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Introduction

It is something of a curiosity to find the phrase 'sanctity of contract' still in frequent use in an era in which little remains sacred. Even allowing that there are strong reasons to favour enforcement of contracts, it would be surprising if they were so strong as to outweigh every other consideration of justice and policy. This is a study of the extent to which English law, and systems closely related to it, have, in the past, and in practice, adhered to a strict doctrine of enforcement of contracts; looking at the matter from the other side, the question to be addressed is the extent to which exceptions have encroached on a principle of strict enforcement, and whether a principle can be identified to support the exceptions. The study is partly historical, and partly critical. The historical aspect, which includes attention to the recent past, seeks to establish that, in a wide variety of circumstances, by various techniques, the courts have very frequently modified or set aside contracts on the grounds that they are highly unreasonable, but that, nevertheless, there remain large gaps. The critical aspect advances the argument that the resulting state of the law contains numerous uncertainties, anomalies, inconsistencies and injustices.

If avoidance of inconsistency were the only object sought to be attained, it might be possible for the law to regress to a rule of absolute sanctity of contracts, but this would require the abandonment of many well-established and recently-affirmed doctrines, including those relating to forfeitures, penalties, equitable relief for unfairness, mistake, frustration, duress, techniques of interpretation, the limits to contractual enforcement, avoidance of unjust enrichment, control of unfair domestic agreements and public policy. When this possibility is discarded as unhistorical, unjust and impractical, the only prospect of coherence lies in the articulation of a principle that can explain and justify the

exceptions. Taking as a given the continued existence of the established exceptions to sanctity of contracts it will be suggested that the only feasible path to a coherent resolution lies in open recognition of a general judicial power to modify highly unreasonable contracts. So long as relief is envisaged as being restricted to isolated categories, severe anomalies are inevitable at their borderlines. The study will consider the balance between assertions of sanctity of contracts on the one hand, and its many exceptions on the other, and will consider the potential effect of other concepts, including good faith, unjust enrichment and abuse of rights. The object will be to make a comprehensive assessment of the law relating to this question, and to offer new perspectives, in this context, on the relation between law and equity and on the relation between contract law and unjust enrichment.

The principal exceptions to strict enforcement of contracts may, from a historical perspective, be divided into concepts derived from equity, and those developed independently of equity. The relevant equitable concepts may be subdivided into relief from forfeiture and penalties, other instances of relief for unfairness and relief for mistake. Concepts independent of equity include duress, techniques of interpretation and implied terms. The common law doctrine of frustration, which may be regarded as a species of relief for mistake, has evolved from a theory based on implied terms into an open recognition that sanctity of contract must yield, in some circumstances, to countervailing considerations of justice.

A relevant feature of contract law, derived from the combined operation of equitable and common law concepts, is that there are important limitations on the extent to which contractual obligations are enforced. If contracts were really sacred, they would be specifically enforced, and breaches of contract would be punished. But most contractual obligations are not specifically enforceable, and the extent of money awards given for breach of contract has been restricted by a number of interrelated factors, including principles of remoteness, mitigation, the refusal (in most cases) of recovery of profits derived from breach, the refusal (in most cases) of punitive damages and the refusal of the law to award damages equal to the full cost of securing substitute performance where the result of doing so would be unreasonable in the circumstances. The threat to break a contract is not always treated as wrongful. Nor are contractual rights treated similarly in all respects to property rights. These features make contractual obligations distinct, any such notion as sanctity being already limited by the internal structure of contractual remedies.

Related in practice to the question of strict enforcement of contracts is the question of when, and to what extent, contractual documents are conclusive. This has become an acute problem in the computer age, where assent can be presumed from a click on a computer screen. The combining of a principle of sanctity of contracts with a rule that a person may be bound by digital terms that cannot in practice be avoided, or even known, has stretched the concept of agreement beyond breaking point, and can lead and has led to very unfair and highly unreasonable results.

The traditional equitable concept of unconscionability has deep roots, but has failed, in modern times, to support a generally recognised power to grant relief from unfair contracts. Possibly a wider understanding of unconscionability might be revived, but the concept of conscience is not very agreeable to twenty-first century thinking as a basis for imposing or modifying legal obligations. Conscience has religious overtones, and suggests matter that is for the private consideration only of the person whose conscience might be affected. Another problem is that 'unconscionable', though originally a synonym for 'inequitable', has been taken by some modern courts and writers to require proof of misconduct, partly because of its meaning in common usage as 'disgraceful'. Alternative conceptual bases for making exceptions to sanctity of contracts include good faith and abuse of rights, but these ideas have their own difficulties and have met widespread, though not universal, resistance in common law thinking.

The development in the twentieth century of the concept of unjust enrichment is highly significant, and its practical effect on the subject of this study has, it will be suggested, been under-appreciated. Many of the older equity cases refer to the concept of unjust enrichment, though not by that name, in articulating the fundamental countervailing reasons for exceptions to sanctity of contracts. The avoidance of consequences that are exorbitant, extravagant and disproportionate was, in 2015, advanced by the UK Supreme Court as the underlying reason for setting aside penalty clauses.[1] It will be suggested that there is a link between the cases on mistake, frustration, failure of consideration and avoidance of grossly unequal exchanges. The link lies in the concept of unjust, disproportionate, undue, excessive, immoderate or extravagant enrichment. The question must be looked at from both sides: the case for modifying

[1] *Cavendish Square Holding BV* v. *Makdessi* [2015] UKSC 67, [2016] AC 1172, discussed in Chapter 2.

highly unreasonable contracts is not only that they are burdensome to the disadvantaged party but also that they often confer an immoderate, or disproportionate, gain on the other party.

Rather surprisingly, nearly a century and a half after the Judicature Acts, the relation of equity to law continues to give rise to sharp differences of opinion, and the debate as to whether there has been partial or complete 'fusion' simmers on. The underlying reason for the inconclusiveness of the debate is that there are elements of truth on both sides: there is indeed a single juridical system that administers both law and equity, but nevertheless equity has retained distinct characteristics, and recourse to the historical origins of equitable doctrines continues to be prominent in judicial reasoning. There is no consensus, nor is any consensus likely to be achieved, on the extent of equitable powers as a matter of history. Those favouring strict enforcement of contracts have tended to minimise early equitable powers, and to present equitable exceptions to sanctity of contracts as distinct islands, each confined to its own very special set of circumstances. Those taking a more expansive view have tended to emphasise the breadth of early equitable powers, and to suggest that instances of equitable intervention are examples of a general power to grant relief where appropriate. Still less is there any consensus on historical trends over time: one side tends to discern a 'high water mark' of such powers in the eighteenth century, with the implication that the waters have since permanently retreated; the other side is apt to suggest that the tide has turned, and that earlier equitable powers have been, or may be, restored, or extended. Since there is sufficient historical material to support both approaches, it is unlikely that any consensus will emerge. Thus, no agreed principle can be identified that describes or explains the power of the court to grant relief from unreasonable contracts. This must be regarded as a deficiency: it ought to be possible for a modern legal system to articulate a principle in general terms that reflects the law on this fundamental question, without demanding resort to perpetually controverted and insoluble historical questions. It will be suggested that the fusion/fission debate, though not capable of resolution in its own terms, can be transcended in this context by recognition of a reserve power enabling the modern court to depart from sanctity of contracts in the face of sufficiently strong countervailing considerations.

Relief for mistake as to facts existing at the time of the contract is closely related to relief for unfairness, and closely related also to relief for mistake as to future events (frustration). Equity gave relief for mistake, while the doctrine of frustration developed at common law. It will be

suggested that there is scope for articulating principles common to both concepts, and that this would clarify both branches of the law, and assist in transcending, in this context, the fusion/fission debate.

Running through many of the cases asserting a rule of strict enforcement is the suggestion that the courts lack power to grant relief unless expressly authorised to do so by legislation. This line of thinking will be examined, and it will be suggested that it is neither historically accurate, nor realistic, to suppose that legislative powers given to the court to grant relief against one particular kind of unfair contract or clause, amount to a positive legislative command that every other imaginable contract, however unfair, must be strictly enforced. This point has particular importance in jurisdictions where consumer protection is weak, but it is relevant in all jurisdictions in respect of instances that fall through the cracks of legislation. Such cases continue to occur: in a decision of the UK Supreme Court in 2015, described by the dissenting judge as 'grotesque' and as 'commercial nonsense', and by one of the majority judges in a later lecture as 'grotesque', the majority (somewhat apologetically) disclaimed any power, in the absence of legislative authority, to modify a contract that turned out to be unexpectedly burdensome to one party and that conferred an extravagant enrichment on the other party.[2]

A deep and paradoxical division of thinking besets any attempt to assess the current state of the law. It can be convincingly shown that, by a variety of techniques, highly unreasonable contracts can be, and have often been, modified. Yet the courts continue to disavow any general power to effect such modifications, with the consequence that, where a case cannot be fitted into an established category of relief, highly unreasonable contracts are sometimes enforced.

This leads to a consideration of the appropriate scope of judicial power. Judgment is certainly required in determining whether the effect of a contract is exorbitant, extravagant or disproportionate, but 'discretion' might not be the best word to describe the exercise of that judgment. Discretion may be taken to imply that the decision-maker may act whimsically or arbitrarily, or that the decision is a matter of indifference, or it may imply a restriction on the scope of appellate review. For these reasons the concept of discretion has encountered deep hostility, and it will be suggested that the concepts of 'power' and 'judgment' would be more appropriate. The UK Supreme Court in 2016 affirmed the propriety

[2] *Arnold* v. *Britton* [2015] UKSC 36, [2015] AC 1619, discussed in Chapter 4.

of the flexible use of judgment in determining the enforceability of contracts in the context of public policy.[3]

Running through many of the cases is the attention of the court to practicalities. This perspective was prominent in the older equity cases: 'necessitous men are not, truly speaking, free men, but, to answer a present exigency, will submit to any terms that the crafty may impose upon them.'[4] The emergence, in every era, of new varieties of highly unreasonable contracts requires, as a practical matter, recognition of a general power of control. Practical considerations are not less important in the twenty-first century where necessity requires assent every day to computer contracts, the terms of which cannot, as a practical matter, be altered, or even examined.

The relation must be considered between sanctity of contracts and public policy. Contracts have often been set aside for public policy reasons that are independent of considerations of justice between the contracting parties. But, though the concept of public policy is distinct from that of unfairness, the concepts are not unrelated, because public policy has sometimes been invoked or adduced to explain or to justify the modification of contracts that are very unfair. More generally, it is relevant to note that public policy constitutes a large and undoubted exception, both in theory and in practice, to the concept of sanctity of contracts. Joseph Story, combining the ideas of public policy and justice between individuals, wrote that 'there is not more intrinsic sanctity in stipulations by contract, than in other solemn acts of parties, which are constantly interfered with by Courts of Equity, upon grounds of a broad public policy, and upon the purest principles of natural justice.'[5]

Domestic contracts have often been overlooked by writers on general contract law, but domestic contracts ought not to be marginalised: they are very frequent and of high importance to the parties and to the public. Domestic contracts have been regularly modified for reasons related to unfairness, and this must be of interest in any study of the concept of sanctity of contracts. In the past, domestic contracts were set aside on the ground that they infringed the public policy against ousting the court's matrimonial jurisdiction, but, in view of the rapidly changing categories of family and family-like relationships, this cannot be a satisfactory basis for control of unfair domestic agreements in the twenty-first century.

[3] *Patel* v. *Mirza* [2016] UKSC 42, [2016] AC 467, discussed in Chapter 12.
[4] *Vernon* v. *Bethell* (1762) 2 Eden 110, 113, 28 ER 838.
[5] Joseph Story, *Commentaries on Equity Jurisprudence: As Administered in England and America* (Hilliard, Gray, 1836) vol. 2, s. 1316.

Failure to recognise a general power to control very unfair agreements will, as elsewhere, create boundary problems in the case of domestic agreements that fall just outside recognised categories of relationships, or just outside the terms of particular statutes.

The expression 'freedom of contract' is often used in this context. The expression sounds benign, but it is ambiguous. It may mean that the law does not usually compel persons to enter into contracts. In this sense the expression is, subject to a few exceptions, an accurate description. But the phrase is often used to support the proposition that agreements, when made, should be stringently enforced. This proposition does not follow from the concept of freedom. The enforcement of a contract is, in a real sense, a restraint on the freedom of the disadvantaged party, as the concepts of 'binding contract' and 'obligation' plainly indicate. If individual freedom, or autonomy, were the only relevant consideration, account would be taken of the wishes of the disadvantaged party at the time for contractual performance: perfect autonomy includes the power to change one's mind. There are, no doubt, good general reasons for enforcement of contracts in most cases, and some of these reasons incorporate the concept of increase of choice for the community at large. But such general considerations do not necessarily outweigh considerations of justice between the individual parties, and a respect for liberty, or for autonomy, cannot in itself support the proposition that contracts should always be enforced. Autonomy might support the toleration of self-inflicted losses that had actually occurred, but the idea of autonomy, standing alone, could not justify the infliction, by an agency of the state, of a loss that had not yet occurred. As Morris Cohen pointed out,

> in enforcing contracts, the government does not merely allow two individuals to do what they have found pleasant in their eyes. Enforcement, in fact, puts the machinery of the law in the service of one party against the other . . . [T]he notion that in enforcing contracts the state is only giving effect to the will of the parties rests upon an utterly untenable theory as to what the enforcement of contracts involves.[6]

Persons are indeed free, as a matter of fact, and as long experience shows, to make very disadvantageous agreements, but it does not follow that a court of justice should always use its coercive powers to enforce those agreements to their full extent, particularly when enforcement results in the extravagant enrichment of the advantaged party.

[6] Morris R. Cohen, 'The Basis of Contract' (1933) 46 Harv LR 553, 562.

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Concepts Derived from Equity

1. Introduction

Before 1875, the English legal system was divided, with separate courts of law and equity. The Chancery Court, administering equity, had power to restrain the exercise of legal rights in order to avoid inequitable results, a power exercised by means of an order known as a common injunction. It was often difficult to determine which court had ultimate jurisdiction, with the consequence that litigants might be bounced from one court to the other, and back again. From the middle of the nineteenth century various attempts were made to blend the powers of the two sets of courts, but these attempts met with only limited success.[1] By 1869 there was a widespread consensus that radical reform was necessary. The Judicature Commission, which reported in that year, did not find it necessary to spell out the reasons for this conclusion, saying simply, under the heading 'Introductory Observations', that 'The evils of this double system of Judicature, and the confusion and conflict of jurisdiction to which it has led, have been long known and acknowledged'.[2] But the precise method of eliminating the separate court of Chancery proved

[1] See Michael Lobban, 'Preparing for Fusion: Reforming the Nineteenth-Century Court of Chancery, Part II' (2004) 22 Law and History Review 565, 590; Catharine MacMillan, *Mistakes in Contract Law* (Hart Publishing, 2010) 82–6; Stephen Waddams, 'Equity in English Contract Law: The Impact of the Judicature Acts (1873–75)' (2012) 33 Journal of Legal History 185; Stephen Waddams, 'Good Faith, Good Conscience, and the Taking of Unfair Advantage' in Andrew Dyson, James Goudkamp and Frederick Wilmot-Smith (eds.), *Defences in Contract* (Hart Publishing, 2017) 63; Stephen Waddams, 'Mistake and Unfairness in Contract Law' in John C. P. Goldberg, Peter Turner and Henry E. Smith (eds.), *Equity and Law: Fusion and Fission* (Cambridge University Press, 2019, forthcoming).

[2] Report of Judicature Commission, Parliamentary Papers 1868–69 xxv 1, 6.

to be highly controversial. By the time the Judicature Act of 1873 came to be drafted it had become apparent, after various false starts, that very explicit provisions were needed to ensure beyond doubt that a single court could dispose entirely of a single case: each judge of the new court must be given not only the power but also the duty to administer law and equity together. To achieve this result without incidentally throwing into doubt the juridical position (i.e., the combined effect of law and equity) on thousands of legal questions, it was necessary to abolish the common injunction and also to provide expressly that, in case of conflict between law and equity, equity should prevail. This was done in the rather lengthy and repetitive sections 24 and 25 of the 1873 Act. In section 25 a number of particular instances of conflict between law and equity were enumerated, and a concluding residual provision stated that 'Generally in all matters not herein-before particularly mentioned, in which there is any conflict or variance between the Rules of Equity and the Rules of the Common Law with reference to the same matter, the Rules of Equity shall prevail'.[3]

This might have seemed like a convincing victory for equity, but, in practice, the equitable powers of the new court came subsequently to be marginalised by being treated as isolated exceptions, regarded with a degree of suspicion, and not to be extended by the new court beyond the precise circumstances in which the court of equity would have intervened before 1875. The concept of a general power to modify the common law in order to avoid inequitable results was, to a considerable extent, lost sight of in the twentieth century. However, it does not follow that the power has been permanently lost: some modern judges and commentators have retained a consciousness of the wide powers exercised by the old court of equity, which, having been inherited by the modern court, can be revived, or extended, where appropriate, to new circumstances.

2. Forfeitures

The court of equity commonly gave relief against forfeitures. The most clearly established case was that of a mortgage of land.[4] Mortgage documents usually provided that, on default in repayment, the land should be

[3] Judicature Act, 1873 s. 25 (11).
[4] Richard Holmes Coote, *A Treatise on the Law of Mortgage* (Butterworth, 1821) 20, mentions cases from the reigns of Elizabeth I and Charles I.

forfeited to the mortgagee. The courts consistently refused to enforce this simple provision, despite the fact that it was well known and perfectly clear. Whatever form of words was used – even if the document evidenced an outright conveyance of the land[5] – the court, if convinced that the substance of the transaction was a mortgage, refused to enforce the document and permitted the borrower to redeem the land:

> So that in every mortgage the agreement of the parties upon the face of the deed, seems to be, that a mortgage shall not be redeemable after forfeiture ... and a mortgage can no more be irredeemable than a distress for rent-charge can be irrepleviable. The law itself will control that express agreement of the party; and by the same reason equity will let a man loose from his agreement, and will against his agreement admit him to redeem a mortgage.[6]

No restriction, even by express agreement, was permitted on the right to redeem. In *Spurgeon* v. *Collier* (1758) Lord Northington said that: 'The policy of this Court is not more complete in any part of it than in its protection of mortgages ... and a man will not be suffered in conscience to fetter himself with a limitation or restriction of his time of redemption. It would ruin the distressed and unwary, and give unconscionable advantage to greedy and designing persons.'[7]

This last sentence compendiously illustrates the impact of the separate but interlocking concepts that have run through the equity cases: relief of the disadvantaged party, avoidance of unjust enrichment of the advantaged party and deterrence of greed and trickery, all linked with 'the policy of this Court'. A few years later the same judge again linked the concepts of reason, justice, freedom of consent and deterrence of trickery:

> This court, as a court of conscience, is very jealous of persons taking securities for a loan, and converting such securities into purchases. And therefore I take it to be an established rule, that a mortgagee can never provide at the time of making the loan for any event or condition on which the equity of redemption shall be discharged, and the conveyance absolute. And there is great reason and justice in this rule, for necessitous

[5] *Maxwell* v. *Mountacute* (1719) Prec Ch 526, 24 ER 235; *Cripps* v. *Jee* (1793) 4 Bro CC 472, 29 ER 994; *Sevier* v. *Greenway* (1815) 19 Ves 413, 34 ER 570.

[6] *Howard* v. *Harris* (1683) 1 Vern 190, 192, 23 ER 406. This passage from the argument of successful counsel was cited, with page reference and near quotation, as having assisted in establishing the law on the point, by Coote, *A Treatise on the Law of Mortgage* (n. 4) 22.

[7] *Spurgeon* v. *Collier* (1758) 1 Eden 55, 59, 28 ER 605 (Sir R. Henley).