Key Ideas in Law

CONTRACT LAW

Nicholas J McBride

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'Clearly written and bursting with interesting and novel ideas, this lively book will be a great resource for anyone interested in Contract Law.'

PAUL S DAVIES, PROFESSOR OF COMMERCIAL LAW, UNIVERSITY COLLEGE LONDON

This book introduces the reader to a number of ideas and issues that underlie the English law of contract – an area of law that is often regarded as forbiddingly dry and technical but which is here made easy to understand and full of interest. Taking as its starting point the role contract law plays in helping markets to operate, the book explains how contract law regulates the commercial risks people take, while at the same time placing limits on what may be bought and sold, and ensuring that contractual powers are not unacceptably abused. A final chapter discusses how contract law can be used to make gifts of binding promises to other people. The book provides a rigorous and stimulating journey through the ideas underpinning contract law and is essential reading for anyone with an interest in the subject.

NICHOLAS J MCBRIDE is Fellow of Pembroke College, Cambridge. He was formerly a Fellow of All Souls College, Oxford. He is the bestselling author of *Letters to a Law Student* (4th edition, 2017), (with Roderick Bagshaw) *Tort Law* (6th edition, 2018), and (with Sandy Steel) *Great Debates in Jurisprudence* (2nd edition, 2018).

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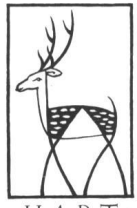

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For Isabel, Ines and Luca
Always

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1

Introduction

This is a short book about contract law, which—for the time being—we can define as the institution that allows people to enter into legally binding undertakings with other people. The book aims to introduce you to a number of key ideas which will help you make sense of the way contract law works, and why it works in the way it does. Chapter 2 explains how contract law is fine-tuned to support the making of exchanges and deals among people trading goods and services with other. Chapter 3 deals with how contract law manages the risk that entering into a contract involves, that the contract may prove to be a bad deal for one of the parties to the contract. Chapter 4 looks at when the courts will refuse to enforce certain contracts or contractual terms because the contracts or terms in question are unfair or 'unconscionable'. Chapter 5 discusses the limits of what can be traded in the marketplace and the consequent limits on what sort of contracts people can enter into with each other. And Chapter 6 looks at the interaction between the law of contract and the law of gifts, and in particular when a promise for which nothing was asked in return will be legally binding.

John Maynard Keynes famously observed that 'The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist' (Keynes 1936, chapter 24).* In the case of contract law, we have been slaves too long to the ideas of a French jurist, Robert Joseph Pothier (1699–1772) and his 1761 work *Traité des obligations*. Written about French law, not English law, Pothier's views on

* Throughout this book, full references to books and articles referenced in the text can be found by consulting the Bibliography at the back of the book.

contract law—in particular, what is sometimes called 'The Will Theory of Contract Law', according to which contract law exists to give effect to the intention of the parties to an agreement that the agreement be legally binding—were seized upon by English contract scholars in the nineteenth century mainly, it seems to this author, because of an inability to imagine any better theory of contract law. (For an account of the reception of Pothier's views among English writers on contract law, see Swain 2015, 148–52, 172–200, 264–65.) This book is an attempt to offer the reader something better than warmed-over Pothier; something that does more justice to the details and features of English contract law than the Will Theory can, and puts the reader in the best possible position to understand and evaluate contract law and develop informed opinions as to what the future of English contract law should look like.

2

Markets

In this chapter, I want to set out a very simple idea—that we have a law of contract in order to facilitate the orderly workings of the marketplace, where people can trade whatever can be lawfully traded.

1. ARTIFICIAL TRUST

For markets to exist, two things are essential (see Mises 1949, at 238). First, it must be the case that no one person can produce everything they need to live—so in order to survive, people have to trade with each other. Second, people need to be able to enjoy (i) secure legal control (in other words, *private ownership*) of the means by which useful things are produced, and the things which are produced with those means, and (ii) the ability to transfer that secure legal control to one another. This then enables people to trade with each other, so that if having secure legal control over *my* apple would be more useful to you than the secure legal control that you currently have over *your* orange, and having secure legal control over *your* orange would be more useful to me than the secure legal control I currently have over *my* apple, then we can enter into a mutually beneficial trade—your orange for my apple.

But if we are to make a trade, we will usually need a third element to be present—we will need to be able to *act as though we trust each other*. This quality of being able to act *as though* I trust you, we can call 'artificial trust' (following Galanter 1998, 806, and Putnam 2000, 147; Cross 2005 calls this kind of trust, 'cognitive trust'). As has long been acknowledged (see Hobbes 1651, XIV; and Hume 1738, 3.2.5.8), if this third element of artificial trust is missing, then people's abilities to make deals with each other become radically attenuated. People would not be able to *stagger*

their exchanges, so that I pay you now for delivery later, or I deliver now and expect payment from you later. My inability to act *as though* I trust you not to let me down later on, after I have performed my side of our deal, will prevent us from doing this. So if I want to buy a car from you for £1,000, the only way that deal could work—in the absence of our being able to act as though we trust each other not to let each other down in performing our side of the deal—would be for me to hand over £1,000 to you at exactly the same time as you hand over the keys to the car to me. However, if you want me to wash your car for £50, that exchange would become impossible in the absence of our third element as we could not (unlike in the previous example) instantaneously swap your £50 for my services in washing your car. One of us will always have to perform before the other and take the risk of being let down by the other. The same point applies to David Hume's example of a trade of services, where Farmer A and Farmer B cannot harvest their ripe corn on their own, but need the other's help to get the corn in. It makes sense for them to trade their services, with Farmer A helping to harvest Farmer B's corn when it becomes ripe, in return for Farmer B doing the same for Farmer A. But making such a trade will be impossible if Farmer A and Farmer B cannot act as though they trust each other as one of them will inevitably have to perform first and hope that the other does not let them down when it comes to their performing their side of the deal.

This is where contract law comes in. It enables people trading in the marketplace to act *as though* they trust each other by making the promises they make to each other legally enforceable. The result is that if A orders some goods from B, promising to pay B at the end of the month, B can sell the goods to A on *credit* (Latin for 'he believes') because B knows that A's promise to pay at the end of the month will be legally enforceable—so if A lets B down and does not pay, B will still be able to extract the promised money from A. B does not have to *actually* trust A to pay—if B did, then B would not have to worry whether A's promise to pay was legally binding. All B has to do, to be able to sell to A on credit, is act *as though* he trusts A to pay—and that is what the law of contract both enables B to do, and aims to enable B to do. As the legal historian Brian Simpson observes, 'the essential function of contract law is to permit credit, money-credit' (Simpson 1975, 281). More generally, 'large-scale, well-functioning markets [cannot] develop without the assistance of law' and contract law 'strengthens and extends markets' (Oman 2016, 35–36; see also Oman 2012) by enabling parties to a deal to act as though

they trust that any promises that are made as part of that deal will be performed. In other words, contract law exists to facilitate exchanges of goods and services in the marketplace by fostering artificial trust among the people engaged in making those exchanges.

2. ASPECTS OF CONTRACT LAW

The role contract law plays in creating artificial trust between actors in the marketplace accounts for a number of different aspects of contract law.

THE DOCTRINE OF CONSIDERATION

The doctrine of consideration says, very roughly, that a promise will only be contractually binding if something of value in the eyes of the law has been given in return for the promise. (Note that some promises for which nothing has been given in return (known as '*gratuitous* promises') can be legally binding—we will deal with these in Chapter 6, where the doctrine of consideration is discussed in much more detail.) Immediately one sees a connection being made here between contract law and the marketplace—according to the doctrine of consideration, a promise will only be contractually binding if something has been given *in return for it.*

In practice, two types of promise will normally be said to be 'supported by consideration' and therefore contractually binding. The first is a promise to reward someone if they act in a particular way, with the result that that someone is induced to act in that way. So, for example, if I promise to pay you £100 if you wash my car, and you are induced by my promise to wash my car, my promise to pay you £100 will be contractually binding—your washing my car has provided the consideration needed to make my promise binding. (Note that there is no need for my promise to be in writing or accompanied by any kind of formality to be legally binding—the joke that 'A verbal contract isn't worth the paper it's written on' is just that: a joke.) The second kind of promise is made as part of an *agreement* under which both of the parties to the agreement promise to do things for each other. The promises made under this agreement will normally be contractually binding, with the promises made by one of the parties providing consideration for the promises made by the other

party and *vice versa*. The agreement reached by the parties is known as a '*bilateral* contract', because *both* parties to the agreement will be contractually bound to perform the promises they made to the other party. Contrast that with the situation where in return for my promise to pay you £100, you have washed my car. As only one of us (me) is legally bound to do something for the other (you) in this situation, lawyers say that there exists here a '*unilateral* contract'.

It has been questioned whether consideration *should* be found in the case of a bilateral *executory* contract—where you and I have reached an agreement under which I promise to deliver 1,000 widgets (an imaginary item of commerce) to you at the end of the month and you promise to pay £500 per widget when they are delivered, but neither of us have yet done anything to perform our sides of the agreement. Why, it has been asked (see Atiyah 1990, 22–25, 167–70, 191–92) should the law find that we are each bound by our promises, even though neither of us have done anything to rely on the other's promises, and one of us may be attempting to pull out of the agreement just five minutes after it was entered into? However, it can easily be seen that contract law would fail in its mission to facilitate the orderly workings of the marketplace were it *not* to find that bilateral agreements are legally binding as soon as they are entered into. In a world where such agreements were not automatically binding, but had to be relied on or part-performed before they could be said to be binding, the chains of contracts that go into the production of something as simple as a pencil would become much more vulnerable to being broken by a party who forms one link in the chain trying to argue that he is entitled to back out of what now appears to him to be a bad deal (see Rudden 1989, 84–89).

OBJECTIVITY

The principle of objectivity in contract law says that if I enter into a contract with you, I am *not* bound to do what I *intended* to promise to do when I entered into that contract, but I am instead bound to do what I *reasonably gave you the impression* I was promising to do when I entered into that contract. More generally, I will not be allowed to argue, 'Term *x* isn't part of the contract I entered into with you because I never intended to agree to that.' If I reasonably gave you the impression that I was agreeing to term *x* being part of our contract, then I will normally be bound

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