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WELFARISM IN THE MODERN LAW OF CONTRACT

LATIFAH ALABDULQADER[1]

ABSTRACT

In modern days, there has been an alleged transformation of the law to introduce values of fairness and cooperation. Nevertheless, these notions of fairness are best described as supplementary rather than limiting notions. This indicates that the sanctity freedom of contract is softened but still dominant. The liberal notions of contract seem to be still dominant, and the notion of freedom of contract particularly stands as a serious obstacle to the development of any general doctrine of substantive fairness. However, this paper argues that the modern law of English contract rejects a general doctrine of substantive fairness but not the idea that fairness is a relevant consideration for contract validity. As a result, fairness is dealt with by indirectly and covertly through doctrinal manipulation. This causes issues of inconsistency and stands against the development of the law. In other words, it addresses the extent to which fairness is preserved by the law of contract.

Keywords: Contract, Fairness, Welfarism.

INTRODUCTION

The most fundamental rules of the marketplace are stated by contract law. It serves the enforceability of transactions and imposes restraints on the conduct of obligations created by parties and limits its enforceability by means of self-help or coercion from legal institutions. Furthermore, the law of contract has the potential to enhance community welfare. The marketplace forms a key mechanism for the production and distribution of wealth in most societies. The modern role of contract law requires the balancing of the contractual relationship rather than mere protection of individually acquired positions. Good morals require contractors to act fairly, honestly and to respect the legitimate rights of others. Exploiting vulnerability or weakness of position of the counter-party to yield self interest runs counter to accepted moral standards. This research is concerned with determining when this changes from being a mere moral obligation to become one that is enforced by the English law.

ENGLISH LAW AND PROCEDURAL FAIRNESS

Under the English law of contract obligations are voluntary based on mutual consent. Duress is an essential equity doctrine by which the law ensures that the consent is voluntary and real. Duress is generally regarded as a defect affecting consent in contract and therefore the validity of the consent. Common law duress in its historical form involves actual or threatened violence to the person. It was closely associated with the legal control of criminal and tortuous conduct. The essential elements of duress were established as early as the mid-thirteenth century (Ogilvie, 1980). Early analysis of duress focused on the act of coercion itself and its effect on the victim in inducing fear. The concept of duress in common law used to be a very narrow one that was restricted to actual or threatened physical violence to the person (Peel, 2011). The practice of common law duress in England has developed a wider scope with regard to contractual freedom. Duress is no longer restricted to actual or threatened physical violence to the person but includes the threat to seize another's property or to damage it (Poole, 2012), in addition to mere economic duress. Economic duress consists of using superior power in an 'illegitimate' way in order to coerce the other contracting party to agree to a particular set of terms (Mckendrick, 2010). Furthermore, the focus of the doctrine has turned to the

[1] Dr. Latifah Alabdulqader, Princess Nourah bint Abdulrahman University, Saudi Arabia. E-mail: Latifa0.0@hotmail.com.

wrongfulness of the threatened conduct rather than the consequences to the coerced party (Halson, 1991). It includes unlawful threats and lawful threats which are used to support unlawful demands (Mckendrick, 2010). However, the rough and tumble of the pressures of normal commercial bargaining does not amount to illegitimate pressure (Poole, 2012).

A second doctrine of procedural justice is undue influence. Under the English law the equitable doctrine of undue influence operates to release parties from contracts that they have entered into as a result of being influenced by the other party. Undue influence is presumed where there is a trust relationship between the parties. Generally, it seems that the court would allow release based on undue influence if the claimant's decision was made by excessive reliance or dependence on the defendant (Peel, 2011). The modern approach to undue influence in English law requires wrongful conduct on the part of the defendant. Generally, it is observed that most cases of undue influence contain such an element of 'wrongful' conduct, in the form of an act of exploitation or taking advantage of the claimant's vulnerability (Mckendrick, 2010). Transactions that amount to undue influence are the kind of transaction that claimants would not have entered into under normal circumstances. In other words, it is when the victim receives no benefit from entering into such a transaction (*Bank of Credit and Commerce International SA v Aboody* [1990] 1 QB 923).

The two procedural doctrines of fairness have been developed in modern times to create more limitations within the law of contract. The development of the two doctrines represents the main modern changes in the acknowledgment of contractual fairness in English law. Contractual freedom is restricted by the relatively new development of the doctrine of economic duress and the stress on 'wrong doing' as the basis for the two doctrines. This involves restriction of the substance of the contract since the two doctrines are invoked when there is imbalance between the counter-values of contract (Stone and Devenney, 2015). Nevertheless, the basis of the two doctrines remains procedural since it cannot be invoked unless there is something wrong with the process by which the contract was concluded. As a result, it intervenes into the substantive fairness of the contract in a very limited sense.

ENGLISH LAW AND SUBSTANTIVE FAIRNESS

The way the English law regulates substantive fairness is not as certain or direct as procedural fairness is regulated due to the ongoing ideological battle. Classical law of contract is based on the assumption that free dealing is fair dealing. Justice is enforced in a contract by ensuring that the process by which the contract was concluded has been freely agreed upon (Devlin, 1965). A transformation is said to have taken place in the late nineteenth century with the doctrine of *laissez-faire* falling out of favour (Epstein, 1975). The alleged transformation of the law is understood to have been reflected in the adoption of values of fairness and cooperation. Notions of inequality of bargaining power, unconscionability, reasonableness and good faith were thus introduced to the law of contract (Brownsword, 2006).

The inequality of bargaining powers is invoked as a starting point for the differentiation between consumer and commercial transactions (Brownsword, 2006). Furthermore, the idea of relative bargaining powers is employed in the statutory regimes which regulate exclusion clauses under the test of reasonableness of the Unfair Contract Terms Act 1977.

The notion of reasonableness seems to stand at the core of modern law of contract (Brownsword, 2006). Reasonableness is widely employed in the contemporary law of contract. It is imposed by legislation on several occasions and has a great effect in the rules and doctrinal formation of the modern law. The most obvious example is the test of reasonableness imposed by legislation in the Unfair Contract Terms Act 1977 (Coote, 1978).

In recent years, good faith has been frequently invoked and wide range of literature is devoted to discussion of the principle of good faith. The English court has shown some willingness to acknowledge the principle of good faith by the law of contract (Paterson, 2015;

Summers, 1968; Zhou, 2014). Furthermore, the notion of good faith is employed in the statutory regimes.[2] A contract can be ruled out based on unconscionability if there is evidence of 'taking advantage' of a disadvantageous party. Yet, the courts' requirement of unconscionability is difficult to satisfy and there is hardly ever a successful claim on unconscionability grounds alone (Poole, 2012).

Nevertheless, these notions of substantive fairness are best described as supplementary rather than limiting notions, which soften the rigidity of the law. Despite the alleged transformation of the law, intervention into the substance of contract to fix the balance of the contractual relation remains minimal. Intervention is mainly limited to procedural doctrines of undue influence and duress, and the intervention by the reasonableness test is limited to exclusion clauses. This indicates that the sanctity freedom of contract is softened but still dominant. Although there is a movement towards the creation of a general doctrine of fairness by English common law, such movement has been hampered. At one point, the idea that fairness should be a condition of the validity of the contract prevailed in the courts. This was later on dismissed by liberal ideas and more precisely by the notion of freedom of contract.

The current state of the English law of contract in relation to substantive fairness brings about the next question: does the rejection of a general doctrine of substantive fairness (outside consumer transactions) by the English courts negate the idea that fairness is relevant to contract validity? This question is addressed next.

THE EFFECT OF THE REJECTION OF A GENERAL DOCTRINE OF SUBSTANTIVE FAIRNESS IN ENGLISH LAW

We have seen that the English law of contract has rejected the development of a general doctrine of substantive fairness. By contrast, substantive fairness is promoted and protected under the consumer theory. One might question why the English law would accept that contract fairness is relevant in one case (consumer transactions) but not relevant in the other case (commercial transactions). Obviously, the law is based on the assumption that commercial contractors are always contracting at arm's length and of equal bargaining positions. But what if this proves not to be the case? For example, when a small and newly established company is contracting with a large powerful company, it would be hard to imagine that they are contracting from equal positions. Why would make the law ignore such inequality whilst acknowledging it in relation to consumers? In other words, how does the law ensure that contracting commercial parties are equal?

It is observed that English courts in fact only reject the name of doctrine but not contractual fairness itself (McKendrick, 1999). Even though courts avoid the admission that fairness is a relevant consideration within contract validation, fairness is still evaluated under the guise of other doctrines (Thal, 1988).[3] McKendrick (1999) indicates that as easy as it seems for an English judge to rule against common principles of fairness, a judge will "think hard and long before ruling against principles of good faith and fair dealing" (p. 46). Waddams (1976) observes that even though courts try to show commitment to the freedom of contract, relief is everyday given against agreements that are unfair, inequitable, unreasonable or oppressive.[4] Atiyah (1985) has rejected the idea that contract regulation is still concerned only with procedural unfairness or the bargaining process and not with the substance of the contract. He

[2] For example the duty to act in good faith under the Commercial Agents (Council Directive) Regulations 1993 (SI 1993/3053) and Unfair Terms in Consumer Contracts Regulations 1999 (SI 1999/2083).

[3] Thal (1988) observes that considerations of fairness have often been determined by the court under the doctrines of duress and undue influence. He cites the courts' decisions in the North Ocean Shipping v Hyundai Construction, The Atlantic Baron [1979] QB 705 (duress) and Allcard v Skinner (1887) 36 Ch D 145 (undue influence) in support for his argument.

[4] Waddams (1976) observes that consideration of substantive fairness is viewed by the court in relation to: penalties, deposits, exemption clauses, incorporation of documents, documents and consents, interpretation, duress, protection of weaker parties, withholding discretionary remedies, consideration, and restraint of trade.

says that fairness is protected by courts even without the assistance of statute. It is also widely acknowledged that judges tend to give effect to their sense of justice through constructing contracts or implying terms.[5] Paterson explains that the fairness notions without doubt will continue to be implied into the law of contract regardless of whether the court is prepared or not to recognise a general duty of fairness. This includes the promotion of duties of loyalty to the contract by precluding parties from engaging in dishonest, uncooperative, opportunistic or irrational behaviour that would undermine their commitment to the contract relationship (Paterson, 2015).[6]

At this point one may be confused as to the approach of the modern law of contract towards fairness of exchange. On one hand, fairness and cooperation are important values that are indicative of the modern transformation of the law of contract. On the other hand, the law seems reluctant to adopt a general doctrine that protects the fairness of deals. The tendency of the English law of contract to shy away from commitments to explicit principles of fairness raises questions about its commitment to protecting the fairness of contract. How do the English courts respond to the adversarial values of the law of contract? Or more precisely how do they respond to inequality of bargaining power and unfairness in contracts?

ENGLISH LAW APPROACH TO PROTECTING CONTRACTUAL FAIRNESS

The modern law of contract acknowledges the fact that contractors hardly negotiate from even bargaining positions. To respond to this fact without causing the contract institution to collapse, a corrective approach has been followed. For example, situational monopoly is regulated by the doctrine of economic duress to protect commercial contractors who are being put under pressure to renegotiate a contract (Brownsword, 2006).

As long as the measures employed are taken to be corrective, the institution of contract will remain based on free and informed consent. Modern corrective intervention is taken to be a restatement of classical contract law and the freedom of contract. Brownsword (2006) explains this point in relation to the doctrine of inequality of bargaining power, which could read either as plaintiff-sided or defendant-sided. It could be defendant-sided in the sense that the stronger party has taken unfair advantage of the weaker party and plaintiff-sided in the sense that the weaker party has not given a free and informed consent to the transaction. As long as the measures taken are understood to be plaintiff-sided, the doctrine could be viewed as a restatement of the ideal of freedom of contract. By contrast, if it were to be defendant-sided, it would mean that it is concerned with fairness and militating against unconscionable advantage-taking. The modern law then, according to him, "is taking on a major reconstruction of institution of contract" (pp. 88-92).

In order to respond to these demonstrated problems of unfairness, Sir Thomas Bingham explains that the English law of contract has "developed piecemeal solutions" (*Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] QB 433, p. 439) Honest behaviour in contract is achieved without adopting a general doctrine but rather through "the adaptation of specific rules that, in particular context, make honesty the best policy" (Waddams 1999, p. 237-56). To some, the English approach serves well enough the way it is. McKendrick (1999)

[5] Atiyah suggests that 'it is no longer possible to accept without serious qualification the idea that law is today solely concerned with the bargaining process and not with the result' (procedural fairness but not substantive fairness). He argues that the English court has over the years expressed real concern with substantive fairness. He cites in this regard the decisions of the English Court of Appeal in Staffordshire Area Health Authority v South Staffordshire Waterworks [1978] 1 WLR 1387 and Tito v Waddell [1977] Ch. 106. He adds that even in cases that are based on traditional procedural doctrines such as undue influence and duress, substantive fairness considerations were taken into acknowledgment by the court, in this regard he cites the English court decisions in Lloyds Bank Ltd v Bundy [1975] QB 326, Cresswell v Potter [1978] 1 WLR 255 and Backhouse v Backhouse [1978] 1 WLR 24.

[6] Paterson made this opinion in relation to the principle of good faith in the light of Yam Seng Pte Limited v International Trade Corporation Limited [2013] EWHC 111 (QB).

points out that the refusal to adopt a general doctrine could be taken as evidence of strength in the law. According to him, the English law manages to serve in other ways what different legal systems pursue through a general doctrine of morality. For example, in dealing with the events occurring after the formation of the contract that have the effect of rendering the performance of a contract impossible, illegal or impracticable, English law responds through the distinct doctrine of frustration. By contrast, German law has to resort to the doctrine of good faith to regulate the matter. Thus, it does not make sense to McKendrick (1999) to abandon a clearly-focused doctrine such as frustration in favour of the more amorphous doctrine of good faith.[7]

IS IT TIME FOR RECONSTRUCTION?

Atiyah (1990) has argued that the 'basic conceptual apparatus' of the English law reflects the situation in the nineteenth century rather than the contemporary moment. These values reflect liberal traditions of belief in the value of the rights of the individual. Nonetheless, he argues that current values of society contradict what used to be admirable in the nineteenth century. Therefore, it is the time to revise the concepts to reflect current societal values.

It is preferable that fairness is dealt with directly by a doctrine that makes an explicit ground for it, rather than covertly through the manipulation of technical rules. Indeed, trying to achieve fairness in the absence of a general doctrine produces incoherent outcomes, leaving judges unable in some situations to achieve justice. The answer could be to adopt a general doctrine of morality which would provide coherent regime that enables judges to deal effectively with unfairness (Powell, 1956).

Dealing with the matter explicitly by adopting a general principle (or principles), according to Trebilcock (1976), would serve the ends of constructive judicial law-making as well as rational independent analysis and the evaluation of the aptness of legal rules. He argues that it would even be cost efficient, because it gives guidance to other parties in their actions, through rules that have some generality of application. He explains that "decisions that are ostensibly confined in their application to narrow technical or factual circumstances only relevant to the case under adjudication" (Trebilcock, 1976, p. 384).

So, what would it take for the English law to adopt a general doctrine of fairness? Perhaps the first obstacle to the creation of a doctrine is the question of defining the idea of fairness of exchange and indeed whether the idea of fairness in exchange itself is a theoretically defensible idea (Atiyah, 1985). Moreover, the issue of how to define the limitation on the freedom of contract doctrine is the most difficult to resolve (Thal, 1988). The problem has been raised both by judges and legal scholars.[8] The issue was concisely stated by Treitel, who explains that the alleged principle is very wide and not well defined (as quoted in Peel, 2011). According to him, English courts, unlike American courts, have no intention of taking the matter far to give clarity to the law. Thus, the matter is better left to Parliament (as quoted in Peel, 2011).

Different approaches have been suggested in this regard. Trebilcock (1976) takes the position that in order to have an effective instrument that tackles contractual unfairness, the adopted doctrine "needs to be sharp in its focus, conceptually sound and explicit in its policy underpinnings, and operational in terms of both the process of judicial inquiry it envisages and the remedial instruments available to a court to abate objectionable phenomena" (p. 385). Treitel on the other hand, focuses only on the substantive side of the matter, suggesting that to

[7]McKendrick (2010) failed in making a sensible argument first, because he did not make good bases for his claim that the adaptation of a good faith doctrine requires abounding the doctrine of frustration. Second, he mentioned that German law deals with issues of impossibility, illegality and impracticability in contract formation by referring to the doctrine of good faith whereas in fact these issues are dealt with by legislation through the German Civil Code; illegality is dealt with in section 134, impossibility 275 (1); impracticability 275 (2).

[8] Some of the best discussions of this problem are found in Tiplady (1983); Beale (1986); National Westminster Bank plc v Morgan [1985] AC 686.

have a sufficiently formalised doctrine we need to define what amounts to an unfair outcome (as quoted in Peel, 2011). Thal (1988) rejects Treitel's proposal, and instead proposes a procedural approach. His view is that the only way to define unfairness is by focusing on the bargaining process and not the outcome.

Brownsword (2006) emphasises the importance of having a specific moral reference point. According to him there are two principle options for such a reference point: (1) the standards of fair dealing recognised by the community of which contracts are most proximately a part; (2) the standards of fair dealing that would be prescribed by the 'best'. Though, the latter option looks difficult to justify either in terms of the practical legitimacy of judicial decisions or in terms of their theoretical justification. He sees a tendency in the English law of contract towards adopting morality doctrines to reflect the expectations associated with good practice in both the field of consumer and of commercial contracting.

Atiyah (1985) on the other hand, acknowledges the fact that courts are giving effect to their sense of justice in construing contracts or implying terms. He rightly explains that ideas of fairness and customary behaviour interact. When a judge implies a term to give effect to his sense of justice rather than the intention of the parties, his sense of justice derives in part from patterns of customary behaviour.

This research upholds the conclusion that the English law of contract should deal with substantive fairness of contract directly and clearly through the adoption of a general principle. The fear that the institution of contract would collapse and the uncertainty regarding a moral reference point should not be an excuse to remain bound by values that no longer reflect society. Continuing to serve justice disguisedly and indirectly in addition to being costly and lacking clarity restricts proper development of the law. It would be much more efficient, clear and simple to militate against unconscionable advantage-taking rather than correcting the wrongdoing when it occurs. Furthermore, when the issue is dealt with directly and clearly through an accepted doctrine mentoring the judicial practice will become more practicable. A sense of justice is always derived from customary behaviour. Thus, allowing judicial intervention both in relation to the process and substance of the contractual relation is likely to reflect societal values.

CONCLUSION

The modern law of English contract rejects a general doctrine of substantive fairness but not the idea that fairness is a relevant consideration for contract validity. As a result, fairness is dealt with by indirectly and covertly through doctrinal manipulation. This causes issues of inconsistency and stands against the development of the law. It seems to be primarily the fear that the contract institution would collapse without it that makes the law keen to preserve a liberal ideology that does not reflect current values. However, as Lord Devilin states, "the true nature of common law is to override theoretical distinctions when they stand in the way of doing practical justice" (*Ingram v Little* [1961] 1 QB 31, p. 66). Thus, any obstacle in front of the application of practical fairness should be removed. The English law should respond to modern social and economic developments by adopting a general doctrine of substantive fairness. It should be recognised in the law of contract that liberalisation is no longer the best way to achieve justice. The creation of a doctrine of substantive fairness is a necessary development of the law. The introduction of a substantive doctrine would serve the consistency, efficiency and clarity of the law. Achieving practical justice requires intervention into the process as well as the substance of the contract. Being focused on one aspect of fairness rather than the other is likely to produce unjust outcomes. Furthermore, ignoring contemporary economic and social developments and needs is likely to produce injustice. This is because fairness is a relevant phenomenon that changes with time and circumstances. This is the main issue facing the development of the English law of contract. It struggles in dealing with

perceived injustice as a result of the determination to remain bound by liberal theory while ignoring changes in economic and social factors.

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