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FROM "SANCTITY" TO "FAIRNESS": AN UNEASY TRANSITION IN THE LAW OF CONTRACTS?

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FROM "SANCTITY" TO "FAIRNESS": AN UNEASY TRANSITION IN THE LAW OF CONTRACTS?*

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I. THE CLASSICAL LAW OF CONTRACT AND THE PARADIGM OF "FREEDOM OF CONTRACT": AN INTRODUCTION

The moral force behind contract as promise is autonomy: the parties are bound to their contract because they have chosen to be.[1]

A. Sanctity of Contract: Pacta Sunt Servanda

Although contract law is one of the basic and ineludable institutions of our society[2] (and its domain has been incredibly vast, complex, and

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* This Article, though not in the nature of a conventional book review, owes much for its inspiration-and exploration of relevant themes-to the excellent study of Dr. Nagla Nassar on the subject. *See* note 68, *infra*.

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1. CHARLES FRIED, CONTRACT AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION 57 (1981). For Fried, the basis of contractual obligation rests, first, on the impermissibility of violating another's autonomy by abusing a trust one has invited by promising and, second, on the duty to respect the autonomy of the promisor by enforcing obligations one has voluntarily assumed. *Id.* at 14, 16-17. An early example of such a normative approach was provided by Lord Mansfield who, "with his flair for rationalisation," consistently espoused the notion of moral obligation as the test of enforceability of promises. SIR DAVID HUGHES PARRY, THE SANCTITY OF CONTRACTS IN ENGLISH LAW 9 (1959).

2. E. Allan Farnsworth, *The Past of Promise: An Historical Introduction to Contract*, 69 COLUM. L. REV. 576, 578-82 (1969); Melvin Aron Eisenberg, *The Bargain Principle and Its Limits*, 95 HARV. L. REV. 741, 741 (1982) (the "institution of contract is central to our social and legal systems, both as reality and as metaphor"); Dietrich A. Loeber, *Plan and Contract Performance in Soviet Law*, *in* LAW IN THE SOVIET SOCIETY 128-29

diverse[3]), in recent years, it has undergone some significant changes.[4] At the heart of these manifold changes has been the much-vaunted sanctity of individual autonomy in contracting, an offshoot of the liberal notion of freedom of contract, which was the ideological backbone for the

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(Wayne R. LaFave ed., 1965) (the attempt by the Soviet Union to administer the economy without the institution of contract failed); 1 E. ALLAN FARNSWORTH & VIKTOR P. MOZOLIN, CONTRACT LAW IN THE USSR AND THE UNITED STATES: HISTORY AND GENERAL CONCEPT 53-54, 56-86 (1987) (the unsuccessful Soviet experience of functioning without contract is fully explained).

3. As an illustration, *see* GRANT GILMORE, THE DEATH OF CONTRACT 1 (Ronald K.L. Collins ed., 2d ed. 1995), which advanced the provocative view that "contract ... is dead" and created a storm of controversy and inspired a large volume of scholarship questioning the historical, analytical and philosophical bases of the rise and fall of classical contract law. For a sampling of these, *see, e.g.*, Richard Danzig, *The Death of Contract and the Life of the Profession: Observations on the Intellectual State of Legal Academia*, 29 STAN. L. REV. 1125 (1977); Gary L. Milhollin, *More on the Death of Contract*, 24 CATH. U. L. REV. 29 (1974) (book review); Richard E. Speidel, *An Essay on the Reported Death and Continued Vitality of Contract*, 27 STAN. L. REV. 1161 (1975) (book review); James R. Gordley, Book Review, 89 HARV. L. REV. 452 (1975); Morton J. Horwitz, Book Review, 42 U. CHI. L. REV. 787 (1975); Arthur T. von Mehren, Book Review, 75 COLUM. L. REV. 1404 (1975); Anthony J. Waters, Book Review, 36 MD. L. REV. 270 (1976). *But see* Kerry L. Macintosh, *Gilmore Spoke Too Soon: Contract Rises from the Ashes of the Bad Faith Tort*, 27 LOY. L.A. L. REV. 483 (1994) (discussing the decline of the cause of action for tortious breach of the implied covenant of "good faith and fair dealing" in contracts); Ellen A. Peters, *Grant Gilmore and the Illusion of Certainty*, 92 YALE L.J. 8 (1982) (speech given at the Yale Law School memorial service for Gilmore). The various contributions in Symposium, *Reconsidering Grant Gilmore's* The Death of Contract, 90 NW. U. L. REV. 1 (1995), evinces that scholarly discussion continues apace and reveals the critical importance of the concept of contract in society. For further bibliographical references, *see* GILMORE, *supra*, at 167-69, added by the editor of the second edition, Professor Ronald K.L. Collins.

4. Contract law is rapidly changing. In particular, the enactment of the Uniform Commercial Code (U.C.C.) by forty-nine states in America, plus the District of Columbia, the Virgin Islands, and Louisiana (partly) has caused a major change of approach in some of the fundamental doctrines. Because much of the law of contract was also commercial law, the U.C.C. has become an important distillation of contract law. 1 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 5-6 (4th ed. 1995). As an example, the term "contract," is in essence defined by the U.C.C. as "the total legal obligation" created by a bargain. U.C.C. §§ 1-201(11), 1-201(3) (1997). Section 1-201(11), read in conjunction with section 1-201 (3), has a somewhat different meaning than it has in transactions not governed by the Code, since the term "bargain" as used in legal parlance includes transactions in which no promise is made, such as the immediate sale of property without warranty in exchange for cash. *See* RESTATEMENT (SECOND) OF CONTRACTS § 3 reporter's note (1979). Moreover, U.C.C. § 2-106(1)(1997) specifically includes sale of goods within the term "contracts."

development of the law of contract.[5] Enshrined in the Biblical injunction of *motzeh sfassecha tishmor* or "thou shall keep thy word,"[6] and in the age-old Roman adage of *pacta sunt servanda ex fide bona*,[7] the modern concept of "freedom of contract" maintains significant roots within the lexicon of contract law, and signifies that parties to an agreement have the right and power (autonomy) to construct their own bargains[8] and insist upon their

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5. A step-by-step evolution of the law of contracts is beyond the scope of this paper, except to note that as England evolved from a relatively primitive backwater to a commercial center with a capitalistic ethic, the law changed with it. *See generally* Frederick Pollock, *Contracts in Early English Law*, 6 HARV. L. REV. 389 (1893); A.W. B. SIMPSON, A HISTORY OF THE COMMON LAW OF CONTRACT: THE RISE OF THE ACTION OF ASSUMPSIT (1975); P.S. ATIYAH, THE RISE AND FALL OF FREEDOM OF CONTRACT (1979).

6. *Numbers* 30: 2 (King James). When a man makes an oath to obligate himself by a pledge, he must not break his word but must do everything he said he would. *Id. Cf. Matthew* 5: 33-37 (King James) and *James* 1: 19-25 (King James).

7. "An abbreviated form of the rule stated in Justinian's Code 2, 3, 29 [is] an expression of the principle that undertakings and contracts must be observed and implemented." DAVID M. WALKER, THE OXFORD COMPANION TO LAW 912 (1980). For an English translation of Codex Justinianus (Code of Justinian) 2, 3, 29, *see* S.P. SCOTT, THE CIVIL LAW 173-74 (1932). For a historical overview, *see* Hans Wehberg, *Pacta Sunt Servanda*, 53 AM. J. INT'L L. 775 (1959); Richard Hyland, Pacta Sunt Servanda: *A Meditation*, 34 VA. J. INT'L L. 405 (1994).

8. Indeed, the ideology of "freedom of contract" became a rallying cry among philosophers and politicians during the eighteenth and nineteenth centuries. *See* Samuel Williston, *Freedom of Contract*, 6 CORNELL L.Q. 365, 373-74 (1921); P.S. ATIYAH, AN INTRODUCTION TO THE LAW OF CONTRACT 8 (5th ed. 1995). "[T]he shibboleths 'freedom of contract' and 'sanctity of contract' became the foundations on which the whole law of contract was built.... [J]udges ... thought that it *was* just to enforce contractual duties strictly according to the letter." *Id.*

Even today some theorists would strongly require courts to refrain from tampering with the terms of the parties' bargains. *See, e.g.*, MILTON FRIEDMAN, CAPITALISM AND FREEDOM 13-14 (1982), but the modern views of freedom of contract recognize that the concept of "freedom" has limitations. W. DAVID SLAWSON, BINDING PROMISES: THE LATE 20TH-CENTURY REFORMATION OF CONTRACT LAW 15-16 (1996). The limitations in the form of certain rules of evidence (for example, the Statute of Frauds and parol evidence mechanism) or certain substantive rules of law (for example, contractual capacity and unconscionability) are, however, to be contrasted with limitations, the sole justification of which is the protection of the individual's own welfare. MICHAEL J. TREBILCOCK, THE LIMITS OF FREEDOM OF CONTRACT 147-63 (1993). These paternalistic limitations, if not justifiable on other independent nonpaternalistic considerations, have been found seriously indefensible as constituting an unwarranted intrusion on one's freedom. *See generally* Anthony T. Kronman, *Paternalism and the Law of Contracts*, 92 YALE L. J. 763 (1983); Rochelle Spergel, *Paternalism and Contract: A Critique of Anthony Kronman*, 10 CARDOZO L. REV. 593 (1988); Duncan Kennedy, *Distributive and Paternalistic Motives*

literal performance. For, since contracts are consensually assumed obligations, in principle, within the confines set by the precepts of illegality and immorality, the parties should be able to specify their own distinctive regime of rules to govern their contractual relationship.

Similar reverence for the ideal of sanctity of agreements (covenants), designed to provide a secure transactional framework, informs all schools of Islamic jurisprudence: *Al Muslimün 'inda shurütihim* (Muslims are bound by their stipulations).[9] In fact, under traditional Islamic (*sharia*) law, there is a much stronger presumption than in most legal systems for leaving the contractually formalized bargain undisturbed. This is in accordance with the strong command in the holy Qur'an on obedience to contracts: "O ye who believe! Fulfill (all) obligations."[10] The verse (*aayat*) expresses the rule of law *pacta sunt servanda*; however, in Islam, the exhortation to fulfill contracts emanates from Allah Himself (and not from a human lawgiver). Thus, in its Arabic aphorism, *Al-Aqud Sharia't Al-Muta'äqdïn*, the contract is the *sharia*, that is, literally, a sacred law between the parties, and is

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in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power, 41 MD. L. REV. 563 (1982).

9. For the principle of freedom of contract in Islamic law, *see* LOUIS MILLIOT, INTRODUCTION A L'ÊTUDE DU DROIT MUSULMAN 205 (1953); SAYED HASSAN AMIN, ISLAMIC LAW IN THE CONTEMPORARY WORLD 45-49 (1985). It has to be borne in mind that since no contract in "derogation of any Islamic principle" is permissible, to that extent, the parties' liberty "to choose the forms and the contents of their agreements" is considerably circumscribed. *Id.* at 46. *See also* Nabil Saleh, *Origins of the Sanctity of Contracts in Islamic Law*, 13 ARAB. L.Q. 252, 263-64 (1998).

10. Sura *Al-Maida* 5:1. Chapter (*sura*) 5 of the Qur'an, sometimes called the Chapter of Contracts (*Surat al-Uqud*), begins "with an appeal to fulfil, as sacred, all obligations, human and divine ...." THE HOLY QUR-ÄN: ENGLISH TRANSLATION OF THE MEANINGS AND COMMENTARY 275 (Ustadh Abdullah Yusuf Ali trans.; the Presidency of Islamic Researches, Ifta, Call and Guidance rev. & ed., Holy Qur-än Printing Complex, Al-Madinah Al-Munawarah, 1410 H [1990], under the auspices of the Ministry of Hajj and Endowment, the Kingdom of Saudi Arabia). In defining *uqüd* (obligation), the learned commentator wrote:

> [T]he Arabic word implies so many things that a whole chapter of Commentary can be written on it. First, there are the divine obligations that arise from our spiritual nature and our relation to Allah.... But in our own human and material life we undertake mutual obligations express and implied. We make a promise; we enter into a commercial or social contract; we enter into a contract of marriage; we must faithfully fulfil all obligations in all these relationships. Our group or our State enters into a treaty; every individual in that group or State is bound to see that as far as lies in his power, such obligations are faithfully discharged.

THE HOLY QUR-ÄN, *supra*, at 276 n.682.

binding until the end of its term, even if it were concluded with unbelievers: "[F]ulfil your engagements [covenants] with them to the end of their term: for Allah loveth the righteous."[11]

There is abundant authority in the Qur'an, the *hadith* (personal acts and sayings of the Prophet Muhammad), and the writings of the jurists, for the principles that the contract is the law of the parties and that Muslims are strictly bound by every lawful contract or contracts into which they may have entered.[12] Since "[n]early one-fifth people in the world today are Muslims, and Islamic law is at the very core of their beliefs and social system,"[13] it is pertinent not to overlook what the *sharia* has to say about contractual obligations. This is particularly so, because a large number of transnational transactions (for example, oil and mineral concessions, production sharing projects, joint ventures, transfer of technology, construction and operation of public utilities as well as loan and other financing agreements), on which the economy of the Western world so vitally depends, have been the subject-matter of many international commercial disputes and arbitrations. These have in turn involved an interplay of the notions of fairness with the Islamic veneration of the stipulations voluntarily inserted by the parties, that is, *ufu bil uqud* (honor your contracts).[14]

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11. Sura *At-Tauba* 9: 4, 7. *See generally* sura *Al-Nahl* 16: 91-94; sura *Bani Isräil* 17: 34, 36; sura *Al-An'äm* 6: 151, 153; sura *Al-Müminun* 23: 1-8.

12. *See generally* J.N.D. Anderson & N.J. Coulson, *The Muslim Ruler and Contractual Obligations*, 33 N.Y.U. L. REV. 917, 923-28 (1958); Saba Habachy, *Property, Right, and Contract in Muslim Law*, 62 COLUM. L. REV. 450, 458-72 (1962); DR. S. E. RAYNER, THE THEORY OF CONTRACTS IN ISLAMIC LAW 91-100 (1991); FRANK E. VOGEL & SAMUEL L. HAYES, III, ISLAMIC LAW AND FINANCE: RELIGION, RISK, AND RETURN 67-68, 97-102 (1998); Mahdi Zahraa, *Negotiating Contracts in Islamic and Middle Eastern Laws*, 13 ARAB L.Q. 265, 274-77 (1998).

13. John Makdisi & Marianne Makdisi, *Islamic Law Bibliography: Revised and Updated List of Secondary Sources*, 87 L. LIBR. J. 69, 71 (1995).

14. The invocation of the doctrine of "changed circumstances" in the context of the Iran-U.S. disputes, and arbitrations involving other Muslim countries, presents a good example of the interaction of the concept of sanctity with fairness under traditional and modern Islamic law. *See generally* RAYNER, *supra* note 12, at 259-63; AMIN, *supra* note 9, at 55-60; WAYNE MAPP, THE IRAN-UNITED STATES CLAIMS TRIBUNAL: THE FIRST TEN YEARS 1981-1991: AN ASSESSMENT OF THE TRIBUNAL'S JURISPRUDENCE AND ITS CONTRIBUTION TO INTERNATIONAL ARBITRATION 134, 139-43 (1993); GEORGE H. ALDRICH, THE JURISPRUDENCE OF THE IRAN-UNITED STATES CLAIMS TRIBUNAL 306-20 (1996); JOHN A. WESTBERG, INTERNATIONAL TRANSACTIONS AND CLAIMS INVOLVING GOVERNMENT PARTIES: CASE LAW OF THE IRAN-UNITED STATES CLAIMS TRIBUNAL 157-85 (1991); Robert B. von Mehren & P. Nicholas Kourides, *International Arbitrations Between States and Foreign Private Parties: The Libyan Nationalization Cases*, 75 AM.

This divine mandate of contractual sanctity, unquestionably common to the laws of all civilized nations in both the common law and Western European legal systems, and hitherto a lynchpin of the autonomy of the parties' will (*volonté*),[15] has been either gradually replaced or, at least, supplemented by other competing considerations of justice, paving way for the emergence of a new contractual morality over a broad spectrum of human activity.[16] This progressive transition from principles to

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J. INT'L L. 476, 513-45 (1981); P. Nicholas Kourides, *The Influence of Islamic Law on Contemporary Middle Eastern Legal Systems: The Formation and Binding Force of Contracts*, 9 COLUM. J. TRANSNAT'L L. 384, 394-98, 408-409, 420-28, 429, 431-35 (1970); Saudi Arabia v. Arabian Am. Oil Co., 27 I.L.R. 117, 162-65 (1963) (popularly known as the ARAMCO Arbitration); Libyan Am. Oil Co. v. Libyan Arab Republic, 20 I.L.M. 1, 47-48, 54-58, 6 Y.B. COM. ARB. 89, 101 (1981) (Mahmassani, Arb.) (popularly known as the LIAMCO Arbitration); HENRY CATTAN, THE LAW OF OIL CONCESSIONS IN THE MIDDLE EAST AND NORTH AFRICA 54-58, 120-22 (1967); WALIED EL-MALIK, SHARIA LAW AND MINERAL INVESTMENT 103, 114 (1993); Walied El-Malik, *State Ownership of Minerals Under Islamic Law*, 14 J. ENERGY & NAT. RESOURCES L. 310, 313-24 (1996).

15. The will theory of contracts gained ascendancy in the early nineteenth century, and the courts simply enforced whatever bargain the parties had made. *See, e.g.*, MORTON J. HORWITZ, THE TRANSFORMATION OF AMERICAN LAW, 1780-1860, at 161-73 (1977); E. Allan Farnsworth, *"Meaning" in the Law of Contracts*, 76 YALE L.J. 939, 944-51 (1967); Samuel Williston, *Mutual Assent in the Formation of Contracts*, 14 ILL. L. REV. 85, 86-89 (1919). The will theory ironically was replaced by an increasingly objective approach to the discovery of the parties' contractual intent, *see* ATIYAH, *supra* note 5, at 459, though the victory of the will theory and the advent of the objective approach did not "proceed at the same pace." GILMORE, *supra* note 3, at 43-44 (noting persistence of "subjective" approach into latter part of nineteenth century). *See generally* Larry A. DiMatteo, *The Counterpoise of Contracts: The Reasonable Person Standard and the Subjectivity of Judgment*, 48 S.C. L. REV. 293 (1997).

16. ROBERT A. HILLMAN, THE RICHNESS OF CONTRACT LAW: AN ANALYSIS AND CRITIQUE OF CONTEMPORARY THEORIES OF CONTRACT LAW 1-6 (1997). Unlike the classical contract doctrine which was more unitary in its broad sweep, applicable to all types of contractual transactions, the modern doctrine is not so all-encompassing. E. ALLAN FARNSWORTH, CONTRACTS 32-33 (2d rev. ed. 1990). Today various branches of specific contracts exist and, notwithstanding a common conceptual core linking them, are oftentimes governed by separate regime of detailed rules, adapted either statutorily or judicially, to respond to the myriad situations represented by their nature. Sale of goods, hire purchase, agency, employment, partnership, insurance, franchise, aviation, computer contracts, government contracts, contracts of international trade, are all examples where it is necessary to proceed from an understanding of the general law of contract to more specific rules relevant to the particular context alone. *Id.* at 33-34.

pragmatism,[17] or doctrine to discretion,[18] in the law of contract has of necessity involved an accommodation with the allegedly Procrustean intellections of, say, consideration, privity, mistake, duress, etc.—not only in the countries of common law orbit[19] but also of civil law lineage[20]—toward producing results that are perceived to be just and fair and in consonance with commercial commonsense.[21] Accordingly, the judicial

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17. *See, e.g.*, P.S. ATIYAH, FROM PRINCIPLES TO PRAGMATISM: CHANGES IN THE FUNCTION OF THE JUDICIAL PROCESS AND THE LAW 5, 6-8, 13, 15, 29-32 (1978).

18. *See, e.g.*, G.H. TREITEL, DOCTRINE AND DISCRETION IN THE LAW OF CONTRACT 2, 10-11, 19-20 (1981).

19. *See, e.g.*, JOHN P. DAWSON, GIFTS AND PROMISES: CONTINENTAL AND AMERICAN LAW COMPARED 1-5, 197-230 (1980).

20. For example, in Belgium, the "freedom to determine the contents of one's contract has been radically affected" by statute or by economic circumstances, because of the realization "that the principle of contractual freedom was not an automatic key to justice and order in commercial relationship." PROF. JACQUES HERBOTS, CONTRACT LAW IN BELGIUM 46 (1995). This approach was though not designed to uproot the time-honored principle of *pacta sunt servanda*, an essential feature of the Belgian law of contracts, *id.* at 130, which, in turn, owed its existence to "a continuation of French law stemming from the period during which [Belgium] was a part of France ...." *Id.* at 46.

Interestingly, the sanctity principle was recognized in France, as early as the twelfth and thirteenth centuries, by the system of royal law developed under the French kings. HAROLD J. BERMAN, LAW AND REVOLUTION: THE FORMATION OF THE WESTERN LEGAL TRADITION 476 (1983). Unlike the British royal courts, the French bailiffs assumed jurisdiction over contracts (and not just over sealed covenants), on the canonist moral principle that contracts must be kept, *pacta sunt servanda*. *Id.* (quoting 2 PHILIPPE DE BEAUMANOIR, COUTUMES DE BEAUVAISIS § 999 (A. Salmon ed., Paris, 1970) all "contracts must be kept and therefore it is written, 'A contract prevails over a law,' except those contracts made for bad purposes [as, for example,] if one contracts with another to kill a man for 100 livres"). Beaumanoir's phrase *Convenance vaint loi*, according to Professor Berman, "is a translation of the Latin expression *conventio vincit legem*, which was often used throughout Europe at that time and is to be found a century earlier in Glanvill. The meaning was that the will of the parties superseded those (nonmandatory) provisions of law which defined contractual obligations 'unless otherwise agreed.'" *Id.* at 629 n.82.

21. Of late, in refutation of the orthodox view that fairness "should play a very small role, if any role at all, in contract law," a very spirited argument has been advanced by Stephen A. Smith, *In Defence of Substantive Fairness*, 112 L.Q. REV. 138, 138 (1996), who, apart from attempting "a comprehensive theoretical analysis—and defence—of substantive fairness and the role that it should play in contract law," *id.* at 139, advances the thesis that contracts which "deviate from normal price can and usually do harm individuals' abilities to plan and thereby to achieve autonomous, fulfilling, lives." *Id.* at 157. *See also* James Gordley, *Equality in Exchange*, 69 CALIF. L. REV. 1587 (1981); Stephen A. Smith, *Future Freedom and Freedom of Contract*, 59 MOD. L. REV. 167 (1996); F. H. Buckley, *Three Theories of Substantive Fairness*, 19 HOFSTRA L. REV. 33

reluctance to "police the fairness of every commercial contract by reference to moral principles"[22] has of late witnessed a significant transformation and shift in legal *mentalité*.

B. A Hurried Perspective of Contract Law: From Subjectivism to Objectivism

Viewing these developments in some perspective, there had been an elaborate and sophisticated law of property and of contract, both in the church and in the mercantile community, for some centuries.[23] But as a separate doctrine, contract law had its origins in the eighteenth century, when it began to emerge from subordination to property law.[24] Indeed, in his *Commentaries on the Laws of England*, published between 1765 and 1769, Sir William Blackstone did not consider contract to be a separate body of law at all, and dispenses it as a whole in a few pages forming a kind of a small appendage to his treatment of the law of property.[25] Because precapitalist notions of property existed and no extensive markets had been developed, the system was characterized by a title theory of exchange with damages calculated under equitable doctrines.[26] These doctrines began in an era which was hardly idyllic and exhibited vastly different social conditions and modes of interaction to those which have been experienced in the late twentieth century. Hence these were to be rejected by modern law in response to cataclysmic social changes—*viz.*, "forced ... adapt[ation] to the appearance of the factory, the rise of the industrial city, and a violent rupture of group life and feeling that crushed traditional forms of moral and

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(1990); Edward A. Harris, Note, *Fighting Philosophical Anarchism with Fairness: The Moral Claims of Law in the Liberal State*, 91 COLUM. L. REV. 919, 944-59 (1991).

22. Banque Keyser Ullmann S.A. v. Skandia (UK) Insurance Co. Ltd., [1990] 1 Q.B. 665, 802 (Eng. C.A.) (Slade L.J.).

23. On the canon law of contracts in the twelfth and thirteenth centuries, *see generally* 2 WILLIBALD M. PLÖCHL, GESCHICHTE DES KIRCHENRECHTS 399 (1955); TIMOTHY LYNCH, CONTRACTS BETWEEN BISHOPS AND RELIGIOUS CONGREGATIONS: A HISTORICAL SYNOPSIS AND A COMMENTARY (1947).

24. Morton J. Horwitz, *The Historial Foundations of Modern Contract Law*, 87 HARV. L. REV. 917, 920 (1974).

25. 2 WILLIAM BLACKSTONE, COMMENTARIES *440-70. Further, in a chapter entitled "Of Injuries to Personal Property," contract appears for the last time. *Id.* at 154-66. For a critical examination of Blackstone's view of contract, *see* Duncan Kennedy, *The Structure of Blackstone's Commentaries*, 28 BUFF. L. REV. 205, 321-25, 337-42 (1979).

26. Horwitz, *supra* note 24, at 920.

community identity"[27]—that took place in the early nineteenth century. It was this experience that forced the development of a more precise legal doctrine that would better cope with the explosion of contractual agreements and with the changing perception of the enforceability of promises between individuals.

The nineteenth century, during which much of the framework of modern contract law was established in a recognizable form, saw the development of the contract as the "indispensable instrument of the enterpriser"[28] based upon the protection by the law of "reasonable expectations created by promises."[29] The central premise of what was to become the classical period of contract law (one Professor Grant Gilmore would suggest of boring formalism) was "freedom of contract."[30] The

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27. Peter Gabel & Jay Feinman, *Contract Law as Ideology*, *in* THE POLITICS OF LAW–A PROGRESSIVE CRITIQUE 497,500 (David Kairys ed., 3d ed. 1998).

28. Friedrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 629 (1943).

29. *Id.* "[I]n the eighteenth century promises were often enforced primarily because the promisee had relied on the promise to her detriment or to the promisor's benefit." Jay M. Feinman, *Promissory Estoppel and Judicial Method*, 97 HARV. L. REV. 678, 679 (1984). ATIYAH, *supra* note 5, at 739-93; HORWITZ, *supra* note 15, at 161-93. However, the nineteenth century saw the ascendance of bargained-for-consideration which pushed reliance-based doctrines into the periphery. Feinman, *supra,* at 679. (This rigid, classical approach of the nineteenth century to contracts largely accounts for the reemergence of promissory estoppel today.)

30. Originating in the late eighteenth and nineteenth centuries, the expression "freedom of contract" reflected the natural law philosophy that the contracting parties were to carry out their agreed-upon obligations. *See* 2 HUGO GROTIUS, DE JURE BELLI AC PACIS LIBRI TRES 391-408 (Francis W. Kelsey trans., 1995). Nineteenth century English commentators borrowed from the works of French legal theorists, who by 1804 had succeeded in embodying in the French Civil Code a highly individualist concept of contract, later adopted by many continental codifications. Earlier, the Prussian Code of 1794 (Allgemeines Landrecht für die Preussischen Staaten) had incorporated a similar philosophy where the parties were regarded as having the power and the unrestricted freedom to make the law which was to govern their relationship. *See, e.g.*, para. I 3.1 of the Prussian Code of 1794, "Undertakings can give rise to [enforceable] rights only insofar as these undertakings are freely given." Para. I 4.4 deals with a declaration of intention, and para. I 5.1 reflects the notion of free will. *See* Dr. Hans Hattenhauer, *Introduction* to ALLGEMEINES LANDRECHT FÜR DIE PREUSSISCHEN STAATEN 17-18 (3d rev. ed., Neuweid, Kriftel, Berlin: Luchterhand Verlag GmbH 1996).

The French CODE CIVIL [C. CIV.] arts. 1108-1112, *translated in* THE FRENCH CIVIL CODE AS AMENDED TO 1 JULY 1994 (John H. Crabb trans., 1995), and the German BÜRGERLICHES GESETZBUCH (Civil Code) [BGB] arts. 116, 145, *translated in* THE GERMAN CIVIL CODE AS AMENDED TO JANUARY 1, 1992 (Simon L. Goren trans., 1994) extol the importance of "freedom of will." This will model was expressly developed as

freedom of autonomous individuals to be able to make bargains as they saw fit (with as little intervention from the state as possible) squarely placed the formation of contract *ex nihilo* in their will.[31] That freedom of contract, as evolved in the spirit of laissez-faire, has found repeated expression in extant case law, and has had an impact on contract law in its tendency to overstress the importance of the "intention of the parties," that is, *jus dispositivum*—to use the phrase of the Romans.[32]

The emphasis on individual will, whereby contractual obligation could be "created by a communion of wills, an act of joint, if purely mental

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a cornerstone of contract by the German pandektists, particularly by Friedrich Carl von Savigny and Otto Bähr. *See generally* JUHA PÖYHÖNEN, SOPIMUSOIKEUDEN JÄRJESTELMÄ JA SOPIMUSTEN SOVITTELU 379-88 (Suomalainen Lakimiesyhdistys, Vammala 1988). This approach, the product of the political liberalism of the eighteenth century, fell in with the economic liberalism of nineteenth century England to produce an equally individualist theory of contract law at that time. In this respect, Robert Joseph Pothier (1699-1772) was in many ways the French Blackstone, whose basic TRAITÉ DES OBLIGATIONS (1761), first translated into English in 1805, had a pronounced impact on nineteenth-century English law. His more specialized TRAITÉ DU CONTRAT DE VENTE (C. Little & J. Brown trans., 1830) (1765) had an equally great impact, particularly on the concept of freedom of contract.

31. According to this "classical" view of contract, as parties freely entered into an agreement as equals, it was not for the law to ensure that a fair bargain had been struck or to inquire whether the parties had in fact met as equals. This attitude was consistent with the idea that contracts should be made by the parties (with freedom of choice) and was also in consonance with a free market economy and the spirit of competition. "[T]wo of the finest flowers of nineteenth century subjectivism—an attitude which modulates smoothly into a theory of the untrammeled autonomy of the individual will and thence into the idea of unrestricted freedom of contract which was surely one of the master concepts of nineteenth century thought." GILMORE, *supra* note 3, at 45. Nevertheless, responding to the new realities, the substantive law was obliged to move away from a purely individualist or subjective approach to contract and thereby abandon the fiction of searching for and complying with the will of the parties. This is, however, not to suggest that classical theory–or its slightly modified version even in the provisions of the first RESTATEMENT OF CONTRACTS (1932) and the Uniform Commercial Code (U.C.C.)–is wholly without relevance. There is no doubt that it shaped the law in a crucial period of its development, and reflected the use made of planned exchanges in the aggressively free enterprise society of the nineteenth century. Naturally, it would not be surprising to find some classical ideas unsatisfactory if the nature of society had itself changed, from out-and-out free enterprise to mixed economy (where resources are allocated partly through the decisions of private individuals and corporations, and partly through the decisions of government–including the courts–and State-owned enterprises).

32. REINHARD ZIMMERMANN, THE LAW OF OBLIGATIONS: ROMAN FOUNDATIONS OF THE CIVILIAN TRADITION 641 n.127 (1990).

procreation,"[33] was commonly accepted by the mid-nineteenth century. The neat and tidy rules of offer and acceptance, consideration and intention were well adapted to the period when contracts could be called sacrosanct, as in the famous dictum of Sir George Jessel, M.R.: "[I]f there is one thing which more than another public policy requires it is that men of full age and competent understanding shall have the utmost liberty of contracting, and that their contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by Courts of justice."[34] In this view, rights and duties of the parties would come into existence only through promises and express agreement of individuals who have the free will[35] and independence to commit themselves legally.

The idea that contractual obligations arise from the will of the individual, determined subjectively, dominated the earlier part of the nineteenth century and persisted well into the latter part of the century,[36]

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33. ATIYAH, *supra* note 5, at 407; Roscoe Pound, *The Role of the Will in Law*, 68 HARV. L. REV. 1, 3 (1954) (commenting that an English Chancellor explained that he "looked at the substance, not the form, and that the intention of those who engaged in a transaction was the substance").

34. Printing and Numerical Registering Co. v. Sampson, 19 L.R.-Eq. 462, 465 (1875) (Sir George Jessel). In classical law, "contractual liability was all or nothing: a person was either subject to contractual obligation (and therefore liable for expectation damages) because of an agreement supported by consideration, or subject to no contract liability at all." Feinman, *supra* note 29, at 681.

35. The "postal rule," or, in its American terminology, the "mailbox rule" that an acceptance completes the formation of a contract as soon as it is posted is an interesting example of will theory and of judicial efforts in fashioning a rule, or legal fiction, that satisfied the requirement that the parties' will concur. *See* Cooke v. Oxley, 3 T.R. 653, 100 Eng. Rep. 785 (K.B. 1790); Adams v. Lindsell, 1 Barn. & Ald. 681, 106 Eng. Rep. 250 (K.B. 1818); Peter Goodrich, *Habermas and the Postal Rule*, 17 CARDOZO L. REV. 1457, 1461 (1996).

36. The classic notion of a contract is the metaphor of a voluntary meeting of the minds, that is, a coincidence of the actual mental process of both parties. The will theory was in vogue from around 1790 to the mid-nineteenth century, and is largely forgotten today except for the phrase *consensus ad idem* ("meeting of the minds"). *See* Williston, *supra* note 15, at 87; Morris R. Cohen, *The Basis of Contract*, 46 HARV. L. REV. 553, 575 (1933) ("the classical ... law of contract gives expression to and protects the will of the parties, for the will is something inherently worthy of respect"). "Was there a *consensus ad idem* or a subjective meeting of the minds?" is the question generally asked in many of these nineteenth-century cases which indicate that the making of a contract depended upon the actual intention of the parties.

During much of this period, the influence of continental thinkers (particularly Robert Joseph Pothier and Carl Friedrich von Savigny) was substantial, and RUDOLPH VON JHERING, DER ZWECK IM RECHT 9-16, 266-67 (1893), had much to say of the "primacy of the will." *See, e.g.*, WILLIAM R. ANSON, PRINCIPLES OF THE ENGLISH LAW OF

and has some advocates even today.[37] The voluntary will of the contracting parties was the axis around which nineteenth century contract law was formulated;[38] the general climate—social, economic and legal—favored freedom of contract and the enforcement of all contractual obligations freely entered into. This view was consistent with the pervasive individualism of that time and the general incorporation into law of notions of liberal political theory.[39]

Late nineteenth-century thinkers like Oliver Wendell Holmes and Samuel Williston, however, reasoned that obligations should attach not according to the subjective intention of the parties, but according to a reasonable interpretation of the parties' language and conduct. As Holmes

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CONTRACT 2 (London, Oxford, 3d ed. 1884). According to THOMAS E. HOLLAND, ELEMENTS OF JURISPRUDENCE 114, 253 (10th ed., 1906), the requirement that there be an agreement of wills and that its expression be in correspondence was of central importance to Savigny's theory of contract. However, a reading of some of the cases such as Kennedy v. Lee, 3 Mer. 441, 451, 36 Eng.Rep. 170, 174 (1817) (Lord Eldon, L.C.) and Browne v. Hare, 3 H. & N. 484, 495, 157 Eng. Rep. 561, 565-66 (1858) (Bramwell, B.) led one distinguished judge to doubt "that the subjective theory of contract was as well-established in the nineteenth century as [it was] sometimes made out." Air Great Lakes Pty. Ltd. v. K.S. Easter (Holdings) Pty. Ltd., [1985] 2 N.S.W.L.R. 309, 335 (Ct. App. 1985) (Austl.) (McHugh, J.A.).

37. HORWITZ, *supra* note 15, at 161-73, has argued that the will theory played an important role in the realm of contract. *See also* Horwitz, *supra* note 24, at 920. For criticism of Horwitz, *see* A.W.B. Simpson, *The Horwitz Thesis and the History of Contracts*, 46 U. CHI. L. REV. 533, 545-46 (1979) (arguing Blackstone's treatment of contract reflects merely an organizational scheme and not a substantive view of contract).

38. Farnsworth, *supra* note 15, at 945 n.34.

39. For example, Emanuel Kant's ethical and Jacques Jene Rousseau's political theories give primary importance to the individual's will and autonomy:

> [A]t the end of the eighteenth century the real intention of the parties had become sacrosanct. It had acquired the dignity of a political and legal principle which became known as the theory of the autonomy of will. This meant, in effect, first, that the real intention must prevail over form, secondly, that the will of the parties is superior to law and, thirdly, that giving effect to this will is just since *ex hypothesi* the parties will not agree to anything harmful to themselves.

A.G. Chloros, *Comparative Aspects of the Intention to Create Legal Relations in Contract*, 33 TUL. L. REV. 607, 615 (1959) (footnotes omitted). This will, according to 1 BERNARD WINDSCHEID, LEHRBUCH DES PANDEKTENRECHTS § 69 n.1a (9th ed. Frankfurt a.M. 1906), must be ascertained in subjective terms. *See generally* IMMANUEL KANT, FOUNDATIONS OF THE METAPHYSICS OF MORALS 17, 31 (Lewis W. Beck trans., 6th prtg. 1959); Peter Benson, *External Freedom According to Kant*, 87 COLUM. L. REV. 559, 560, 578-79 (1987); Arthur von Mehren, *A General View of Contract*, 7 INT'L ENCYCLOPEDIA COMP. L. 17-18 (1982).

succinctly stated: "The law has nothing to do with the actual state of the parties' minds. In contract, as elsewhere, it must go by externals, and judge parties by their conduct."[40] The doctrinaire denial that individual will controlled the making or interpretation of contracts led to the ascendancy of the reasonable observer's interpretation of behavior or words that determined the contents of the transaction (and not the actual thoughts of the parties).[41]

This approach of objective interpretation[42] narrowed the potential

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40. OLIVER WENDELL HOLMES, JR., THE COMMON LAW 309 (Sheldon M. Novick ed., unabrid. reprint 1991) (1881). For a valuable judicial analysis of the objective/subjective dialectic, see *Newman v. Schiff*, 778 F.2d 460, 464-65 (8th Cir. 1985). Although the subjective form of the will theory was widely accepted when the French Civil Code was drafted and the French theorists still incline to that approach, "[i]n practice, the test adopted by French law is not very different from the objective test of English law." Chloros, *supra* note 39, at 616. However, the German Civil Code is less committed to the subjective theory than is the French law. *See generally* Arthur von Mehren, *The Formation of Contracts*, 7 INT'L ENCYCLOPEDIA COMP. L. 30-33 (1993).

41. *See* Learned Hand's famous, oft-quoted, "twenty bishops" statement to this effect in *Hotchkiss v. National City Bank*, 200 F. 287, 293 (S.D.N.Y. 1911), *aff'd*, 201 F. 664 (2d Cir. 1912), *aff'd*, 231 U.S. 50 (1913):

> A contract has, strictly speaking, nothing to do with the personal, or individual, intent of the parties.... [If] it were proved by twenty bishops that either party, when he used the words, intended something else than the usual meaning which the law imposes upon them, he would still be held, unless there were some mutual mistake or something else of the sort.

Similar expressions appear in *Eustis Mining Co. v. Beer, Sondheimer & Co. Inc.*, 239 F. 976, 984-85 (S.D.N.Y. 1917) (Hand, J.): "It makes not the least difference whether a promisor actually intends that meaning which the law will impose upon his words. The whole House of Bishops might satisfy us that he had intended something else, and it would make not a particle of difference in his obligations." The older "subjective" or "will" theory justified contract enforcement if there had been evidence of the "meeting of the minds" between the parties. *See, e.g.*, Cohen, *supra* note 36, at 575-78. Constant references to "manifestations" of intent indicate that the objective approach has been embodied in the RESTATEMENT (SECOND) OF CONTRACTS § 17 (1979) ("the formation of a contract requires ... a manifestation of mutual assent to the bargain"). *See also id.* §§ 18, 19, 24, 27, 29, 33, 38, 53(3), 65 cmt. a, 71 cmt b, 164, 175.

42. The movement "from 'subjective' to 'objective,' from 'internal' to external,' from 'informal' to 'formal,'" GILMORE, *supra* note 3, at 46, has been a relatively universal phenomenon. For example, with respect to Australia, the High Court, in *Taylor v. Johnson*, 151 C.L.R. 422, 429 (1983), while discussing the law relating to unilateral mistake, ruled that "[w]hile the sounds of conflict have not been completely stilled, the clear trend in decided cases and academic writings has been to leave the objective theory in command of the field." Similarly, in English law, the "general principle on interpretation of contracts was, in the older view, to ascertain the actual intention of the

grounds of avoiding liability for a bargained-for-exchange by eliminating the excuse that a party was subjectively mistaken about contract terms, was otherwise imprudent about the use of language, or had a good reason for nonperformance. However, even in this objectified form, the will theory of contract was equated with the absence of state regulation, and reflected the dominance of free-market values in the late nineteenth century.[43] Thus, freedom of contract attained a uniquely privileged position for practical reasons as well as moral ones. The new legal principles served an eminent social function in enabling the mobility of the economic community, insurance against calculated economic risks (through the award of damages or specific performance), and the freedom to negotiate a beneficial bargain.[44]

However, since contract was not to be seen as a social institution (but

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parties to the contract. The modern view is to ascertain 'what each [party] was reasonably entitled to conclude from the attitude of the other.'" PAUL DOBSON, CHARLESWORTH'S BUSINESS LAW 213 (16th ed. 1997) (quoting McCutcheon v. David MacBrayne Ltd., [1964] 1 W.L.R. 125, 128 (H.L.) (Lord Reid)). Thus, Lord Denning, M.R., in *Storer v. Manchester City Council*, [1974] 1 W.L.R. 1403, 1408 (Eng. C.A.), extolled the objectification of modern contract law:

> In contracts you do not look into the actual intent in a man's mind. You look at what he said and did. A contract is formed when there is, to all outward appearances, a contract. A man cannot get out of a contract by saying: "I did not intend to contract" if by his words he has done so. His intention is to be found only in the outward expression ....

This approach was recently reemphasized by Lord Steyn in the House of Lords:

> [O]ur law of construction [of a contract] is based on an objective theory. The methodology is not to probe the real intentions of the parties but to ascertain the contextual meaning of the relevant contractual language. Intention is determined by reference to expressed rather than actual intention. The question therefore resolves itself in a search for the meaning of language in its contractual setting. That does not mean that the purpose of a contractual provision is not important. The commercial or business object of a provision, objectively ascertained, may be highly relevant.... But the court must not try to divine the purpose of the contract by speculating about the real intention of the parties. It may only be inferred from the language used by the parties, judged against the objective contextual background. It is therefore wrong to speculate about the actual intention of the parties ....

Deutsche Genossenschaftsbank v. Burnhope, [1995] 1 W. L. R. 1580, 1587 (H.L.) (Lord Steyn, dissenting).

43. ATIYAH, *supra* note 5, at 402-403.

44. W. FRIEDMANN, LAW IN A CHANGING SOCIETY 119 (2d ed. 1972).

only as an exchange of mutual promises, governed by the will and intention of the parties, rather than the substantive merit or fairness of what they agreed to), courts quickly became unwilling to interfere with the contract-making process beyond interpretation once evidence of assent had been established.[45] This principle of free contract, which was the legal encapsulation of laissez-faire and the mainstay of industrialization, worked on the basis that everyone had complete freedom of choice in determining who they would contract with, on what terms, and that oppressive bargains could be avoided by simply finding someone else to make the bargain with.[46]

The heyday of industrial and imperial Britain, and later America after the American Revolution, with its laissez-faire economy, was well served by the classical law of contract, because, once a principle had been developed, many nineteenth century jurists found it difficult or undesirable to depart from it whatever the particular circumstances of the case may have been.[47] Therefore, the parties to the contract alone were seen as fit to determine its adequacy, without the courts seeking to uphold fair relations between them in a paternalistic way.[48] This was thought to be consonant

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45. Kessler, *supra* note 28, at 630; ATIYAH, *supra* note 8, at 8: "[T]he law of contract was designed to provide for the enforcement of the private arrangements which the contracting parties had agreed upon. In general the law was not concerned with the fairness or justice of the outcome ...." Of course, the promisor was not required to perform, but only to pay damages for her or his nonperformance. *See* Oliver W. Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 462 (1897); "The duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it, and nothing else."

46. However, the assumption that most contracting parties negotiated on an equal bargaining level was seriously flawed in that the concentration of economic power in a few, giving rise to monopoly, led the weaker parties to contract only on terms dictated by those stronger contracting parties who controlled means of production and acquisition in the market. SLAWSON, *supra* note 8, at 22-23. There was virtually no choice to escape from the coercion of the emergent corporate structure to whom law guaranteed property. *See* MAX WEBER ON LAW IN ECONOMY AND SOCIETY 189 (Max Rheinstein ed., 1954, reprinted 1967); Kessler, *supra* note 28, at 640.

47. HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW, 1836-1937, at 1-5, 7 (1991).

48. For example, the Contracts Clause of the U.S. CONST. art. I, § 10, cl.1 that "[n]o State shall ... pass any ... Law impairing the Obligation of Contracts" prevents the states from passing any legislation that would alleviate the commitments of one party to a contract or make enforcement of the contract unreasonably difficult. Contracts were just beginning to gain prominence in Anglo-American law as it adapted to a growing market economy. HOVENKAMP, *supra* note 47, at 23-24. Many decisions of both the Marshall Court and the Taney Court, in conjunction with the Contracts Clause, considered under

with a free-market economy and the spirit of competition, and was the locus of contractual relationships among independent individuals.[49]

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due process the substantive rationality of restrictions that infringed on the rights to pursue a trade, make contracts and establish conditions of employment. *Id.* at 17-35. Marshall helped expand the notion of contract to the point where contract doctrines "greedily swallowed up other parts of the law." LAWRENCE M. FRIEDMAN, A HISTORY OF AMERICAN LAW 244 (1973). In the case symbolizing these developments, *Lochner v. New York*, 198 U.S. 45, 53, 57 (1905), the Court struck down a state law restricting bakers' hours as an "illegal interference" with "the right of free contract." *Id.* The Court's willingness to find laissez-faire economic rights to be the very "substance" of due process stemmed from a variety of political, legal, and intellectual influences arising in late nineteenth century America: common law traditions, the legacy of Adam Smith's economic liberalism, and the social Darwinism of Herbert Spencer and William Graham Sumner. *See generally* RICHARD HOFSTADER, SOCIAL DARWINISM IN AMERICAN THOUGHT (rev. ed. 1955); ROBERT GREEN MCCLOSKEY, AMERICAN CONSERVATISM IN THE AGE OF ENTERPRISE (1951); LOREN BETH, THE DEVELOPMENT OF THE AMERICAN CONSTITUTION, 1877-1917 (1971); Roscoe Pound, *Liberty of Contract*, 18 YALE L.J. 464 (1909); ARNOLD M. PAUL, CONSERVATIVE CRISIS AND THE RULE OF LAW: ATTITUDES OF BAR AND BENCH, 1887-1895 (Peter Smith reprint 1976) (1960).

Thus, by the turn of the century, the principle of freedom of contract had been elevated to the dignity of a fundamental constitutional property right, abridgeable only by exceptions of "public interest" and "police power." Though the Court vacillated in its devotion to the doctrine, many post-*Lochner* and *Adkins v. Children's Hospital*, 261 U.S. 525 (1923) decisions, including the dissents of Mr. Justice Holmes in both *Lochner* and *Adkins*, provide a fascinating reading in attacking conservative justices' atavistic adherence to the amoral abstraction of freedom of contract in the face of the social costs. *See generally* James L. Kainen, *Nineteenth-Century Interpretations of the Federal Contract Clause: The Transformation from Vested to Substantive Rights Against the State*, 31 BUFF. L. REV. 381 (1982). This approach ultimately paved the way for the acceptance of the permissibility of reasonable legislative regulation of contractual relations, thereby subordinating liberty of contract to the dictates of social legislation. *See generally* KEVIN M. TEEVEN, A HISTORY OF THE ANGLO-AMERICAN COMMON LAW OF CONTRACT 299-303 (1990); Kirsten L. McCaw, *Freedom of Contract Versus the Antidiscrimination Principle: A Critical Look at the Tension Between Contractual Freedom and Antidiscrimination Provisions*, 7 CONST. L. J. 195 (1996); Kevin M. Teeven, *Decline of Freedom of Contract Since the Emergence of the Modern Business Corporation*, 37 ST. LOUIS U. L.J. 117 (1992); Walton H. Hamilton, *Freedom of Contract*, *in* 6 ENCYCLOPAEDIA OF THE SOCIAL SCIENCES 450, 452-55 (Edwin R.A. Seligman & Alvin Johnson eds., 1931). *Lochner* and like cases were functionally, if not explicitly, overruled in *West Coast Hotel Co. v. Parrish*, 300 U.S. 379 (1937). *See generally* Michael J. Phillips, *How Many Times Was* Lochner*-Era Substantive Due Process Effective?*, 48 MERCER L. REV. 1049, 1050 n.3, 1086 n.197 (1997).

49. *Cf.* LAWRENCE M. FRIEDMAN, CONTRACT LAW IN AMERICA: A SOCIAL AND ECONOMIC CASE STUDY 20-22 (1965) (classical contract law, displaying a high degree of internal consistency, is a reflection of the free economic marketplace); Kronman, *supra* note 8, at 797 (contract law "tends to treat the impersonal market transaction as the paradigm of all exchanges"); ROBERTO MANGABEIRA UNGER, THE CRITICAL LEGAL

C. Nineteenth-Century Contract Law and Its Modern-Day Adaptations: A Move from "Sanctity" to "Fairness"?

Thus, essentially, the nineteenth century contract doctrine was the inheritance of the Anglo-American and Anglo-Australian jurisprudence.[50] This doctrine evolved largely through the application of general principles as molded by the changing social and economic forces of society, commencing with agrarian feudal England to the more pronounced upsurge of commerce in an industrializing culture.[51] But as the twentieth century progressed, particularly since the end of World War II when concepts of social welfare expanded, it began to be realized that social change was continuing on apace and that some elements of that doctrine no longer applied to the society it operated in and on.[52]

Of course, the law did not remain static, and alterations can be observed to be in response to social change.[53] Social scientists have ceased to believe that legal principle will act as an incentive or as a disincentive to human behavior, and the spread of egalitarian ideals has meant that people are less willing to accept a principle that seems unjust.[54] Thus, since the social and political upheavals of the early twentieth century, the intellectual story of the movement has been one of attempts to reconcile, on the one hand, the pull of established doctrine and of stare decisis, representing the philosophy of the "sanctity" of contracts,[55] and, on the other hand, the

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STUDIES MOVEMENT 67 (1986) (a "regime of contract is just another name for a market").

50. FRIEDMAN, *supra* note 49, at 20-24; CHESIRE & FIFOOT'S LAW OF CONTRACT 857-59 (N.C. Seddon & M.P. Ellinghaus eds., 7th Austl. ed. 1997); DAVID E. ALLAN & MARY E. HISCOCK, LAW OF CONTRACT IN AUSTRALIA 10-14, 30-34 (2d ed. 1992).

51. MARTHA MINOW, MAKING ALL THE DIFFERENCE: INCLUSION, EXCLUSION, AND AMERICAN LAW 124-27 (1990).

52. The contemporary ideas in social sciences dictated that short-term results (the particular case) were to be seen as a price to be paid for longer-term benefits (the sustenance of the principle, the consistency of law that is necessary so that it may maintain its social-conditioning purpose). ATIYAH, *supra* note 17, at 3, designates the function of law which "provide[s] incentives and disincentives for various types of behaviour" its "horatory function" and argues that the nineteenth century particularly favored it as law's primary function. *Id.* at 8.

53. *See, e.g.*, KERMIT L. HALL, THE MAGIC MIRROR: LAW IN AMERICAN HISTORY 189-210 (1989).

54. *Id.* at 294-96; MINOW, *supra* note 51, at 149.

55. Even classical paragon Williston, a conservative thinker, frequently criticized the formalism of English contract law and the reluctance of English judges to develop more flexible rules, and, by 1920, recognized that "unlimited freedom of contract, like

needs for "fairness," reflected in the increasingly judicial and legislative regulation of contractual relationships.[56]

Thus, in the twentieth century the tide has turned away from the nineteenth-century obsession toward unrestrained freedom and sanctity of contracts to that of fairness and cooperation.[57] That this has been so, both through the limitations of mandatory law imposed by legislation (regulating commercial activity and standardizing contracting procedures) and through the judicial process of construction of the terms of the contract (designed to neutralize the abuse of superior bargaining power by the stronger party), is a phenomenon that needs hardly any extensive documentation.[58] The nineteenth-century view of the freedom of contract as the consensual vehicle of free choice and individualism for the ordering of private rights scarcely offers the basis of modern-day contracts.[59] For, in the wake of the proliferation of one-sided, often unread, and unbargained standard-form contracts, the assumption that the freedom of contract presupposes that the

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unlimited freedom in other directions, does not necessarily lead to public or individual welfare ...." Williston, *supra* note 8, at 374.

56. von Mehren, *supra* note 39, at 69:

> The emergence of new approaches to the problems of substantive justice presented by contracts, especially those taking standard forms, resulting from a process of one-sided ordering reflects tensions that began to develop in the late nineteenth century within traditional contract law. Nineteenth-century contract doctrine had abandoned notions of the objective fairness of the terms of exchange ... in favor of an approach that scrutinized the contracting process to see if each party had freely consented to the terms, whatever those terms might be. In the twentieth century, courts are concerned not only about the process in which the transaction originated but also increasingly about its contents. At an accelerating rate, covert tools that police the substantive justice of standardized justice of standardized contracts through a fictionalized appeal to the will of the parties or to interpretation have been abandoned in favor of more direct and frank methods. At first, this development went on in the courts. More recently, standards, rules and approaches have been furnished by legislation. (Footnote omitted.)

57. *See, e.g.*, MINOW, *supra* note 51, at 166; Duncan Kennedy, *Distributive and Paternalistic Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power*, 51 MD. L. REV. 563, 570, 588-90, 631-33 (1982).

58. *See, e.g.*, HUGH COLLINS, THE LAW OF CONTRACT 252-82 (2d ed. 1993).

59. MINOW, *supra* note 51, at 277-83; HALL, *supra* note 53, at 296-97: "The scope and implementation of contract law changed in response to the demands of a legal culture that placed increasing weight on equitable solutions to disputes rather than strict adherence to the idea that private parties, left to themselves, could best maximize their interests."

parties know what is best for themselves and that their decisions in that regard ought to be given effect has ceased to be a commonplace reality.[60]

Since people cannot avoid making certain contracts, the chimera of a freely negotiated contract is totally inappropriate for many of these transactions. There is no consensual foundation, except illusive freedom—the freedom not to acquire a business, not to have a fax machine or computer, not to purchase an airline ticket, not to insure one's life or property, not to have public utilities (such as gas or electricity), and so on. In such a situation, freedom of contract is no more than a romantic illusion especially for parties who lack leverage and are forced to acquiesce into controlled marketplace transactions (dictated by standard-form contracts of industrial and commercial monopolies on a take-it-or-leave-it basis) which they did not have the liberty to bargain for, or, at times, even the capacity to understand the often incomprehensible terms.[61] Moreover, without genuine economic equality, absolute freedom cannot really exist, since parties are rarely completely equal in economic or social terms. One's freedom to contract is thus clearly limited by social, commercial and legally acceptable norms.

Nevertheless, the formalistic common law construct recognizing the strict application of traditional contract doctrines, like objective intention, adequacy of bargained consideration, Statute of Frauds, and the parol evidence rule, reflected courts' obeisance to freedom of contract and individualism, notwithstanding the stark reality that the standardized contracts (weighted in favor of the entrepreneurs) were neither read nor understood.[62] Thus, when faced with written contracts, to avoid jury favoritism for the consumer on questions of consent and fairness, courts oftentimes turned the notion of freedom of contract into a question of law based on form,[63] once the external formalities of contract were seen to have been complied with. Though constrained by positive rules of law, nevertheless, the imaginative judicial minimalism practiced by the

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60. RICHARD LAWSON, EXCLUSION CLAUSES 69-70 (2d ed. 1983); DAVID YATES, EXCLUSION CLAUSES IN CONTRACTS 1-11 (1982).

61. *Cf.* Morehead v. N.Y. *ex rel.* Tipaldo, 298 U.S. 587, 632 (1937) (Stone, J., dissenting): "There is grim irony in speaking of the freedom of contract of those who, because of their economic necessities, give their services for less than is needful to keep body and soul together." *Id.* RESTATEMENT (SECOND) OF CONTRACTS § 208 adopts the relative bargaining power of the parties as a factor in limiting the enforceability of unfair terms. *See generally* Arthur A. Leff, *Unconscionability and the Code–The Emperor's New Clause*, 115 U. PA. L. REV. 485 (1967).

62. *See supra* note 60.

63. *See, e.g.*, ATIYAH, *supra* note 5, at 732-34.

nineteenth-century courts within that formalistic structure led to increasing legislative intrusions.[64] This was in response to the effects of industrialization and consumerism toward curtailing the abuses of unfairness generated by the substitution of equality of bargaining with standardized contracts of adhesion. Thus, "in their efforts to ensure contractual justice all legal systems have increasingly restricted the freedom of the parties to fix the terms of their contracts"[65] by considerations of fairness as to the means and ends of contracting.[66]

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64. YATES, *supra* note 60, at 73-122.

65. KONRAD ZWEIGERT & HEIN KÖTZ, AN INTRODUCTION TO COMPARATIVE LAW 22 (Tony Weir trans., 2d rev. ed. 1987). The growing awareness of the desirability of governmental intrusion in the economy-that is, the transition from "nineteenth century individualism to the welfare state and beyond"-led to an eventual undermining of the individualist premises of the classical contract law. GILMORE, *supra* note 3, at 104.

66. For example, the recent European Community Directive on Unfair Contract Terms, Council Directive 93/13 EEC, art. 3(1), 1993 O.J. (L95/29)-implemented in the United Kingdom by the Unfair Terms in Consumer Contracts Regulations (SI 1994 No. 3159)-is particularly significant for the European legal profession. Article 3(1) of the Directive, embodied in § 4.1 of the Regulations, reads: "A contractual term which has not been individually negotiated shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations under the contract." *See generally* Ewoud Hondius, *EC Directive on Unfair Terms in Consumer Contracts: Towards a European Law of Contract*, 7 J. CONT. L. 34 (1994); Hugh Beale, *Legislative Control of Fairness: The Directive on Unfair Terms in Consumer Contracts, in* GOOD FAITH AND FAULT IN CONTRACT LAW 231 (Jack Beatson & Daniel Friedmann eds., 1995); LAURENCE KOFFMAN & ELIZABETH MACDONALD, THE LAW OF CONTRACT 198-211 (2d ed. 1995), which contains a new chapter entitled "The European Community Directive on Unfair Terms in Consumer Contracts." For a discussion of the problem of uncertainty, arising in the rapidly increasing area of EC legislation in the context of the Unfair Contract Terms Directive, *see* Trevor C. Hartley, *Five Forms of Uncertainty in European Community Law*, 55 CAMBRIDGE L.J. 265 (1995).

II. SANCTITY OF CONTRACTS REVISITED: LONG-TERM INTERNATIONAL TRANSACTIONS

[P]acta sunt servanda *is not really a rule on its own, but is merely a reflection of the nature of a contractual obligation. The problem is to decide when the rule admits of exceptions.*[67]

A. From Classical Theory to Relationalism

A relatively recent study by Dr. Nagla Nassar, a meticulous and talented comparative lawyer from Egypt (who possesses a commendable grasp of both civil law and common law doctrine), addresses to some of the sanctity-and-freedom-of-contract-oriented issues in modern contract law.[68] In the introductory chapter, by drawing upon a vast array of sources, the author has sought to encapsulate, with commendable brevity, the salient features of contract law through various phases.[69] According to her, contract law, traditionally viewed in all Western legal systems as a body of basic concepts and doctrines for giving effect to voluntary agreements according to the intent of the parties, has struggled in the twentieth century to adapt itself to a wholly new economic situation.[70] For the liberal fiction that all the effects of a contract should be attributed to the will of those who made it still persists through contract law today even though the overwhelming majority of contracts are the product of the will of only one of the contracting parties.[71] This has led some theorists to insist that the mainstays of contract law are radically inappropriate to the late-twentieth century and that we need to replace them with an ideology that is more in

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67. Lord Justice Mustill, *The New* Lex Mercatoria: *The First Twenty-Five Years*, *in* LIBER AMICORUM FOR LORD WILBERFORCE 174 n.83 (Maarten Bos & Ian Brownlie eds., 1987).

68. NAGLA NASSAR, SANCTITY OF CONTRACTS REVISITED: A STUDY IN THE THEORY AND PRACTICE OF LONG-TERM INTERNATIONAL TRANSACTIONS (1995).

69. *Id.* at 1-29.

70. *Id.* at 14-15: "The emphasis on the individual, his freedom and his role in society enhanced individualism in intellectual ideas [and] gave rise to [David] Hume's utilitarianism and Adam Smith's market economy philosophies. These two schools of thought have much in common, especially in their conceptualization of contractual agreements and the role they play in the social mechanism."

71. *See supra* notes 59-61, and accompanying text.

tune with current conditions and practices.[72]

Doubtless, academic criticism of contract law has been harsh, with one leading critic labeling it "dead"[73] and another calling contract theory "a mess"[74] and suggesting that we need to construct a new theoretical structure.[75] There has been a proliferation of a whole range of perspectives (for example, legal realism,[76] religious dimension,[77] law and economics

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72. For a perceptive critique of these theories, "bring[ing] out the range of views on contract law and ... identify[ing] a pragmatic middle ground," *see* HILLMAN, *supra* note 16, at 1, 267-74.

73. GILMORE, *supra* note 3, at 1, 112 (arguing that promissory estoppel's basis in reliance indicated that contract and the ever-expanding realm of tort were reuniting, thereby leading to contract law's death as a separate body of law). *Id.* at 95-112. Recently, in *Henderson v. Merrett Syndicates Ltd.*, [1994] 3 W.L.R. 761, 787 (H.L.), Lord Goff of Chieveley, deprecating analysis which "involves regarding the law of tort as supplementary to the law of contract," affirmed the modern trend, saying that "the law of tort is the general law, out of which the parties can, if they wish, contract." Thus, Lord Goff acknowledges the superiority of contract. Death-of-contract scholars contend that the acceptance of the reliance principle has seriously undermined the promissory "bargained for" exchange basis of classical contract law, thereby reducing the respect for the sanctity of bare promises "expressed a century ago." ATIYAH, *supra* note 5, at 655. That both death-of-contract scholars and promise-focused theorists have overstated their case is convincingly explored in Phuong N. Pham, *The Waning of Promissory Estoppel*, 79 CORNELL L. REV. 1263 (1994). *But see* Eric Mills Holmes, *The Four Phases of Promissory Estoppel*, 20 SEATTLE U. L. REV. 45 (1996). In any event, any obituary for contract turns out to have been monstrously premature.

74. Brian Coote, *The Essence of Contract*, 1 J. CONT. L. 91, 94 (1988) (citing P.S. ATIYAH, PRAGMATISM AND THEORY IN ENGLISH LAW 173 (1987)).

75. ATIYAH, *supra* note 5, at 778; ATIYAH, *supra* note 8, at 27-35.

76. For an examination of the impact of the legal realism movement, particularly of the major changes from the classical contract law of Samuel Williston to the realism of Karl Llewellyn, on contract law and its principal legislative monument (Article 2 of the Uniform Commercial Code), *see generally* James J. White, *Promise Fulfilled and Principle Betrayed*, 1988 ANN. SURV. AM. L. 7. *See also* Cohen, *supra* note 36, at 575. Llewellyn's view that the contract of the parties consisted of the bargain-in-fact, tempered by rules requiring minimum commercial morality, is best incorporated in U.C.C. §1-201 (3) which states that "agreement means the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance." *See* John E. Murray, Jr., *The Article 2 Prism: The Underlying Philosophy of Article 2 of the Uniform Commercial Code*, 21 WASHBURN L. J. 1, 19-20 (1981).

77. *See, e.g.*, Judith A. Shapiro, Note, *The Shetar's Effect on English Law–A Law of the Jews Becomes the Law of Land*, 71 GEO. L. J. 1179 (1983); Harold J. Berman, *The Religious Sources of General Contract Law: An Historical Perspective*, 4 J.L. & RELIGION 103 (1986); Andrew W. McThenia, Jr., *Religion, Story and the Law of Contracts: Reply*

analysis,[78] Critical Legal Studies,[79] feminist—or feminine—contract ideology[80]), generating a richly divergent cornucopia of competing theories

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to Professor Berman, 4 J.L. & RELIGION 125 (1986); Kristin L. Peters Hamlin, *The Impact of Islamic Revivalism on Contract and Usury Law in Iran, Saudi Arabia, and Egypt*, 22 TEX. INT'L L.J. 351 (1987); Roger Bern, *A Biblical Model for Analysis of Issues of Law and Public Policy: With Illustrative Applications to Contracts, Antitrust, Remedies and Public Policy Issues*, 6 REGENT U. L. REV. 103, 131-52 (1995); VOGEL & HAYES, *supra* note 12, at 53-69, 97-128.

78. The influence of the law-and-economics movement, dealing with the application of economic analysis to contract law, in recent years, has been quite significant. The movement postulates generally that the ultimate social goal is wealth maximization, also known as efficiency, a goal whose accomplishment depends on the enforcement of private contracts. *See* RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW § 1-2, at 13-15 (4th ed. 1992); THE ECONOMICS OF CONTRACT LAW 1-7 (Anthony T. Kronman & Richard A. Posner eds., 1979); Ian Ayres, *Three Proposals to Harness Private Information in Contract*, 21 HARV. J. L. & PUB. POL'Y 135 (1997). Significantly, L.L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages:1*, 46 YALE L.J. 52 (1936), anticipated many of the insights of the law-and-economics analysis of contract remedies. *See, e.g.*, Charles J. Goetz & Robert E. Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 YALE L.J. 1261 (1980). However, this law-and-economics approach does not seem to have influenced the transnational economic law in any significant way. *But see generally* Georg Ress, *Ex Ante Safeguards Against Opportunism in International Treaties/Theory and Practice of International Public Law*, 150 INST. & THEORETICAL ECON. 279 (1994).

79. Critical legal treatments of contract law have questioned the abstract and formal doctrines, developed by both classical and neoclassical theorists, and have also assessed many aspects of contemporary alternatives to existing contract doctrines. *See generally* Clare Dalton, *An Essay in the Deconstruction of Contract Doctrine*, 94 YALE L.J. 997 (1985); RICHARD W. BAUMAN, *Contract Law*, *in* CRITICAL LEGAL STUDIES: A GUIDE TO THE LITERATURE 59, 61-64 (1996); Thomas Wilhelmsson, *Questions for a Critical Contract Law–and a Contradictory Answer: Contract as Social Cooperation*, *in* PERSPECTIVES OF CRITICAL CONTRACT LAW 9 (Thomas Wilhelmsson ed., 1993).

80. *See generally* Mary Joe Frug, *Re-Reading Contracts: A Feminist Analysis of a Contracts Casebook*, 34 AM. U. L. REV. 1065 (1985); Mary Joe Frug, *Rescuing Impossibility Doctrine: A Postmodern Feminist Analysis of Contract Law*, 140 U. PA. L. REV. 1029 (1992); CAROLE PATEMAN, THE SEXUAL CONTRACT (1988); Martha A. Fineman, *A Legal (and Otherwise) Realist Response to "Sex as Contract": Abortion and Expanded Choice*, 4 COLUM. J. GENDER & L. 128 (1994); Gillian K. Hadfield, *The Dilemma of Choice: A Feminist Perspective on* [Michael J. Trebilcock's] The Limits of Freedom of Contract, 33 OSGOODE HALL L.J. 337 (1995); Gillian K. Hadfield, *An Expressive Theory of Contract: From Feminist Dilemmas to a Reconceptualization of Rational Choice in Contract Law*, 146 U. PA. L. REV. 1235 (1998); Ruthann Robson & S.E. Valentine, *Lov(h)ers: Lesbians as Intimate Partners and Lesbian Legal Theory*, 63 TEMP. L. REV. 511 (1990); Kellye Y. Testy, *An Unlikely Resurrection*, 90 NW. U. L. REV. 219, 220 (1995) (identifying "lesbian legal theory's insurrection of contract as a response to the shortcomings of feminist theory's approach to contract"); Carol Weisbrod,

and doctrinal analyses, and focusing specifically on the relationship between contract law and society at a more fundamental level in suggesting that the ideology of contract has been a vehicle of social control.[81] Similarly, empiricists have pointed out that the operation of contract in society is at variance with the way it is assumed to operate by theorists and practitioners alike.[82] The author does not content herself with mere descriptions of the relevant schools of thought, but highlights links between them as well as special conditions that may be responsible for the evolution of doctrine and jurisprudence.[83]

Whilst it is true that modern commercial agreements are generally of a more complicated nature, extant research indicates that business people today generally execute contracts without consideration of the legal principles involved, except in circumstances which dictate the resort to a carefully drafted instrument.[84] The empirical data found that commercial

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The Way We Live Now: A Discussion of Contracts and Domestic Arrangements, 1994 UTAH L. REV. 777; Martha M. Ertman, *Contractual Purgatory for Sexual Marginorities: Not Heaven, but Not Hell Either*, 73 DENV. U. L. REV. 4 (1996).

81. HILLMAN, *supra* note 16, at 267-74.

82. *See, e.g.*, Stewart Macaulay, *An Empirical View of Contract*, 1985 WIS. L. REV. 465, 467.

83. NASSAR, *supra* note 68, at 19-28.

84. *See, e.g.*, Comment, *The Statute of Frauds and the Business Community: A Reappraisal in Light of Prevailing Practices*, 66 YALE L. J. 1038 (1957) (survey of ninety-two manufacturers revealed Statute often ignored); Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963) (sixty-eight businesses invariably settled cancellations for only expenses without recourse to contractual remedies); Stewart Macaulay, *The Use and Non-Use of Contracts in the Manufacturing Industry*, 9 PRAC. LAW. 13 (1963); Hugh Beale & Tony Dugdale, *Contracts Between Businessmen: Planning and the Use of Contractual Remedies*, 2 BRIT. J. L. & SOC'Y 45 (1975) (English study parallels to Macaulay's findings); Stewart Macaulay, *Elegant Models, Empirical Pictures, and the Complexities of Contract*, 11 L. & SOC'Y REV. 507, 507-509 (1977); Britt-Mari Blegvad, *Commercial Relations, Contract, and Litigation in Denmark: A Discussion of Macaulay's Theories*, 24 L. & SOC'Y REV. 397 (1990); Russell J. Weintraub, *A Survey of Contract Practice and Policy*, 1992 WIS. L. REV. 1; James J. White, *Contract Law in Modern Commercial Transactions: An Artifact of Twentieth Century Business Life?*, 22 WASHBURN L.J. 1 (1982); Janet T. Landa, *A Theory of the Ethnically Homogeneous Middleman Group: An Institutional Alternative to Contract Law*, 10 J. LEGAL STUD. 349 (1981) (explaining how the Chinese middleman groups reduced transaction costs and facilitated bargains in the absence of contract laws); Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992) (describing the relations of merchants in the New York's diamond industry toward dispute resolution). *See also* Clyde W. Summers, *Collective Agreements and the Law of Contracts*, 78 YALE L.J. 525,

bargains are commonly struck on the basis of a mutual trust between the contracting parties, in deference to unwritten laws of fair behavior, to avoid the inconvenience, expense and added difficulty of composing formal contracts.[85] Because of the air of informality (a mere telephone call or exchange of letters) many of these agreements were admittedly of dubious legal validity.[86] Nevertheless, nonperformance of contractual obligations was typically resolved without resort to tribunals or courts due to the defaulting party's desire to avoid adverse consequences that this would have on its reputation and future trading relations.[87]

Although further studies exploring "more fully the extent to which the availability of contract law makes possible reliance on arrangements and negotiations that are not explicitly or formally legal"[88] are needed, even the existing research is significant in indicating that people do engage in economic transactions in many situations where they should understand that contract law could play but little role in reinforcing their obligations. It is not fanciful to suggest that commercial contracts are not always meant to be legally enforceable. Businesses live with risks, for trust can rest on many norms and structure reinforcing commitments other than contract law.

An excellent example is furnished by Professor Stewart Macaulay in his recent case study of a complex architectural project, involving the internationally renowned architect, Frank Lloyd Wright, and S.C. Johnson Son, Inc., where the parties performed their complex commitments "without formal planning and even implicit threats to use legal sanctions."[89]

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528 (1969); ROGER COTTERRELL, THE SOCIOLOGY OF LAW: AN INTRODUCTION 32-33, 319 (2d ed. 1992); MAX WEBER, *supra* note 46, at 307; Peter Vincent-Jones, *Contract and Business Transactions: A Socio-Legal Analysis*, 16 J.L. & SOC'Y 166, 169 (1989) (referring to the work of Max Weber that the mutual expectations of parties can be ensured both contractually and extra-contractually, particularly through an informal recognition of self-interest in honorable behavior). *Cf.* ATIYAH, *supra* note 5, at 713-15; Edward L. Rubin, *The Nonjudicial Life of Contracts: Beyond the Shadow of the Law*, 90 NW. U. L. REV. 107 (1995).

85. Beale & Dugdale, *supra* note 84, at 47. *But see* Veronica L. Taylor, *Continuing Transactions and Persistent Myths: Contracts in Contemporary Japan*, 19 MELB. U. L. REV. 352, 352 (1993) (the "paradigmatic view that law is largely irrelevant to Japanese ... business relationship [is] misleading," and that "comparative studies which analyse the market characteristics of different contract types in Japan are needed").

86. Beale & Dugdale, *supra* note 84, at 48.

87. *Id.* at 47-48.

88. AUSTIN SARAT & THOMAS R. KEARNS, LAW IN EVERYDAY LIFE 45 (1993).

89. Stewart Macaulay, *Organic Transactions: Contract, Frank Lloyd Wright and the Johnson Building*, 1996 WIS. L. REV. 75, 77.

If these empirical studies are an accurate reflection of current commercial trends, as one should believe they are, then, two observations may be made. First, it is the spirit of trust, rather than the mechanics of agreement, which has become the inspiring principle behind the majority of commercial transactions.[90] And, second, in the commercial context, various extra-contractual devices (cooperation, flexibility, willingness to adjust terms) operate to reduce the rigid usage of contract law and may often involve the "entangling strings of friendship, reputation, interdependence, morality, and altruistic desires."[91] This is perhaps a marked indication of the reduced importance of the sanctity of contract, that is, adherence to precise promises, to modern commercial dealings.

This phenomenon has been further reinforced by relational theorists,[92] including the author, who have offered interesting insights and opened new vistas in appreciating the growing obsolescence of the classical contract thinking in the context of modern business transactions, for example, franchises, long-term leases, output and requirement contracts, construction and civil-engineering contracts, investment and joint-venture agreements, license and know-how agreements, management, marketing and other collective employment agreements and so on.[93] The author has endeavored to show that this new approach—endorsed by Lord Wilberforce in his perceptive Foreword[94]—fits the reality of many long-term international

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90. Stewart Macaulay, *The Reliance Interest and the World Outside the Law Schools' Doors*, 1991 WIS. L. REV. 247, 262.

91. Ian R. Macneil, *Restatement (Second) of Contracts and Presentiation*, 60 VA . L. REV. 589, 595 (1974) [hereinafter Macneil, *Presentiation*].

92. The summation of the relational approach in the text is directly concerned with the work of Professor Ian R. Macneil, which is both complex as well as voluminous. *See, e.g.*, IAN R. MACNEIL, THE NEW SOCIAL CONTRACT: AN INQUIRY INTO MODERN CONTRACTUAL RELATIONS (1980); Ian R. Macneil, *The Many Futures of Contracts*, 47 S. CAL. L. REV. 691 (1974) [hereinafter Macneil, *Many Futures*]; Ian R. Macneil, *Relational Contract: What We Do and Do Not Know*, 1985 WIS. L. REV. 483; Ian R. Macneil, *Values in Contract: Internal and External*, 78 NW. U. L. REV. 340 (1983); Ian R. Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law*, 72 NW. U. L. REV. 854 (1978) [hereinafter Macneil, *Adjustment*]; 1 STEWART MACAULAY ET AL., CONTRACTS: LAW IN ACTION 511-20 (1995). For reviews of Macneil's work, *see* William Whitford, *Ian Macneil's Contribution to Contracts Scholarship*, 1985 WIS. L. REV. 545; Takashi Uchida, *The New Development of Contract Law and General Clauses-A Japanese Perspective*, 4 J. JAPAN-NETHERLANDS INST. 120 (1992).

93. Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1089-91 (1981).

94. Lord Wilberforce, *Foreword* to NASSAR, *supra* note 68, at xi.

contracts and transactions (LTICTs) far better than the classical (or even neoclassical[95]) ones which did not readily accommodate transactions unavoidably lacking definiteness and mutuality.

Inspired by the distinction between "discrete" and "relational" exchanges, championed by Professor Ian Macneil (the primary relational theorist) and his allies,[96] the author's model offers interesting insights about the workings of LTICTs.[97] Many simple exchanges, a common feature of day-to-day life, like the casual purchase of a newspaper from a roadside vendor, taking a public transport, or getting a haircut, are usually completed more or less instantaneously or within a short time frame, and there need be no relevant background of prior or subsequent dealings between the parties to consider (hence "discrete," one-time transaction).

Traditional contract doctrine takes as its model the discrete transaction.[98] In contemporary economic life such transactions continue,

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95. The body of law, usually associated with Langdell, Holmes, Williston and the first RESTATEMENT OF CONTRACTS (1932), dominant in the late nineteenth and early twentieth centuries, is referred to as "classical contract law." Later contract law, often referred to as "neoclassical contract law," is the product of the partial accommodation of new realities which "attempts to balance the individualist ideals of classical contract with communal standards of responsibility to others." Jay M. Feinman, *The Significance of Contract Theory*, 58 U. CIN. L. REV. 1283, 1287-88 (1990). Nevertheless, the core remains the principle of "freedom of contract," wherein "the classical values of liberty, privacy and efficiency" are weighed "against the values of trust, fairness, and cooperation," *id.* at 1288, "tempered both within and without [contract's] formal structure by principles such as reliance and unjust enrichment, that focus on fairness and the interdependence of parties rather than on parties' actual agreements." *Id.* at 1288 (quoting Robert A. Hillman, *The Crisis in Modern Contract Theory*, 67 TEX. L. REV. 103, 104 (1988)). Although the adaptation of neoclassical contract law through the aegis of the U.C.C. and the RESTATEMENT (SECOND) OF CONTRACTS (1979)–and similar analogues in other common law and civil law jurisdictions–has successfully responded to some of the glaring shortcomings of earlier contract law, much remains to be done. Macneil, *Adjustment*, *supra* note 92, at 862-86 (neither formulations–"classical" and "neoclassical"–of contract law are suited to today's world of relational contracting); *see* EDWARD J. MURPHY & RICHARD E. SPEIDEL, STUDIES IN CONTRACT LAW 89 (4th ed. 1991) ("from roughly 1940 to date" the neoclassical contract law, based on legal realism, has occupied itself with protecting commercial expectations and fairness of exchanges); Steven R. Salbu, *Evolving Contract as a Device for Flexible Coordination and Control*, 34 AM. BUS. L.J. 329 n.1 (1997).

96. The other leading relational pioneer is Professor Stewart Macaulay. *See* Robert W. Gordon, *Macaulay, Macneil, and the Discovery of Solidarity and Power in Contract Law*, 1985 WIS. L. REV. 565; Thomas M. Palay, *A Contract Does Not a Contract Make*, 1985 WIS. L. REV. 561.

97. NASSAR, *supra* note 68, at 21-24.

98. JOHN ADAMS & ROGER BROWNSWORD, KEY ISSUES IN CONTRACT 80 (1995).

but it is difficult to accept them as representative of the complex negotiations typical of substantial transactions which are not so straightforward.[99] In the first place, parties may expect to be cooperating over an extended period of time that it is not feasible for them to specify all the stipulations at the outset exactly. In other words, intertwined relations embrace many factors that simply defy any presentiation (that is, the incorporation of the future into a present agreement); the parties will have to adjust their relationship as it progressively develops.[100] Or, the transaction may involve many other people, say, for the long-term supply of energy, for the construction and development of a shopping center project, for the friendly takeover of a corporate entity, or the signing of a franchising agreement. The negotiations in such transactions are a far cry from the simple bargaining envisioned by the classic rules of contract formation and often involve, over a considerable period of time, the input of corporate executives, financiers, engineers, lawyers, and many others, in a continuum of relations ranging from the discrete to the highly complex.[101] Projects of this nature, given the massive investment of capital and technical know-how (not to speak of labor, equipment and materials), are often unavoidably complex and are intended to have a relatively long life.

The parties may deal with various complexities either by entering into long-term contracts (perhaps with several parties), or they may have a series of piecemeal, and ancillary short-term contracts. In either event, where persons and businesses are in relationships, the law may have to address this ongoing contracting—as it becomes more complex, complicated and prolonged—differently, by allowing flexibility or by recognizing that these several short-term contracts, constituting one economic project, are merely components of continuing relations where it is increasingly unrealistic to employ a discrete model of contract to express legitimate expectations that necessarily evolve gradually through experience and close association.[102] Hence, the deal may not capture the entire transaction but only establishes an interrelationship among the contracting parties that is broader than their contractually-defined obligations. One can think of the succession of short-term contracts, of which certain terms are renegotiated on each renewal, as the practical and legal response to the flexibility in a long-term

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99. *Id.* at 80-81.

100. Macneil, *Presentiation*, *supra* note 91, at 595-97; Macneil, *Adjustment*, *supra* note 92, at 890.

101. Macneil, *Adjustment*, *supra* note 92, at 887.

102. *Id.* at 895-97.

synallagmatic contract.[103]

Whereas under the classical theory, each of the several contracts must be viewed separately as discrete transactions, the relational model normally regards the economic and functional link between the contracts as forming one unit in a juridically relevant manner.[104] Or, to use the picturesque words, "parties treat their contracts more like marriages than like one-night stands.... [T]he object of contracting is not primarily to allocate risk, but to signify a commitment to cooperate."[105] The general agreement may be fleshed out incrementally as it proceeds by its overall social matrix: This includes such matters as (1) custom and mercantile usages to which the parties are subject (by a course of dealing prior to their agreement, or by a course of performance after their agreement), (2) cognizance of the social and economic roles of the parties, (3) general notions of decency and fairness, (4) basic assumptions shared but unspoken by the parties, and (5) other factors in the particular and general context in which the parties find themselves in the governance of their affairs.[106] "[J]ust as a mountain changes shape and color as one approaches it ever closer and shuts out other vistas, so too the common norms oriented toward discreteness take on new characteristics as they more and more dominate the contract landscape,"[107] thereby developing a complex web of unspoken norms and tacit assumptions about many elements of the ongoing relationship that do not require further negotiation.[108]

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103. Macneil, *Many Futures*, *supra* note 92, at 792-93.

104. While developing a comprehensive social theory of contract that more exchanges are based upon relations than upon discrete transactions, Macneil also suggests that wealth maximization is not the only aim of contracting parties, but the preservation of the relationship, harmonization of conflicts and reciprocity are some of the equally important additional goals. MACNEIL, *supra* note 92, at 66-70. However, of late, some law and economics scholars have dealt with the peculiar problems of relational contracting, discussing specifically problems of "transaction costs" and "lack of information" that involve economic appraisal of contract issues. *See, e.g.*, Robert E. Scott, *Conflict and Cooperation in Long-Term Contracts*, 75 CALIF. L. REV. 2005 (1987); Ian Ayers & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87 (1989); Juliet P. Kostritsky, *Bargaining with Uncertainty, Moral Hazard, and Sunk Costs: A Default Rule for Precontractual Negotiations*, 44 HASTINGS L.J. 621 (1993).

105. Gordon, *supra* note 96, at 569.

106. *Id.*

107. MACNEIL, *supra* note 92, at 60.

108. David Campbell, *The Relational Constitution of the Discrete Contract*, *in* CONTRACT AND ECONOMIC ORGANISATION: SOCIO-LEGAL INITIATIVES 41-42, 45-61 (David Campbell & Peter Vincent-Jones eds., 1996).

In this moving landscape, courts have been increasingly called upon to accommodate imaginatively the traditional contract doctrines with the increased variety and complexity of the disputes engendered by the sophisticated nature of such relational or intertwined transactions. These transactions are of a more involved structure, and—even if not of long-term duration—exist frequently over a substantive period.[109] This accommodation has taken place, for the most part, outside the doctrines of contract law according to nonlegal norms and obligations developed and mutually accepted by the parties themselves,[110] with "equitable discretion using the contract as a framework and reference point."[111] Even without the principal goal of seeking enforcement through legal intervention, these nonlegal norms, which are immanent in the context, are invoked by the contracting parties to set general standards and limits for their conduct in regulating their complex business transactions.[112]

This relational approach[113]—where the parties are more allies than adversaries and value shared interests more than individual ones and where goodwill, compromise, trust, reciprocity, and cooperation are privileged norms—stresses that the law's paradigm of contract (an isolated, discrete

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109. *Id.*

110. Contracting in this context signifies a commitment to cooperate, and relationships involve "complex entanglements of reputation, interdependence, morality, altruism, friendship, and self-interest." JAY M. FEINMAN, ECONOMIC NEGLIGENCE: LIABILITY OF PROFESSIONAL AND BUSINESS TO THIRD PARTIES FOR ECONOMIC LOSS § 7.3.1., at 193 (1995). Marianne M. Jennings, *The True Meaning of Relational Contracts: We Don't Care About the Mailbox Rule, Mirror Images, or Consideration Anymore-Are We Safe?*, 73 DENV. U. L. REV. 3 (1995), deals with some of these noncontractual norms in the context of "strategic supplier partnering" (SSP), but, unfortunately, the seriousness of these persuasive insights is unnecessarily diminished by the adoption of a writing style which is-perhaps deliberately-both somewhat flippant and unorthodox for serious legal writing.

111. Queens Office Tower Assocs. v. Iran Nat'l Airlines Corp., 2 Iran-U.S. Cl. Trib. Rep. 247, 253 (1983 I); *see* Hugh Collins, *Competing Norms of Contractual Behaviour*, *in* CONTRACT AND ECONOMIC ORGANISATION: SOCIO-LEGAL INITIATIVES, *supra* note 108, at 67, 70-72, 81-82, 93-94.

112. Ian R. Macneil, *Relational Contract Theory as Sociology* 143 J. INST. & THEORETICAL ECON. 272, 274 (1987).

113. *Cf.* H.G. BEALE ET AL., CONTRACT-CASES AND MATERIALS 4 (2d ed. 1990):

> There is no such thing as a contract in the abstract. Every contract is made, or is found by the court to exist, in a particular context-a contract to sell goods to a consumer, a contract to charter the services of a ship, a contract to look after an elderly relative in exchange for a share in his property when he dies: the possibilities are almost endless.

exchange) has ill-equipped it to grapple with transactional relationships. It often takes a great deal of ingenuity to see how the implications of the relational view of contract are worked out in the details of contract law, for, in these situations, a contract is not only a momentary picture of reality, but it also covers processes which develop in the future.[114]

B. LTICTs: An Intermix of Classicism and Relationalism? An Emergent Theory of Contractual Undertakings

Against the backdrop of the classical theory of contractual absoluteness (with its emphasis on formalism, technical rules and predictable precise solutions), the author welcomes the emergence of modern relational contextual approach. For such an approach, apart from recognizing that whenever appropriate fairness norms supplement (or even transcend) freedom of contract, also permits a revision of the parties' agreement and thus effect a de facto modification of their contractual undertakings.[115] That such an approach has been unqualifiedly discernible in all sorts of contracts, regardless of their subject-matter and geographical operation, is certainly not the assertion of the author. For, in the wake of the increasing globalization of the world economy, many contractual undertakings are no longer confined to domestic terrains but are increasingly assuming transnational significance. This phenomenon has spurred issues surrounding the harmonization of international law and resolution of transnational commercial disputes to the forefront.[116]

This is not confined only to financial or monetary arrangements (for example, loans and bonds) which involve international credit and financial institutions, governmental or nongovernmental. These undoubtedly require a specialist treatment in the light of differing policy considerations informing these transactions (whether these be environmental values or other human rights issues). Contracts nevertheless these are, but because of the interplay of conflicting issues of law and policy many of these transactions oftentimes raise issues which are not easily addressed to by the purely conventional principles of contractual law alone, either from the perspective of lenders like the International Bank for Reconstruction and

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114. Should, then, contract law itself respond by developing special rules for relational contracts, say, by relaxing the rules of offer and acceptance so that these contracts are not enforced on grounds of uncertainty and indefiniteness? Or, say, by broadening the category of "changed circumstances" to permit nonperformance or adaptation? These questions do not admit of easy answers.

115. NASSAR, *supra* note 68, at 80-81.

116. *Id.* at 1.

Development or of the innate pragmatism of the borrowers of many third world countries. As such, Dr. Nassar has wisely refrained from testing the validity of her thesis on the anvil of this category of commitments which raise significantly different and "an independent set of principles and policy considerations ...."[117]

Rather, in a very cautious and measured examination of her thesis, Dr. Nassar has chosen only one category of contracts, that is, LTICTs, which are "becoming more the norm than the exception."[118] In the realm of today's burgeoning international trade, LTICTs "are the most appropriate tool available to meet the demands of an ever-increasing sophistication in prevailing technological and financial techniques."[119] One of the major premises of the author's exploration of the conceptual basis of LTICTs is that the traditional principles of contract law (for example, direct exchange, reciprocity of mutual promises, consent, freedom of contract) are no longer suitable for these complex agreements and that contract law may even be dead–not necessarily in the Gilmorian sense–for such transactions.[120] Instead, a wholly new regime of law, an intermix of rules and practices,

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117. *Id.* Furthermore, it has been suggested that the banking or financial services institutions have had relatively little exposure to international arbitration and, in fact, have shown a marked tendency to avoid arbitration, preferring instead adjudication by national courts. *See, e.g.*, William W. Park, *When the Borrower and the Banker Are at Odds: The Interaction of Judge and Arbitrator in Trans-Border Finance*, 65 TUL. L. REV. 1323 (1991). Whether this reluctance stems from the substantive deficiencies of arbitration or from the lack of understanding regarding the efficacy of arbitration and other nonjudicial mechanisms are among the questions which require further study. However, in other fields, the importance of arbitration for resolving international commercial disputes, with its ability to render a binding and enforceable award, has remained virtually uncontested, as evidenced by a phenomenal surge in the number of parties resorting to arbitrations each year. *See, e.g.*, *1994 Statistical Report*, I.C.C. INT'L CT. ARB. BULL., May 1995, at 3; Materials on International Commercial Arbitration (Feb. 28, 1996) (from Debevoise and Plimpton and Price Waterhouse LLP Seminar on Developments in International Arbitration) (on file with the author).

118. NASSAR, *supra* note 68, at 1. The concept of international trade is used to include not only trade transactions for the supply or exchange of goods or services, but also other types of economic transactions, such as investment and/or concession agreements, contracts for professional services, etc. *See generally* David Goddard, *Long-Term Contracts: A Law and Economics Perspective*, 1997 N.Z. L. REV. 423; Veronica L. Taylor, *Contracts with the Lot: Franchises, Good Faith and Contract Regulation*, 1997 N.Z. L. REV. 459; Luke Nottage, *Planning and Renegotiating Long-Term Contracts in New Zealand and Japan: An Interim Report on an Empirical Research Project*, 1997 N.Z. L. REV. 482.

119. NASSAR, *supra* note 68, at 1.

120. *Id.* at 233-34.

representing essentially an adaptation (or modification) of contractual principles, might be occupying the field where, say, LTICTs are not looked in terms of the parties' reciprocal promises alone but are increasingly viewed as obligations that "are not only defined by the parties' will, but are also a product of prevailing rules and practices."[121]

Insofar as the larger part of the law of contract is a matter of construction of the intent of the parties, the author, through a searching examination of a multitude of arbitral cases, has provided illustrations therefrom of how a tribunal in a particular situation performed the task of construction, and, in so doing, has tried to identify a contractual model, described as the contractual equilibrium theory, which has increasingly influenced the implementation of LTICTs.[122] Although the author "does not venture an overall revision of contract theory in international law"[123] generally, her study does painstakingly demonstrate the extent to which the models and definitions represented by the classical and modern theories of contract have in practice been either overridden, modified or supplemented in the case of LTICTs and provides a coherent structure of the theory and practice thereof.[124]

This is presumably so because the law of the arbitration (*lex arbitrationis, loi de l'arbitrage*) can be determined by the parties, and the arbitrators are not bound by a particular domestic law if they have been empowered by the parties to decide *ex aequo et bono*.[125] But even absent

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121. *Id.* at 2.

122. *Id.* at 237-43.

123. *Id.* at 2. Contracting parties usually have the freedom (or autonomy) to choose the system of law applicable to their undertaking, except for those choices prohibited or mandated by national law. *See generally* JEAN-CRISTOPHE POMMIER, PRINCIPE D'AUTONOMIE ET LOIS DU CONTRAT EN DROIT PRIVÉE CONVENTIONNEL (1992); A. F. M. Maniruzzaman, *International Arbitrator and Mandatory Public Law Rules in the Context of State Contracts: An Overview*, 7 J. INT'L ARB. 53 (1990); Patrick C. Osode, *State Contracts, State Interests and International Commercial Arbitration: A Third World Perspective*, 30 COMP. & INT'L L.J. S. AFR. 37 (1997).

124. NASSAR, *supra* note 68, at 237-43.

125. *See* DIG. 1.1 ("Ulpianus, libro primo institutionum: [U]t eleganter Celsus definit, ius est ars boni et aequi." That is, "Ulpian, *Institutes, book* 1.1: For, in terms of Celsus' elegant definition, the law is the art of goodness and fairness." 1 THE DIGEST OF JUSTINIAN 1 (Theodor Mommsen & Paul Krueger eds. Latin text, Alan Watson ed. Eng. trans., 1985)). Many conventions authorize arbitrators to adopt this approach of "goodness and fairness." *See, e.g.*, Geneva Convention on International Commercial Arbitration art. VII(2) (1961); *UNCITRAL Model Law of International Commercial Arbitration*, U.N. Commission Int'l Trade Law, 18th Sess., Annex 1, art. 28(3), U.N. Doc. A/40/17 (1985).

such a specific authorization there is now evident a growing trend to let arbitrators invoke principles and rules different from those adopted in national jurisdictions.[126] Furthermore, in practice, contracting parties of different nationalities oftentimes state, especially, with respect to concession agreements for the exploitation of natural resources or for transactions for the construction of industrial works, that any contractual dispute is to be resolved in conformity with the terms of the contract and "the customs and usages of international trade," the "general principles universally recognized by civilized nations," or the *lex mercatoria*.[127] They thus ensure

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126. This tendency has recently been confirmed by the *UNCITRAL Model Law*, *supra* note 125, art. 28(1), which states that the "arbitral tribunal shall decide the dispute in accordance with such rules of the law as are chosen by the parties as applicable to the substance of the dispute" and that only "[f]ailing any designation by the parties, the arbitral tribunal shall apply the law determined by the conflict of laws rules which it considers applicable" *Id.* art. 28(2). Similarly, the I.C.C. Rules of Arbitration, art. 17, I.C.C. Pub. No. 581 (1997), as well as the I.C.C. recommendation to the arbitrators, allow them to apply general principles of law, international customary rules and trade usages when the parties have expressed an intention that no national law should apply to the contract. *See generally*, Michael Joachim Bonell, *The UNIDROIT Principles of International Commercial Contracts*, *in* PROCESS AND SUBSTANCE: LECTURES ON COMPARATIVE LAW 45, 68-72 (Roger Cotterrell ed., 1995); Michael Joachim Bonell, *The UNIDROIT Principles of International Commercial Contracts: Why? What? How?*, 69 TUL. L. REV. 1121, 1144-46 (1995); Harold J. Berman, *The Law of International Commercial Transactions* (Lex Mercatoria), 2 EMORY J. INT'L DISP. RESOL. 235 (1988).

For arbitral awards directly applying the *lex mercatoria* as the law to a contractual relationship, even without a contractual agreement referring to it, *see, e.g.*, I.C.C. Award, Case No. 2583/76, 104 J. DU DROIT INT'L 950 (1977); I.C.C. Award, Case No. 2291/75, 103 J. DU DROIT INT'L 189 (1976); I.C.C. Award, Case No. 1641/69, 101 J. DU DROIT INT'L 888 (1974). *See generally* PETER F. WEISE, LEX MERCATORIA: MATERIELLES RECHT VOR DER INTERNATIONAL HANDELSSCHIEDSGERICHTSMBARKEIT (1990); Klaus P. Berger, *Lex mercatori in der Internationalen Wirtschaftsschiedsgerichtsbarkeit: Der Fall "Compania Valenciana,"* 1993 PRAXIS DES INTERNATIONALEN PRIVAT-UND VERFARENSRECHTS 281.

127. The concept represents an autonomous legal order, without reference to any specific jurisdiction or the legal system of any given country, which encompasses general principles of law common to trading nations and the usages of international trade and commercial transactions "designed to regulate situations that neither domestic nor international law was intended to cover ...." Georges R. Delaume, *Comparative Analysis as a Basis of Law in State Contracts: The Myth of the Lex Mercatoria*, 63 TUL. L.REV. 575, 611 (1989). For some examples, *see* FELIX DASSER, INTERNATIONALE SCHIEDSGERICHTE UND LEX MERCATORIA, RECHTVERGLEICHENDER BEITRAG ZUR DISKUSSION UBER EIN NICHSTAALTICHES HANDELSRECHT 159 (1989); Berthold Goldman, *The Applicable Law: General Principles of Law–the Lex Mercatoria*, *in* CONTEMPORARY PROBLEMS IN INTERNATIONAL ARBITRATION 113 (Dr. Julian D.M. Lew ed., 1986); Jan

"themselves a theoretically neutral, non-national law to govern their agreements."[128] In such situations, obviously, acting as *amiables compositeurs*, or deciding in equity, arbitrators increasingly rely upon the most elastic of criteria, rules and principles which are either universally accepted or considered to be particularly suitable for international contracts.[129] In doing so, they oftentimes tend to infuse these *principia*

Paulsson, *Dispute Resolution*, *in* ECONOMIC DEVELOPMENT, FOREIGN INVESTMENT AND THE LAW 209, 230-32 (Robert Pritchard ed., 1996); Lord Justice Mustill, *supra* note 67, at 155:

> Although the essence of the *lex mercatoria* is its detachment from national legal systems, ... some ... of its rules are to be ascertained by a process of distilling several national laws. The intellectual justification for this process ... must ... be found in the idea that rules of the *lex mercatoria* exist *in gremio legis* as a complete, albeit inexplicit, and evolving whole; that they are received, at least in part, into individual national laws or are reflected by them; and that by careful analysis the dross of the rigidities, impracticabilities, and distinctions imposed by each individual national law can be purged away, leaving behind the pure gold of the underlying international legal order.

Dr. Nassar is careful to point out that the term, trade usage, "defined as a set of practices reflecting a pattern of dealing" should be contrasted from the *lex mercatoria*, which denote a set of independent concepts and rules of customary mercantile law that substitute for the lex contractus. The latter has thus wider implications, whereas trade usage merely connotes "a recognized method of dealing in a certain trade." Thus, the two concepts operate only "as parallels, not synonyms" and have been so referred in many awards. Furthermore, trade usage, unlike custom (which is a binding rule of law), is regarded as a question of fact to be established by the party invoking it. NASSAR, *supra* note 68, at 84-85.

128. Note, *General Principles of Law in International Commercial Arbitration*, 101 HARV. L. REV. 1816, 1833 (1988). For example, according to some authors, the *United Nations Convention on Contracts for the International Sale of Goods*, U.N. Doc. A/CONF. 97/18, *reprinted in* 19 I.L.M. 668 (1980), in force in over forty-seven countries by the end of 1995, resolves the problems of the elusive and evanescent *lex mercatoria* in the form of modern international commercial law treaties with the force of law. *See, e.g.*, Kenneth C. Randall & John E. Norris, *A New Paradigm for International Business Transactions*, 71 WASH. U. L.Q. 599 (1993); Richard E. Speidel, *The Revision of UCC Article 2, Sales in Light of the United Nations Convention on Contracts for the International Sale of Goods*, 16 NW. J. INT'L L. & BUS. 165, 166-67 (1995).

129. *See generally* Ole Lando, *The Lex Mercatoria in International Commercial Arbitration*, 34 INT'L & COMP. L.Q. 747 (1985); Int'l Chamber of Commerce, *INCOTERMS: International Rules for the Interpretation of Trade Terms*, I.C.C. Pub. No. 350 (1980); Int'l Chamber of Commerce, *Uniform Customs and Practice for Documentary Credits*, I.C.C. Pub. No. 400 (1983); Ole Lando, *Assessing the Role of the UNIDROIT Principles in the Harmonization of Arbitration Law*, 3 TUL. J. INT'L & COMP. L. 129 (1994); Bernardo M. Cremades & Steven L. Plehn, *The New Lex Mercatoria and the*

mercatoria with concepts drawn from their own juridical background or commercial experience.[130] Thus, possessed of some degree of resilience, arbitrators often have commodious leeways to overcome the strictures of traditional contract law in the context of the performance of long-term commercial obligations and relationships.

It is also becoming fairly evident that international arbitrations are increasingly eclipsing litigation in national forums in many parts of the world, and that more and more business persons—and their lawyers—might say with William Shakespeare: "The end crowns all; and that old common arbitrator, time, will one day end it. 'So to him we leave it.'"[131] These days, civil trial by jury has become mostly uncommon, and virtually unheard of in commercial disputes, many of which are now submitted to arbitral processes. In particular, when businesses enter into transnational transactions for the sale of goods, construction projects, joint ventures, or franchises, the contract usually provides for arbitration for resolving any disputes arising out of the contractual arrangement, and for regulation of the contracts by a body of law acceptable to the parties (particularly the investor). This has now become increasingly the accepted norm (as it allows each contracting party to avoid the national courts of the other and overcome difficulties emanating from their differing juridical status), prompting one leading practitioner to observe that "in today's world the dispute resolution mechanism will invariably be arbitration."[132] The

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Harmonization of the Laws of International Commercial Transactions, 2 B.U. INT'L L.J. 317 (1984).

130. *Cf.* Sigvard Jarvin, *The Sources and Limits of the Arbitrator's Powers*, *in* CONTEMPORARY PROBLEMS IN INTERNATIONAL ARBITRATION, *supra* note 127, at 50, 66-71; Ning Jin, *The Status of* Lex Mercatoria *in International Commercial Arbitration*, 7 AM. REV. INT'L ARB. 163, 170-71, 193-95, 197 (1996); Tom Carbonneau, *The Remaking of Arbitration: Design and Destiny*, *in* LEX MERCATORIA AND ARBITRATION: A DISCUSSION OF THE NEW LAW MERCHANT 23, 34-35 (Thomas E. Carbonneau ed., rev. ed. 1998).

131. WILLIAM SHAKESPEARE, TROILUS AND GRESSIDA act 4, sc. 5, ll. 224-26 (1602), *in* THE ANNOTATED SHAKESPEARE 558, 613 (A.L. Rowse ed., 1984). Hector and Ulysses suffer misery over the unpredictable outcome of the Trojan war during an interim suspension of hostilities, when all the gods had shown themselves partial and incompetent to arbitrate. But Ulysses did not leave it on this basis alone, as he had earlier agreed. Instead, he devised the Trojan horse, in derogation of all the time-honored rules of dispute resolution.

132. Gerald Aksen, *Arbitration and Other Means of Dispute Settlement*, *in* INTERNATIONAL JOINT VENTURES: A PRACTICAL APPROACH TO WORKING WITH FOREIGN INVESTORS IN THE U.S. 287, 287 (David Goldsweig & Roger Cummings eds., 1990).

international commercial arbitration is now indeed flourishing,[133] has become fully capable of dealing with today's complex business transactions toward providing a wide range of relief, and is playing an increasingly significant role in maintaining international economic relationships.

Dr. Nassar has attempted to identify a coherent list of general principles—a sort of modern *jus commune*—which may be extrapolated from these recent arbitral awards in respect of LTICTs, showing an interplay between the principles of sanctity and fairness with the growing ascendance of the latter. Since the rules of commercial contracts vary around the globe, the task of deciphering such a pattern may be rendered particularly difficult. (One has, however, to bear in mind that the awards analyzed are based on reasons, though, at present, there is no universal rule that in international arbitrations written reasons must be provided.[134])

C. The Enigmatic "Fairness" of Clausula Rebus Sic Stantibus: Has the Bell Completely Tolled on "Sanctity"?

Nevertheless, the author does not rightly make the brazen assertion that the considerations of fairness have completely decimated the sanctity principle in the case of LTICTs.[135] On the contrary, as her comprehensive treatment of the practical application of *clausula rebus sic stantibus* (a concept somewhat analogous to changed circumstances) indicates, the sanctity principle will probably endure for a long time to come, of course, within the parameters of the suggested contractual equilibrium theory.[136]

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133. YVES DEZALAY & BRYANT G. GARTH, DEALING IN VIRTUE: INTERNATIONAL COMMERCIAL ARBITRATION AND THE CONSTRUCTION OF A TRANSNATIONAL LEGAL ORDER 311 (1996).

134. The *UNCITRAL Model Law*, *supra* note 125, art. 31, London Court of International Arbitration [LCIA] Rules art. 6, American Arbitration Association (AAA) International Rules art. 28(2), 1993 WL 498527, CPR Institute for Dispute Resolution Model ADR Procedure rule 14.2, and the British Columbia International Commercial Arbitration Centre (BCICAC) Rules § 34(4) require reasons, unless the parties have agreed otherwise. The International Chamber of Commerce (ICC) Court of Arbitration Rules art. 27 (1997), requiring that the award in "draft form" be submitted to the ICC Court of Arbitration, which may draw the arbitrator's "attention to points of substance," may arguably–by necessary implication–be seen to require that some reasons be given. *See generally* E.D.D. Tavender, *Considerations of Fairness in the Context of International Commercial Arbitrations*, 34 ALBERTA L. REV. 509 (1996).

135. NASSAR, *supra* note 68, at 234.

136. *Id.* at 205-30.

1. Rebus Sic Stantibus: A Transnational Amalgamation of National Approaches?

Some elucidation of *clausula rebus sic stantibus,* now generally accepted as a very limited rule applicable to the international law of treaties,[137] is necessary to appreciate its application to international contracts. For, apparently, the problem of hardship and adaptation of a contract to altered circumstances as a legal consequence thereof has hitherto remained relatively less elaborated and acknowledged, at least on the international level, than the principle of sanctity.[138] In the experience of humankind, contingencies often arise with which the contracting parties have not specifically dealt or have not made adequate provisions ex ante. If this happens, then, the parties may disagree about their respective rights and responsibilities ex post. Often, during the performance phase, some unanticipated events, either caused by the voluntary actions of the parties, or, beyond the control of the parties (natural disasters—floods, earthquakes, storms—, wars, strikes, political insurrection, revolution and fire), do occur, and, absent a specific risk allocation clause, require a procedure for dispute resolution from an international perspective.[139]

Throughout history, contracting parties have grappled with the problem of nonperformance of the contract after its formation (or "conclusion" in civil law parlance) but before its completion, caused by unexpected upheavals.[140] Various legal systems have coped with these situations in different ways, using a variety of approaches. Thus, the

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137. *See, e.g.*, Akos Toth, *The Doctrine of* Rebus Sic Stantibus *in International Law*, 19 JURID. REV. (n.s.) 56, 147, 263 (1974). This doctrine, as its name suggests, appears to derive, according to ZIMMERMANN, *supra* note 32, at 579-82, from a gloss to Gratian's *Decretum*, and to have infiltrated the Roman law tradition by being generalized by the commentators. On the historical development of the doctrine, which can be traced through the Middle Ages from the Byzantine glossators right up to Hugo Grotius and Samuel Pufendorf and beyond, *see, e.g.*, KARL LARENZ, GESCHÄFTSGRUNDLAGE UND VERTRAGSERFÜLLUNG (3d ed. 1963). It was later included in the "Codex Maximilianeus Bavaricus Civilis" of 1756 and in the Prussian General Land Law of 1794. ZWEIGERT & KÖTZ, *supra* note 65, at 557.

138. *But see* MAPP, *supra* note 14, at 134, 139-43.

139. *See infra* notes 141-48 and the accompanying text.

140. The effect of the subsequent disappointing event upon the unperformed contractual obligations is commendably discussed in the Digest (or Pandects) of the Byzantine Emperor, Justinian, published in 533 A.D. DIG. 45.1.23, 33, *in* 4 THE DIGEST OF JUSTINIAN, *supra* note 125, at 653-54.

English common law doctrine of frustration (one of respectable antiquity[141]),

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141. Until the middle of the nineteenth century the English common law had no general doctrine of excuse of contractual performance. Paradine v. Jane, Aleyn 26, 27, 82 Eng. Rep. 897, 897 (K.B. 1647). In that case a lessee sought to be relieved from paying rent because a "German prince, by name Prince Rupert, an alien born, enemy to the King and kingdom," *id.*, ejected him from the land, so that he could not take income from it. This, though, did not involve impossibility, because he could still have paid the rent. The Court of King's Bench declared that

> when the party by his own contract creates a duty or charge upon himself, he is bound to make it good, if he may, notwithstanding any accident by inevitable necessity, because he might have provided against it by his contract. And therefore if the lessee covenant to repair a house, though it be burnt by lightning , or thrown down by enemies, yet he ought to repair it.

Id. The rationale for such a rule was that the parties were free to protect themselves from unforeseen contingencies by express stipulation; if they chose not to do so, then, they could not be subsequently heard to complain because events did not transpire as they had hoped. For the background and impact of *Paradine*, *see* David Ibbetson, *Absolute Liability in Contract: The Antecedents of* Paradine v. Jayne, *in* CONSENSUS AD IDEM: ESSAYS IN THE LAW OF CONTRACT IN HONOUR OF GUENTER TREITEL 1 (F.D. Rose ed., 1996); John D. Wladis, *Common Law and Uncommon Events: The Development of the Doctrine of Impossibility of Performance in English Contract Law*, 75 GEO. L.J. 1575 (1987); S. J. STOLJAR, A HISTORY OF CONTRACT AT COMMON LAW 187-99 (1975).

The growth of commercial activity in the nineteenth century, however, made this rigidity of the doctrine of impossibility both economically and socially unworkable. So the English courts, recognizing these changed conditions, relaxed the constraints on the doctrine imposed by the principle of sanctity of contracts as followed since *Paradine*. *See, e.g.*, Taylor v. Caldwell, 3 B.& S. 826, 122 Eng. Rep. 309 (Q.B. 1863). It based such relaxation on the theory of an implied condition arising without express condition in the contract itself. Taylor was to have the use of Caldwell's music hall for performance on four days, in return for payment of £100.00 at the close of each day. When the hall was accidentally destroyed by fire less than a week before the first performance, Taylor sued Caldwell for breach of contract, claiming as damages the expenses he had incurred in preparing for the performances. The Court of King's Bench held, however, that Caldwell was excused because, "looking at the whole contract ... the parties contracted on the basis of the continued existence of the Music Hall at the time when the concerts were to be given; that being essential to their performance." 3 B. & S. at 839, 122 Eng. Rep. at 314.

This case, the fountainhead of the modern law of impossibility, signaled the gradual evolution of a doctrine which has since mitigated the harshness of the absolute contract rule. Thus, in *Krell v. Henry*, [1903] 2 K.B. 740 (Eng. C.A.), one of the celebrated coronation cases, a party was discharged from paying, because there was frustration of the purpose of the contract (rooms had been let to view a procession which was postponed due to the King's sudden illness). The courts have now come to realize that at times some catastrophic event will occur without the fault of either party which will change or destroy the basis of a contract, and that in these circumstances relief ought to be granted. Probably the best statement of the basis of the doctrine of frustration was made by Lord Radcliffe:

the American doctrine of commercial impracticability[142] (involving extensive commentary[143]), the German doctrine of *wegfall der geschäftsgrundlage,*

> [F]rustration occurs whenever the law recognizes that without default of either party, a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract. Non haec in foedera veni. It was not this that I promised to do.

Davis Contractors Ltd. v. Fareham Urban District Council, [1956] App. Cas. 696, 729. *See also id.* at 719-21 (Lord Reid). This "radically different" test prevails in English law today, but its application has been very strict, as the Suez Canal cases demonstrate. *See, e.g.*, Carapanayoti & Co. Ltd. v. E. T. Green Ltd., [1959] 1 Q. B. 131 (1958), *overruled by* Albert D. Gaon & Co. v. Société Interprofessionelle des Oléagineux Fluides Alimentaires, [1960] 2 Q. B. 334 (1959), *aff'd*, [1960] 2 Q.B. 348 (Eng. C.A.); Tsakirogolou v. Noblee and Thorl Gmbh, [1962] App. Cas. 93 (1961). *See generally* G. H. TREITEL, FRUSTRATION AND FORCE MAJEURE 178-86 (1994); Robert L. Birmingham, *A Second Look At The Suez Canal Cases: Excuse For Nonperformance Of Contractual Obligations In The Light of Economic Theory*, 20 HASTINGS L.J. 1393 (1969); Andrew Phang, *Frustration in English Law—A Reappraisal*, 21 ANGLO-AM. L. REV. 278 (1992).

142. Both the U.C.C. § 2-615 (1997) and the RESTATEMENT (SECOND) OF CONTRACTS §§ 261-272 (1979) contain a broad concept of excusable nonperformance, but make it clear that the new synthesis is subject to the assumption of greater liability through the agreement of the parties. The change from the narrow defense of impossibility to the broader principle of impracticability has enabled the courts to allocate risks that were not anticipated by the parties. *See, e.g.*, Harper & Assocs. v. Printers, Inc., 46 Wash. App. 417, 730 P. 2d 733 (1986) (narrow defense of impossibility has been subsumed in the more commercially oriented and broader categories of impracticability); Transatlantic Fin. Corp. v. United States, 363 F. 2d 312, 315 (D.C. Cir. 1966) (Skelly Wright, J.) (the new doctrine of commercial impracticability has been freed from the earlier fictional and unrealistic strictures of the implied term).

143. The scholarly literature concerning impracticability (and its historic predecessors, impossibility and frustration) is quite extensive. *See, e.g.*, JOHN D. CALAMARI & JOSEPH M. PERILLO, THE LAW OF CONTRACTS 535-84 (3d ed. 1987); ARTHUR L. CORBIN, CORBIN ON CONTRACTS 1088-153 (1952); 2 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS 497-588 (1990 & Supp. 1998); 1 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE 163-82 (4th ed. 1995); 3 SAMUEL WILLISTON, THE LAW OF CONTRACTS 3279-372 (1920); Christopher J. Bruce, *An Economic Analysis of the Impossibility Doctrine*, 11 J. LEGAL STUD. 311 (1982); John P. Dawson, *Judicial Revision of Frustrated Contracts: The United States*, 64 B.U. L. REV. 1 (1984); E. Allan Farnsworth, *Disputes over Omission in Contracts*, 68 COLUM. L. REV. 860 (1968); Sheldon W. Halpern, *Application of the Doctrine of Commercial Impracticability: Searching for "the Wisdom of Solomon,"* 135 U. PA. L. REV. 1123 (1987); Robert A. Hillman, *An Analysis of the Cessation of Contractual Relations*, 68 CORNELL L. REV. 617 (1983); Marianne M. Jennings, *Commercial Impracticability—Does It Really Exist?*, 2 WHITTIER L. REV. 241 (1980); Paul L. Joskow, *Commercial Impossibility, the Uranium Market and the Westinghouse Case*, 6 J. LEGAL STUD. 119 (1977); Andrew Kull, *Mistake,*

unmöglichkeit,[144] the French doctrines of *force majeure*[145] and *imprévision*[146]

Frustration, and the Windfall Principle of Contract Remedies, 43 HASTINGS L.J. 1 (1991); Daniel T. Ostas & Frank P. Darr, *Understanding Commercial Impracticability: Tempering Efficiency with Community Fairness Norms*, 27 RUTGERS L.J. 343 (1966); Richard A. Posner & Andrew M. Rosenfield, *Impossibility and Related Doctrines in Contract Law: An Economic Analysis*, 6 J. LEGAL STUD. 83 (1977); Richard E. Spiedel, *Excusable Nonperformance in Sales Contracts: Some Thoughts About Risk Management*, 32 S.C. L. REV. 241 (1980); Alan O. Sykes, *The Doctrine of Commercial Impracticability in a Second-Best World*, 19 J. LEGAL STUD. 43 (1990); George G. Triantis, *Contractual Allocations of Unknown Risks: A Critique of the Doctrine of Commercial Impracticability*, 42 U. TORONTO L. J. 450 (1992); Michelle J. White, *Contract Breach and Contract Discharge Due to Impossibility: A Unified Theory*, 17 J. LEGAL STUD. 353 (1988); Wladis, *supra* note 141. For an unusually elaborate bibliography, see Leon E. Trakman, *Winner Take Some: Loss Sharing and Commercial Impracticability*, 69 MINN. L. REV. 471, 472-74 nn.4-9 (1985).

144. *See generally* Henri Lesguillons, *Frustration*, Force Majeure, Imprévision, Wegfall der Geschäftsgrundlage, 5 DROIT ET PRATIQUE DU COMMERCE INTERNATIONAL 507 (1979); A. H. Puelinckx, *Frustration, Hardship*, Force Majeure, Imprévision, Wegfall der Geschäftsgrundlage, Unmöglichkeit, *Changed Circumstances: A Comparative Study in English, French, German and Japanese Law*, 3 J. INT'L ARB. 47 (1986); Peter Hay, *Frustration and Its Solution in German Law*, 10 AM. J. COMP. L. 345 (1961).

145. The doctrine of *force majeure* (irresistible force), expressed in the French C. CIV. arts. 1147, 1148, requires three prerequisites for discharge: (1) unforeseeability of a fortuitous event, (2) absolute impossibility of performance and not mere onerousness, and (3) no fault on the promisor's part. ARTHUR T. VON MEHREN & JAMES R. GORDLEY, THE CIVIL LAW SYSTEM 1047-48 (2d. ed. 1977); *see also* René David, *Frustration of Contract in French Law*, 28 J. COMP. LEGIS. & INT'L L. (3d ser.) 11, 11-12 (1946); J. Denson Smith, *Impossibility of Performance as an Excuse in French Law: The Doctrine of Force Majeure*, 45 YALE L.J. 452, 465-66 (1936); BARRY NICHOLAS, FRENCH LAW OF CONTRACT 200-10 (2d ed. 1992); RENÉ DAVID, ENGLISH LAW AND FRENCH LAW 119-95 (1980). For Belgian interpretations of the doctrine, see HERBOTS, *supra* note 20, at 181-87.

146. After the First World War, the doctrine of *imprévision* (lack of foresight) was repeatedly applied by the Conseil d'État, the highest administrative court in France, in government contracts (for public works, for public utilities such as gas, water, and electricity) toward abrogating or modifying the contractual obligations if the performance of the contract had subsequently become *eccessivamente onerosa* (excessively onerous). This was done in an effort to preserve the public welfare in the continuance of contracts which were essential to the orderly conduct of public life, "a need which is not usually found in ordinary commercial contracts and one which in any event a court would hardly be justified in meeting at the expense of one of the parties." Barry Nicholas, *Force Majeure in French* Law, *in* FORCE MAJEURE AND FRUSTRATION OF CONTRACT 21, 29 (Ewan McKendrick ed., 2d ed. 1995); VON MEHREN & GORDLEY, *supra* note 145, at 551; P. Delvolvé, *The French Law of* Imprévision *in International Contracts*, 2 INT'L CONT. & FIN. REV. 3 (1981). However, the civil courts remained quite inflexible in insisting upon the very strict conditions of *force majeure*.

and the Swiss doctrine of impossibility without fault,[147] applied nationally and internationally (in latter with appropriate modifications), deal with changes in the economic, political, technological, legal and business realities "when unforeseen occurrences, subsequent to the date of the contract, render performance either legally or physically impossible, or excessively difficult, impractical or expensive, or destroy the known utility which the stipulated performance had to either party."[148] The limits of these doctrines are however not easy to define, for the notions of excuse or readjustment often collide with the bargain expectations of the parties, thereby seriously impairing the freedom and the sanctity of contracts. But how much of a modification or dissolution of onerous contractual obligations for fairness,

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This rigid attitude led to legislative intervention after both World Wars and also encouraged French businessmen to incorporate "war- or currency-clauses in long-term contracts [for] an express allocation of risks, or have recourse to arbitral tribunals which they absolve from strict adherence to law and empower to adapt the contract to the changed circumstances in the light of what is fair and reasonable ...." ZWEIGERT & KÖTZ, *supra* note 65, at 220; *see generally* David, *supra* note 145.

The negative attitude of the French civil court is a natural corollary of a strong principle of "sanctity" of contract, as enshrined in C. CIV. art. 1134: "[L]es conventions légalement formées tiennent lieu de loi à ceux qui les ont faites." That is: "[A]greements lawfully made have the force of statute for those who made them ...." In the famous Cass. civ., Mar. 6, 1876, *De Galliffet v. Commune de Pélissane* [popularly known as *Canal de Craponne*], DP 1876, I. 193; S. 1876, I. 161, the Cour de cassation quashed the decision of the Aix Court of Appeal relying on article 1134. It has consistently ruled that the "law of the parties," in the words of article 1134, must be respected like the law of Parliament, and that "it is not for the courts however equitable their decisions may appear, to take [account] of time and circumstances . . . in order to modify the parties' agreement and to substitute new clauses for those freely accepted by the contracting parties." VON MEHREN & GORDLEY, *supra* note 145, at 1051 (quoting *De Galliffet*, *supra*).

147. There is no mention of "impossibility" in THE SWISS FEDERAL CODE OF OBLIGATIONS AS OF JANUARY 1, 1984 arts. 97, 119 & 373 (Simon L. Goren trans., 1987), but the Swiss courts, including the Bundesgericht, the highest Swiss Federal tribunal, are certainly aware of kindred problems. They too have adopted a concept of *Geschäftsgrundlage* (foundation of the contract) to be read with article 2, section 2 of the SWISS CIVIL CODE (Ivy William et al. trans., 2d ed. 1987), which requires good faith. *See generally* Hans Smit, *Frustration of Contract: A Comparative Attempt at Consolidation*, 58 COLUM. L. REV. 287, 289-96 (1958); Iur Peter Gauch, *Price Increases or Contract Termination in the Event of Extraordinary Circumstances: The Frequently Overlooked Provision of Art. 373, Para. 2 of the Swiss Code of Obligations*, 4 INT'L CONSTR. L. REV. 265 (1987).

148. Smit, *supra* note 147, at 287; *see generally* Dr. Theo Rauh, *Legal Consequences of Force Majeure Under German, Swiss, English and United States' Law*, 25 DENV. J. INT'L L. & POL'Y 151 (1996). In international contract for the sale of goods, there is a generally accepted "act of God" defense known as *force majeure*. *United Nations Convention on Contracts for the International Sale of Goods*, *supra* note 128, art. 79.

resulting from the occurrence of an unforeseen event, should be permissible as a just and reasonable solution in the new circumstances? It is only in relatively recent times that the courts in most common law and civilian systems have softened their rigid insistence that the strict words of a contract be religiously adhered to regardless of any changes in circumstances which were not in the contemplation of the contracting parties.

Departing from the old English common law rule of impossibility, the American practice—both in section 2-615 of the Uniform Commercial Code (U.C.C.) (1997) and section 268(2) of the *Restatement (Second) of Contracts* (1979)—has adopted a new test of commercial impracticability toward excusing or partially relieving a party from its contractual obligations when presupposed conditions or contingencies upon which the contract was based have not been met.[149]

The modern English practice, though less liberal than its American counterpart, has recognized that if some catastrophic event occurs for which neither party is responsible and if the result of that event is to destroy the very basis of the contract, so that the venture to which the parties now find themselves committed is radically different from that originally envisioned, then, the contract is forthwith discharged.[150] However, the mere fact the unexpected turn of events have rendered the contract more onerous or more costly than originally contemplated by the parties is not enough.[151] In other words, no hardship, no unforeseen hindrance, no difficulty short of absolute impossibility, will excuse the parties from doing what they have expressly agreed to do.[152] Rather, there "must be as well such a change in the significance of the obligation that the thing undertaken would, if performed, be a different thing from that contracted for."[153]

The French and Swiss doctrines of *force majeure* and impossibility, based on statutory provisions,[154] discharge contractual obligations only in

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149. *See supra* note 142.

150. *See, e.g.*, Davis Contractors Ltd. v. Fareham Urban District, [1956] App. Cas. 696, 729.

151. *Id.*

152. *Id.*

153. *Id.* at 728-29.

154. French law, like many other legal systems, proceeds on the basis that a promise to do the impossible is null and void (*impossibilium nulla obligatio*). The principle, though not expressly stated, appears to be implicit in C. CIV. arts. 1108, 1126-30, 1172, 1302 & 1601, and there are various particular applications in arts. 1722, 1741, 1788, 1790. For the Swiss position, *see generally*, *supra* note 147.

cases of such impossibility (as opposed to mere hardship), which were unforeseen, unavoidable (that is, not preventable by the party seeking relief) and without the fault of either party.[155] The apparent harshness of these rules has, however, been alleviated in practice as these provisions are applied in light of the good faith and equity requirements of both the French Civil Code (articles 1134 and 1135) and the Swiss Civil Code (article 2).[156] This liberal approach renders the concepts of *force majeure* and impossibility virtually analogous to the judicially-created French and German doctrines of *imprévision* and *wegfall der geschäftsgrundlage*, respectively, which both allow a contract to be adjusted for the increased burden of economic hardship in the wake of extraordinary circumstances.[157]

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155. It should not be overlooked that most civil law countries, unlike their common law counterparts, follow the principle that there cannot be a contract to do an impossible act. *See, e.g.*, THE SWISS FEDERAL CODE OF OBLIGATIONS, *supra* note 147, art. 20; THE GERMAN CIVIL CODE, *supra* note 30, art. 306. Such a position, incidentally, also operates in India. Indian Contract Act, 1872, § 56, *in* 14 THE AIR MANUAL: UNREPEALED CENTRAL ACTS 335, 653 (Nagpur, India: All India Reporter Ltd., 5th ed. 1989): "An agreement to do an act impossible in itself is void." However, these cases of ab initio antecedent impossibility at the time of contract formation need not detain us here as we are primarily concerned with supervening or post-formation impossibility typically associated with an event during the performance stage of the contract.

156. NASSAR, *supra* note 68, at 197 nn.17 & 18.

157. Under the influence of Professor Paul Oertmann's doctrine of the "basis of the transaction" (*Geschäftsgrundlage*) and by using the well-known sections 157 and 242 BGB on good faith, the Reichsgericht began, in the aftermath of Wold War I, to allow readjustment of obligations based on *wegfall der geschäftsgrundlage*. The revolutionary events and unparallelled inflation had greatly affected the German economy and upset the basis of many contracts. ZWEIGERT & KÖTZ, *supra* note 65, at 214-17; *see generally* E.J. Cohn, *Frustration of Contract in German Law*, 28 J. COMP. LEGIS. & INT'L L. (3d ser.) 15, 16-24 (1946); NORBERT HORN ET AL., GERMAN PRIVATE AND COMMERCIAL LAW: AN INTRODUCTION 136 (Tony Weir trans., 1982); Werner Lorenz, *Contract Modification as a Result of Change of Circumstances*, *in* GOOD FAITH AND FAULT IN CONTRACT LAW, *supra* note 66, at 357, 365-76; John P. Dawson, *Judicial Revision of Frustrated Contracts: Germany*, 63 B.U. L. REV. 1039 (1983); Joachim Meinecke, *Frustration in the West German Law of Contract*, 13 IRISH JURIST 83 (1978); Ingeborg Schwenzer, *The Law of Contracts*, *in* INTRODUCTION TO GERMAN LAW 173, 181 (Werner F. Ebke & Matthew W. Finkin eds., 1996). Incidentally, this model of revision seems to have been adopted by many recent codes: GREEK CIVIL CODE § 388 (Constantine Taliadoros trans., 1982), INTRODUCTION TO GREEK LAW 77-78 (Konstantinos D. Kerameus & Phaedon J. Kozyris eds., 1988), ATHANASIUS TH. IATROU, AN OUTLINE OF THE GREEK CIVIL LAW 114 (1986); THE ALGERIAN CIVIL CODE art 107, *in* COMMERICAL LAWS OF THE MIDDLE EAST: ALGERIA 19 (Gamal M. Badr ed., 1988); ITALIAN CODICE CIVILE [C.C.] art. 1467. In Sweden, Denmark and Norway, the doctrine of economic impossibility has been developed, but it seems that Swedish courts now favor the direct test of hardship to the artificial concept of impossibility. S.P. de Cruz, *A Comparative Survey of the Doctrine*

The foregoing national approaches, both judicial and legislative, closely interconnected, have been sought to be amalgamated by the international arbitral tribunals in the omnibus and synthesized new concept of *rebus sic stantibus* or "changed circumstances" to appraise the implications of varied changes on the performance of contracts.[158] One should, however, be cautious to note, that although the arbitrators have used the terms *force majeure*, physical impossibility, frustration of purpose and commercial impracticability, *rebus sic stantibus* and changed circumstances rather interchangeably, they do not necessarily carry the same meaning as those given in national jurisdictions, although the situation conveyed by all these expressions may be basically the same.[159] Nonetheless, on the international level, these concepts (their technical differences being not relevant to the present discussion) have been appropriately adapted to suit the needs of international trade and possibly a transnational *lex mercatoria.* Instruments like the Vienna Convention on the Law of Treaties of 1969[160] and the UNCITRAL *Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works*,[161] among many others, have also played a significant role in that process.[162]

In the ultimate analysis, the problem created by a situation of changed circumstances is whether departure from the stipulations of the contract should be allowed, by means of the contract's adjustment, postponement or ex nunc termination, if the parties themselves have not addressed the

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of Frustration, 2 LEGAL ISSUES OF EUR. INTEGRATION 51, 56 (1982).

158. NASSAR, *supra* note 68, at 193.

159. *Id.* at 199.

160. Vienna Convention on the Law of Treaties, *Reproduced in* 8 I.L.M. 679 (1969).

161. *UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works*, CN. 9/SER. B/2, United Nations Publication Sales No. E. 87. V. 10, ISBN 92-1-133300-8 04200p (1988). *See also Force Majeure and Hardship*, ICC Pub. No. 421 (Paris, 1985); David Yates, *Drafting* Force Majeure *and Related Clauses*, 3 J. CONT. L. 186 (1991); Rainer Geiger, *The Unilateral Change of Economic Development Agreements*, 23 INT'L & COMP. L.Q. 73 (1974); Michael Furmston, *Drafting of* Force Majeure *Clauses—Some General Guidelines*, *in* FORCE MAJEURE AND FRUSTRATION OF CONTRACT, *supra* note 146, at 57; Alan Berg, *The Detailed Drafting of a Force Majeure Clause*, *in* FORCE MAJEURE AND FRUSTRATION OF CONTRACT, *supra* note 146, at 63; Ole Lando, *Renegotiation and Revision of International Contracts: An Issue in the North/South Dialogue*, 23 GERM. Y. B. INT'L L. 37, 52 (1980).

162. NASSAR, *supra* note 68, at 193.

disruptive event ex ante.[163] The dilemma can be best understood as a conflict between the classical theory of freedom of contract, tellingly epitomized in the maxim *pacta sunt servanda*, and the suggested need of attributing a social vision of fairness to private autonomy, thereby extolling the significance of extra-contractual norms, such as good faith, reasonableness and practicality.[164] In this context, one has also to recognize that the problem of changed circumstances is not new, having known a considerable historical development in the various legal systems.[165]

While the international commercial practice regards *rebus sic stantibus* as a general principle of law (albeit "of strict and narrow interpretation"[166]), it is treated "as a dangerous exception to the principle of sanctity of contracts"[167] and is applied only "to cases where compelling reasons justify it."[168] Strictly speaking, such an approach, even though very restrictive, is, in principle, a deviation from the faithful application of the classical theory.[169] For, under the classical theory, if a transaction conformed to the needed formalities, the court was obliged to enforce it and desist from

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163. For example, a building or engineering contract might specifically provide for what will happen in the event of a strike. Thus, the parties themselves deal with the consequences of future events in certain types of agreement which are particularly susceptible to disruption by unforeseen calamities. For an example involving such a clause, *see* Eastern Airlines v. McDonnell Douglas Corp., 532 F. 2d 957, 962 (5th Cir. 1976).

164. *Cf.* The Hon. Andrew Rogers, Q.C., *Foreword* to FORCE MAJEURE AND FRUSTRATION OF CONTRACT, *supra* note 146, at v-vi.

165. *See* ZWEIGERT & KÖTZ, *supra* note 65, at 211. The classical Islamic law (*sharia*) extends its scope of *qūwa qāhira* or *qūwat al-qānūn* (corresponding to *force majeure*), exempting liability for nonperformance, not only to supervening impossibility of performance, but also to situations where it has been rendered materially different or unreasonably burdensome from what was originally contracted for. RAYNER, *supra* note 12, at 260. Modern legislation in Bahrin, Egypt, Iran, Kuwait, Libya, Syria, and United Arab Amirates (UAE) is, however, slightly more restrictive (and, perhaps, "more judicious") in that the circumstances must be unforeseen and of a public nature. The judicial discretion is designed only to alleviate the obligation of the parties rather than to extinguish it altogether. *Id.* at 260-63.

166. I.C.C. Award, Case No. 1512/70, Indian Cement Co. v. National Bank of Pakistan, 1 Y.B. COM. ARB. 128, 129 (1976).

167. *Id.*

168. *Id. See also* Hungarian State Enterprise v. Yugoslav Crude Oil Pipeline, 9 Y.B. COM. ARB. 69, 70 (1989). Furthermore, "*force majeure* conditions have to be pleaded, proved, communicated to the other party and narrowly interpreted." NASSAR, *supra* note 68, at 203.

169. NASSAR, *supra* note 68, at 203.

making any normative judgments.[170] However, neoclassical theorists have allowed for some flexibility to let considerations of fairness pervade the entire spectrum of contract, from formation to cessation.[171] Under the classical theory unforeseeable (unpredictable) and disruptive events (but not self-induced), causally rendering performance completely and materially impossible (whether physical or economic), may justify nonperformance, thereby letting the loss lie where it falls; otherwise, bargains remain enforceable according to their original terms.

If the risk of the supervening events is allocated by the contractual terms, then, such an allocation is unlikely to be judicially (or arbitrally) interfered with lightly.[172] Similarly, if the parties, while fully aware of the foreseeable risks, nevertheless choose not to guard against them, then, in many circumstances, it would often be a factor that suggests that they assumed the risk of such occurrence. It would then be difficult for them to satisfy a court or an arbitrator that it is legitimate to relieve a party from carrying out its bargain (or paying damage in lieu thereof).[173] In this situation, the normal and prima facie inference (though rebuttable) is that the parties have voluntarily assumed the risk of foreseen (or readily foreseeable) events,[174] and that any intrusion on the sanctity of contracts should be seriously resisted.[175] Thus, though under the contemporary theory of frustration the foresight of the parties may be of considerable

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170. *Id.*

171. *See* U.C.C. §§ 1-209 (19), 1-203, 2-103 (1)(b), 2-209 cmt. 2 (1997); RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979).

172. *See, e.g.*, Comptoir Commercial Anversois v. Power Son & Co., [1920] 1 K.B. 868, 895, 901.

173. *See, e.g.*, Walton Harvey, Ltd. v. Walker & Homfrays, Ltd., [1931] 1 Ch. 274, 282 (Eng. C.A.) (Lord Hanworth, M.R.); [1931] 1 Ch. at 285-86 (Romer L.J.); Davis Contractors Ltd. v. Fareham Urban District, [1956] App. Cas. 696, 724 (the delay "was not caused by any new and unforeseeable factor or event") (Lord Reid); [1956] App. Cas. at 731 ("the possibility of enough labour and materials not being available was before [the parties'] eyes") (Lord Radcliffe); Paal Wilson & Co. A/S v. Partenreederei Hannah Blumenthal, [1983] 1 App. Cas. 854, 909 (for frustration "there must be some outside event or extraneous change ... not foreseen or provided for by the parties") (Lord Brandon of Oakbrook). Decisions and dicta which appear to conflict with the general principle that foreseen or foreseeable events are excluded from the purview of frustration are convincingly explained away in TREITEL, *supra* note 141, at 461-71.

174. *See, e.g.*, Lloyd v. Murphy, 25 Cal. 2d 48, 54, 153 P. 2d 47, 50 (1944) (Traynor, J.). "If [the risk of the frustrating event] was foreseeable there should have been provision for it in the contract, and the absence of such a provision gives rise to the inference that the risk was assumed." *Id.*

175. TREITEL, *supra* note 141, at 49-51.

importance (*not* conclusive) in allowing a just solution to be arrived at,[176] the classical theory does not support an adjustment model, whereby, depending upon the kind of change of circumstances, contracts could be adapted, modified, supplemented or even excused.[177]

2. Gradual Erosion of the Nonadjustment Approach

The nonadjustment approach of the classical theory, with its emphasis on the sanctity of the promise, has been trenchantly criticized by the author as it is completely out of tune with the functional realities of the long-term transactions, where unforeseeability is endemic:

> First, in many LTICTs, once the initial investment is made, it is hard to pull out of the contract since it is difficult to transfer the invested capital to other uses. In addition, to reap the returns of one's investment, contractual partners may have to remain in the relationship for a minimum period of time. Early termination in such situations would adversely affect not only the contractual parties, but also those who are involved in, or dependent on, the project's completion. An adjustment of the contractual relationship in such cases, besides being more equitable, is also more desirable from a market efficiency perspective. Also, the classical model of nonadjustment ironically defeats its own purposes and encourages opportunistic behavior by permitting windfall gains.
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> Second, the classical theory ignores that rationality ... has its limitations. To what extent are potential contracting parties prepared to invest in feasibility studies and other information-generating activities to ensure that they have provided for every possible eventuality? In addition, in some cases, revealing the potential disruptive effect of some future eventuality is beyond the state of art and available technology. Extensive geological surveys can be carried out to identify possible oil reserves or the condition of land in a construction site. Yet, upon the commencement of drilling or construction, a contractor may discover dry wells or swamps beneath hard earth surfaces. In such cases, even from a cost/benefit analysis, it is easier, cheaper

176. *See, e.g.*, Opera Co. v. Wolf Trap Found, 817 F. 2d 1094, 1102-1103 (4th Cir. 1987).

177. Rogers, *supra* note 164, at v.

> and more equitable to adjust the parties' contractual relationship. To accommodate these criticisms, the classical model was revised to allow for remedial measures in some limited situations. Otherwise, however, the classical model still applies the old rule that lets the loss lie where it falls.[178]

Although the harshness of the rule that lets the loss lie where it falls has been mitigated by apportioning the loss in the arbitral tribunal's equitable discretion and the question of changed circumstances has been examined and answered differently in relation to each specific contractual obligation, in practice, the "obvious rigidity and unfairness of the classical model has undermined [the] effectiveness"[179] of such efforts. For, in the sixty-five cases, in which *rebus sic stantibus* had been pleaded (excluding cases relating to the effects of changed circumstances on forum selection clauses), the Iran-U.S. Claims Tribunal exercised its discretion in only five of them, thereby indicating the very minimal extent to which it was prepared "to sacrifice contractual clauses for the benefit of fairness."[180] In most of these situations, even the most sibylline drafter would not have anticipated the turn of events and envisage all the contingencies that the future may bring at the time of contracting.

It is however only now that in contradistinction to the nonadjustment model of the classical theory of *rebus sic stantibus* the contract drafting has focused its attention toward dispute resolution through adjustment of contractual relationship, rather than termination or suspension, following changed circumstances.[181] Increasingly, these explicit mechanisms of

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178. NASSAR, *supra* note 68, at 206-207. Examples can be multiplied to demonstrate that particularly troublesome problems are encountered by the impact of technological breakthroughs and, not unsurprisingly, the risk of unforeseen and unforeseeable developments grows as the lifetime of the contract increases.

179. *Id.* at 215.

180. *Id.* The author's conclusion contrasts with the American approach to overcome the harshness of classical contracts' "all-or-nothing" approach. *See* Robert W. Reeder III, *Court-Imposed Modifications: Supplementing the All-or-Nothing Approach to Discharge Cases*, 44 OHIO ST. L.J. 1079 (1983): "[C]ourts have developed an array of doctrines .... [T]hese doctrines assist courts in defining 'a shifting line of compromise between the impulse to uphold the sanctity of business agreements and the desire to avoid imposing obligations that are ... unduly burdensome.'" *Id.* at 1080 (quoting L.L. Fuller & William R. Perdue, Jr., *The Reliance Interest in Contract Damages: 2*, 46 YALE L.J. 373, 379 (1937)).

181. NASSAR, *supra* note 68, at 218. *See generally* Erich Schanze, *Failure of Long-Term Contracts and the Duty to Re-negotiate*, *in* FAILURE OF CONTRACTS: CONTRACTUAL, RESTITUTIONARY AND PROPRIETARY CONSEQUENCES 155-65 (Francis Rose ed., 1997).

contractual allocation of risk, often characterized as adaptation or renegotiation clauses, are of sufficient generality to accommodate even such hardships where supervening circumstances of any kind (including a change in government policy) have rendered contractual performance not only excessively burdensome but also financially less remunerative.[182] That this drafting strategy, apparently designed to neutralize the delimiting constraints of unforeseeability and unavoidability in the traditional concept of *rebus sic stantibus* for relational transactions (which at times might be found suitable for discrete contracts),[183] is preferable to the classical model of excused performance for the special nature of LTICTs is convincingly demonstrated.[184]

In the first place, as discussed earlier, the very nature of relational contracts presupposes a continuing adjustment of the parties' obligations in the light of gradually unfolding and unanticipated changed circumstances, not in sight, when the contract was formed, or, human prescience being limited, the parties could not have settled all the terms exhaustively in advance.[185] For, despite careful and dexterous planning, best-laid arrangements may often go awry long before their contemplated date of execution. Sudden events like stringent foreign exchange controls, devaluation, currency fluctuations, nationalization or compulsory appropriation of physical assets (plant and equipment) and intellectual property (patents, trademarks, copyrights), etc., may seriously overturn the inceptive apportionment of risk upon which the contract was initially based. Thus, notwithstanding lawyerly ingenuity (and aspiration) to regulate in extreme detail, depth, and scope the behavior of the contracting parties, it is only a benign illusion that the draftsperson can always successfully tame away the shrew of all the uncertainties and vagaries of the future. In the telling words of Lord Denning, we "no longer credit a party with the

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182. WOLFGANG PETER, ARBITRATION AND RENEGOTIATION OF INTERNATIONAL INVESTMENT AGREEMENTS 154 (1986); Karl-Heinz Böckstiegel, *Hardship,* Force Majeure *and Special Risk Clauses in International Contracts*, *in* 3 ADAPTATION AND RENEGOTIATION OF CONTRACTS IN INTERNATIONAL TRADE AND FINANCE 159 (Norbert Horn ed., 1985); P.J.M. Declercq, *Modern Analysis of the Legal Effect of Force Majeure Clauses in Situations of Commercial Impracticability*, 15 J. L. & COM. 213 (1995). Incompetence, inattention, oversight, or haste in omitting such clauses has no longer a defensible place in the drafter's repertoire.

183. PETER, *supra* note 182, at 148-66; NASSAR, *supra* note 68, at 216-18.

184. NASSAR, *supra* note 68, at 219.

185. Macneil, *Presentiation*, *supra* note 91, at 596-97, 608-10; Nagla Nassar, *Internationalization of State Contracts: ICSID, The Last Citadel*, 14 J. INT'L ARB. 185, 192-93 (1997).

foresight of a prophet or his lawyer with the draftsmanship of a [Mackenzie] Chalmers."[186] Rather, most of the LTICTs fall in the category of relational transactions as they share the elements of trust, cooperation and interdependency.[187]

Secondly, an increasingly large number of LTICTs involve massive and high-risk investments which, being specific to the particular enterprise, are not readily transferable and yield dividends only after a period of time.[188] Much of this investment will be lost if the venture is terminated, for it could be hard to switch to a different type of business. It is thus economically more sensible to adjust parties' obligations in such complex undertakings (and conserve resources) than to terminate their business relationship altogether. The consequences of termination are very expensive and time-consuming in themselves and such a choice in most cases is not an enviable option for either of the parties.[189] Therefore, compelled by economic circumstances, parties remain anxious to consider the continuation rather than the dissolution of their contractual relations, in spite of the changed circumstances.

Thirdly, contractual adjustment discourages opportunistic behavior, including unjust enrichment or impoverishment, by disallowing windfall gains and losses.[190] Since both the parties were equally devoid of any foresight of the potential change of circumstances, it is inappropriate to protect or penalize only one or the other. The absolutist-rigid formalism of the all-or-nothing approach of the classical model, bringing in its train automatic discharge, which lets losses lie where they fall, should therefore be replaced by the adjustment model of loss-sharing of the relationist theorists. For such a rule of adjustment "will encourage the pursuit of successful adaptations of contractual relationships [and the] party refusing modification will not only risk being charged with breach of contract, but

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186. British Movietonews Ltd. v. London and District Cinemas Ltd., [1951] 1 K.B. 190, 202 (Eng. C.A.) (Lord Denning), *rev'd on other grounds*, [1952] App. Cas. 166.

187. ADAMS & BROWNSWORD, *supra* note 98, at 80, 87.

188. NASSAR, *supra* note 68, at 206.

189. *Id.* at 206-207.

190. At times, termination may be a preferred alternative to enable the parties to negotiate their relationship afresh, if they so wish, without any constraints of "opportunism" in a situation of "bilateral monopoly" where the parties are "locked into" their contractual relationships. The problems of any opportunism are not entirely hypothetical, although, in practice, they are likely to be more subtle and insidious.

will also seriously damage his commercial reputation."[191] However, the classical approach does not allow the contract to continue and to adapt its terms to the changed circumstances or to replace different terms more appropriate for the drastically changed realities than the terms negotiated in the original contract. In particular, no relief is available on the ground that performance of the contract has become unprofitable for the promisor. Such a draconian approach produces neither fairness nor economic efficiency.

Undeniably, the present conditions of adjustment—change of circumstances, adverse effects and causal nexus—as required by the Vienna Convention and those recommended by the UNCITRAL model are somewhat restrictive (because of the use of foreseeability and avoidability language). One should nevertheless applaud their relational flair and also appreciate the emergent trend of those international arbitral awards which determine the legal consequences of *rebus sic stantibus* in terms of relational standards, overshadowing the doctrine of unforeseen events (*théorie de l'imprévision*).[192] The remedies granted under the adjustment model of relationalism have admittedly not been uniform, because what is equitable in one circumstance may not be necessarily so in others.[193] This trend, still in its nascent stage, has, however, not ripened into a general rule of law, thereby replacing the dominant and all-pervasive excuse doctrine where contractual relationships are either terminated or suspended (but not

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191. NASSAR, *supra* note 68, at 220. There is, obviously, a strong trend within the United States to prefer an adaptation if a dramatic and unpredictable change impacts severely on the commercial survival of both the contractual project and the contracting partners. *See generally* Russell J. Weintraub, *A Survey of Contract Practice and Policy*, 1992 WIS. L. REV. 1. The commercial culture of many countries, particularly in Asia, regards a contractual agreement more as a broad framework of parties' obligations than as an exhaustive catalog of inflexible and categorical commitments. As such, adaptation requests are expected to be accommodated in a reasonable way. *See generally* DOMINIQUE BLANCO, NÉGOCIER ET RÉDIGER UN CONTRAT INTERNATIONAL 11-16 (1993) (offers a valuable comparison of civil and common law jurisdictions). *See also* Shiela Slocum Hollis & John W. Berresford, *Structuring Legal Relationships in Oil and Gas Exploration and Development in 'Frontier' Countries*, *in* INTERNATIONAL OIL AND GAS INVESTMENT: MOVING EASTWARD? 29, 30-31, 35-36, 52-53 (Thomas W. Wälde & George K. Ndi eds., 1994).

192. NASSAR, *supra* note 68, at 220-21. *See, e.g.*, *LIAMCO Arbitration*, *supra* note 14; Dutch/Saudi Arabian Pipeline Contractor v. US/Saudi Arabian Oil Company, 14 Y.B. COM. ARB. 47 (1989); Hungarian State Enter. v. Yugoslav Crude Oil Pipeline, 9 Y.B. COM. ARB. 69 (1989); Subcontractor v. Main Contractor, 8 INT'L ARB. REP. A1 (1993) (Milan Arbitration Association); Gould Marketing, Inc. v. Iran, 6 Iran-U.S. Cl. Trib. Rep. 272 (1984 II).

193. NASSAR, *supra* note 68, at 227.

adjusted) in cases of changed circumstances.[194] In other words, except for a modest beginning, the principle of the sanctity of contracts has remained largely unimpregnable, in its application of the doctrine of *rebus sic stantibus*, even in the context of LTICTs.[195]

3. Arbitral Infusion of Fairness-Related Norms: A Measured or *Sub-Rosa* Imperceptible Process?

That fairness-related norms have percolated somewhat imperceptibly may not be readily apparent to a less attentive reader. However, from a rereading of some of the awards, one suspects that one major reason may be that the arbitrators are reluctant to resort to relational norms when the parties have themselves already provided for a clause, explicitly or obviously (*sinngemäss*), regulating the consequences of changed circumstances.[196] Oftentimes, parties do qualify their contractual obligations by a cancellation clause, giving it a general power of termination; a *force majeure* clause, excusing it on the occurrence of specified types of events; a disclaimer clause, restricting (or exempting) its liability for breach; a variation clause, allowing it to change the scope of the work and to pass on additional costs as the work progresses to the other party; or any such device, restricting its obligations only to use reasonable efforts.[197]

Obviously, in many cases, the presence of such a clause contemplating a specific risk-distribution could justifiably be seen by many arbitrators as overriding the effects of changed circumstances, thereby inhibiting their discretion in readily relieving a party from the burdensome consequences of unanticipated catastrophes. They very logically conclude that such risks having already been so meticulously allocated by the contracting parties should not be reallocated differently by the arbitral tribunals. For otherwise how could *rebus sic stantibus* give a party that it would normally not be entitled under its own contractually-stipulated clause, providing for specific obstacles to performance? Doing so, that is, requiring a party, for instance, to pay an amount far in excess than originally agreed upon would be plainly a much more indefensible arbitral trespass on the sanctity of contract than merely to relieve them from their remaining obligations. Furthermore, any arbitral adjustment of loss that travels well beyond the confines of the

194. *Id.* at 230.

195. *Id.*

196. *Id.* at 215.

197. FARNSWORTH, *supra* note 16, at 678-79.

agreement impairs the ex ante bargain and imposes an unjustifiable ex post adjustment of losses upon the parties. Is it then unreasonable to assume that in consciously bargaining for their own exculpation or limitation clause the parties, consistent with their freedom to contract, were only striving for certainty in delineating the parameters of their liability, thereby intending it to be the sole and exclusive repository of their understanding? If so, then, the general principle of *rebus sic stantibus* should very properly yield to a specific (albeit, contrary) contractual provision by which the parties may explicitly assume or assign a greater liability or lesser obligation/risk allocation than envisioned in the standards set forth in the concept of commercial impracticability or impossibility arising in the wake of changed circumstances.

Thus, unless it be concluded that the exculpatory clause was merely intended to supplement (and not supplant) the legal doctrine,[198] the arbitrators are highly unlikely to intrude upon the contractual autonomy of the parties in dealing in advance with the manifold problems of performance following changed circumstances as they thought it most appropriate. The focus thus being on the parties' freedom of contract—and depending upon the value the contracting entities attach to their continuing business relationship—they may themselves decide whether or not they want to discharge their respective obligations or to put a renegotiation or contract-adjustment clause in their agreement. The remedial flexibility of such clauses offers a significant advantage over the rigidity of the general law.

Thus, indubitably, notwithstanding the increases in transaction costs, a wide range of "[s]uch provisions[,] when agreed upon, *leave no doubt as to the intent of the parties*. They clearly reflect that the parties intended to avoid that the impossibility to perform be considered as the sine qua non

198. In *American Bell Int'l, Inc. v. Iran*, 12 Iran-U.S. Cl. Trib. Rep. 170, 184 (1986), the tribunal found that where the contract provided for allocation of costs on termination due to *force majeure* the contract would apply. But, for costs not covered by the contract, "the determination of the rights and liabilities of the parties is subject 'to the Tribunal's equitable discretion, using the contract as a framework and reference point.'" *Id.* at 186. The approach of the tribunal was "to reach a result which as closely as possible corresponds to the contractual scheme." *Id.* at 188.

For an examination of the question whether the presence of a *force majeure* clause operates to exclude the doctrine of frustration, *see* Ewan McKendrick, *Force Majeure and Frustration—Their Relationship and a Comparative Assessment*, *in* FORCE MAJEURE AND FRUSTRATION OF CONTRACT, *supra* note 146, at 33, 34-37. The learned author's conclusion is in the negative; he further demonstrates the advantages of relying upon a *force majeure* clause as "the doctrine of frustration in English law operates within very narrow confines ...." *Id.* at 37.

requirement for *force majeure*."[199] The language of such clauses, drafted in a multitude of forms, naturally needs to be examined in each case, as with all contractual terms, in the context of the contract as a whole to determine the limits of each party's assumption of risk. Naturally, many arbitrators, steeped in the judicial tradition that a decision-maker should not commit the blasphemy of making a contract for the parties, sometimes bridle at undertaking the gratuitous task of interfering with the drafter's intent through a process of conjecture or ex post speculation as to how the parties might have allocated the risk of loss had they contemplated that risk at the time of contracting.[200] They, therefore, defer to individual autonomy by strictly enforcing express allocations of risk as a matter of construction; otherwise, the result of the hard bargaining of the informed parties would be undermined by the hindsight and subjective judgment of an arbitrator. This sensitivity, as seen earlier, explains that why the Iran-U.S. Claims Tribunal strictly applied such clauses "regardless of whether they suited the changed circumstances or produced an equitable solution."[201]

Secondly, the consequences of *rebus sic stantibus* do not always raise the same ethical issues of unfairness deserving of moral opprobrium as are normally implicit in situations of, say, unconscientious behavior, duress, fraud, coercion and misrepresentation. Apparently, arbitrators (and judges) have been enormously sensitive in condoning egregious conduct which is outrightly destructive of commercial morality and a sense of fair play.[202] This is so, because the principle of sanctity of contract, like many legal principles, does not embody an absolute value. However, in other relatively amoral situations, not involving extreme examples of revolting unfairness—and the doctrine of discharge because of *rebus sic stantibus* is certainly one of them—, the arbitrators have been acutely conscious of the danger that the doctrine could needlessly undermine the time-honored

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199. National Oil Corp. (Libya) v. Libyan Sun Oil Co. (US), I.C.C. Award, Case No. 4462/85, 16 Y.B. COM. ARB. 54, 59 (1991) (emphasis added). NASSAR, *supra* note 68, at 223. It is understandable that an arbitrator should respect an express contractual provision which clearly stipulates that performance will not be forthcoming if certain facts cease to exist during the tenancy of the transaction.

200. *See, e.g.*, Walker v. Keith, 382 S.W. 2d 198, 204 (Ky. 1964); Deadwood Lodge v. Albert, 319 N.W. 2d 823 (S.D. 1982).

201. NASSAR, *supra* note 68, at 215. The Iran-U.S. Claims Tribunal thus invariably followed the rule that the loss must "lie where it falls" regardless of the equities of the situation. *Id.* at 214 n.82. Risk allocation (and not loss sharing) is the raison d'être of the classical theory.

202. *See, e.g.*, JOHN BELL, POLICY ARGUMENTS IN JUDICIAL DECISIONS 173-82 (1983); ROY GOODE, COMMERCIAL LAW IN THE NEXT MILLENNIUM 12-14 (1998).

principle of *pacta sunt servanda*.

As an illustration, the restrictive nature of the concept is neatly demonstrated by *Mobil Oil Iran v. Iran*.[203] The respondent claimed that the long-term agreement for the exploitation of oil resources was frustrated by the dramatic political changes brought about by the Islamic Revolution and the decision of the new regime to follow a policy radically different from that of the previous government in the oil industry, thereby discharging it from further performance of the contract. While recognizing that changes of such a character and magnitude could not be without significance, the tribunal rejected the mere fact of the revolution as being a sufficient "change of circumstances" to justify termination of the contract without appropriate compensation. Since the case concerned a long-term oil exploitation compact that is necessarily subject to progressive modification (reflecting the changing balance of power between the companies and the oil exporting countries), the tribunal ruled that the legitimate expectations of the contracting parties in respect of the agreement could not be so easily defeated by recourse to frustration. Otherwise, the integrity of the contractual relationship would be seriously undermined. Such an approach probably explains the arbitral reluctance to apply the theoretically infinite doctrine of changed circumstances readily as the sole basis of contractual discharge, thereby indicating that certainty and the sanctity of contract are values not to be tempered with lightly.

Thirdly, even if arbitrators are favorably inclined, or feel obligated by the notions of justice and rationality, to adopt a more realistic relational approach towards LTICTs, they would nevertheless seek to draw support for their decisions by reference to black-letter law as well. For an astute arbitrator would be acutely conscious of the practical considerations affecting the recognition and enforcement of foreign awards. As an illustration, *The Gov't of Kuwait v. Am. Indep. Oil Co.*[204] (popularly known

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203. 16 Iran-U.S. Cl. Trib. Rep. 3, 39 (1987 III). The reasoning of this case was followed in *Phillips Petroleum Co. v. Iran*, 21 Iran-U.S. Cl. Trib. Rep. 79, 107-08 (1989 I). Another case, *William L. Pereira Assocs. v. Iran*, 5 Iran-U.S. Cl. Trib. Rep. 198 (1984), also adopts a restrictive approach to the doctrine of *rebus sic stantibus*. However, such an approach was not followed in *QuesTech, Inc. v. Iran*, 9 Iran-U.S. Cl. Trib. Rep. 107, 121 (1985 II), and some like cases, which related to secret military intelligence projects of unique political sensitivity. Iran was however obligated to compensate the claimant for losses suffered up to and including the termination of the contract. *Id.* at 123.

204. 21 I.L.M. 976 (1982) [hereinafter AMINOIL Arbitration]. Incidentally, this seminal arbitration cast grave doubts on the efficacy of the stabilization clauses as a protective device for the foreign investor over the long term. The tribunal found that the sovereign rights of the state could be contracted away only for a relatively limited period of time, *id.* at 1043 (Fitzmaurice, Arb., dissenting), and that "what that would involve

as the *AMINOIL Arbitration*) demonstrates that adherence to *pacta sunt servanda* may be the preferred mechanism to bring a fair and equitable outcome envisioned by the parties and insist that contracts must be performed in accordance with their terms. Thus, while confirming the binding force of contracts under international law and ruling that the stabilization clause did not affect the unquestionable right of a state to nationalize as an expression of its territorial sovereignty, the arbitral tribunal, nevertheless, on a construction of the clause, concluded that the nationalization did not encompass confiscatory "takings" and that the sovereign's right of nationalization was limited by the respect due for contractual rights. Such an interstitial infusion of fairness, somewhat subterranean, leaves no doubt that the rule *pacta sunt servanda* is indispensable:

> The *AMINOIL* award represents a balanced holding that promotes not only the relational aspects of LTICTs, but also the interests of both parties. At the same time, it achieves these aims without unduly straining, or destroying the stability of the contractual relationship. It is relational in character because it accommodates future, unidentified changes, which are to be dealt with as they occur over the course of the contract. Such potential changes are not to be evaluated in light of the parties' original contractual agreement, but in reference to the relationship as a whole. The interests of the parties are treated not as competing with, but as complementing, the contractual goal.[205]

A fourth possible reason may be that the guidelines of the various international instruments, though designed to encompass relational realities in contract drafting, have in practice not proved fully effective in furthering the goals of relationalism and loss sharing. Perhaps, the guidelines relating to the desirability of hardship clauses (UNCITRAL adopted a far less ambitious approach because of political differences between developed and developing countries) need to be significantly revised so as to banish the

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would be a particularly serious undertaking which would have to be expressly stipulated for." *Id* at 1023. A similar conclusion was reached in BP Exploration Co. (Libya) v. Libyan Arab Republic, 53 I.L.R. 297 (1979); Liberian E. Timber Corp. (LETCO) v. Republic of Liberia, 26 I.L.M. 647 (1987). *See generally* John Crawford and Wesley Johnson, *Arbitrating with Foreign States and Their Instrumentalities*, 5 INT'L FIN. L. REV. 11 (1986); Amoco Int'l F. Corp. v. Islamic Republic of Iran, 15 Iran-U.S. Cl. Trib. Rep. 189 (1987).

205. NASSAR, *supra* note 68, at 137.

requirements of unforeseeability, unpredictability and nonavoidability—which have been the mainstays of the classical theory of *rebus sic stantibus*. Otherwise, the citadel of sanctity will continue to retain its relative invulnerability from any substantial intrusions of fairness for years to come. For *pacta sunt servanda* is so axiomatic a rule that any doctrine, purporting to encroach upon it and to offer relief from an express promise, is likely to meet with resistance and often with rejection. Not unnaturally, oftentimes, varying the contract, or of adapting it to the changed circumstances, or of suspending its performance are regarded as sources of undesirable uncertainty, virtually amounting to an undesirable arbitral usurpation of making a contract for the parties. Thus, though the doctrine of changed circumstances is potentially a very flexible instrument to adjust contractual relationships, in actual application, it has advanced rather slowly, thereby remaining essentially a marginal exception to the general principle of *pacta sunt servanda*.[206]

III. THE CONTRACTUAL EQUILIBRIUM THEORY: PENUMBRAS AND EMANATIONS FROM INTERNATIONAL ARBITRAL PRACTICE?

Is there ... any justification for the present generation of [contract] lawyers holding back from the task of deducing new principles of general application suitable for the new millennium?[207]

A. Formalism to Prudent Relationalism: Interpretation of the Contractual Context

Turning to the author's suggested contractual equilibrium theory, it should be noted, at the outset, that the selection of international arbitral awards, by no means idiosyncratic—starting from the *AMINOIL Arbitration*, ranging from the exceptionally rich output of the Iran-U.S. Claims Tribunal to International Center for Settlement of Investment Disputes (ICSID) and International Chamber of Commerce (ICC) arbitrations and a potpourri of many ad hoc disputes—offers the best blend of case histories toward explaining the obviously developing law of contract governing LTICTs.[208] Grounded on prodigious research in thousands of pages of arbitral awards, the resultant analysis and examination seeks to strike a rapprochement

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206. *Id.* at 230.

207. Ewan McKendrick, *English Contract Law: A Rich Past, An Uncertain Future?*, 50 CURRENT LEGAL PROB. 25, 64 (1997).

208. Lord Wilberforce, *Foreword* to NASSAR, *supra* note 68, at xi.

between the two extremes of the principle of sanctity on the one hand and the approach of relationalism on the other toward maintaining the contractual equilibrium. In this discretionary model of reasonableness, parties' obligations are not defined slavishly by reference to their originally agreed-upon terms but by reference to the existing contractual context:

> The parties' behavior before and after the conclusion of the agreement can often give significant clues as to how a contract should be constructed. For example, the parties' interaction during the life of a long-term agreement often deviates quite significantly from the rules of the agreement itself. Parties may, by explicit or implicit consent and often without complying with the agreement's pre-established adaptation and ratification procedures, behave very differently from the contractual "programme." There may be board or committee decisions (minuted perhaps), government declarations (formally accepted or not), ongoing negotiations (reaching some sort of formal agreement on all or on parts of the agreement or not). In the case of most long-term agreements, some sort of continuously negotiated and implicitly accepted (if only by compliance) renegotiation has, as a rule, taken place. This tacit adaptation should certainly guide the arbitrator-interpreter who should not try to roll back the parties to the original contract and give them a lesson in how a formal contract adaptation should have been carried out, but instead, should proceed cautiously and with respect for the parties' evolving relationship.[209]

Interpretation of context can thus be a basis for finding that the parties agreed to goals of cooperation, trust and reasonableness not necessarily reflected in contract documents. For example, the *AMINOIL Arbitration*

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209. Thomas W. Waelde & George Ndi, *Stabilizing International Investment Commitments: International Law Versus Contract Interpretation*, 31 TEX. INT'L L.J. 215, 255 (1996). *Cf.* Towne v. Eisner, 245 U.S. 418, 425 (1918) (Holmes, J.) ("[a] word is not a crystal, transparent and unchanged, it is the skin of a living thought and may vary greatly in color and content according to the circumstances and the time in which it is used"); KARL N. LLEWELLYN, THE BRAMBLE BUSH 89 (1960) ("[n]o language stands alone. It draws life from its background"). *See also* Dennis M. Patterson, *Good Faith, Lender Liability, and Discretionary Acceleration; Of Llewellyn, Wittgenstein, and the Uniform Commercial Code*, 68 TEX. L. REV. 169, 175 (1989): "The new conception engineered by Llewellyn presupposes that the meaning of the agreement of the parties does not depend exclusively or even primarily on the written terms of one or another document."

offers a good example of such a situation where actual party behavior, over an extensive period of time, deviated significantly from the original written agreement, without a formal renegotiation document ever coming into existence. The decade-long discussions between the Government of Kuwait and the American Independent Oil Company gradually led to a tacit (and thereby de facto) acceptance of some of the renegotiated aspects of the original agreement, without any formal documentation.

Anxious to promote the values of reasonableness, and in search of justice, many arbitrators in their discretion have thus oftentimes recognized the unreality of gathering the intention of the parties within the four corners of the document. Instead, whenever appropriate, they have ventured to travel beyond such a restrictive approach and strive to identify a configuration of commitments patterned not in the words of the contract but in the underlying relation of the contractual realities itself.[210] Such a departure, besides highlighting the significance of the Baconian maxim, "*ambiguitas verborum latens verificatione suppletur; nam quod ex facto oritur ambiguum verificatione facti tollitur*,"[211] emphasizes that contractual undertakings should be viewed in light of the parties' conduct and circumstances, whether before or after the writing was executed which form integral part of the contractual milieu.

B. "Surrounding Circumstances" and Contract Interpretation

The concept of surrounding circumstances, the first major pillar of the contractual equilibrium theory, owes much, particularly in recent years, for its marked resuscitation, to the illuminating contribution of Lord Wilberforce.[212] For, undeniably, it is well-known amongst lawyers that

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210. NASSAR, *supra* note 68, at 50, 54 nn.31-34, 55 n.35.

211. SIR FRANCIS BACON, A COLLECTION OF SOME PRINCIPALL RULES AND MAXIMES OF THE COMMON LAWES OF ENGLAND WITH THEIR LATITUDE AND EXTENT (London 1630). The Maxim 23, in the text above and appearing in NASSAR, *supra* note 68, at 33, translated here probably conveys the precise legal nuance that Bacon had in mind: "A latent ambiguity in the language of a written instrument may be explained by evidence; for it arose on evidence extrinsic to the instrument and it may therefore be removed by other similar evidence." For an English translation of all the twenty-five maxims compiled by SIR FRANCIS BACON, *supra*, which now appear together in English, perhaps, for the first time, *see* John C. Hogan & Mortimer D. Schwartz, *A Translation of Bacon's Maxims of the Common Law*, 77 L. LIBR. J. 707, 711-18 (1984-85).

212. As a Judge of Appeal, particularly in the House of Lords and the Judicial Committee of the Privy Council (1964-1982), Lord Wilberforce made an outstanding contribution, inter alia, to the progress and development of the various facets of international commercial law. *See, e.g.*, Lord Justice Kerr, *Commercial Dispute*

disagreement about the meaning of contracts, notably in respect of international transactions, is one of the most fertile source of contractual litigation and arbitration. The parol evidence rule, traditionally applied only to extrinsic evidence that affects to add, delete or vary the terms of a written contract, has been held to be inapplicable where a party seeks to avoid the contract, because of illegality, fraud, duress, mistake or failure of consideration. These defenses are raised without much doctrinal difficulty since they do not turn on contract terms, but rather on other detestable circumstances which have virtually nothing to do with the terms of the agreement itself.

Nevertheless, undeterred by the parol evidence rule (which embodies the sanctity principle in its most stringent form)—and apparently not satisfied with its already existing myriad exceptions—, in a series of landmark cases,[213] his Lordship articulated that while the use of prior negotiations for the purpose of ascertaining the parties' *subjective* intentions was not permissible, such an evidence could nevertheless be examined to determine *objectively* the "genesis" or "aim" of the transaction.[214] Such an

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Resolution: The Changing Scene, *in* LIBER AMICORUM FOR LORD WILBERFORCE, *supra* note 67, at 111; THE PHILIPPINE BRANCH OF THE INTERNATIONAL LAW ASSOCIATION, SELECTED PRIVY COUNCIL JUDGMENTS OF LORD WILBERFORCE 85-91, 133-41 (1983); THE PHILIPPINE BRANCH OF THE INTERNATIONAL LAW ASSOCIATION, SELECTED HOUSE OF LORDS JUDGMENTS OF LORD WILBERFORCE 15-20, 21-42, 100-104, 108-11, 169-81, 188-95, 247-52, 294-97, 305-13, 314-19, 320-31, 386-91, 416-31, 478-81 (1983).

213. *See, e.g.*, Prenn v. Simmonds, [1971] 1 W.L.R. 1381 (H.L.); F. L. Schuler A.G. v. Wickman Machine Tool Sales Ltd., [1974] App. Cas. 235 (H.L. 1973); Reardon Smith Line, Ltd. v. Vngvar Hansen-Tangen, [1976] 1 W.L.R. 989 (H.L.).

214. *Prenn*, [1971] 1 W.L.R. at 1383-84; Lord Wilberforce restated the notion of the totality of the circumstances analysis in *Reardon Smith Line*, [1976] 1 W.L.R. at 995-96:

> No contracts are made in a vacuum: there is always a setting in which they have to be placed. The nature of what is legitimate to have regard to is usually described as "the surrounding circumstances" .... In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating.

After discussing *Utica City Nat. Bank v. Gunn*, 222 N.Y. 204, 118 N.E. 607 (1918), *Prenn*, [1971] 1 W.L.R. at 1383-84, and *F. L. Schuler A.G.*, [1974] App. Cas. at 261-63, his Lordship continued:

> It is often said that, in order to be admissible in aid of construction, these extrinsic facts must be within the knowledge of both parties to the contract, but this requirement should not be stated in too narrow a sense. When one speaks of the intention of the parties to the contract, one is speaking objectively—the parties cannot themselves give direct evidence of what their intention was—and what

iconoclastic approach (also espoused in Australia[215]), which, in our respectful submission, amounts to no more than effectively engrafting yet another cleverly-disguised exception to the controversial parol evidence rule[216] (and thereby causing another major chink in the Prometheus of the

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> must be ascertained is what is to be taken as the intention which reasonable people would have had if placed in the situation of the parties. Similarly when one is speaking of aim, or object, or commercial purpose, one is speaking objectively of what reasonable persons would have in mind in the situation of the parties.

Reardon Smith Line, [1976] 1 W.L.R. at 996.

215. Codelfa Construction Pty. Ltd. v. State Rail Authority of New South Wales, 149 C.L.R. 337, 352 (1982) (Mason, J.). Apart from its own earlier decisional law on the subject, the High Court of Australia drew additional support from the views of Lord Wilberforce. J.W. CARTER & D. J. HARLAND, CASES AND MATERIALS ON CONTRACT LAW IN AUSTRALIA 281 (3d ed. 1998), would have perhaps welcomed greater "discussion of earlier cases" on the subject by the High Court than attempted in *Codelfa*.

216. Classical theorist and judges, expressing strong faith in the objectivity of language, extolled the prudence of the parol evidence rule as a valuable incentive to reduce agreements to writing and, equally as an important safeguard against dissemblers. By contrast, modern scholars and judges have been critical both of the parol evidence rule and the classical interpretive maxims. *See generally* Eric A. Posner, *The Parol Evidence Rule, The Plain Meaning Rule, and the Principles of Contractual Interpretation*, 146 U. PA. L. REV. 533, 554-61 (1998). In fact, in *F. L. Schuler A.G.*, [1974] App. Cas. at 268, Lord Simon of Glaisdale advocated the adoption of an expanded concept of "surrounding circumstances" as a new evidentiary rule for modern contractual relationships (which would have led to the full demise of the sanctity of the written contract):

> [T]he distinction between the admissibility of direct and circumstantial evidence of intention seems to me to be quite unjustifiable in these days. And the distinction between patent ambiguities, latent ambiguities and equivocations as regards admissibility of extrinsic evidence are based on outmoded and highly technical and artificial rules and introduce absurd refinements.

Id. The House however did not fully embrace the expansive approach of Lord Simon of Glaisdale and ruled that evidence of subsequent conduct should be excluded. Lord Reid, who agreed with Lord Wilberforce, was persuaded by the floodgates argument made by the plaintiff's attorney that "such a policy [of making subsequent conduct admissible] would entail the law embarking on a slippery slope on which there is no halting place [and that it] would be the end of certainty in relation to the construction of documents." *Id* at 241. Further, it did not find any "substantial support in the [existing] authorities for any general principle permitting subsequent actings of the parties to a contract to be used as throwing light on its meaning." *Id.* at 252.

Similarly, the "present authority of the High Court of Australia [also] appears to be against the use of post-contract conduct in aid of the construction of a written contract." Hide & Skin Trading Pty. Ltd. v. Oceanic Meat Traders Ltd., 20 N.S.W.L.R. 310, 315 (Ct. App. 1990) (Austl.) (Kirby, P.); FAI Traders Co. Ltd. v. Savoy Plaza Pty. Ltd., [1993] 2 V.R. 343 (App. Div.) (Austl.); *contra* Spunwell Pty. Ltd. v. BAB Pty. Ltd., 36

principle of sanctity), does recognize with considerable pragmatism that contractual obligations (particularly commercial) are not formed on a *tabula rasa* or in a vacuum, but are very much a product of an operational factual context. They cannot be viewed in isolation from their natural habitat, lest they wilt and lose their flavor:

> The time has long passed when agreements ... were isolated from the matrix of facts in which they were set and interpreted purely on internal linguistic considerations .... We must ... enquire beyond the language and see what the circumstances were with reference to which the words were used, and the object, appearing from those circumstances, which the person using them had in view.[217]

According to his Lordship, the formalist edifice of the parol evidence rule no longer reflected actual business practices and bore little relation to existing commercial realities, for parties' actual agreement often resided outside of the four corners of the written contract. As such, it is only appropriate that a decision-maker should "know the commercial purpose of the contract [which] in turn presupposes knowledge of the genesis of the transaction, the background, the context, [and] the market in which the parties are operating."[218] Thus, in arbitral awards, a vast array of facts (all of the surrounding circumstances), existing at the time of agreement, have been relied upon to remove ambiguities (patent or latent),[219] but, those arising later (after the initial phase of contracting), have been looked at only in "delimit[ing] the boundaries of ambiguous clauses."[220] The relevant

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N.S.W.L.R. 290 (S. Ct. 1994) (Austl.) (Santow, J.). *See generally* Stephen Charles, *Interpretation of Ambiguous Contracts by Reference to Subsequent Conduct*, 4 J. CONT. L. 16 (1991).

217. *Prenn*, [1971] 1 W.L.R. at 1383-84. Often the meaning attached to a word by the parties must be gleaned from its context, including all the circumstances of the transaction. Sometimes the context may reveal that the contract was made with reference to a specialized vocabulary of technical terms or other words of art, or that the parties contracted with respect to a usage in their trade or even with respect to a restricted private convention or understanding. *Id.*

218. *Reardon Smith Line*, [1976] 1 W.L.R. at 995-96.

219. NASSAR, *supra* note 68, at 53-54, 57, 69. *See, e.g.*, First Travel Corp. v. Iran, 9 Iran-U.S. Cl. Trib. Rep. 360, 367 (1985); Trustees of Columbia Univ. v. Iran, 10 Iran-U.S. Cl. Trib. Rep. 319, 326 (1986).

220. NASSAR, *supra* note 68, at 69; SEDCO, Inc. v. Iranian Oil Co., 10 Iran-U.S. Cl. Trib. Rep. 207, 218 (1986-I).

circumstances surrounding the transaction include all writings, oral statements, and other conduct by which the parties manifested their assent, together with any prior negotiations between them and any applicable course of dealing, course of performance, or pertinent custom and trade usage.[221] In particular, prior dealings often help determine if the contracting parties have developed a common understanding unique to their relationship, including an assessment of their comparative sophistication, knowledge, and experience to make informed judgments.

In this respect, three generalizations may be advanced. First, since the purpose of this inquiry is to ascertain the meaning to be given to the language, depending on the nature of ambiguity, arbitrators have often used surrounding circumstances into implying terms and duties where the parties' expectations cannot be ascertained (but not to override express terms).[222] In this exercise, particularly in situations of complex ambiguity, surrounding circumstances occupy a primordial place and become the primary source of the parties' contractual obligations. In other instances, where the ambiguity is relatively less complex, such circumstances usually occupy only a secondary source in supplementing the parties' agreement.[223]

This somewhat chameleonic character of ambiguity determines the varying role attached to surrounding circumstances in establishing broader grounds for judicial intervention, as is evident from a perusal of the various arbitral awards, say, in *AMINOIL Arbitration*,[224] *Main Contractor v. Sub-*

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221. *See, e.g.*, Lischem Corp. v. Atomic Energy Org. of Iran, 7 Iran-U.S. Cl. Trib. Rep. 18, 23 (1984-III); Sea-Land Service, Inc. v. Iran, 6 Iran-U.S. Cl. Trib. Rep. 149, 161 (1984-II).

222. NASSAR, *supra* note 68, at 81.

223. *Id.* at 87, 187-88.

224. 21 I.L.M. 976 (1982). In this arbitration, the parties' subsequent conduct was found to have resulted in a de facto modification of their contractual undertakings:

> While attributing its full value to the fundamental principle of *pacta sunt servanda*, the Tribunal has felt obliged to recognize that the contract ... has undergone great changes since 1948 .... These changes have not been the consequence of accidental or special factors, but .... took place progressively [and] brought about a metamorphosis in the whole character of the .... contract .... The Tribunal wishes ... to stress ... that [this] case is not one of a fundamental change of circumstances (*rebus sic stantibus*) .... It is not a case of a change involving a departure from a contract, but of a change in the nature of the contract itself, brought about by time, and the acquiescence or conduct of the Parties.

NASSAR, *supra* note 68, at 135, quoting *AMINOIL Arbitration*, *supra* note 204, at 1023-24.

Contractor,[225] and *First Travel Corp. v. Iran*.[226] However, if a written contract has been expressed in clear and facially unambiguous language, then, the words are not subject to interpretation or construction; they have to be given their plain and ordinary meaning. For the purpose of a written agreement is to give the contracting parties some measure of certainty as to their rights and obligations both in performance and in the event of a dispute. This is particularly so in the changeable world of international business transactions.

Secondly, most arbitral tribunals resolve the question of surrounding circumstances—that is, prior negotiations, trade usage, subsequent conduct and paralegal norms—on an ad hoc basis and thus, understandably, treat them as of equal significance.[227] Again, a careful scrutiny of the awards in *Anaconda-Iran, Inc. v. Iran*,[228] *Sea-Land Service, Inc. v. Iran*,[229] *Lischem Corp. v. Atomic Energy Org. of Iran*,[230] *Establishment of Middle East Country X v. South Asian Constr. Co.*,[231] *SEDCO, Inc. v. National Iranian Oil Co. (NIOC)*[232] and *Iran v. United States, Case B-1*,[233] despite understandable difficulties involved in stating a general rule on this issue, reveals that most arbitrators regard surrounding circumstances (stemming from prior dealings, precontractual negotiations, and course of performance) as a principal source of contractual obligations if they are "coherent and clear enough to represent voluntarily accepted and settled practice."[234] Otherwise, either these acquire only a subservient position or are even ignored altogether.[235]

Thirdly, the duties to cooperate, to inform and disclose, and to negotiate a modification or adjustment, and the consequence of their nonobservance can be best evaluated in light of the surrounding

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225. I.C.C. Award, Case No. 4975/88, 14 Y.B. COM. ARB. 122 (1989).

226. 9 Iran-U.S. Cl. Trib. Rep. 360 (1985).

227. *See infra* notes 228-35.

228. 13 Iran-U.S. Cl. Trib. Rep. 199 (1986 IV).

229. 6 Iran-U.S. Cl. Trib. Rep. 149 (1984 II).

230. 7 Iran-U.S. Cl. Trib. Rep. 18 (1984 III).

231. 12 Y.B. COM. ARB. 97 (1987).

232. 15 Iran-U.S. Cl. Trib. Rep. 23 (1987 II).

233. 10 Iran-U.S. Cl. Trib. Rep. 207 (1986 I).

234. NASSAR, *supra* note 68, at 239.

235. *Id.*

circumstances.[236] For one cannot assert dogmatically, say, that every nondisclosure[237] amounts to a misrepresentation or absence of cooperation necessarily connotes a breach of contract. It may very well be so in a given context, but the universality of such a proposition sits oddly with commercial realities.[238] Hence, to prevent absurd and unreasonable results, international arbitral awards have recognized that since contracts do not operate in a framework devoid of dynamic context of evolving facts appropriate allowance ought to be made for them.[239]

Furthermore, many contractual provisions are honored, ensuring contract performance and limiting disputes, even when there is no powerful sanction for their breach.[240] This is, presumably, because of the existence of informal and extra-legal sanctions, including a sensitivity of commercial righteousness, and the preservation of a reputation of business morality and

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236. *Id.*

237. The law, in most legal systems, does not generally mandate disclosure of all information in commercial dealings, unless the parties in the contractual transaction had operated under such different circumstances that the information was not equally available to their efforts. Since information is oftentimes costly to produce, the assignment of property rights in information (copyright, patented inventions and trade secrets) is a familiar feature of most legal systems. *See, e.g.*, Raymond T. Nimmer & Patricia A. Krauthaus, *Information as a Commodity: New Imperatives of Commercial Law*, 55 LAW & CONTEMP. PROBS. 103 (1992). Imposing a carte blanche duty to disclose upon the knowledgeable and dexterous information-gatherer would be antithetical to the notion of a property right as it would deprive its holder of an economic advantage which the information would otherwise entail.

238. On the normative question of determining the appropriate rule (of disclosure or nondisclosure) for a particular class of cases, and what the law ought to be, from the standpoint of economics and of moral philosophy, extensive literature exists. *See, e.g.*, Anthony T. Kronman, *Mistake, Disclosure, Information, and the Law of Contracts*, 7 J. LEGAL STUD. 1 (1978); Sanford Grossman, *The Informational Role of Warranties and Private Disclosure of Product Quality*, 24 J. L. & ECON. 461 (1981); KIM LANE SCHEPPELE, LEGAL SECRETS: EQUALITY AND EFFICIENCY IN THE COMMON LAW 31-42 (1988); Jules L. Coleman et al., *A Bargain Theory Approach to Default Provisions and Disclosure Rules in Contract Law*, 12 HARV. J. L. & PUB. POL'Y 639 (1989); Randy E. Barnett, *Rational Bargaining Theory and Contract: Default Rules, Hypothetical Consent, the Duty to Disclose, and Fraud*, 14 HARV. J. L. & PUB. POL'Y 783 (1992); Steven Shavell, *Acquisition and Disclosure of Information Prior to Sale*, 25 RAND J. ECON. 20 (1994); ANTHONY DUGGAN ET AL., CONTRACTUAL NON-DISCLOSURE: AN APPLIED STUDY IN MODERN CONTRACT THEORY 198-208 (1994).

239. NASSAR, *supra* note 68, at 239.

240. Commercial contractors often act in a spirit of cooperative endeavor instead of choosing combative alternatives with a view to preserving their long-term relationships. *See* ADAMS & BROWNSWORD, *supra* note 98, at 295-329.

its effects on other potential trading partners in the market.[241] In some societies, as experience counsels, recourse to litigation is attended by a particular opprobrium, and, unless the dispute is unusual, such resort in most cases would inevitably ruin any future business and private dealings between the parties.[242] Relational culture particularly recognizes that business people, anxious to preserve their business associations, do not insist upon a rigid Shylockian application of contract rules, thereby paving way for a prudential accommodation of their relational contract practices. Most commercial enterprises are generally concerned with preserving than with discontinuing their contractual commitments notwithstanding any performance disruptions.[243]

C. "Reasonableness": Informed Behavior, Knowledge of the Contractual Context, and Implication of "Good Faith" Norms

"Reasonableness" is the second pillar of the contractual equilibrium theory.[244] The circumstances of the individual case, rather than the formalistic principles, have been relied upon by the arbitral tribunals in determining whether or not a particular practice or conduct is improper or unreasonable. In particular, whether there is any justification for imposing upon the parties noncontractual duties like that of good faith and fair dealing, rooted in established practices or general legal standards,[245] with a view to nurturing an environment of honesty, fairness, and decency in commercial dealings. Most arbitral awards seem to equate reasonableness

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241. *Id.* at 299-311.

242. *See, e.g.*, Jane K. Winn, *Relational Practices and the Marginalization of Law: Informal Financial Practices of Small Business in Taiwan*, 28 L. & SOC'Y REV. 193 (1994).

243. ADAMS & BROWNSWORD, *supra* note 98, at 297-303.

244. NASSAR, *supra* note 68, at 239.

245. The good faith obligation dates to Cicero's dialogue, *De Officiis* (On the Nature of Duties), but its definition remains elusive largely because it is situational rather than unitary. Yet, according to received doctrine, a party has a duty to avoid conduct unnecessary to realizing that party's reasonable expectations if that conduct would impair a counterparty's reasonable expectations. For a discussion of the good-faith doctrine in relational contracts, *see* William W. Bratton, *Self-Regulation, Normative Choice, and the Structure of Corporate Fiduciary Law*, 61 GEO. WASH. L. REV.. 1084, 1122-24 (1993); Melvin A. Eisenberg, *Relational Contracts*, *in* GOOD FAITH AND FAULT IN CONTRACT LAW, *supra* note 66, at 291.

with what is rational and informed behavior,[246] given all available "knowledge" and the "intended purpose" of the agreement. It thus seems logical to treat one party's concurrence to the agreement with knowledge of the other party's general purposes as a ground for resolving doubts in favor of a meaning that will further those ends, rather than a meaning that will frustrate them.

Knowledge of the extra-contractual context, actual or presumed, helps define whether or not the parties have voluntarily undertaken the changes. For a rational individual who, armed with knowledge of the changes in the contractual content, chooses nevertheless not to demur and assail expeditiously as it could or should have been done, is deemed to have voluntarily (that is, knowingly and freely) accepted—or acquiesced in—such changes.[247] For, on learning the truth, the innocent party is expected to resile from the contractual undertaking and render no further performance. Not doing so results in de facto modification of contractual obligations by subsequent conduct which, though not willful in terms of the classical theory, is appropriately regarded voluntary.[248] For not to regard it so would be plainly irrational and unreasonable, especially when the parties had full knowledge of the contextual elements.[249] Thus, the reasonableness test in part guards against manufactured subjective differences in intention, and prohibits opportunistic behavior that may occur because of a change of conditions not anticipated by the parties.[250] Undoubtedly, this shift from classical model's "willfulness" to "voluntariness" as the criterion for

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246. *Cf.* Michael D. Bayles, *Legally Enforceable Commitments*, 4 L. & PHIL. 311, 313 (1985): "A rational person uses logical reasoning and all relevant available information in ... deciding what to do, and [in] accepting legal principles."

247. NASSAR, *supra* note 68, at 240.

248. *Id.*

249. *Cf.* Timothy J. Muris, *Cost of Completion or Diminution in Market Value: The Relevance of Subjective Value*, 12 J. LEGAL STUD. 379, 383-84 (1983):

> Not only must the subjective value exist, it must also be foreseeable.... A defendant cannot be held to an unusual loss of the plaintiff unless, at the very least, he has, or should have, knowledge of the loss. Within the context of subjective value, the foresight requirement means that the party in breach must have some knowledge of the circumstances (usually from communication with the innocent party) that make it likely that breach will cause subjective losses. Only if courts apply the foresight reqirement will the party with knowledge of the special circumstances have the proper incentive to guard against the loss, including disclosing the problem to the other party, which may then be paid a premium to assume the additional risks. (Footnote omitted.)

250. *Cf.* NASSAR, *supra* note 68, at 218-19.

admitting contextual elements—prior negotiations, subsequent conduct, trade usage, etc.—greatly weakens the sanctity principle of the autonomous will of the contracting parties.[251]

Knowledge plays an equally decisive role in appraising the consequences of informational changes.[252] For example, those who advocate the validity and enforceability of stabilization guarantees for LTICTs define knowledge in reference to a fixed time, whereas, those who favor full recognition of the effects of informational changes and acquired knowledge on the parties' relationship, oppose any form of stabilization or freezing of contractual terms.[253] In cases of *rebus sic stantibus* knowledge helps define foreseeability and the occurrence of the nondisruptive changes of circumstances; the party seeking suspension or cessation of performance, based on *force majeure*, must prove that it had no knowledge of the event.[254] Knowledge is thus used as a relevant factor for evaluating the change of circumstances against which the contract was initially formed.[255] Also, where the newly-acquired knowledge renders the old contractual terms otiose and unsatisfactory to respond to the requirements of the newly-acquired information, the duty to negotiate is imposed upon the parties.[256] Similarly, if the defaulting party possessed the knowledge, real or constructive, that certain acts would expose the contract to unbearable tensions and thereby collide with the "intended purpose" of the contractual undertaking, or that the cost of performance might be disproportionate to the value or the benefits received by the plaintiff for the performance, then, a failure to communicate such information would constitute a breach of the duties to inform and to cooperate.[257]

The second element of reasonableness, the intended purpose of the transaction, has involved an interplay of subjective and objective approaches.[258] Modern arbitral practice veers in favor of the approach that the likely intent of the contracting parties should be gleaned from the agreement "as written," unless there be cogent evidence that the intended

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251. *Id.* at 240.

252. *Id.* at 240-41.

253. *Id.* at 240. For an examination of the various issues associated with the use of stabilization clauses, *see* Waelde & Ndi, *supra* note 209, at 255.

254. NASSAR, *supra* note 68, at 240.

255. *Id.*

256. *Id.*

257. *Id.* at 240-41.

258. *Id.* at 241.

purpose has changed over the passage of time.[259] Nonetheless, the original intended purpose formula is not entirely subjective, primarily reflecting the will theory, for, like Humpty Dumpty, parties may use language as they like, but the secret meaning entertained by only one party may not be relied upon to change the ordinary denotation of a word in its natural and plain sense.[260] In those relatively rare cases in which the parties attached the same meaning to the language in question, the arbitrators have carried out their intentions. But if the parties attached different meanings to that language, the arbitrators' task became the more complex one of applying a standard of reasonableness to determine which party's intention is to be preferred at the expense of the other's.[261]

Therefore, in many arbitrations, involving economic projects comprised of a number of independent but indivisible contracts, under the rubric of interpreting the original intended contractual purpose, arbitrators have looked to the extra-contractual context either as a primary or secondary source in deciphering the contractual content or the goal the parties might reasonably be deemed to have sought. For instance, in *Establishment of Middle East Country X v. South Asian Constr. Co.*,[262] both prior negotiations and subsequent conduct were examined to ascertain the real purpose of a consulting agreement, which was assailed as allegedly encompassing a bribery contract. Such noncontractual obligations, as are necessary for the successful execution of the original intended purpose of the transaction, are thus regarded as part of the parties' relationship.[263]

Thus, while the arbitrators have declined to impose an implied covenant of good faith and fair dealing, they have nevertheless recognized that these duties may arise as a result of a special relationship between the parties governed or created by a contract.[264] Even under the guise of

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259. *Id.*

260. LEWIS CARROLL, THROUGH THE LOOKING-GLASS AND WHAT ALICE FOUND THERE 124 (1871):

> "When I use a word," Humpty Dumpty said in rather a scornful tone, "it means just what I choose it to mean—neither more nor less."
>
> "The question is," said Alice, "whether you *can* make words mean so many different things."
>
> "The question is," said Humpty Dumpty, "which is to be master—that's all."

261. NASSAR, *supra* note 68, at 55, 57.

262. 12 Y.B. COM. ARB. 97 (1987).

263. NASSAR, *supra* note 68, at 144-45.

264. *Id.* at 142 nn.4 & 9.

revision, gap-filling, and modification arbitral tribunals adhere to the intended purpose standard—a standard which sets the outer limits of the duties of good faith and fair dealing.[265] These and other fairness-oriented good faith duties to inform and to cooperate are imposed as higher ethical standards in contract dealing only where the successful pursuit of the contractual project would otherwise be jeopardized or would tend to eviscerate the intended purpose of the transaction.[266]

In other words, contractual terms may be implied and modified only if it would not emasculate the ultimate nature and goal of the original agreement and would help restore its original equilibrium.[267] Such a prudential approach could greatly change parties' rights and duties by focusing on their relationship and dealings rather than on their presentiated consent to these obligations. Otherwise, as arbitrators have explained repeatedly, "[a]n arbitrator's role is not to make a contract for the parties."[268]

The sacrosance of the original intended purpose is thus preserved zealously, unless it is demonstrated that the planning-processes for conducting exchanges and other aspects of performance in an indefinite future have so markedly changed over the life span of a given long-term relationship as to amount to a radical "change in the nature of the contract itself, brought about by time, and the acquiescence or conduct of the parties."[269] Such content, under the yardstick of reasonableness, is then articulated by recourse to available knowledge and the intended purpose of the contractual undertaking.[270] The arbitral tribunals have increasingly recognized that, unlike the discrete transactions (where specificity and measurement result in very certain and complete planning), in relational contracts, particularly when the planning processes involve protracted long periods, flexibility must be the norm.[271] For, in light of available knowledge and the intended purpose, in increasingly complex relational transactions, it may not appear reasonable for the law to expect the parties to spell out all their obligations with greater precision in advance—as some

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265. *Id.* at 146-67.

266. *Id.* at 241.

267. *Id.* at 242.

268. *Id.* at 173.

269. *Id.* at 242 (quoting *AMINOIL Arbitration*, *supra* note 204, at 1024).

270. NASSAR, *supra* note 68, at 242.

271. *Id.* at 21-24.

nonroutine contingencies are effectively noncontractable.[272] In a commercial world of relational contracts, trust and cooperation are essential, and resort to such general terms like "reasonable," "best efforts," "fairness" or "good faith" is often a method of allowing for adjustments to future contingencies.[273] Such duties require a party to make such efforts as are reasonable in the light of that party's ability and the means at its disposal and of the other party's justifiable expectations.[274]

The notion of "reasonableness" is also central to many of the *UNIDROIT Principles*—for example, articles 4.1 (2) (contract interpretation), 5.3 (duty of cooperation), and 7.4.12 (assessment of damages)—which encourages a reorientation toward what constitutes proper conduct in the international marketplace.[275] As that market becomes increasingly unified, reasonableness or commercial reasonableness may also acquire an increasingly identifiable content. Furthermore, "good faith and fair dealing" is also a fundamental norm underlying the *UNIDROIT Principles*.[276]

D. Contractual Equilibrium Theory: A Prudential Framework for LTICTs

It is, however, important to recognize that the contractual equilibrium

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272. *Id.* at 22, 23, 24.

273. *Id.* at 24-25.

274. *Id.*

275. INTERNATIONAL INSTITUTE FOR THE UNIFICATION OF PRIVATE LAW, PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS (1994) [hereinafter UNIDROIT PRINCIPLES]. These are also reproduced in an annex *in* MICHAEL JOACHIM BONELL, AN INTERNATIONAL RESTATEMENT OF CONTRACT LAW—THE UNIDROIT PRINCIPLES OF INTERNATIONAL COMMERCIAL CONTRACTS 271 (2d enl. ed. 1997).

276. UNIDROIT PRINCIPLES, *supra* note 275, arts 1.7, 2.15, 3.5, 3.10, 4.8, 7.1.6. This duty is based on fundamental notions of fairness and its scope necessarily varies according to the nature of the agreement. *See also* John Klein & Carla Bachechi, *Precontractual Liability and the Duty of Good Faith Negotiation in International Transactions*, 17 HOUS. J. INT'L L. 1 (1994); E. Allan Farnsworth, *Duties of Good Faith and Fair Dealing Under the UNIDROIT Principles, Relevant International Conventions, and National Laws*, 3 TUL. J. INT'L COMP. L. 47 (1995); BONELL, *supra* note 275, at 136-50. Moreover, contrary to other international instruments that do not address the questions of substantive validity, the UNIDROIT PRINCIPLES, *supra* note 275, provide a variety of means for policing the contract for its individual terms against both procedural and substantive unfairness. *See* Michael Joachim Bonell, *Policing the International Commercial Contract Against Unfairness Under the UNIDROIT Principles*, 3 TUL. J. INT'L & COMP. L. 73 (1995).

theory, as gleaned from the international arbitral practice, does not regard LTICTs as creating disguised form of status relationships.[277] But, since agreed-upon terms are no longer the exclusive reservoir of contractual undertakings and contractual obligations are no longer absolute, the contractual equilibrium theory, in its legitimate search for a mutually-beneficial adaptation of the parties' interests, allows arbitral tribunals to invoke "surrounding circumstances" and "reasonableness" and thus base their decisions not on abstract rules alone, but on the pragmatic evaluation of the context.[278] This may not always operate in immaculate form like Alighieri Dante's Paradiso,[279] but influences the determination that extra-contractual contexts are sources of norms as well as rules.[280]

The new model thus understandably accords consent a relatively diminished role and recognizes that contextual norms of fairness and reciprocity, positive law, and usages will significantly qualify obligations assumed by contracting parties in regard to LTICTs, and will even impose

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277. The development of private law from status to contract has shown sign in recent years of going into reverse. Instead of being formed by contract freely reached, the legal relations between individuals are becoming more and more fixed as status-relations. The contract of marriage is governed by rules of a status kind from which the parties cannot escape by private agreement, and by rules of testamentary disposition certain types of beneficiaries simply cannot be disinherited completely. The relationships of landlord and tenant, and employer and employee, are increasingly regulated by similar rules of a status kind, governing the right to enter into and remain in such a relationship, and governing its terms. Company law and the special rules on partnership also show the willingness of the law to provide special regimes for recurrent forms of long-term relationship. Whether one classifies such relationships as special contracts or noncontractual relationships, it is noteworthy that the ordinary rules of contract law may well not be the way in which many LTICTs are handled by the current international arbitral practice. The truth is that contract, seen as a social institution, is being readjusted so as to make it more just. The phenomena which are seen as examples of retrogression into status are in fact instances of the degeneration of contract. Its regeneration is possible and has already started. It falls to us to advance it. For an illustration of such a phenomenon in the area of family law, *see* Stephen Cretney, *From Status to Contract?*, *in* CONSENSUS AD IDEM, *supra* note 141, at 251.

278. NASSAR, *supra* note 68, at 237-38.

279. For example, in 2 DANTE ALIGHIERI, THE DIVINE COMEDY: PARADISO, CANTO II (Charles S. Singleton trans. & ed., 1975), when Dante and his celestial guide (Beatrice) enter the Moon, part of Paradise, the cause of the spots or shadows (which appear in that body) is explained to him. Beatrice explains that the Moon does not really have dark patches, or blemishes, as perceived from Earth. Rather, the variation of its luminosity owes much to the light that falls upon it from other levels of Paradise.

280. NASSAR, *supra* note 68, at 22, 28-29.

obligations beyond those assumed by the parties.[281] But, nonetheless, these contracts are initially the result of individually negotiated bargains and thus are not subject ex post to certain status obligations.[282] Absent opportunistic behavior, contract terms in LTICTs are enforced as the parties have agreed.[283] In any event, the contractual equilibrium theory provides a framework for LTICTs within which individuals or commercial entities can plan and monitor the future course of their business activities, secure in the confidence that the premise on which they began (that the law would indicate the extent to which it would support and implement their intent) was well justified.[284] This should help promote the values of flexibility and rational processes of contract revision in accordance with the economic changes at the global level. Otherwise, the doctrines of *pacta sunt servanda* and sanctity of contract reinforced in their widest possible extent by such rigid devices as unlimited stabilization and freezing clauses would seriously collide with the concepts of fairness or economic equilibrium in global developments.

That the current patterns in the arbitral awards reveal such a trend where contract law is no longer an artificial ivory tower "abstraction"[285] is not only convincingly demonstrated by the author in the context of LTICTs, but she has further performed the daunting task of encapsulating these oftentimes irreconcilable (and not readily amenable to sweeping generalizations) patterns of arbitral case law and international practice, from a comparative lawyer's perspective, in the ornamental cast of a coherent theoretical framework, which is intensely thought-provoking.[286] The book's theoretical sophistication is impressive, and the author's conclusion is persuasive that the contractual equilibrium theory does not purport to demolish individual self-determination and laissez-faire theory as a regulatory mechanism but, contrary to the relational or contextual model, merely endeavors, albeit not unsuccessfully, to rectify the shortcomings of the promise principle and thereby recognize that "[o]ccasions often arise when ... it becomes just to set aside ... the carrying

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281. *Id.* at 237.

282. *Id.* at 242. *See supra* note 277.

283. NASSAR, *supra* note 68, at 219-20.

284. *Id.* at 242.

285. GILMORE, *supra* note 3, at 14.

286. NASSAR, *supra* note 68, at 237-43. One who has not followed through the exposition of the author carefully right from the beginning may find it difficult to appreciate the real thrust of the contractual equilibrium theory so tersely described in the concluding chapter of the book.

out of a promise ...."[287] And, in so doing, the contractual equilibrium theory recognizes that it is high time not only to transcend the methodology that once treated judicial contract doctrine (an autonomous body of law) as the apotheosis of legal theory, but also to emphasize that the parties to international commercial arbitrations realize that the limits of the reach of the law of contract have been significantly changed.[288] It is in this context that often there have been many reasons to impose nonconsensual notions like good faith, unconscionability, promissory estoppel, and presumptions against the drafter (*contra proferentum*) that, however described, reflect social judgments and involve an attempt to reach the result the parties would have desired in LTICTs.[289] The author's thorough and compelling analyses are instructive about how arbitral tribunals apply relational ideas in practice, while, at the same time, fully appreciating that the consensual freedom of contracting parties to make choices is still the raison d'être of modern law.[290] As such, a large number of awards reverberate the language of sanctity of contracts,[291] although some awards have played

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287. MARCUS TULLIUS CICERO, ON DUTIES 13 (M.T. Griffin & E.M. Atkins eds., 1991); PLATO, THE REPUBLIC, 331B.

288. NASSAR, *supra* note 68, at 237.

289. *Id.* at 113, 141-43, 170.

290. *Id.* at 234.

291. *See, e.g.*, Sapphire International Petroleum Ltd. v. National Iranian Oil Co., 35 I.L.R. 136, 181 (1967) ("[t]he rule *pacta sunt servanda* is the basis of every contractual relationship [and agreement]"); Libyan Am. Oil Co. v. Libyan Arab Republic, 20 I.L.M. 1, 54, 6 Y.B. COM. ARB. 89, 101 (1981) (the "right to conclude contracts .... is protected and characterized by two important propositions ... that 'the contract is the law of the parties,' and ... that '*pacta sunt servanda*' (pacts are to be observed).... [T]he principle of the sanctity of contracts ... has always constituted an integral part of most legal systems .... based on Roman law, the Napoleonic Code ... and other European civil codes, as well as Anglo-Saxon Common Law and Islamic Jurisprudence (*sharia*)"); I.C.C. Award, Case No. 5485/87, Bermudian Co. v. Spanish Co., 14 Y.B. COM. ARB. 156, 168 (1989) ("the rule *pacta sunt servanda* implies that the contract is the law of the parties"); I.C.S.I.D. Award, Case No. ARB/81/1, AMCO Asia Corp. Pan American Development Ltd. and PT AMCO Indonesia (US) v. Republic of Indonesia, 23 I.L.M. 351, 359, 10 Y.B. COM. ARB. 61, 62 (1985) (a contract "is to be construed in a way which leads to find out and to respect the common will of the parties: such a method of interpretation is but the application of the fundamental principle *pacta sunt servanda*, a principle common, indeed, to all systems of internal law and to international law"). *See also* Klaus Peter Berger, *The* Lex Mercatoria *Doctrine and the UNIDROIT Principles of International Commercial Contracts*, 28 LAW & POL'Y INT'L BUS. 943, 983 (1997) (referring to the I.C.C. Award No. 8486, dealing with a dispute between a Dutch and a Turkish party, which pointed out "the dominance of the principle of *pacta sunt servanda* expressed in the hardship provision of article 6.2.1 of the [UNIDROIT PRINCIPLES, *supra* note 275]").

down its spirit.[292]

IV. CONTINUING DEMISE OR RESURGENCE OF FREEDOM OF CONTRACT: MYTH OR REALITY?

Freedom of contract has been conclusively labeled a naive myth, but the forms of that mythology still bind.[293]

A. Changing Horizons of Contract Law and Fairness

One may legitimately wonder if the arbitral trend described heretofore might not be equally noticeable in a much wider area of transactions (commercial or noncommercial), strictly outside the ambit of LTICTs, given the somewhat cyclical nature of the principle of sanctity of contract, that is, the promisor's absolute liability within a bargain.[294] Instead of an artificial aberration, many key concepts, or old natural law notions, such as promises, reliance, privity, interdependence, exchange and unconscionability, have steadily undergone considerable transformation and change, appropriate to the needs of the modern societal transition from laissez-faire to welfare state economies, and have been used to overcome the formal contract law requirements.[295]

For instance, classical contract theory, epitomizing the ascendance of sanctity of contract, has been significantly replaced by case law (and statutory provisions) that expanded liability for unfulfilled promises, brought the law into conformity with modern commercial practice, and thereby provided greater judicial flexibility in adjudicating disputes to

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292. *See, e.g.*, Anaconda-Iran, Inc. v. Iran, 13 Iran-U.S. Cl. Trib. Rep. 199, 233 (1986 IV) (the "doctrine of *pacta sunt servanda* is not a rule which, *per se*, suffices to resolve [the pertinent choice of law] issues in this [c]ase"); Lischem Corp. v. Atomic Energy Org. of Iran, 7 Iran-U.S. Cl. Trib. Rep. 18 (1984-III) (the arbitration, despite the clarity of the wording of the contract, ignored the application of the sanctity principle and, contrary to the classical theory, relied upon precontractual negotiations as evidence to negate the plain and unambiguous meaning of the text); Sea-Land Service, Inc. v. Iran, 6 Iran-U.S. Cl. Trib. Rep. 149 (1984-II) (the arbitrator looked to surrounding circumstances as a primary source of contractual obligations).

293. Betty Mensch, *Freedom of Contract as Ideology*, 33 STAN. L. REV. 753, 754 (1981) (book review).

294. *See, e.g.*, Ralph James Mooney, *The New Conceptualism in Contract Law*, 74 OR. L. REV. 1131, 1187-1204 (1995).

295. *See, e.g.*, ADAMS & BROWNSWORD, *supra* note 98, at 1-13, 123-24, 160-61, 196-97, 253-54, 328-29, 362 (1993).

achieve equitable and fair results in individual cases.[296] Undeniably, the emergent contours of good faith and related concepts do constitute the very real chinks in the cold armor of individualism, freedom of contract, caveat contractor and any other laissez-faire notions in that the contracting parties are not regarded any longer the autonomous individuals who are the exclusive masters of their bargains capable of safeguarding their own interests.[297]

Whether one describes the departure from the classical contract's monolithic reverence for freedom of contract as an aspect of "social conceptualism,"[298] or as emphasizing "social control,"[299] or as "mixed contract,"[300] or as "cooperative contract,"[301] their overall object is to deal with the perceived infirmities in the concept of unbridled individualism.[302] Absent the development of suitable alternatives to formalism, judges and legal thinkers have increasingly looked to natural law notions of fairness and justice in response to deeply felt social ideals. These rationales can be distilled from the varying fact patterns of the cases, involving an intermix of subjective-objective norms: "[S]ubjective principles should be employed where they serve both fairness and policy, and when they do not ... the principles employed will ... typically depend on objective variables that provide a reliable surrogate for state of mind."[303] In any event, the search

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296. *Id.* at 257-91.

297. *See, e.g.*, Friedrich Kessler & Edith Fine, Culpa in Contrahendo, *Bargaining in Good Faith, and Freedom of Contract: A Comparative Study*, 77 HARV. L. REV. 401 (1964); Robert S. Summers, *The General Duty* of *Good Faith—Its Recognition and Conceptualization*, 67 CORNELL L. REV. 810 (1982).

298. Karl Klare, *Contracts Jurisprudence and the First-Year Casebook*, 54 N.Y.U. L. REV. 876, 880-81 (1979) (reviewing CHARLES L. KNAPP, PROBLEMS IN CONTRACT LAW: CASES AND MATERIALS (1976)).

299. FRIEDRICH KESSLER ET AL., CONTRACTS: CASES AND MATERIALS 2 (3d ed. 1986).

300. Jay M. Feinman, *Critical Approaches to Contract Law*, 30 UCLA L. REV. 829, 834-36 (1983).

301. *See generally* Douglas K. Newell, *Will Kindness Kill Contract?*, 24 HOFSTRA L. REV. 455 (1995); Roger Brownsword, *From Co-operative Contracting to a Contract of Co-operation*, *in* CONTRACT AND ECONOMIC ORGANISATION: SOCIO-LEGAL INITIATIVES, *supra* note 108, at 14, 37-38.

302. *Cf.* Anthony T. Kronman, *Contract Law and Distributive Justice*, 89 YALE L.J. 472, 477-83 (1980). *See also* Kennedy, *supra* note 8, at 580-83.

303. Melvin Aron Eisenberg, *The Responsive Model of Contract Law*, 36 STAN. L. REV. 1107, 1111-12 (1984); *see generally* MELVIN ARON EISENBERG, THE NATURE OF THE COMMON LAW 8-10, 14-16 (1988); Karl N. Llewellyn, *What Price Contract?—An Essay in Perspective*, 40 YALE L.J. 704, 750-51 (1931).

for fairness or reasonableness in contracts is not new, although often the courts recoil from espousing such solutions, because adherence to a rigid formal rule offers them a convenient, though harsher, answer.

Nevertheless, the growing willingness of many twentieth century courts to (1) excuse performance (for example, because of a mistake of fact or of unforeseen circumstances and thereby apply principles far removed from the parties' bargain), (2) encourage expansion of the protean doctrine of promissory estoppel (significantly eclipsing bargain theory's dominant role in imposing absolute liability), (3) liberalize the concept of "privity" (giving right to the third party to claim relief independently), and (4) invoke the concept of "unconscionability" in a diverse range of situations (outlawing unacceptably exploitative abuse of superior bargaining power) can be neatly illustrated by many examples drawn from the recent American,[304] Australian[305] (particularly of the last two decades[306]) and, to

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304. *See generally* Larry A. DiMatteo, *The Norms of Contract: The Fairness Inquiry and the "Law of Satisfaction"—A Nonunified Theory*, 24 HOFSTRA L. REV. 349, 379-94 (1995); Emily L. Sherwin, *Law and Equity in Contract Enforcement*, 50 MD. L. REV. 253 (1991).

305. It has been increasingly accepted both by the Australian courts and the legislatures that, because of the changing commercial reality of the contemporary marketplace, contracting parties today are not often all equal or free to negotiate their bargains. In no small measure, the abolition of appeals from the High Court to the Privy Council in 1975 has also contributed to the development of a distinctively Australian judge-made contract law after a "long slumber." Sir Anthony Mason, Book Review, 1 J. CONT. L. 265 (1989). *See also* Sir Anthony Mason, *Australian Contract Law*, 1 J. CONT. L. 1 (1988); P. Ellinghaus, *An Australian Contract Law?*, 2 J. CONT. L. 13 (1989); Sir Anthony Mason, *Australian Law for Australia*, 26 AUSTL. L. NEWS, No. 10, Nov. 1991, at 14.

306. Over a span of approximately two decades, various High Court decisions, in conjunction with legislative initiatives, suggest that concepts of fairness have eroded the principle of sanctity of contract. Prior to this Australian courts were generally disinclined to review contracts and liberally find an abuse of bargaining power to justify relieving a party from a harsh transaction. *See, e.g.*, South Australian Railways Commissioner v. Egan, 130 C.L.R. 506 (1973). In this case, the Court, while noting the exceedingly unbalanced nature of the standard form contract, nevertheless declined to infer from the form and circumstances of the contract any abuse of bargaining power. Only when established principles of law or equity were available was justice done.

Now not only have the courts, particularly the High Court, shown themselves to be willing to refashion old doctrines to produce more evenhanded solutions but have also displayed the juristic determination to be innovative in their judgments. For example, the High Court was prepared to read, in *Commercial Bank of Australia v. Amadio*, 151 C.L.R. 447 (1987), notions of unconscionable behavior and unequal bargaining power widely. It has been equally innovative in the areas of restitution (*Pavey & Matthews Pty. Ltd. v. Paul*, 162 C.L.R. 221 (1987)), unjust enrichment (*ANZ Bank v. Westpac*, 164 C.L.R. 673 (1987), *David Securities Pty. Ltd. v. Commonwealth Bank of Australia*, 175 C.L.R. 353

a lesser extent, English[307] experience, as well as from some civil law

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(1992), permitting recovery of sums paid under mistakes of fact and of law, respectively), privity of contract (*Trident General Insurance Co. Ltd. v. McNeice Bros. Pty. Ltd.*, 165 C.L.R. 107 (1988)), and damages for late payment of money (*Hungerfords v. Walker*, 171 C.L.R. 125 (1989)). The doctrine of promissory estoppel, as recognized in *Legione v. Hateley*, 152 C.L.R. 406 (1983), has been upheld and extended in *Waltons Stores (Interstate) Ltd. v. Maher*, 164 C.L.R. 307 (1988), and in *Commonwealth v. Verwayen*, 170 C.L.R. 394 (1990). Similarly, the concepts of unilateral mistake (*Taylor v. Johnson*, 151 C.L.R. 422 (1980)) and of economic duress (*Crescendo Management Pty. Ltd. v. Westpac Banking Corp.*, 19 N.S.W.L.R. 40 (Ct. App. 1988) (Austl.)), have been accorded extensive judicial recognition.

These developments provide valuable evidence that the Australian High Court has been prepared to make significant changes to the law as it has come down from the past in order to make it more relevant to modern-day conditions and commercial realities. *See generally* Paul Finn, *Commerce, The Common Law and Morality*, 17 MELB. U. L. REV. 87 (1989); Derek Davies, *Restitution and Equitable Wrongs: An Australian Analogue*, *in* CONSENSUS AD IDEM, *supra* note 141, at 158, 159-61; Nicholas Seddon, *Australian Contract Law: Maelstrom or Measured Mutation*, 7 J. CONT. L. 93 (1994); John Gava & Peter Kincaid, *Contract and Conventionalism: Professional Attitudes to Changes in Contract Law in Australia*, 10 J. CONT. L. 141, 142 (1996) ("[c]ontemporary [Australian] law has moved a significant way from will-based contract towards a regime where contractual obligations are better understood as imposed by the courts according to notions of fairness and community expectations").

307. English judges, stubbornly wedded to classical contract doctrine, have been relatively less solicitous of consumers (with the notable exception of Lord Denning) than their American and Australian counterparts, and have been slow to advance the doctrines of good faith, estoppel and unconscionability. Instead, it has been mostly left to Parliament to make necessary reforms. *See, e.g.*, Unfair Contract Terms Act, 1977, ch. 50 (Eng.). This measured inertia is largely attributable to the fact that English courts follow a positivist approach to the law, basing their decisions (and their reasoning) upon the formalism of the doctrine of stare decisis rather than upon any broad policy-oriented ideas. *See, e.g.*, Andrew Phang, *Positivism in the English Law of Contract*, 55 MOD. L. REV. 102 (1992). This accounts for the traditional dogma that there is no inquiry permissible into the fairness of a bargain by reference to the adequacy or otherwise of consideration.

Nevertheless, English courts have often concerned themselves with fact-specific cases of substantive fairness (for example, illusory contracts, option contracts, requirement and output contracts, defenses of mistake, misrepresentation, fraud, duress and undue influence, and even frustration and penalty clauses) through the devices of implication, construction, and interpretation and other means. P.S. ATIYAH, *Contract and Fair Exchange*, *in* ESSAYS ON CONTRACT 329 (1986), originally published in 35 U. TORONTO L.J. 1 (1985); COLLINS, *supra* note 58, at 18-32 (while many of the doctrines of English law are in fact concerned with promoting fairness to some extent, Professor Collins' account, unlike Professor Atiyah's, seems somewhat exaggerated). In essence, English law's preference has been to respond to perceived cases of unfairness by devising piecemeal solutions. McKendrick, *supra* note 207, at 33-37, 46-47, 63-63; Johan Steyn, *Contract Law: Fulfilling the Reasonable Expectations of Honest Men*, 113 L.Q. REV. 433,

systems.[308]

B. "Sanctity" vis-à-vis "Fairness": An Uneasy Transition from Reverence to Realism in the Law of Contracts?

Whether this approach of judicial solicitude for fairness and commercial morality is superior or inferior to the fact-centered specificity, case law particularism, and anticonceptualism of the legal realist is not the issue. However, these transformative developments in the law of contracts do reveal a vision of incomparable magnitude as a revolutionary process through which the Holmesian "felt necessities of the time"[309] manifest themselves. The law suitably adapts itself to those exigencies, either through judicial innovations or legislative intrusions, toward softening the asperities of freedom of contract. In particular, the gradual emergence of detrimental reliance as an independent and potentially exclusive criterion of promissory obligation is a significant development in the modern evolution of contract law in England, United States and Australia.[310]

Dr. Nassar's study obviously does not explore all these broad issues of sanctity vis-à-vis fairness outside the ambit of LTICTs. But faulting her

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438, 442 (1997). This explains its refusal to adopt an explicit overriding requirement of good faith. *See, e.g.*, Walford v. Miles, [1992] 2 App. Cas. 128.

308. *See, e.g.*, Camille Jauffret-Spinosi, *The Domain of Contract: French Report*, *in* CONTRACT LAW TODAY: ANGLO-FRENCH COMPARISONS 113-44 (Donald Harris & Denis Tallon eds., 1989); MICHAEL H. WHINCUP, CONTRACT LAW AND PRACTICE: THE ENGLISH SYSTEM AND CONTINENTAL COMPARISONS (1990); BLANCO, *supra* note 191; Norbert Reich, *From Contract to Trade Practices Law: Protection of Consumers' Economic Interests by the EC*, *in* PERSPECTIVES OF CRITICAL CONTRACT LAW 55 (Thomas Wilhelmsson ed., 1993); COMMISSION ON EUROPEAN CONTRACT LAW, THE PRINCIPLES OF EUROPEAN CONTRACT LAW, PART I: PERFORMANCE, NON-PERFORMANCE AND REMEDIES (Ole Lando & Hugh Beale eds., 1995) (further parts are expected); Hugh Beale, *The "Europeanisation" of Contract Law*, *in* EXPLORING THE BOUNDARIES OF CONTRACT 23 (Roger Halson ed., 1996); MARY ANN GLENDON ET AL., COMPARATIVE LEGAL TRADITIONS 306-39 (2d ed. 1994).

309. HOLMES, *supra* note 40, at 1.

310. *See, e.g.*, LORD DENNING, THE DISCIPLINE OF LAW 197-222 (1979) (English developments); FARNSWORTH, *supra* note 16, at 453-60 (American law); Patrick Parkinson, *Equitable Estoppel: Developments After* Waltons Stores (Interstate) Ltd. v. Maher, 3 J. CONT. L. 50 (1990), Sir Anthony Mason, *The Place of Equity and Equitable Remedies in the Contemporary Common Law World*, 110 L. Q. REV. 238, 253-56 (1994) (Australian initiatives). The precise relation between reliance and detriment is still a matter of considerable debate in Australia. *See, e.g.*, Foran v. Wight, 168 C.L.R. 385, 413 (1989); Jacobs v. Platt Nominees Pty. Ltd., [1990] V.R. 146, 153; Commonwealth v. Verwayen, 170 C.L.R. 394, 413-16, 429, 454 (1990).

painstaking study on that score would not only be gratuitous but also amount to criticizing her for not writing a book that she had never intended to undertake. Nevertheless, happily, the transfiguration of the concept of sanctity in the context of LTICTs has been so commendably conceptualized in the contractual equilibrium theory that it can, from a vantage point, significantly contribute to our understanding of many contractual problems in new contexts. More specifically, such studies should help develop what some call international commercial custom, that is, model clauses and contracts, which are appropriate for transnational trade, on the basis of current trade practices relating to specific types of transactions or particular aspects thereof.[311] This is, however, not to dispute that although the principle of freedom of contract is of fundamental importance in international global economy, with or without trade barriers, it is not an absolute principle.[312] Rather, the principle has been correctly circumscribed by extra-contractual norms of good faith, fair dealing and justice in the wake of "a startling move away from the dominance of the will theory and the principle of *pacta sunt servanda*."[313]

In the same vein, in the realm of contract law in general, perhaps, it may not be unreasonable to say that fairness is equally gaining widespread acceptance as the more important element. But, despite being continually eroded at the edges, the twin doctrines of freedom of contract and sanctity of contract are nonetheless destined to have a tantalizing place in the judicial universe of contract law as their recent suggested resurgence in England[314] and in the United States[315] indicates. One plausible explanation

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311. *See, e.g.*, E. Allan Farnsworth, *Uniform Law and Its Impact on Business Circles (General Report)*, *in* INTERNATIONAL UNIFORM LAW IN PRACTICE, ACTS AND PROCEEDINGS OF THE 3RD CONGRESS ON PRIVATE LAW 547, *in* UNIDROIT (1988); Peter Winship, *Changing Contract Practice in the Light of the United Nations Sales Convention: A Guide for Practitioners*, 29 INT'L LAW. 525 (1995); Joseph M. Perillo, *UNIDROIT Principles of International Commercial Contracts: The Black Letter Text and A Review*, 63 FORDHAM L. REV. 281 (1994); Klaus Peter Berger, *International Arbitral Practice and UNIDROIT Principles of International Commercial Contracts*, 46 AM. J. COMP. L. 129 (1998).

312. NASSAR, *supra* note 68, at 64-65, 80-81.

313. *Id.* at 152.

314. ATIYAH, *supra* note 5, surveying the genesis of the concept of "freedom of contract" against the backdrop of political, economic, social and legal influences, concluded that it was in decline towards the end of the 1970s. But, in the last decade, there has been a strong resurgence of free-market ideology, of the individual's right to make one's own free choices, concomitantly accompanied by a growing distrust of bureaucratic and state-controlled decisionmaking. Thus, freedom of contract's star has been rising in the 1980s and the inevitable tension between legal paternalism and an

for this phenomenon may be that, since effective economic activity is not possible without reliable promises, a party to a contract must execute its part of the bargain if justice so demands.[316] After all, contract law involves

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individual's right to make her or his own contract have come into prominence yet again. For example, in the much-criticized decision, *Walford v. Miles*, [1992] 2 App. Cas. 128, the House of Lords strongly emphasized the parties' freedom to pursue their own self-interest unrestrained by any notion to negotiate in good faith.

315. That over the past dozen or so years, American courts have also retreated significantly toward the classical conceptualist position of freedom of contract in interpreting arbitration clauses, standardized releases, insurance exclusions, and warranty disclaimers is explored in Mooney, *supra* note 294, at 1187-1204. A similar pattern is noted in the realm of securities regulation in Margaret V. Sachs, *Freedom of Contract: The Trojan Horse of Rule 10b-5*, 51 WASH. & LEE L. REV. 879 (1994); Symposium, *Securities Arbitration: A Decade After McMahon: Contract Theory and Social Securities Arbitration: Whither Consent?*, 62 BROOK. L. REV. 1335 (1996). *See also* Carnival Cruise Lines Inc.v. Shute, 499 U.S. 585 (1991); L. Gordon Grovitz, *Rescuing Contracts from High Weirdness*, WALL. ST. J., Aug. 3, 1988, at 16, *reprinted in* A CONTRACTS ANTHOLOGY 423, 423-25 (Peter Linzer ed., 2d ed. 1995); C. M. A. McCauliff, *Freedom of Contract Revisited:* Johnson Controls, 9 J. CONT. L. 226 (1995); RICHARD A. POSNER, LAW AND LEGAL THEORY IN ENGLAND AND AMERICA 60-61 (1996). *See supra* notes 8, 36.

316. Apparently, this view of the sacrosance of the contractual terms influenced Oliver, J., in *Radford v. De Froberville*, [1977] 1 W.L.R. 1262 (Ch. D.), in assessing damages for the guilty party's failure to construct a wall as stipulated in a contract for sale of land between the plaintiff (Radford) and the defendant (De Froberville). If the damages were assessed by the diminution in market value measure, then, they would have been nominal. However, the cost of erecting a wall in accordance with the appropriate contractual specification was, at the date of trial, approximately £3,400.00. In discussing as to which would be the correct measure of damages, diminution in market value or the cost of reinstatement value, Oliver, J., observed:

> Now, it may be that, viewed objectively, it is not to the plaintiff's financial advantage to be supplied with the article or service which he has stipulated. It may be that another person might say that what the plaintiff has stipulated for will not serve his commercial interests so well as some other scheme or course of action. And that may be quite right. But that, surely, must be for the plaintiff to judge. Pacta sunt servanda. If he contracts for the supply of that which he thinks serves his interests—be they commercial, aesthetic or merely eccentric—then if that which is contracted for is not supplied by the other contracting party I do not see why, in principle, he should not be compensated by being provided with the cost of supplying it through someone else or in a different way ....

Id. at 1270. *Cf.* Kupfersmith v. Delaware Ins. Co., 84 N.J.L. 271, 275, 86 A. 399, 401 (1913):

> The law will not make a better contract for the parties than they themselves have seen fit to enter into, or alter it for the benefit of one

the duties individuals impose on themselves as a result of the reciprocity of promises that they make to one another. Thus, the terms expressly agreed to should not arbitrarily be replaced with different ones simply because, in hindsight, these would yield a more reasonable or efficient outcome than actually envisioned by the parties.

The recent trends in contract law do not question this aspect[317] but rather place the doctrine of sanctity of contract (which is certainly not a naive myth) within the ambit of principles of fairness, having regard to the fact that it has little relevance to modern society as a doctrine of privileged status in its own right. It is considered preferable to sacrifice some of the values of the twin pillars of classical contract doctrine, certainty and predictability,[318] in exchange for what are more relevant rationales and just results.[319] Thus, the principle of the fidelity to the given word and an unswerving allegiance to *pacta sunt servanda* must admit of some reasonable limits.

Any expansive meaning of the value of freedom of contract (though the notions of individualism are enormously powerful) is now subject to attenuated protection. Not unsurprisingly, competing social values with fluid notions of justice, equity, and fairness can no longer be used to gain

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party and to the detriment of the other. The judicial function of a court of law is to enforce a contract as it is written.

317. The will of the parties (and its expression) being the bedrock of individualism, it is therefore understandable to claim, in a comparative perspective, that the "notion of private autonomy still has some validity today, in the sense that the expressed will of the parties serves as the impetus to the formation of contract and as the justification for its legal enforcement." ZWEIGERT & KÖTZ, *supra* note 65, at 8. *Cf.* P.S. ATIYAH, FREEDOM OF CONTRACT AND THE NEW RIGHT 406 (1989): "[E]ven the modern [English] lawyer, accustomed as he is to the many derogations from freedom of contract today, still takes it for granted that contractual obligations are created by the will or the intention of the parties."

318. If courts can set aside contracts too easily, then, the commercial world will not be able to rely on any promises. This is, of course, criticized by lawyers and business people as lack of certainty and predictability would give rise to increased litigation. *See, e.g.*, Donovan W.M. Waters, *Equitable Doctrines: Canadian Experience, in* EQUITY, TRUSTEES AND FIDUCIARIES 432 (Timothy G. Youdan ed., 1989). For, without certainty and predictability, business people will be unable to exercise their free choice in choosing or avoiding the rules of contract that are implied by the courts.

319. *E.g.*, Commonwealth v. Amann Aviation Pty. Ltd., 174 C.L.R. 64, 102 1991: "In evaluating a plaintiff's benefits ... , the court does not look solely at the express terms of the contract but evaluates the plaintiff's rights to benefits of any kind, whether those benefits are expressed by the terms of the contract or are ascertainable by reference to circumstances extrinsic to those terms." (Brennan, J.)

undue advantage or avoid obligations in contractual relationship.[320] As Lord Wilberforce candidly noted: "I think that the movement of the law of contract is away from a rigid theory of autonomy towards the discovery—or I do not hesitate to say imposition—by the courts of just solutions, which can be ascribed to reasonable men in the position of the parties."[321] Thus, undeniably, deviating from traditional laissez-faire concepts (and adopting more generalized ethical norms), modern contract law is increasingly moving towards more open-ended, collective values of

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320. This is, for instance, evident in the provisions of the Contracts Review Act, 1980, § 9(2) (N.S.W.) (Austl.) under which a contract may be declared unjust if it is a "product of both procedural and substantive injustice" and that the enactment may have even signalled "the end of much of classical contract theory in New South Wales." West v. AGC (Advances) Ltd., 5 N.S.W.L.R. 610, 620, 621 (Ct. App. 1986) (Austl.) (McHugh, J.A.). But note the views of another judge:

> [T]he steadily increasing use in Australia this century of expansive definitions of unconscionability in both state and Commonwealth in a way almost scandalous to adherents of nineteenth century Anglo-Australian doctrine and have caused both lawyers and people regularly encountering contract law to become much more comfortable with the court's potential presence as a contract alterer and fixer.

Mr. Justice L.J. Priestley, *A Guide to a Comparison of Australian and United States Contract Law*, 12 U. NEW S.WALES L.J. 4, 10 (1989) (footnote omitted). The ambiguity of the legislation has, however, not escaped criticism both in academic and judicial writings. *See, e.g.*, A.L. Terry, *Unconscionable Contracts in New South Wales: The Contracts Review Act 1980*, 10 AUSTL. BUS. L. REV. 311 (1982). The observations of Mr. Justice Michael McHugh, the author of the *West* decision, and now a justice of the High Court of Australia, are particularly noteworthy:

> Civil litigation has ... increased because courts are increasingly directed by legislatures to re-arrange people's legal rights by reference to vague standards which sound attractive but which are so indefinite that they are extremely difficult to apply to everyday disputes....
>
> The difficulties in applying such vague criteria [as those contained in the Contracts Review Act, 1980 (N.S.W.)] mean that parties to contracts have difficulty in knowing what their rights are. Litigation is forced upon them. When courts have to apply vague standards, consistency of decision-making—which is one of the primary benefits of the rule of law—is difficult to achieve. Moreover, the decision of a court applying such vague criteria often seems arbitrary. Dissatisfaction with the decision-maker in particular cases is often the result. In time, confidence in the judicial system is undermined.

Justice M. H. McHugh, *The Growth of Legislation and Litigation*, 69 AUSTL. L.J. 37, 43 (1995). *See also* Luke R. Nottage, *Form and Substance in US, English, New Zealand and Japanese Law: A Framework for Better Comparisons of Developments in the Law of Unfair Contracts*, 26 VICT. U. WELLINGTON L. REV. 247 (1996).

321. National Carriers Ltd. v. Panalpina (Northern) Ltd., [1981] App. Cas. 675, 696.

welfare, fairness, and social justice, both in the realm of consumer cases and commercial transactions, in securing the protection and implementation of the legitimate expectation of the contracting parties. Holmes' timeworn aphorism that "[i]t is revolting to have no better reason for a rule of law than that so it was laid down in the time of Henry IV"[322] could have been written with the Benthamite law of freedom of contract in mind.

Is contract then dead or *en renaissance*? Perhaps, in the ultimate analysis, it is appropriate not to overlook the Rawlsian notion that "all obligations arise from the principle of fairness,"[323] and, at the same time, recognize that a judge "is not a knight-errant, roaming at will in pursuit of his own ideal of beauty or of goodness."[324] The tension that exists between the notions of "sanctity" of contract and "fairness" of the transaction—perhaps, a perennial one—may be recalled in the eloquent words of Mr. Justice Cardozo: "Something, doubtless, may be said on the score of consistency and certainty in favor of ... stricter standard. The courts have balanced such considerations against those of equity and fairness, and found the latter to be the weightier."[325] One should then realize that "freedom of contract" is today perhaps not among the most sacrosanct Western legal constructs and the ringing phrase it once was.[326]

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322. Holmes, *supra* note 45, at 469.

323. JOHN RAWLS, A THEORY OF JUSTICE 342 (1971). Analyzing a range of difficult and controversial cases involving normative judgments, such as blood donation, organ transplantation, pornography, free trade, immigration, prostitution, surrogacy, and racial discrimination, some limits of freedom of contract are perceptively explored in TREBILCOCK, *supra* note 8.

324. BENJAMIN N. CARDOZO, THE NATURE OF THE JUDICIAL PROCESS 141 (1921), *in* SELECTED WRITINGS OF BENJAMIN NATHAN CARDOZO 107, 164 (Margaret E. Hall ed., 1947). For a thorough and imaginative examination of Cardozo's views on the role of judges against the backdrop of logic, history, custom, and public policy considerations, *see* ANDREW L. KAUFMAN, CARDOZO 199-222 (1998).

325. Jacob & Youngs, Inc. v. Kent, 129 N.E. 889, 891 (N.Y. 1921); KAUFMAN, *supra* note 324, at 350-56, 446, 449.

326. *But see* Arthur Chrenkoff, *Freedom of Contract: A New Look at the History and Future of the Idea*, 21 AUST. J. LEGAL PHIL. 36, 54-55 (1996).