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The Law in General

This book is about commercial, as opposed to consumer, contract law. It does not deal with questions of consumer protection and consumer rights. So it makes no reference to such matters as consumer legislation (which has culminated in the Consumer Rights Act 2015, coming into force at the time of writing and which promises to be of great importance), except where it affects contract law generally.

The book is about the law of England and Wales, though in practice the contract laws of the four other legal systems within the United Kingdom will not be much different. (They are the legal systems of Scotland, Northern Ireland, the Isle of Man and the Channel Islands.)

Law is based around the principle of the nation-state. Each country has its own legal system and its own laws. So a dispute under a contract subject to French law will be decided by the procedures and principles that govern French law, a contract subject to German law by German procedures and principles, and so on. An attempt a few years ago to combine sharia law with English law in a contract, *Shamil Bank of Bahrain EC* v. *Beximco Pharmaceuticals Ltd* (2004), was rejected. The court stated that one cannot combine legal systems. (A judge under any other system would say the same.) However, the court did accept that it might well be possible for a contract governed by English law to incorporate a specific rule from another legal system.

A contract between two English companies carried out in England will be subject to English law, almost automatically, and any dispute will be settled in the UK. But with any trans-national contract there will be a choice. The choice decides which law will govern the contract and apply to any dispute, and perhaps also the place where that dispute will be decided. With most complex commercial contracts the broad outlines of law will be much the same in most

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countries. However, the detail may well be very different, and the dispute procedures will be different. The parties should make a conscious choice, not an accidental one. See the case of *Entores* v. *Miles Far East Corporation* (1955) in Chapter 4 below.

The point is covered by the Contracts (Applicable Law) Act 1990, and the Private International Law (Miscellaneous Provisions) Act 1995, with reference to Article 4(2) of the 1980 Rome Convention on the Law Applicable to Contractual Obligations. These provide that the law applicable to any contract should be governed by the 'principal place of business' of the parties, or one of them, unless under the terms of the contract performance was to be elsewhere, when another law might be selected. It was discussed in the case of *Enstone Building Products Ltd* v. *Stanger Ltd* (2004) which concerned a contract between two English companies for an investigation of building materials to be carried out in Scotland, with a report then to be submitted by the English office of one party to the other. No applicable law was stated in the contract. The court decided that the contract was governed by English law.

There are a number of preliminary points to remember.

1.1 A little understanding

Almost everyone can drive a car. Very few of us are skilled mechanics or physicists. We do not understand Newton's first and second laws of motion or how to take a car engine apart. We do not need to. But an understanding of the basics does help if the road is icy or the car has a mechanical problem. Contracts are just the same. Most of the time we do not have any difficulties, but the knowledge is useful, just in case.

1.2 Why contract law?

We live in a market economy. Almost every country in the world is a market economy, more or less. The economic theory behind the market economy is the maximisation of special skills. Everyone should concentrate upon his own special skills, then sell the results of those special skills and buy the results of other people's skills. In that way everyone can maximise his own output, and so the economy as a whole can prosper.

The contract is the basic tool of the market economy. It creates certainty that, barring accidents, a seller will deliver and a buyer will pay. It simply needs to have a clear set of rules and be supported by an efficient enforcement/dispute

resolution system such as that of the courts or arbitration. The aim of the law of contract is to provide the rules.

Because the system needs contracts the process of making and managing the contract must not be too difficult. If it becomes too difficult, bearing in mind that the vast majority of contracts are either made by consumers who know little if anything of the niceties of the law or commercial people who are too busy to give more than the minimum time to the exercise, then the system will not work. So it is essential that the rules should be simple, and if they cannot be simple then at the least they must be fairly straightforward and easy to apply to the vast majority of real-life situations.

1.3 Commerce and judges

There is a significant difference between the judge and the organisation. The organisation must react immediately to a situation, or as nearly immediately as makes no difference. Sometimes it has to react without full information. A judge has the luxury of looking at a dispute with time at his disposal and with all the benefits of hindsight. Anyone reading the report of a commercial dispute that has gone to court over the past 30 to 40 years will realise that the events which gave rise to the litigation had happened usually at best some three or four years before the court hearing, and often much earlier than that.

The commercial organisation needs certainty. It needs to know precisely what obligations it has under the contract, and what powers it has to manage the contract. Every legal adviser will find himself faced with different varieties of the same question, on numberless occasions. 'I have a contract; it has gone wrong; what can/should/must I do in these circumstances?' This then leads to two further questions. 'Am I in breach, or is he in breach, or are both of us in breach? Secondly, if he is in breach, am I entitled to a significant sum in damages, and, if I decide that I want to do so, can I terminate?' The organisation needs to know the answers to these questions probably on the day the contract is signed, and certainly on the day when a breach occurs, because it must act correctly. If it does not, it may either lose a legitimate opportunity or risk being dragged into court by the other side.

In contrast to this a judge wants flexibility. When he finds himself faced with a dispute in court, one party will claim that the contract justified him in what he did and the other side will claim the opposite. The function of the judge is give a decision which is legally correct, but which will also produce a fair result in all the circumstances, based upon the evidence that the parties put before him. If all he can do is treat the contract as a rigid book of rules, then his ability to be fair is limited.

1.4 Dispute resolution

Many years ago almost every dispute ended in litigation, before a judge. Now that is not so. The great majority of disputes go elsewhere – to arbitration, adjudication, or, increasingly, mediation/conciliation, all of which are very much quicker. The advantage of litigation is a guarantee of the legal competence/quality of the tribunal. But its twin problems are time and cost.

1.5 Where does the law come from?

Contract law is what is called a 'common law' area of law. This means that most of the law that we have today was not created by parliament, but by the decisions of judges presiding over cases in the courts (over a period of 150 years or more). This has serious implications for the way the law works in practice.

It means that there is often no easy way for the layman to find out what the latest position is, first, because there is no easy point of access, second, because judges often discuss cases, not principles, and third, because the various law reports cover hundreds of thousands of cases. It can be equally difficult for the professional lawyer.

It means that rules can remain in place simply because of accident rather than because of intelligent design.

It also means that the development of the law is often haphazard. It depends to an unhealthy extent upon the cases that have actually come before the courts. Inevitably those cases come from the 'difficult' areas. No one can fail to be struck by the high proportion of cases originating in consumer protection, the shipping world, local government, building/civil engineering, liability insurance and the second-hand car trade. In contrast there are very few cases about disputes in the service, oil, electrical, mechanical, chemical/processing engineering, electronics or IT industries.

What is more, 'normal' disputes seldom come to court – they are settled by negotiation, mediation/conciliation, or perhaps arbitration or adjudication. If occasionally they do go to litigation they are usually settled before the court stage is reached. Many of the cases that come to court involve non-normal circumstances – fraud, sharp practice or total incompetence by one of the parties, a major shift in market values or a major accident or loss. This creates a difficulty for the judge – does he apply the law with cold, impartial objectivity, or does he try to give some degree of justice to the injured party? Judges are human beings like everyone else. The problem is that when judges try to be 'fair', they sometimes bend the law or facts a little. This affects the way the law is explained in judgments, with such judgments then creating the law.

1.6 Keeping law up to date

The common law precedent system has served the UK brilliantly, in the sense that judges of high quality have made decisions that have created a system of contract law that in general fits the needs of society.

But it does have one serious, if occasional, disadvantage. It cannot easily update itself. Every system needs to be updated, and law is no exception. Some decisions will be wrong. Some turn out to have unforeseen consequences. A decision that was completely adequate for the world of 1900 may be hopelessly inadequate in the world of 2000. What are the alternatives? First, someone can bring a test case and then appeal it up to the appropriate level so that the previous decision can be reversed (cancelled out), or qualified (changed or adapted). This is expensive in time and resources. It happens only rarely. Second, which happens occasionally, is that a particularly unfortunate decision will be 'distinguished on the facts'. Whenever it is raised the court will say that the facts in the case now before it are different. As the facts are different, the law can be different. Finally, law can be, and most usually is, updated by legislation. The difficulty here is that this can also mean waiting for several years until parliament can find an empty slot in a packed legislative schedule.

1.7 Objectivity and subjectivity

There are two approaches that one can take to motives. One is to consider what the person actually thinks – a subjective approach. The other is to consider what a reasonable, rational and intelligent person in that position might or should have thought – an objective approach. Over the years, lawyers, both academic and others, have argued at length about which approach the law should take.

The law assumes that in the commercial world the parties to the contract are more or less equal in understanding, and are also professionals – so that they behave in a rational way. Therefore all that they need is to know is what the rules are, and once those rules are clear, they can play the game. So the law for commercial contracts always aims to be objective, taking little account of what individual motives are, except where some degree of deceit or fraud is involved. In the world of consumer contracts the law takes a much more subjective approach.

1.8 Is law 'fair'?

Well, sometimes. The original principles of the law as created in the Victorian age were that every person was competent and could look after his best interests. But even then the law recognised that the vulnerable, children for

example, needed some protection. In the modern era the concept of fairness has extended into areas such as consumer and employment protection and the control of unbalanced competition and unfair contract terms, particularly in relation to liability limitation and exclusion clauses.

But in some areas the law does not aim to be fair. In particular, in the area with which this book is mostly concerned, commercial contracts, the law expects competent people to be able to look after themselves. If they cannot do so (see *L'Estrange* v. *Graucob* (1934) below as a prime example), the law will not protect them. Another area where the law is not 'fair' is in litigation or arbitration. Here the law is 'just', simply giving each side the opportunity to present its case and contest the case put forward by the other side. Then the party that puts forward the better case (or puts its case in a better or more convincing way) wins.

1.9 But there is a further question – does law require *the parties* to be fair?

The answer to this question is worth a complete book on its own. There are conflicting principles.

- The law expects competent people to be professional. If I am rather more professional than you, or have rather more bargaining power than you, the contract may favour me more than it favours you. That is only to be expected.
- Second, as has been said, all is fair when in a dispute.
- Third, the law expects the parties to comply more or less exactly with what they have agreed to do in their contract. And the law expects the contract to set out all the rules that are to apply. As long as the parties comply, the law does not require them to be fair in the way in which they comply.

But –

- The law will do its best not to allow a party to a contract to benefit where there is clear evidence of sharp practice. The law on misrepresentation and unilateral mistake are examples of this.
- The law imposes some standards of behaviour on the parties, such as terms that are implied by law or legislation – restrictions on 'unfair' clauses and on clauses in unfair restraint of trade, or restrictions under the Unfair Contract Terms Act or the provisions of the sale of goods legislation and other legislation for reasonable levels of quality and so on, or the doctrine of promissory estoppel.
- The law expects certain standards of conduct in various types of relationship, such as employment or agency contracts.

- There is a solid body of legislation and practice supporting the rights of the consumer to fair treatment.
- Also, in respect of contracts made by private people as opposed to commercial organisations, the law takes at times a rather more subjective approach.

1.10 The two aspects of commercial contracts

Finally, remember that there are two aspects to many commercial contracts.

There is the *transaction*, perhaps the purchase or sale. It is feasible to set out all rules governing the transaction in a contract.

But in addition there is the *relationship*, maybe a joint venture to develop a market or product or a frame contract to cover long-term supply/procurement through a supply chain. These contracts may need to last for a long time and to change to meet unforeseen and unforeseeable circumstances. Here it is simply not always practicable to set out all the terms in the contract.

There has been a steady change in a number of industries towards working within the context of longer-term relationships. This trend is slowly being recognised by law; see for example the 2013 case of *Yam Seng Pte Ltd* v. *International Trade Corporation* where the court was prepared to put a significant amount of emphasis on the need for the parties within a contract relationship to treat each other fairly.

1.11 What does contract law set out to do?

The question is a simple one. The answer is not.

First, contracts can be of many different sizes and types and be intended to operate in many different types of situation. So there is an exception to almost every rule. What is a good rule for auction sales will not fit the world of standard commercial purchasing, for example.

Then the law sets out to do several completely different things at the same time. Sometimes these will be inconsistent, and sometimes they will be directly in conflict with each other.

1. The law is there to provide a framework within which the competent individual or organisation can operate.

   In this sense contract law is just like the law that requires people in the UK to drive on the left, or people in France to drive on the right. It sets out clear

and sensible rules that people can follow easily, and so use the law to get on with their business.

2. The law is designed to allow the maximum possible freedom to people and organisations to make whatever contracts they wish and to manage those contracts in accordance with normal practice.

   The idea of freedom of contract is to some extent a historical accident. It comes from the fact that most of the law was worked out during the laissez-faire non-interventionist Victorian age, but people in general and commercial organisations in particular know their business better than the law. So the law does try not to interfere with normal contractual arrangements more than the absolute minimum.

3. The law is intended to protect the private person against the power of the organisation to treat him unfairly.

   The concepts of consumer protection and employee protection have a considerable impact upon various aspects of contract law, especially where badly drafted or 'unfair' clauses limiting or excluding one party's liability to the other for breach of contract are concerned.

4. The law in a modern state must regulate commercial behaviour in the national interest.

   Increasingly the law sets out to regulate various aspects of commercial activity in the overall interests of the public/economy at large. This leads to an interventionist approach by government, whatever its colour. There is and will always be a constant stream of legislation to regulate various aspects of commercial contracts.

5. The law is there to prevent the unrestricted use of monopolistic power to distort normal commercial behaviour.

   Whilst this is largely only peripheral to this book, any organisation dealing with matters such as contracts for the licensing of intellectual property or the creation of a distributor network within the European Union will need to be well aware of the regulatory requirements.

6. The law sets out to provide a framework within which disputes can be settled by 'legal' means.

   The law never likes to tie the hands of the courts too tightly. It will always therefore allow a considerable degree of flexibility to the dispute tribunal to allow it to make a 'fair' decision. So it will always allow the lawyers to 'do a Portia' and play with the words of the contract, if the parties give them the opportunity.

The overall result is that the law is straightforward in principle, but can also be anything but straightforward when applied to a complex situation.

1.12 Transaction versus relationship

The law of contract is not really designed to deal with relationships. The basic theory is that the contract must include all the rules that are to govern the way that the contract is to be carried out, which is completely acceptable in a contract to buy a car, but not really practicable in a contract to collaborate in a long-term project or trading relationship. It has developed to a large extent in connection with transactions – sale, purchase, repair, transport and so on. So, in a transaction contract dispute we can usually predict what a judge will decide.

But the modern world is more and more concerned with long-term relationships, between customers and regular suppliers, the various partners involved in long-term projects and so on. The courts see very few disputes about relationships (and of these the most common are employment and agency contracts). So it is often going to be difficult to predict what a judge might decide in these contexts.