Chapter 1

Contract and market

A. Regulating markets

The law of contract states the fundamental legal rules governing market transactions. In most societies markets serve as the principal mechanism for the production and distribution of wealth. This part of the law reveals some of the basic organising principles of their economic arrangements. It describes the elementary regulation of such key economic institutions as sale of goods, employment relations, arrangements for credit, and the provision of professional services. Individuals enter these market transactions for a variety of motives. The law of contract supports these practices by making transactions legally enforceable, but at the same time it places restraints on conduct, shapes the types of obligations which can be created, and limits the extent to which the parties may enforce their agreement by means of self-help or coercion from legal institutions.

A study of the legal regulation of the market system as a whole would require an examination of every branch of private law and other aspects of state regulation of the economy. Such an investigation would encompass the law of private ownership of property and the rules of tort law which require the observance of obligations to respect the economic and personal interests of others. Although no sharp distinction can be drawn, the law of contract focuses on the practices of entering transactions or exchanges, and of making binding commitments with respect to future economic behaviour. But this focus covers an enormous variety of market practices, ranging from consumer purchases in shops to international business transactions, or from the supply of a professional service to a major construction project.

These market practices may be examined from a variety of perspectives. An economic perspective analyses how transactions create wealth. A sociological

perspective examines the patterns of behaviour of the parties to market transactions. A moral perspective might evaluate the conduct of the parties and the justice of the economic system. The legal perspective, like the others, serves to organise and rationalize our understanding of events. The objective of legal analysis differs, however, for its purpose lies ultimately in a determination of how these market practices should be governed by state regulation. The law of contract contains a set of legal concepts which are employed simultaneously to analyse the events of economic transactions and then to regulate the conduct of the parties.

Although the legal analysis of market transactions is distinct, it must be informed by the other perspectives. In order to achieve effective regulation, the law must take into account the likely response to its rules. It must also beware of regulation which damages the prospects of the market system for the production of wealth. For these reasons the legal analysis must be guided by sociological and economic perspectives. But this endeavour proves difficult, for each perspective tends to operate within its own closed system of analysis and evaluation. The concepts used in the legal analysis of contracts do not embrace economic or sociological ideas, so that the significance and effects of legal regulation cannot be immediately comprehended. The law of contract, therefore, constantly runs the risk of what Teubner calls 'the regulatory trilemma': either the legal rules may fail to have an impact on social practice, or they may subvert the desirable social practices by impractical demands, or the law may lose the coherence of its own analytical framework by seeking to incorporate sociological and economic perspectives in its reasoning.[1]

The legal analysis of market transactions may only represent a partial perspective, but it holds great interest because it displays the detailed ramifications of ideological debates within a society. Since the law can rely in the last resort upon a legitimate claim to the monopoly of violence in order to insist upon behaviour according to its vision, it becomes a principal site of disputes about the justice of the market order. The law's link to state power requires that its doctrines conform to shifts in the claims for legitimacy on which effective state power rests.

The legal analysis of market transactions holds particular interest, of course, for practising lawyers, who may be brought in to advise businesses on how best to organise their transactions. Lawyers devise contractual arrangements which give their clients the maximum legal advantage. This practice establishes a recursive process under which the courts and legislature observe how lawyers have reformulated contracts to escape legal restrictions on the pursuit of their clients' interests, and then seek to re-regulate contractual practices in order to restore the original policy decision. Lawyers also try to formulate standardised contracts that can be used over and over again. These standard form contracts preserve the

1 Teubner, 'After Legal Instrumentalism? Strategic Models of Post-Regulatory Law', in G Teubner (ed), *Dilemmas of Law in the Welfare State* (New York/Berlin, 1988) 299, at p 309.

wisdom of the firm of lawyers about the best way in which to handle recurrent problems of negotiation and performance. In the context of mass production of goods and services, this use of standard forms gives rise to the most significant new phenomenon in the practice of making contracts in the twentieth century: the application of mass contracts to consumer transactions. Lawyers devise a printed contract which businesses try to use in all their dealings with customers. With respect to consumers, businesses offer these standard form contracts on a take-it-or-leave-it basis, which has earned them the sobriquet of 'adhesion contracts'. One of the major challenges for legal regulation of markets during the twentieth century has been the requirement to restrict the advantages which businesses can obtain against consumers by deploying standard form contracts. This regulation has reached the stage where in simple retail sales there remains little or no scope for manipulating legal rights through the written contract, so in this context the standard form may gradually fall into disuse.[2]

The legal concept of contract law constantly evolves by expanding or contracting its scope, further differentiating its rules, and revising its basic principles. This evolution is prompted by changes in the social practices of the economy, the reception of new social policies and political ideals, and interactions with other fields of law. Despite this permanent evolutionary trajectory, we can discern in retrospect that during the nineteenth century lawyers in Europe and North America devised a new, radical system of contract law with which to interpret and regulate economic practices. This powerful vision persists in its influence today by providing the basic framework of the legal analysis of market transactions. Having considered the principal elements of this concept of contract law, however, I shall argue that it structures our thoughts about the market order in a way which once seemed so illuminating, but now seems to obscure, distort, and impede understanding and practical reasoning.

B. The classical law of contract

The new law of contract in the nineteenth century possessed two striking features. It was simultaneously sparse in content and imperialist in its ambitions of interpretation and regulation. These features have subsequently earned it the title of the 'classical law of contract'.

The simplicity and rigour of the doctrinal system of thought betrayed its dependence upon a relatively small set of fundamental principles. The nineteenth-century conception of contract law plundered highly selectively the antecedent intellectual traditions, thus abandoning their rich moral texture for a

2 Micklitz, 'Directive 93/13 in Action: A Report on A Research Project on Unfair Terms in Consumer Sales Contracts', in C Willett (ed), *Aspects of Fairness in Contract* (London, 1996) 77, at p 78

thin collection of organizing principles.[3] This impoverishment of the law permitted its restatement in a few terse rules.

A second distinctive characteristic of the nineteenth-century conception of contract law was the extent to which lawyers conceived so many different types of social relationships as falling within the conceptual framework of contracts. Together with the law of private property, the law of contract supplied most of the key principles through which lawyers sought to interpret and thence regulate every aspect of economic social relations. Obligations based upon status, trust and economic dependence were reinterpreted as contractual arrangements to be governed by the new organizing classification of contract law. The potential scope of this classification stretched from marriage to business, companies and employment, and from sales of private property to the provision of public services by governments. The new category of contract law threatened to subject nearly every kind of social and economic relation to its logic. The empire of the law of contract expanded in tandem with what Marx decried as the commodification of social life.[4]

We can discern both of these features of the law of contract developed in the nineteenth century in a case familiar to many law students: *Carlill v Carbolic Smoke Ball Co*.[5] The defendant manufacturer of these carbolic smoke balls placed an advertisement in a number of magazines which claimed that the product would cure all sorts of ailments including coughs, hay fever, loss of voice, asthma, influenza and many others. The defendant added that it would pay £100 in compensation to anyone who contracted influenza despite using the smoke ball according to the printed directions supplied with the ball, and, to demonstrate its sincerity, the defendant deposited £1,000 in a bank. Needless to say, the plaintiff caught influenza despite having purchased this quack remedy in a shop and having used it faithfully according to the directions. The Court of Appeal upheld the plaintiff's claim for £100, asserting that she had formed a contract with the manufacturer on the terms of the advertisement.

The amusing circumstances of the case should not obscure the surprising extent to which the court was prepared to conceive social relations in terms of contracts. The parties to the alleged contract had never met or communicated with each other directly. Nor had they exchanged goods, money or services between themselves. The law of contract is used by the court as an instrument for discouraging misleading and extravagant claims in advertising and for deterring the marketing of unproven, and perhaps dangerous, pharmaceuticals. The court protects the gullible and confused consumer by interpreting the events in the form of a contractual relationship giving rise to reciprocal obligations. In so doing

3 J Gordley, *The Philosophical Origins of Modern Contract Doctrine* (Oxford, 1991).
4 K Marx, *Capital* (London, 1867), Vol 1, ch 1.
5 [1893] 1 QB 256, CA; Simpson, 'Quackery and Contract Law: The Case of the Carbolic Smoke Ball' (1985) 14 *Journal of Legal Studies* 345.

it ignores alternative interpretations of these events, such as the idea that the misleading advertisement might constitute a civil wrong in itself, or that consumers who are ignorant of the properties of goods put on the market should be protected against any harmful consequences.

At the same time, the reasoning of the Court of Appeal in concluding that the plaintiff could succeed in her claim for £100 displays considerable analytical rigour based upon a terse set of rules. The court operates a checklist for determining whether an enforceable contract has been made. The judges run through a shopping-list of questions:

- Was there a promise?
- Was the promise serious and intended to be acted upon?
- Was the promise sufficiently definite and certain?
- Was the promise accepted by the plaintiff?
- Did the plaintiff perform some action in exchange for the promise?

If these questions, and others, are answerable in the affirmative, the court holds itself bound to find the existence of a legally enforceable contract. The legal reasoning thus takes the form of a brief and finite set of rules which must be applied to the facts of the case. The rules establish binary oppositions: either the test is satisfied, or it is not. No questions of degree, apportionment of blame, compromise of interests, or social policy imperatives will be considered.

Carlill v Carbolic Smoke Ball Co illustrates both the extensive province of the category of the nineteenth-century law of contract and its logical and formal reasoning process. The court employs its simple checklist of rules to interpret and regulate any kind of economic relationship. The generality and abstraction of the rules permit both the extensive utilization of this category of law and its application to the case, without any discussion of such matters as the moral claims of the parties, the nature of the market for pharmaceuticals and the problems generated by misleading advertising. The new textbooks on the law of contract in the nineteenth century both helped to create and to reinforce the construction of this category in the law.[6] The writers performed a crucial role in organizing the legal materials, individuating the rules and tests, and carving out this branch of the law from other categories such as the law of property rights, status, and civil wrongs. Most books on contract law have altered little since that time in their organization of the materials, their chapter headings, their identification of the rules and their conceptions of the scope of the subject. Although some significant challenges have been mounted against this classical system of thought,[7] the law of

6 Eg W Anson, *Principles of the Law of Contract* (Oxford, 1879); F Savigny, *System des heutigen Romischen Rechts* (Berlin, 1840–48).

7 Eg G Gilmore, *The Death of Contract* (Columbus, Ohio, 1974); Macneil, 'The Many Futures of Contract' (1974) 47 *Southern California Law Review* 691; Slawson, 'The New Meaning of Contract: The Transformation of Contracts Law by Standard Forms' (1984) 46 *University of Pittsburgh Law Review* 21; Feinman, 'Critical Approaches and Contract Law' (1983) *UCLA Law*

contract as it was constructed in the nineteenth century survives with an assurance – and even complacency – which renders it a daunting target for criticism.

The timing of the origins of this conception of the law of contract provides an important clue to its success. This category of the law supplied an essential tool for lawyers to understand the social and economic relations which were formed in the course of the explosion of a market economy. As markets became the dominant instrument for the production and allocation of wealth, the nineteenth-century conception of contract law created the tool by which these market relations could be understood and regulated. Such an understanding could perhaps have been achieved by a reworking of other categories of law concerning property and status. But the law of contract held a powerful attraction for lawyers. It offered both a framework for understanding the social relations thrown up by a market economy and a theory for the legitimate exercise of state power.

The latent social ideal of the nineteenth-century law of contract embodies a libertarian state, in which the law maximizes the liberty of individual citizens, encourages self-reliance and adopts an avowedly neutral stance with regard to permissible patterns of social life. The law of contract secures these goals perhaps more effectively than any other category of the law by facilitating the creation of legal obligations on any terms which individuals freely choose. We should recognize, therefore, that not only was the law of contract a convenient way of understanding the social relations of a market economy, but also it represented a particular theory of the legitimacy of state power, one which limited the exercise of such power in the name of respecting the liberty of citizens under the banner of freedom of contract.[8]

The fundamental analytical framework of the law of contract became one which focused upon the voluntary choices of individuals. The role of the law of contract was conceived principally as the facilitation of voluntary choices by giving them legal effect. To achieve this purpose, however, the law had to protect this social facility by identifying and declining to enforce those undertakings which were not truly voluntary. The textbooks described exhaustively what kinds of choices would be regarded as sufficiently voluntary to justify the imposition of legal obligations. The shopping-list of rules used by the court in *Carlill v Carbolic Smoke Ball Co* illustrates clearly how all the crucial questions were directed to ascertaining the choices of the parties concerned. The court ostensibly awarded a contractual remedy, not because the manufacturer of the smoke ball deserved to be made to pay up for its lies, but because it had voluntarily chosen to undertake that obligation. As a necessary corollary to this conception of the law of contract,

Review 829; P Atiyah, *Essays on Contract* (Oxford, 1988); T Wilhelmsson (ed), *Perspectives of Critical Contract Law* (Aldershot, 1993).

8 P Atiyah, *The Rise and Fall of Freedom of Contract* (Oxford, 1979).

the books excluded from consideration those instances where the law imposed obligations regardless of, or for reasons independent of, choice, such as those branches of law described today as tort and unjust enrichment (restitution), even though these sources of obligations have profound effects on the regulation of market transactions.

The unity and simple analytical framework of the law of contract, which was provided by the cardinal principle of respecting and enforcing voluntary choices, established a closed system of thought which necessarily excluded inconsistent rules and doctrines. There could be no place, for example, for a rule which insisted upon the fairness of the exchange between the parties, because that would contradict the fundamental assumption of this system of doctrinal thought that it was designed to facilitate and enforce the voluntary choices of individuals regardless of the wisdom or prudence of such choices. Nor could the traditional conception of contract law acknowledge the possibility of imposed contracts without the consent of the parties, for again that would contradict the basic tenets of the system. In some instances, of course, a court may have wanted to refuse to enforce a contract because of its shocking unfairness, or may have wanted to impose a contract regardless of consent for some instrumental purpose. In these cases, the integrity of the traditional doctrine prohibited any express recognition of such possibilities. The courts had to justify the results within the logic of the traditional doctrine. They had to argue in the case of unfairness that the choice was not truly a voluntary one; and in order to impose a contract, the court had to claim that the circumstances in fact revealed an agreement, as occurred in *Carlill v Carbolic Smoke Ball Co.*

This traditional conception of contract law persists in part because of the need to preserve the integrity and, hence, the legitimacy of this closed doctrinal system of thought.[9] Its doctrinal integrity helps to achieve legitimacy, because the law can be presented as objective and neutral, not a matter of politics or preference, but a settled body of rules and principles, legitimated by tradition and routine observance, and applied impartially and fairly to all citizens.

Even in modern accounts of the law of contract, therefore, one cannot ignore the traditional conception of contract law based upon the idea of facilitating voluntary choices. Its presence in the origins of the subject, the continuity of the tradition for more than a century, and its power as an analytical tool for understanding market relations and legitimating legal decisions, seem to render it almost immune from challenge. But challenge it we must. Whilst the legal presentations of the law of contract may have stalled, the market system and the content of legal regulation have altered dramatically. The classical concept of contract law now prevents us from understanding the significance of these developments by treating them as irrelevant or distorting their implications.

9 For this sense of integrity, see R Dworkin, *Law's Empire* (Cambridge, Mass, 1986).

C. Towards a new conception

We have already glimpsed typical defects in the traditional conception of contract law in our discussion of *Carlill v Carbolic Smoke Ball Co*. Such an event, were it to occur today, would almost certainly be understood through the spectacles of the law in a radically different way. Legal regulation proscribes the marketing of dangerous or ineffective drugs through licensing systems and bans supported by criminal sanctions. These laws set limits to the range of products and services which can be offered in the market, and confine the number and type of persons who may engage in such transactions. More general criminal regulations prohibit unsafe products from being put on the market, and permit government agencies to intervene to prevent such products from being marketed.[10] A further array of criminal regulations control unfair marketing practices such as false and misleading advertising.[11] The relevant trade association insists upon certain standards of conduct from its members, and breach of these Codes of Practice might be given legal sanctions.[12] Furthermore, the events of *Carlill v Carbolic Smoke Ball Co* would have to be considered in the light of legislation and judicial decisions which have recognized increasingly that consumers need to be protected from their free choices, since these are so often based upon inadequate information and lack of expertise. Finally, we might observe that the economic relation between manufacturer and consumer has become the subject of mandatory laws which establish strict liability for defects resulting in personal injuries irrespective of the choice of the parties.[13] From this perspective, the relation between Mrs Carlill and the manufacturer might be regarded as one based not on voluntary choice but economic dependence, which in turn justifies the imposition upon the producer of compulsory duties of care with respect to the quality of the product and the information supplied about it. To interpret the events of the case as a voluntary choice to undertake an obligation was at the time regarded as stretching the category of contracts, but within the framework of today's laws and regulations it seems to provide a perverse understanding of the issues and problems to be addressed.

We need to construct a new conception of the law of contract.[14] It should provide a system of thought that illuminates present concerns of government, and that

10 General Product Safety Regulations 1994, SI 1994/2328; EC Directive 2001/95/EC on General Product Safety.

11 Control of Misleading Advertisements Regulations 1988, SI 1988/915; Trade Descriptions Act 1968.

12 Enterprise Act 2002, s 8.

13 Consumer Protection Act 1987, implementing EC Directive 85/374/EEC on Liability for Defective Products.

14 For other critical reformulations, see: Friedman and Macaulay, 'Contract Law and Contract Teaching: Past, Present and Future' (1967) *Wisconsin Law Rev* 805; Leff, 'Contract as Thing' (1970) 19 *American University Law Review* 131; Lewis, 'Criticisms of the Traditional Contract Course' (1982) 16 *Law Teacher* 111; Summers, 'Collective Agreements and the Law of Contracts' (1969) 78 *Yale Law Journal* 525; P Birks (ed), *Examining the Law Syllabus* (Oxford,

helps to analyse issues within an intellectual framework which has a place for all the relevant rules and doctrines. It should also provide a key for an interpretation of law's past, which simultaneously reconstructs the law and enables further transformations to take place.

The place to start no doubt, as did the Victorians before us, is with a desire to understand the market order. We still require legal systems of thought for interpreting, analysing, and guiding events and relations in the marketplace. The difference between our enterprise and theirs springs not from the site of the inquiry, but rather from the alteration in both the market order itself, and the nature of political and moral justifications for its legal regulation.

During the twentieth century, the state intervened to devise new principles to govern the operation and outcomes of the market. With respect to outcomes, the evidence is incontrovertible. Instead of permitting the distribution of wealth to be determined by voluntary choices to enter market transactions, the social security system which relieves poverty and all the other dimensions of the Welfare State, funded largely through progressive taxation, clearly affect the eventual outcomes of the distribution of wealth. What seems to be less generally perceived is that at the same time similar ideals of social justice have justified the channelling and regulation of market transactions. The purpose of these limits upon the exercise of voluntary choices lies in the realization of a compatible scheme of social justice.[15] The persistence of traditional descriptions of the law of contract no doubt contributes to this failure to perceive how the ground rules for the establishment of obligations in economic relations have been substantially altered in order that they may fit better with contemporary ideals of social justice.

How, therefore, should we conceive the law of contract today? It comprises those rules, standards, and doctrines which serve to channel, control, and regulate the social practices which we can loosely describe as market transactions. This branch of the law certainly facilitates the growth of the social practice of making economic transactions, especially those transactions where performance is not instantaneous; but it also sets limits to the exercise of voluntary choice. By emphasizing how modern ideals of social justice channel market transactions into approved patterns, this conception of contract removes the assumption that the law provides an open-ended facility for making binding commitments. Although some flexibility persists, especially with regard to the price, this freedom should be regarded as a privilege granted on stringent conditions, rather than a general licence to enter contractual obligations of one's choice.

1992); Frug, 'Re-reading Contracts: A Feminist Analysis of a Contracts Casebook' (1985) 34 *American University Law Review* 1065; D Campbell (ed), *The Relational Theory of Contract* (London, 2001); R Brownsword, *Contract Law: Themes for the Twenty-First Century* (London, 2000).

15 T Wilhelmsson, *Critical Studies in Private Law* (Dordrecht, 1992); R Brownsword, G Howells, T Wilhelmsson (eds), *Welfarism in Contract Law* (Aldershot, 1994).

As a consequence, the traditional contrast between imposed and voluntary obligations ceases to provide a crucial characteristic of the scope of the law of contract. Within the conception of the subject to be pursued here, we should define the field of inquiry by considering all those rules which serve to mould the form and content of market transactions, whether they be criminal offences, civil obligations of compensation imposed by the law, administrative regulations, or legislation which fixes the terms of obligations. It should be apparent that this conception of the subject incorporates many aspects of the law traditionally excluded from the classification of contract, because those topics cannot be derived from the concept of voluntary consent.

In one respect, however, this revised conception of contract law narrows the focus of study. Because the traditional conception offered to analyse so many types of relation within its logic, it lacked any determinate boundaries. Indeed, the subject became almost incoherent, because its expansive generality had to be constrained artificially by excluding such matters as marriage and property transactions in order to prevent it from occupying nearly all of private law. At the same time, the necessary generality of the traditional conception rendered it increasingly irrelevant to contractual disputes, where almost invariably some particular rules of law governed the transaction, such as the law governing sales, credit arrangements, and employment. In order to counter this incoherence and redundancy, the conception of contract law employed here focuses on the social context of market transactions, ie where people seek to acquire property or services by dealing with others. Whilst acknowledging that the law regulates these transactions by classifying them into particular types, this conception of contract law seeks to understand the general principles and social policies which inform and guide the legal classifications and regulation.

In the remaining sections of this chapter, we will examine the nature of the market transactions which the law seeks to regulate, the significance of market transactions in the social system, and the complex relation between the social system and legal regulation. In the following chapter, the values which inform the modern law of contract will be explored in greater detail by contrasting them with the traditional libertarian ideals briefly described above. We shall note how these changes have forced a modification in the form of the law and have drawn upon new sources of law.

D. The market order

Every society creates an order of wealth and power. It establishes rules and institutions which direct the means for the creation and distribution of wealth and allocate power to certain individuals to control others. In modern western societies, market transactions play a central role in establishing the order of