibility Doctrine: A Post-modern Feminist Analysis of Contract Law" (1992) 140 *University of Pennsylvania Law Review* 1029, 1064.

137 See Otto, "A Barren Future? Equity's Conscience and Women's Inequality" (1992) 18 *Melbourne University Law Review* 808, 812.

138 See Shaughnessy, "Gilligan's Travels" (1988) 7 *Law and Inequality Journal* 1.

139 See, eg, MacKinnon, *Feminism Unmodified* (1987).

140 Sheehy, Background Paper, "Personal Autonomy and the Criminal Law: Emerging Issues for Women", reproduced in Graycar and Morgan, *The Hidden Gender of Law* (1990), p 42.

between men and women, "then the differences themselves must also be examined to ascertain whether they are consequences of social or economic oppression". [141]

Applied to contract law, the subordination approach suggests that the gender of the parties, and consequentially the power relation between them, must be taken into account in resolving contractual disputes. [142] The subordination approach makes high demands of the law in resolving disputes. It requires the law to go beyond formal legal principles to examine the reality of the power relations between the parties involved. This approach offers a radical re-envisioning of the role and function of contract law.

Feminist approaches and the "wives" special equity

[1.95] These three feminist approaches can be illustrated by considering the decision in *Garcia v National Australia Bank Ltd*. [143] In that case the High Court of Australia recognised the continued existence of a special principle protecting women who guarantee their husbands' business loans, where the woman has either been subject to undue influence by her husband or has misunderstood the effect of the guarantee. [144]

A proponent of the identical treatment approach might argue that maintaining a special equity or principle applying to wives perpetuates undesirable sexual stereotypes of women as incapable of making financial decisions or protecting their own interests. Thus, for example, Kirby J said in *Garcia*:

> For this court to accept that principle is to accord legitimacy to a discriminatory rule expressed in terms which are unduly narrow, historically and socially out of date and unfairly discriminatory against those who may be more needful of the protection of a "special equity" but who do not fit within the category of married women. [145]

Proponents of both the difference and the subordination approaches might argue that an approach based on formal equality would ignore the very real social differences between men and women. Proponents might argue that women do not always exercise independent judgment in deciding to guarantee their husbands' business loans. [146] Thus, in *Garcia* the High Court said:

> That Australian society and particularly the role of women in that society has changed in the last six decades is undoubted. But some things are unchanged. There is still a significant number of women in Australia in relationships which are, for many and varied reasons, marked by disparities of economic and other power between the parties. [147]

Given this social reality, Richard Haigh and Samantha Hepburn argue that the *Garcia* principle is desirable even though it relies on a stereotype because it operates to protect a

141 Sheehy, Background Paper, "Personal Autonomy and the Criminal Law: Emerging Issues for Women", reproduced in Graycar and Morgan, *The Hidden Gender of Law* (1990), p 42.

142 Frug, "A Critical Theory of Law" (1989) 1 *Legal Education Review* 43, 56.

143 [1998] HCA 48; (1998) 194 CLR 395.

144 The decision is discussed further in Chapter 37.

145 *Garcia v National Australia Bank Ltd* [1998] HCA 48; (1998) 194 CLR 395, 425.

146 We might also note that, although numerous cases have come before the courts on this issue, there is little statistical information on the extent of the problem: see Haigh and Hepburn, "The Bank Manager Always Rings Twice: Stereotyping in Equity after Garcia" (2000) 26 *Monash University Law Review* 275, 303-4.

147 *Garcia v National Australia Bank Ltd* [1998] HCA 48; (1998) 194 CLR 395, 403-4.

vulnerable group in society.[148] They explain that the "type of analysis required in *Garcia* relies on stereotypes not to cement prejudice in place, but to critically reassess the nature of spousal guarantees and thereby balance gender ideals with practical realities".[149]

A proponent of the difference approach might argue that the special protective principle in *Garcia* is justified because, in deciding to guarantee their husbands' business borrowings, women are often influenced by factors other than their own economic interests. Wives are sometimes subjected to pressure by their husbands. Even in the absence of pressure, wives may be influenced by the bonds of relationship, trust and reliance. Proponents of the difference approach might argue that legal protection is needed to ensure that the trust and reliance shown by wives is not abused or exploited. This view is reflected in the reasoning of the majority judges in *Garcia*. Their Honours explained that the rationale of the principle "is not to be found in notions based on the subservient or inferior economic position of women. Nor is it based on their vulnerability to exploitation because of their emotional involvement".[150] Instead, the majority judges said, the principle "is based on trust and confidence, in the ordinary sense of those words, between marriage partners".[151]

Proponents of the subordination approach, while not disagreeing with the special protection accorded to wives by the decision in *Garcia*, might focus on the disparities of power that may exist between husband and wife. It might be said that, because of the subordinated position of many married women, a woman's guarantee of her husband's debts cannot be presumed to have been given freely. It might be argued that the law should go beyond merely recognising the vulnerability of wives guaranteeing their husbands' debts, and should strive to address that vulnerability. Thus Dianne Otto argues that if the principle applied in *Garcia*:

> is applied paternalistically so as to protect the wife/woman because of her subordinate position, the [principle] does nothing to change her position of inequality. In effect, it operates to institutionalise her subordination by presuming that protection is necessary. On the other hand, if the [principle] arises from an acknowledgement of the socio-structural origins of women's inequality, and the legal response is directed towards altering the distribution of power that creates the relationship of influence, some broader social change may result.[152]

The *Garcia* decision treats the provision of independent advice as a panacea for some of the problems faced by women guaranteeing their husbands' debts. Proponents of the subordination approach might argue that providing independent advice is not a solution where the woman's consent to the guarantee is a result of her subordination to her husband.[153] Accordingly, measures with deeper implications for the power relationship might be required. Otto suggests that a legal response directed to altering the distribution of power might, for example, be achieved by requiring husbands (seeking to borrow on the strength of guarantees given by

148 Haigh and Hepburn, "The Bank Manager Always Rings Twice: Stereotyping in Equity After Garcia" (2000) 26 *Monash University Law Review* 275, 127.

149 Haigh and Hepburn, "The Bank Manager Always Rings Twice: Stereotyping in Equity After Garcia" (2000) 26 *Monash University Law Review* 275, 302.

150 *Garcia v National Australia Bank Ltd* [1998] HCA 48; (1998) 194 CLR 395, 404.

151 *Garcia v National Australia Bank Ltd* [1998] HCA 48; (1998) 194 CLR 395, 404.

152 Otto, "A Barren Future? Equity's Conscience and Women's Inequality" (1992) 18 *Melbourne University Law Review* 808, 820.

153 Otto, "A Barren Future? Equity's Conscience and Women's Inequality" (1992) 18 *Melbourne University Law Review* 808, 826.

their wives) "to show that they have taken tangible steps to alter their position of social dominance in the relationships in question". [154]

Feminist perspectives are further considered in relation to terms in standard form contracts in Chapter 12 and in relation to third party impropriety in Chapter 37.

CONTRACT AS SOCIAL RELATION

[1.100] Contract can also be seen as a social relationship between transacting parties, which is an inseparable part of a much broader web of social relations. A major criticism of classical contract theory and neo-classical economic theory is that they both assume that each contract involves a discrete, one-off exchange. Empirical study has shown that this does not always reflect the way in which people do business, and this has led to a substantial movement that focuses on the social relations between contracting parties. This approach is sometimes described as *relational contract theory*.

Empirical studies

[1.105] Interest in the relational aspect of contract began with a groundbreaking empirical study by Stewart Macaulay in the 1960s, which revealed that in certain contexts some business people pay little regard to the law of contract when they enter into business transactions, make adjustments and resolve disputes. [155] Instead of looking at the role of contract law in the courtroom, Macaulay looked at the role of contract law in business practices and the extent to which business people actually *used* contract law. Macaulay focused on the manufacturing sector in Wisconsin. His approach was to interview a large number of business people and lawyers employed by manufacturing companies and to consider the extent to which principles of contract law shaped planning, adjustment and dispute resolution amongst those involved in the industry.

Planning

[1.110] The principles of contract law are based on the assumption that contracting parties carefully plan their relationships. Lawyers and judges assume that the parties will make provision for as many future contingencies as can be foreseen. [156] Many transactions are indeed planned very carefully. Large one-off transactions tend to be extensively planned, and most companies engage in standardised planning through the use of standard forms. [157] Macaulay found, however, that parties often failed to detail their obligations properly. Expensive machinery, for example, was often ordered without agreement on performance specifications. Macaulay noted that business people often preferred to rely on a person's word or handshake, or "common honesty and decency", even when a transaction involves exposure

154 Otto, "A Barren Future? Equity's Conscience and Women's Inequality" (1992) 18 *Melbourne University Law Review* 808, 820.

155 Macaulay, "Non-Contractual Relations in Business: A Preliminary Study" (1963) 28 *American Sociological Review* 55.

156 Macaulay, "An Empirical View of Contract" [1985] *Wisconsin Law Review* 465.

157 Macaulay, "Non-Contractual Relations in Business: A Preliminary Study" (1963) 28 *American Sociological Review* 55, 57-8.

to serious risks. [158] The desire was to keep transactions simple and avoid red tape. In most cases, buyers and sellers were simply concerned to ensure that there was agreement on the basics (quantity, specifications and price) and did not care about the "boilerplate" on the back of the forms.

Adjustment

[1.115] Exchanges are adjusted when the parties agree to modify or cancel a transaction because of changed circumstances. [159] A buyer may, for example, be allowed to cancel an order for goods because they are no longer needed, or a seller may be paid more than the contract price because of an unexpected rise in the cost of inputs. Macaulay found that all purchasing agents expected to be able to cancel orders, subject only to paying for major wasted expenditure, even though sellers would be legally entitled to more extensive compensation, including lost profits. [160] He found that sellers routinely accepted cancellations even though the buyer had no legally recognised excuse. One sales representative for a paper company said "[y]ou can't ask a man to eat paper when he has no use for it". [161]

Settlement of disputes

[1.120] Macaulay's findings in relation to the settlement of disputes are perhaps the least surprising aspects of his study. Given the high cost of litigation, it is no surprise that businesspeople find other ways to resolve disputes. What is perhaps surprising is that most disputes were solved without any reference to the agreement or the parties' legal rights. [162] Macaulay found that the threat of legal sanctions ranked very low on the scale of reasons for keeping contractual promises. [163] Contractual obligations were kept in order to maintain personal relationships, business relationships and reputation in the industry. Litigation was most common *after* a relationship had been terminated or because of termination of a relationship (such as the termination of a dealer's franchise). There was then no relationship to preserve.

Conclusions and implications

[1.125] Macaulay's most important findings have been confirmed by other researchers. Other studies have shown that while large sales transactions tend to be carefully negotiated and documented, [164] businesspeople in some contexts are "neither aware of nor significantly

158 Macaulay, "Non-Contractual Relations in Business: A Preliminary Study" (1963) 28 *American Sociological Review* 55, 58.

159 See further [4.65]-[4.105].

160 Macaulay, "Non-Contractual Relations in Business: A Preliminary Study" (1963) 28 *American Sociological Review* 55, 61.

161 Macaulay, "Non-Contractual Relations in Business: A Preliminary Study" (1963) 28 *American Sociological Review* 55, 61.

162 Macaulay, "Non-Contractual Relations in Business: A Preliminary Study" (1963) 28 *American Sociological Review* 55, 61.

163 See further Charny, "Nonlegal Sanctions in Commercial Relationships" (1990) 104 *Harvard Law Review* 373.

164 Beale and Dugdale, "Contracts Between Businessmen: Planning and the Use of Contractual Remedies" (1975) 2 *British Journal of Law and Society* 45, 50; Keating, "Exploring the Battle of the Forms in Action" (2000) 98 *Michigan Law Review* 2678, 2697-8.

influenced by" relevant principles of contract law. [165] Buyers and sellers are willing to adjust contract prices and modify contractual obligations in a range of circumstances. [166] It is important to note, however, that these conclusions are based on only a few small-scale studies that have focused on practices in particular industries in particular locations. We need to be cautious about drawing general conclusions. [167] If the behaviour of contracting parties in other areas of commercial life was examined, a different picture might well emerge. Corporations supplying goods and services to consumers, for example, tend to engage in careful standardised planning through the use of standard forms [168] and may be more likely to rely on contract terms in resolving disputes. [169] If one looked at commercial banking one would also be likely to find an extremely high degree of planning (extensive articulation of the parties' obligations and provision for a wide range of future contingencies), heavy reliance on the existence of legal sanctions and frequent use of legal sanctions. Even when legal sanctions are not commonly used, they may play an important role in deterring breach and providing some assurance of performance. [170] Nevertheless, the studies by Macaulay and others in a similar vein offer two important insights. First, they draw our attention to the fact that trust and social relationships play a significant role in some contractual relations. Secondly, they show that contractual rights and obligations are not always the most important factors influencing business people planning transactions, adjusting agreements and resolving disputes.

Relational contract theory

[1.130] The empirical studies discussed at [1.05]-[1.125] suggest that parties to commercial contracts are not necessarily the hard-bargaining individuals engaged in well-planned, discrete transactions that classical contract theory and neo-classical economics may lead us to believe. Parties to commercial contracts are often engaged in long-term relationships with one another, or as part of a close-knit industry, and that has a significant impact on the way in which they deal with one another. These empirical insights have given rise to a new way of looking at contracts. Rather than viewing contracts as discrete exchanges between utility-maximising individuals, relational contract theory views contract as a more complex social interaction. Macaulay identified the need to view contracts in a different way, which took into account the relations between the parties. Ian Macneil and others have explored what it meant to look at contract from a relational perspective. [171]

165 Schultz, "The Firm Offer Puzzle: A Study of Business Practice in the Construction Industry" (1952) 19 *University of Chicago Law Review* 237, 283. See also Keating, "Measuring Sales Law Against Sales Practice: A Reality Check" (1997) 17 *Journal of Law and Commerce* 99; Keating, "Exploring the Battle of the Forms in Action" (2000) 98 *Michigan Law Review* 2678; Beale and Dugdale, "Contracts Between Businessmen: Planning and the Use of Contractual Remedies" (1975) 2 *British Journal of Law and Society* 45.

166 Weintraub, "A Survey of Contract Practice and Policy" [1992] *Wisconsin Law Review* 1, 18-24.

167 See Korobkin, "Empirical Scholarship in Contract Law: Possibilities and Pitfalls" [2002] *University of Illinois Law Review* 1033, 1051-6; Hillman, *The Richness of Contract Law* (1998), pp 244-55.

168 Hillman, *The Richness of Contract Law* (1998), p 247.

169 Whitford, "Law and the Consumer Transaction: A Case Study of the Automobile Warranty" [1968] *Wisconsin Law Review* 1006.

170 Weintraub, "A Survey of Contract Practice and Policy" [1992] *Wisconsin Law Review* 1, 24-6.

171 Macneil's principal works on relational contract theory are: "The Many Futures of Contracts" (1974) 47 *Southern California Law Review* 691; "Contracts: Adjustment of Long-term Economic Relations under Classical, Neo-classical and Relational Contract Law" (1978) 72 *Northwestern University Law Review* 854; *The*

The discrete-relational spectrum

[1.135] Relational analysis of contracts is based on the recognition of the fact that contractual relations are conducted within a social matrix. Exchange is only possible within a society that provides: first, a means of communication (so the parties can understand one another); secondly, a system of order (so that the parties use exchange rather than force to get what they want); thirdly, a payment mechanism; and, fourthly, where some performance is to take place in the future, a mechanism for the enforcement of promises. [172] Since a contract can only be made against such a social background, all contracts are *relational*, in that they involve social relations and are embedded in a much broader social web. However, some contracts are more relational than others in that they are more deeply embedded in social relations. Macneil has suggested that there exists a spectrum of contractual behaviour, with highly relational contracts at one end and highly discrete transactions at the other.

The relational end of the spectrum

[1.140] A highly relational contract is one in which social relations play a significant role. This may be because performance of the contract is closely integrated with the parties' other activities, because the parties are relying heavily on social conventions or because the parties are involved in a long-term relationship. In a highly relational contract the parties are less likely to be able to predict and deal with future contingencies. The more relational the exchange, the less the parties will plan the substance of the exchange and allocate risks. In these transactions more flexibility will be required during the course of the relationship. Rather than setting out in detail their rights and obligations in relation to possible future eventualities, the parties to a highly relational contract are more likely to "plan structures and processes to govern the relation in the future". [173] Macneil notes that highly relational agreements that "contain a great deal of process planning" include collective bargaining agreements, corporate constitutions, government contracts and standardised construction contracts. [174]

Social relations may play a significant role in an exchange because the parties expect each other to behave in accordance with social customs and conventions which define their respective roles. [175] The role of medical practitioners, for example, is defined by social convention. A patient consulting a doctor about a particular medical problem would find it very difficult to spell out in advance the doctor's obligations in respect of diagnosis, treatment

New Social Contract (1980); "Economic Analysis of Contractual Relations: Its Shortfalls and the Need for a Rich Classificatory Apparatus" (1981) 75 *Northwestern University Law Review* 1018; "Efficient Breach of Contract: Circles in the Sky" (1982) 68 *Virginia Law Review* 947; "Values in Contract: Internal and External" (1983) 78 *Northwestern University Law Review* 340; "Relational Contract: What We Do and Do Not Know" [1985] *Wisconsin Law Review* 483; "Relational Contract Theory: Challenges and Queries" (2000) 94 *Northwestern University Law Review* 877. See also Campbell (ed), *The Relational Theory of Contract: Selected Works of Ian Macneil* (2001) and Campbell, Mulcahy and Wheeler, *Changing Conceptions of Contract: Essays in Honour of Ian Macneil* (2013).

172 Macneil, *The New Social Contract* (1980), p 11; Macneil, "Values in Contract: Internal and External" (1983) 78 *Northwestern University Law Review* 340, 344; Macneil, "Relational Contract Theory: Challenges and Theories" (2000) 94 *Northwestern University Law Review* 877, 884.

173 Gudel, "Relational Contract Theory and the Concept of Exchange" (1998) 46 *Buffalo Law Review* 763, 765. See Macneil, "The Many Futures of Contracts" (1974) 47 *Southern California Law Review* 691, 761-7.

174 Macneil, "The Many Futures of Contracts" (1974) 47 *Southern California Law Review* 691, 760.

175 Macneil calls this relational norm "role integrity"; see *The New Social Contract* (1980), pp 40-4, 65-6.

and referral. Instead of attempting to define the doctor's obligations in advance, the patient relies on the doctor to operate within and fulfil the doctor's socially understood role.

Social relations may also be important because the contract involves performance over a long period of time. Parties to a long-term contract, such as a contract of employment, must be flexible and co-operative in order to preserve the relationship. What the employer and employee expect of one another will inevitably change over the course of the relationship, and the parties embark on the relationship on the understanding that they will adapt to change. The parties cannot plan the entire future of the relationship, but trust and rely on each other to deal with contingencies as they arise. These relational features are evident in the planning and adjustment of contracts between manufacturers and suppliers studied by Macaulay. Instead of planning for various contingencies at the outset, the parties deal with problems as they arise by adjusting their obligations and granting concessions in relation to time of performance or price. It may even be expected that one party will release the other from his or her contractual obligations altogether in order to preserve the broader relationship between the parties or one party's reputation within the industry.

The discrete end of the spectrum

[1.145] At the discrete end of the relational spectrum are transactions that are more isolated from the social context in which they are made. A relatively discrete transaction does not involve any significant co-ordination between performance of the contract and the parties' other activities, requires less flexibility and co-operation between the parties and does not draw so heavily on social conventions or understandings. A one-off exchange will usually be relatively discrete, but this will not always be the case. A single visit to a medical practitioner is likely to be highly relational, for the reasons discussed earlier in this chapter, even if the patient has not seen the doctor before and never does again.

Macneil's example of a highly discrete transaction is a motorist making a cash purchase of petrol at a service station on a highway on which the motorist rarely travels. This transaction involves the simultaneous (or almost simultaneous) exchange of goods and money, and does not involve any ongoing obligations. [176] Even this transaction is deeply embedded in a broad and complex social web consisting of such things as social conventions regarding behaviour, brand loyalty (possibly involving loyalty reward schemes) and credit card or electronic payment mechanisms. [177]

An executory contract is one in which the obligations of the parties are to be performed at some time in the future. An executory contract may be relatively discrete, even if performance is to take place over a long period. In a discrete transaction, however, the parties are more likely to rely on specific planning than co-operation or flexibility to deal with future contingencies. An executory contract involves the creation in the present of an obligation to perform an act in the future. Macneil uses the word "presentiation" to describe the process of treating the future as though it were the present. Presentiation in contract involves the parties attempting to anticipate every possible contingency which may affect the parties' performances and providing exhaustively for the consequences. You will recall that Macaulay regarded this sort of planning as "contractual" behaviour.

176 Macneil, "The Many Futures of Contracts" (1974) 47 *Southern California Law Review* 691, 720-1.

177 Macneil, "Values in Contract: Internal and External" (1983) 78 *Northwestern University Law Review* 340, 344-5.

Contract law is premised on the assumption that parties will undertake this exercise when entering into a contract. The concept of converting the future into the present is fundamental to contract law. The assurance that the law will enforce executory promises (or promises to confer benefits in the future) allows future rights to be given a present value for the purposes of trade and credit. Elaborate planning makes a contract more discrete because it separates the transaction from the social relations between the contracting parties.

The importance of relational contracts

[1.150] Macneil argues that the needs of "a technologically complex and heavily capitalized society" cannot be satisfied by discrete transactions alone. [178] While some goods and services can be exchanged through relatively discrete transactions, greater flexibility is required for more complex forms of production and distribution. [179] An enterprise that cannot be completely planned from the beginning must have the capacity for "growth and change" that is provided by more relational arrangements. [180] This may explain why Macaulay found the manufacturing sector to use relational rather than "contractual" exchanges. Macneil illustrates the point by reference to the sale of wheat in the "heyday of laissez faire" in the 19th century. A sale of wheat may itself have been discrete, but there was a complex web of relationships involved in its production, including family farming partnerships, harvesting teams, milling and storage co-operatives, haulage and railroad companies and baking partnerships or companies. Each of those entities had a complex internal structure and relied on its own network of relationships, including those with financiers and employees. [181]

Consequences for contract law

[1.155] The next question is: what are the implications for contract law of these relational insights? Macneil has stressed that his work is principally concerned with analysing the role of social relations in exchange transactions, rather than offering prescriptions for contract law. [182] The relational perspective does, however, suggest a deficiency in the classical approach to contract law. As we discussed earlier, classical contract law is based on the idea that parties enter into discrete exchanges, negotiate their rights and obligations fully and make provision for most of the likely contingencies in an agreement concluded at an identifiable point in time. Consequently, Gudel observes: "Contract law was and is relatively well adapted to dealing with discrete transactions. However, it was and is ill-equipped to deal with problems arising out of contract relations." [183] Macneil has observed that "transactional contract doctrines", such as the rules of offer and acceptance, are unsuited to exchanges that are not fully presentiated. He has suggested that it is possible to articulate "precise, intellectually coherent

178 Macneil, "The Many Futures of Contract" (1974) *Southern California Law Review* 691, 758-66.

179 Gudel, "Relational Contract Theory and the Concept of Exchange" (1998) 46 *Buffalo Law Review* 763, 765.

180 Macneil, "The Many Futures of Contract" (1974) 47 *Southern California Law Review* 691, 765-6.

181 Macneil, "Relational Contract: What We Do and Do Not Know" [1985] *Wisconsin Law Review* 483, 490-1.

182 See, eg, Macneil, "Relational Contract Theory: Challenges and Theories" (2000) 94 *Northwestern University Law Review* 877, 898-9.

183 Gudel, "Relational Contract Theory and the Concept of Exchange" (1998) 46 *Buffalo Law Review* 763, 766.

principles" which are "sufficiently open textured for effective use in the law of modern contractual relations" [184] and that these legal rules should track relational behaviour and relational norms. [185]

Catherine Mitchell has argued in a recent book that relational theory justifies a stronger focus on the commercial expectations of contracting parties than English law currently allows, and less deference to contractual documents. [186] Mitchell advocates moving beyond the contextual interpretation of contractual agreements to a "fully contextual approach" to resolving commercial contract disputes. Such an approach would not begin with contractual documents but with "other aspects of the contractual relationship" which "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." [187] In another recent book, *Contract Law Minimalism*, Jonathan Morgan draws something close to the opposite conclusion. [188] Morgan argues that the relational perspective supports his argument that contract law should consist of minimalist, bright-line rules which can be easily understood by commercial parties and modified where necessary. Morgan's primary argument against more flexible, context-sensitive rules is that the courts lack the capacity to regulate effectively for trust and cooperation so it is better for the law to provide a set of simple, clear and unambitious optional rules which the parties can modify by express contractual provision.

The basis of contract

[1.160] Relational contract theory also has implications for unitary theories of contract law, such as promise and consent theory. [189] Relational theory contests the idea that promise is at the heart of contract. In more relational exchanges, since the parties do not plan in a comprehensive way, their promises are likely to be incomplete and so their association will be governed by relational norms. [190] Those relational norms include co-operation, compromise, flexibility and contractual solidarity. [191] A focus on promise as the basis of contract prevents us from understanding the nature of contract because it distracts attention from the important social context in which promises and express commitments are made.

Formation and contractual obligations

[1.165] For relational theorists, the classical notion of formation appears misconceived because it is based on the idea of an identifiable moment of contract formation at which the parties reach a "meeting of the minds". At the moment of formation, the contract is supposed

184 Macneil, "Reflections on Relational Contract" (1985) in Campbell (ed), *The Relational Theory of Contract: Selected Works of Ian Macneil* (2001), p 295.

185 Macneil, "Relational Contract Theory: Challenges and Queries" (2000) 94 *Northwestern University Law Review* 877, 903. For an example of how this might be done, see Lees, "Contract, Conscience, Communitarian Conspiracies and Confucius: Normativism through the Looking Glass of Relational Contract Theory" (2001) 25 *Melbourne University Law Review* 82.

186 Mitchell, *Contract Law and Contract Practice: Bridging the Gap Between Legal Reasoning and Commercial Expectation* (2013).

187 Mitchell, *Contract Law and Contract Practice* (2013), p 11.

188 Morgan, *Contract Law Minimalism: A Formalist Restatement of Commercial Contract Law* (2013).

189 Gudel, "Relational Contract Theory and the Concept of Exchange" (1998) 46 *Buffalo Law Review* 763, esp at 769-86. For a defence of consent theory, see Barnett, "Conflicting Visions: A Critique of Ian Macneil's Relational Theory of Contract" (1992) 78 *Virginia Law Review* 1175.

190 Hillman, "The Crisis in Modern Contract Theory" (1988) 67 *Texas Law Review* 103, 124.

191 Macneil, "Values in Contract: Internal and External" (1983) 78 *Northwestern University Law Review* 340, 347.

to spring into existence, with the parties having agreed on all of their rights and obligations into the future. Both classical and contemporary contract law persistently try "to locate the entire content of the parties' agreement, and thus the entire source of their obligation to one another, in an initial moment of agreement". [192] From a relational perspective, reaching agreement on contract terms can be seen as an "incremental process" in which the parties "gather increasing information and gradually agree to more and more as they proceed". [193] Relational contract theory suggests that, when committing to an exchange relationship, contracting parties "cannot specify all of the obligations and responsibilities that relation will entail". [194] Contracting parties make commitments that were not the subject of explicit promises at the time of formation. They commit themselves to doing what is necessary to "maintain the health" of the relationship and implicitly agree that the timing, manner, motivation and process of termination will be consistent with relational norms of behaviour. [195]

Two recent trends in Australian contract law may be said to reflect relational ideas. [196] First, as we will see in Chapter 3, Australian courts are increasingly willing to accept that a contract can be formed when agreement can be inferred from the conduct of the parties, even though a clear offer and acceptance cannot be identified. [197] In *Integrated Computer Services Pty Ltd v Digital Equipment Corporation (Australia) Pty Ltd* [198] the New South Wales Court of Appeal accepted that the classical requirement of offer and acceptance was unsuited to contemporary commercial arrangements and that it may not be possible to identify all of the parties' rights and obligations by reference to the moment of formation. Referring specifically to empirical evidence as to the flexibility that is necessary to maintain ongoing business relationships, McHugh JA said:

> [I]n an ongoing relationship, it is not always easy to point to the precise moment when the legal criteria of a contract have been fulfilled … In a dynamic commercial relationship new terms will be added or will supersede older terms. It is necessary therefore to look at the whole relationship and not only at what was said and done when the relationship was first formed. [199]

A second relational trend in Australian law is the willingness of courts to recognise that contracting parties owe one another a duty to act in good faith when exercising contractual rights. In some cases contracting parties have been held to owe an implied duty to act in good faith when exercising a power to terminate a contract. [200] In such cases the courts look beyond the express promises made at the time of formation and require the parties to conform to

192 Gudel, "Relational Contract Theory and the Concept of Exchange" (1998) 46 *Buffalo Law Review* 763, 757.

193 Macneil, "Economic Analysis of Contractual Relations: Its Shortfalls and the Need for a "Rich Classificatory Apparatus"" (1981) 75 *Northwestern University Law Review* 1018, 1041. See also Macneil, "The Many Futures of Contract" (1974) 47 *Southern California Law Review* 691, 751.

194 Gudel, "Relational Contract Theory and the Concept of Exchange" (1998) 46 *Buffalo Law Review* 763, 786.

195 Gudel, "Relational Contract Theory and the Concept of Exchange" (1998) 46 *Buffalo Law Review* 763, 786. For a full explanation of relational norms, see Macneil, "Values in Contract: Internal and External" (1983) 78 *Northwestern University Law Review* 340.

196 Hillman, *The Richness of Contract Law* (1998), pp 262-3 notes that US law meets relational needs in the same way.

197 See [3.145].

198 (1988) 5 BPR 11,110.

199 *Integrated Computer Services Pty Ltd v Digital Equipment Corporation (Australia) Pty Ltd* (1988) 5 BPR 11,110, 11,117-11,118.

200 See Chapter 14.