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978-1-107-02808-1 - Commercial Contract Law: Transatlantic Perspectives

Edited by Larry A. Dimatteo, Qi Zhou, Séverine Saintier and Keith Rowley

Excerpt

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PART I

The Role of Consent

Part I begins with an introductory chapter that explains the purpose of the book. Put succinctly, the book seeks to compare the common law systems of the United Kingdom and the United States in the area of commercial contract law at the levels of theory, doctrine, and practice. The ultimate goal of the book is to highlight the differences between the two systems and to suggest areas that would benefit from law reform. Part I explores the core concepts of what makes certain promises legal or moral commitments. It also reviews the coherence of the views or roles of contract law as facilitator of the exercise of private autonomy versus contract as a regulatory regime that controls the free exercise of such autonomy. This analysis concludes that the dichotomy between immutable and default rules is a false one. Finally, this part analyzes the issue of whether a legal obligation under contract law is equivalent to a moral obligation to honor the contract. This analysis is done in the context of strategic mortgage defaults. Chapter 2 reviews six theories of contracts – exchange of promises, agreement in fact, reliance, assumption of legally binding obligations, relationship- or status-based, and transfer of rights. The chapter concludes that a number of these theories do not adequately explain contract law as currently practiced and should be discarded. The remaining theories can be subsumed under an “agreement plus intention” model. It also suggests that European contract law has moved more actively in the direction of this model, while American contract law has yet to make a full commitment. In the end, the chapter asserts that a pure form of such a model requires a reassessment of the doctrine of consideration and the

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area of third-party rights, as currently formulated. Chapter 3 questions the premise that a contract is the end product of the parties' will. Instead, contract law should be seen as a three-party exchange among the parties and the regulatory nature of judicial review. It makes the bold assertion that the distinction between immutable and default rules is a fallacy. The courts retain overarching power to modify, enforce, and even covertly avoid default rules. It concludes that there is no such thing as a self-enforcing contract, even if the parties opt out of the judicial system. Finally, courts often cloak their decisions in the veil of party consent in order to mask the exercise of regulatory control. Chapter 4 analyzes the morality of promise in the context of strategic mortgage defaults where the mortgage principal exceeds the value of the home. The morality of commitment implied in explicit promises holds that the breach of the promise to repay is inherently immoral in situations where the mortgagor has the financial means to pay. This chapter argues that the immorality of promise breaking in strategic default is avoidable if the promisor does not view the promise as a moral obligation. Because of the impersonal, distant nature of modern-day lending, the mortgagor does not view the promise to repay as a moral commitment, but as merely a legal commitment with legal consequences. As such, the moral imperative to repay when financially able is dampened, but not necessarily eliminated.

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[More information](#)

1

Transatlantic Perspectives

Fundamental Themes and Debates

Larry A. DiMatteo, Qi Zhou, and Séverine Saintier

This chapter provides the reasons and purposes for the writing of this book. It briefly discusses the importance of a comparative analysis of English and American common law in the area of commercial contract law. It also provides a roadmap of the collection of essays incorporated in the book by previewing the themes and topics covered in the book's remaining twenty-one chapters.

I. LEGACY OF ROB BRADGATE

This book is the product of a symposium held in September 2011 in honour of Rob Bradgate, Edward Bramley Professor of Commercial Law at the University of Sheffield School of Law. Professor Bradgate is a remarkable figure in English commercial law scholarship. He studied law at the University of Cambridge, joined the University of Sheffield as lecturer in law in 1989, obtained a Chair in Commercial Law in 2002, and was appointed Edward Bramley Professor of Commercial Law in 2008. He retired in 2010, becoming Emeritus Professor of Law. Professor Bradgate faithfully served the University of Sheffield School of Law for twenty-one years until his retirement. He has published widely in the fields of commercial law, specializing in commercial and consumer transactions. His book, *Commercial Law*, published by Oxford University Press, is regarded as one of the leading authorities on English commercial law. Professor Bradgate served as the convener of the contract, commercial and consumer law group of the Society of Legal Scholars for many years. He has worked tirelessly to build links, platforms, and opportunities for legal scholars around the world. Professor Bradgate wished to enhance communications among scholars on both sides of the Atlantic. The symposium was a step towards achieving this objective. It is, thus, fitting that the book be dedicated to such an outstanding person and scholar.

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A. Commercial Contract Law in the United Kingdom and United States

Commercial contract law evolved from commercial practice. It is shaped and developed constantly by interactions between commercial transactions and judicial decisions. The international and dynamic features of commercial contracting make it one of the most fascinating topics in the scholarship of contract law. Although the United States and the United Kingdom share the same common law tradition, commercial contract law in the two countries differs in many ways. Common law lawyers and scholars in both camps share the same foundational principles and concepts in almost all areas of law. They “speak” the same legal language. America’s embrace of *Hadley v. Baxendale* in 1854, seventy-one years after its independence, attests to the fact of the overwhelming commonality of their contract laws. However, like any other branch of a legal tradition, American law has forged its own path – still solidly rooted in English common law – which has led to divergence and variations between the two in areas of substantive law. It is important to emphasize that most of the time, the differences have been more a matter of degree than of kind, but now and then significant divergences have appeared. This book focuses on the law of commercial contracts as constructed by the American and UK legal systems in order to survey the nuances of those differences. It brings together prominent legal scholars from the US and the UK including representatives from Scotland, Wales, and Northern Ireland.

1. Statutory Interventions into the Common Law

One formulaic difference is that in the area of the international commercial sale of goods the US is a signatory to the United Nations Convention on Contracts for the International Sale of Goods (CISG), and the UK is not. Another stark reality is the UK’s membership in the European Union. As such, numerous EU Directives and Regulations have pre-empted the working of the common law. The US’s federal and state governments also intervene in numerous areas of private law pre-empting the existing common law. Often times these interventions are undertaken with the intention to modernize, simply, or codify what has been created by the common law but has grown chaotic over time. The most popular example of this codification and modernization of the common law is the American Uniform Commercial Code (UCC), which substantially harmonized vast areas of commercial law among the fifty American states. The English Sale of Goods Act did the same but does not capture the many areas of commercial law, such as negotiable instruments, documents of title, secured transactions, wire transfers, and so forth, found in the UCC. Thus, some of the differences between UK and US commercial contract law are associated with various legislative enactments. However, it should be kept in mind that these statutory initiatives remain embedded in the common law system. As such, it

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is the courts that determine the ultimate meanings and scope of these interventions into the common law. In essence, the statutory incursions into the common law are captured by the common law.

In the United States, federal intervention has a more harmonizing effect since federal statutes are interpreted by a unified court system. But, at the state level there are fifty separate common law systems (not including the District of Columbia and US territories or possessions). Therefore, the ubiquity of the UCC masks the differences of interpretation created by the self-contained state court systems. The same can be said about the more substantial differences between English and Scottish law. This book touches upon some of these differences, but its main focus is on the broader conceptualizations of commercial contracts from the different perspectives of scholars from the American, English, and Scottish legal traditions, along with the views of scholars from Northern Ireland and Wales.

2. Divergence, Convergence, and Law Reform

Some of the differences between UK and American law are seen at the level of meta-principles. The two most obvious are the duty of good faith (and fair dealing) and the doctrine of unconscionability. The role of the duty of good faith continues to expand in the United States from its humble beginnings in sales and negotiable instrument law to employment law and landlord-tenant law. One of the key forces behind this broadened use in the United States has been the impact of the American UCC. The impact of the UCC on American commercial law is generally understood as the harmonization of law among the fifty American states. But equally important is the fact that numerous principles codified in the UCC, such as the duty of good faith and fair dealing, as well as the doctrine of unconscionability, have been applied by analogy to other areas of contract law. In essence, this process of analogizing has worked to change the common law of contracts in a way not found in the United Kingdom. Along with the duty of good faith, the doctrine of unconscionability is more fully developed in the United States than in the United Kingdom.

History indicates that such divergence may be more a matter of evolutionary lag than of a permanent schism. The common law continues to evolve to respond to the rapidly changing transactional landscape. In this way, English common law's moving to a greater use of the principles of good faith and unconscionability is possible, if not, likely. An analogy can be offered in the area of contract interpretation. Just as both systems have moved away from formalistic interpretation of contracts to various uses of contextual evidence, the speed of this change in interpretive methodology has varied between the US and UK. Although the US may have moved more quickly to embrace contextualism, the movement is apparent in both systems. That said, many years have passed since the decision in *Hadley v. Baxendale*, and, in practice, the two systems have become more distant from each other, more so

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than is the case among the UK and the English Commonwealth countries. This fact makes such comparative discussions as represented by the contributions in this book all the more important, because with divergence comes the opportunity to learn from perspectives and roads taken by the related system. This leads to a better understanding of the variations in the common law systems, as well as comparative benchmarks for future reforms.

B. Major Themes

Unconscionability and good faith are only the more grandiose and obvious examples of the differences between the US and UK common law. There are many more subtle disparities – seen at the doctrinal level, as opposed to the level of meta-principles discussed previously – such as the judicial attitude toward contractual interpretation, legal remedies for misrepresentation and breach of contract, and rules relating to implied terms. This book examines a number of important topics of commercial contract law in both countries. The eminent scholars from both the UK and the US who have contributed to this undertaking present their latest research on the most important issues of comparative commercial contract law.

The broader conceptualizations noted previously provide the framework for the comparative analyses in this book. The chapters analyse various themes and topics at levels of theory, doctrine, and practice. In the area of contract theory, analyses are offered on competing theories of contract law, as well as its core concepts – the role and conceptualization of promise and consent. Normative offerings of what the law should be include chapters on a “naturalistic” approach to contracts, the role of contracts in a “networked” world, and the continued role of equity in contract law. So as not to get completely lost in the theoretical and normative realms, the book changes focus to analyse the freedom incumbent in private law as stressed in a chapter on reasonability and contract design. As noted previously, the general duty of good faith has been more openly embraced in US contract law, but mostly rejected in English contract law. A chapter is offered that presents a relational approach to the duty of good faith.

The pivotal role of the judiciary is studied in chapters on implied terms and contract interpretation, and subsequently in chapters reviewing some of contract law’s policing doctrines. The foundation of contract law is the principle of freedom of contract. Put simply, private parties create their own law through the contract. Courts mostly play the neutral role of arbiter of disputes but essentially are under a duty to enforce the agreed upon bargain strictly. However, unfettered freedom leads to abuse and overreaching. Because of such misbehaviour, contract law’s primary function of facilitating private ordering is accompanied by a secondary regulatory function. This secondary function of contract law primarily regulates impermissible

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conduct through the policing of unfair terms. This policing, often premised upon the belief that the unfair terms are generally a product of bargaining power and informational disparities, takes two forms – long-standing common law policing doctrines and more recent legislative enactments.

The major area of policing in which differences are apparent is the regulation of unfair terms and the protection of perceived weaker parties. Consumers for the most part have been the beneficiaries of this regulation. Much of this is due to the UK's membership in the EU, which has been active in enacting directives in many areas, such as distance contracts, products liability, privacy protection, and guarantees. One chapter is devoted to conceptualising the remedial scheme for calculating the remedy for the termination of a commercial agency relationship, something which does not exist in the United States. Another chapter examines the regulation of unfair terms under the Draft Common Frame of Reference (DCFR). An American scholar visits the issue of the regulation of unfair terms in software contracts. The scholar speaks to the lack of express regulation of unfair terms in software contracts in the United States and explores avenues for such regulation. Finally, the general policing doctrine of unconscionability is the subject of another chapter. The chapter reviews the American experience in the use of this doctrine in regulating “unconscionable” terms and contracts. This is an area of divergence between American and English common laws. The unconscionability doctrine is more liberally recognized in the United States, although it is important to realize that the doctrine in the United States is almost exclusively used for purposes of consumer protection and plays little role in commercial contracts. Thus, in the area of commercial contracts, American and English laws are very much aligned on this issue.

Two chapters focus their attention on the more targeted, traditional policing doctrine of misrepresentation. One chapter reviews an increasingly chaotic English jurisprudence involving the different types of misrepresentation and suggests the development of an integrated system to replace the current complexity of misrepresentation law. Another chapter re-examines the nature of damages in cases of fraudulent misrepresentation. Another author provides a comparative analysis of damages awarded for documentary breaches under English law and the CISG. This part concludes with an examination of the role (or lack thereof) of the “performance interest” under English and Scottish laws.

Finally, in response to regionalization and globalization, the move towards greater harmonization of laws has become more pronounced and heavily analysed. The movement of EU harmonization of law has advanced into the area of private law including the areas of general contract and sales law. The issues discussed include the difficulties and issues relating to the harmonization of default rules, as opposed to mandatory rules. The most recent attempt at the Europeanization of private law – Proposed Common European Sales Law or CESL – is analysed and critiqued, and,

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finally, a review of the current state of the international harmonization of sales law as represented by the CISG is offered. The rest of this chapter provides additional information, albeit brief, on the material covered in this book.

1. Topical Preview

At the risk of being redundant, this section provides added detail of the specific topics covered in the book by way of introduction. It provides not only the specific topics but the key issues addressed in those topical areas.

2. Consent and Promise

Part I presents a theoretical inquiry into the role of consent in contract law. In Chapter 2, the author ventures into the quagmire of the many different competing theories of contract law. He points out the interconnections between the different theories and offers an innovative new theory. This theory explains the role of consent through an “agreement plus intention” model. He asserts that this model borrows from the best of the competing theories and offers a consensus model of the bindingness of some, but not all agreements or promises. Chapter 3 questions the premise that the contract is created by the parties’ will. Instead, the author asserts that the illusion of party-willed consent is a result of a conflation between consent and efficiency. Therefore, contractual consent is best understood as the product of a three-party interaction among the parties and a judge. From this perspective the idea of self-enforcing contracts becomes illusory. Courts continue to cloak their decisions in the veil of party consent when, in fact, contractual interpretation is merely an exercise of regulatory control. In Chapter 4, the author poses a number of provocative questions including whether mortgage contracts, notably the promise to repay the loan, should be considered as enforceable promises and whether strategic defaults should be considered immoral acts. The deflation of housing prices in the ongoing financial crisis has left many homeowners with the dilemma of continuing to make mortgage payments on homes that are worth less than the principal of the mortgage loan. In such cases, should the mortgage contract, given the traumatic change of circumstances, generate the same expectation of repayment as is found in other contracts?

3. Theories of Contract, Networks, and Equity

Part II challenges conventional contract theories, in particular the classical contract model and the supremacy of the freedom of contract paradigm. In Chapter 5, the author explains that new research findings in neuroscience provide valuable insights into contract law and questions the validity of conventional contract theories. In fact, he argues that contract doctrine fails to reflect the normative commitments represented by consequentialist and deontological theories of human agency. In Chapter 6, the author argues that existing contract law fails to deal adequately with

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the world of network contracts. As such, it needs to be reformed. First, in contract interpretation a contract that is part of a network of contracts needs to be interpreted on the basis of the context of the network. Second, the interface between network contracting and the regulation of consumer transactions needs to be reflected in contract doctrine. Finally, in Chapter 7, the author examines the role of equitable principles in regulating trust and fiduciary relationships as the basis to support the argument that equitable principles continue to play a major role in the construction of commercial contracts and in the application of commercial contract law. In essence, equity is playing an increasing role in regulating commercial transactions, thereby replacing some functions of contract law.

4. Discrete and Relational Contracting

Part III focuses on the problems and issues presented by online contracting and the role of good faith in the renegotiation of relational contracts. Chapter 8 deals with the phenomenon of mass consumer online agreements and the importance of the necessity for contract law to confront the distinction between offline and online contracting. The author explores the importance of contract design in protecting consumers in online transactions. The core argument is that the online contract's form and manner of presentation are as important as the contract's content. The manipulation of the design of online contracts impacts the quality of consent. The contract drafter can mask the bindingness of the contract and manipulate consumer behavior through design. Therefore, the courts should consider contract design in online consumer contracts in the interpretation and enforcement of the terms of the contract, and the degree of their bindingness. Chapter 9 moves from the discreteness of online consumer transactions to the area of long-term, relational contracting. The author examines the expanded role that the concept of good faith should play in the context of relational contracts. The author argues that the duty of good faith should be more broadly recognised in English contract law, especially in the role of regulating long-term contracts, where dramatic changes in circumstances and expectations often require good faith renegotiation.

5. Implied Terms and Contract Interpretation

Part IV critically evaluates two judicial techniques of contract regulation, namely, implied terms and interpretation. Chapter 10 continues the analysis of the good faith theme of the previous chapter by making the unique argument that the implication of contract terms in English law is often used as a technique to reach minimal thresholds of good faith (despite the lack of a good faith doctrine in English common law). However, the author asserts that because of the limited recognition of the duty of good faith in English contract law, the technique of implied terms cannot be employed to its full extent. The requirement of neutrality largely restricts the

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discretion of judges to use implied terms as a regulatory method. Chapter 11 reviews different theoretical approaches to contractual interpretation, arguing that none of the existing approaches is satisfactory; and, therefore, a more adequate theoretical method of contractual interpretation is needed. The author advances a law and economics or consequentialist approach to contract interpretation. This approach is represented by a simple question: Given the words the parties used, what is the best (surplus maximizing) interpretation of the bargain? Interestingly, this question leads the author to conclude that the new formalism advanced by some law and economics scholars actually works to decrease party-generated surpluses (increases inefficiency in contract interpretation). Instead, purposivism, contextualism, and consequentialism are forms of interpretation most likely to reduce costs and create surpluses.

6. Contract Law's Regulatory Function

Part V further studies the regulatory function of contract law discussed above in relationship to the regulatory function of implied terms. Chapter 12 investigates the impact of EU law on national contract laws. It examines the EU Directive 86/653 on self-employed commercial agents and its implementation in France, Germany, and the UK. The author shows that the countries' implementations possess substantial variance due to their different perspectives on the protections needed in the principal–commercial agent relationship, as well as the meanings of “compensation” and “indemnity.” It concludes by offering an innovative approach to unifying the two forms of recovery under the Directive. Chapter 13 reviews the development of the concept of unconscionability in American contract law and further illustrates how it is used to regulate contractual relationships. The author gives a historical accounting of the doctrine in the United States, assesses the continuing feasibility of the procedural-substantive unconscionability dichotomy, and anticipates future developments in the application of the doctrine. Chapters 14 and 15 offer different perspectives on the important issue of the regulation of standard contract terms. Chapter 14 presents a comparative analysis of legal rules governing unfair contract terms between the US and the UK, critically evaluating the different regulatory approaches employed in the two jurisdictions. It examines the shortcomings of the American Law Institute's Principles of Software Contracts and the EU Directive on Unfair Contract Terms in Consumer Contracts. In the end, each initiative possesses a number of strengths that should be combined to regulate unfair terms better. Chapter 15 provides a broad view of the consolidation of European private law. It examines the past and current attempts at EU private law harmonization and finds that the litany of initiatives have been contradictory in numerous ways. The chapter then focuses on the regulation of unfair contract terms in relationship to the Draft Common Framework Reference (DCFR). It then offers an assessment of the areas