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(Citation)
CDAMS(「市場化社会の法動態学」研究センター）ディスカッションペイパー,04/ 2E

(Issue Date)
2004-03

(Resource Type)
technical report

(Version)
Version of Record

(URL)
https://hdl.handle.net/20.500.14094/80100024

CDAMS Discussion Paper
04/2E
March 2004

The Relational Constitution of Contractual Agreement

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THE RELATIONAL CONSTITUTION OF CONTRACTUAL AGREEMENT

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> Madness is not believing quietly that you are Napoleon; it is demonstrating it, slipping your hand inside your jacket and striking a military pose.
>
> Paul Theroux (1973, p. 79)

Introduction

Liberal democratic society's best claim to legitimacy rests not on the moral value of particular social goals set by that society but on the extent of the freedom of its citizens to set their own goals. One may say that the goal of liberal democratic society should be to eschew the pursuit of social goals. In particular, the claim that the market economy is efficient is not a claim that that economy efficiently produces a particular set of morally valued goods but that goods are allocated through the choices of economic actors. The first theorem of welfare economics, Pareto optimality, identifies perfect allocative efficiency as a market equilibrium under conditions of general competition in which exchanges take place wholly in accordance with the choices of economic actors seeking to maximise their utilities. However, the new institutional economics has shown that general competition can arise only when exchanges are costless, a situation which can never empirically obtain. The welfare economics of the market therefore has to be concerned with the analysis of second best Pareto optimisation when the costs of exchanges are positive, that is to say, under positive transaction costs.

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In this paper I will try to contribute to the principal task which therefore faces new institutional economics, the analysis of the market as an institutional structure for exchange under positive transaction costs. Writing as a contract scholar, I will focus on the role of the law of contract in the constitution of the market, but what I say will have missed its target if it is not found interesting by economists, sociologists and those in corollary disciplines sympathetic to institutional economics. Coase's stress on the role of the law in constituting markets has shown both the necessity and the possibility of giving the law an integral place in new institutional economics. However, the extraordinary growth of law and economics as a discipline has been characterised by 'too much one-way traffic' (Goodhart 1997) in that, certainly until quite recently, the amount of normative work evaluating existing legal structures for their supposed economic rationality has greatly outweighed the amount of positive work done on analysing the role of the law in constituting markets. Of course, both positive and normative law and economics have suffered as a result for, to the extent that our understanding of the role of the law in the economy remains limited, evaluations of existing economic laws are bound to that extent to be wrong (Campbell and Picciotto 1998).

Among the reasons for this, I believe the most important theoretical one is a serious shortcoming in the concept of the transaction cost itself. This concept has, of course, been most exhaustively discussed in the economic and related literature, and the contribution a contract scholar realistically might hope to make is to show how far it is possible, as a practical matter of institutional design, to give legal encouragement to welfare optimising choice. The particular instance of impractical institutional

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which first appeared in P Heugens et al, The Social Institutions of Capitalism: Evolution and Design of Social Contracts, Cheltenham, Edward Elgar, 2003, pp 38-65.

design caused by too much intellectual traffic from ‘economics’ to ‘law’ which I will address in this paper is our understanding and evaluation of the doctrine of agreement in contract law. The economic actor’s choice is given institutional expression in the market as an agreement to exchange. Fairness is taken to be opposed to choice and therefore Pareto efficiency (Kaplow and Shavell 2002). I want to argue that developments in the law of contract show this strong opposition to be misconceived.[1] In the common law world essentially composed of the countries formerly of the British Empire, the doctrine of agreement has undergone radical shifts which, I think, show that the regulatory promotion of fairness actually is a condition of a sustainable market which facilitates choice. That this is not fully understood even by institutional economists follows from the shortcoming in the concept of the transaction cost I have in mind.

For though appreciation of the transaction cost has been the basis of the new institutional economics’ argument for the importance of institutions, the transaction cost concept tends to promote what I will call a negative attitude to those institutions. The transaction cost has a vital role, but the goal of transaction cost engineering is to minimise those costs, for that is, of course, what one should do with costs. But as vital economic institutions are being described as costs, a blanket strategy of minimisation of these costs, and negative attitude towards institutions, is far too blunt a guide for economic and legal policy. A more balanced, positive stance towards what it is we describe as transaction costs is necessary. Though my principal aim is to show the necessity of shifting our normative stance towards the transaction cost, this itself involves a shift in our understanding of what these costs actually represent.

The subjective doctrine of agreement

If general competition is to carry any positive welfare implications, the assumption that 'each consumer acts so as to maximise his utility' (Arrow and Debreu 1954, p. 59) requires that the utility actually is his. That 'by his market behaviour' the economic actor 'reveals his preference pattern – if there is such a pattern' (Samuelson 1948, p. 243) is a condition of ever regarding the market as efficient. It is a principal function of the law of contract to ensure that market behaviour does reveal preferences, attempting to do so by requiring that an enforceable contract be an agreement, a voluntary acceptance by one party of a voluntary offer by the other. The first way this was systematically understood in commentary upon the English law of contract was subjectively.[2] An agreement was taken to be a meeting of the minds, a consensus ad idem, with the implications both that a lack of consensus should vitiate any apparent agreement and, conversely, that when interpreting contracts the court should seek to give effect to the wills of the parties when they do reach consensus. This 'will theory' is the core of what has come to be called the 'classical law' of contract (Collins 2003, pp. 3-7). Atiayh (1979, pp. 399-400) has shown that the general acceptance of the will theory was heavily influenced by the English reception of the first modern treatise on contract law, Pothier's Law of Obligations, originally published in French between 1761-1764 and translated into English in 1806 by the barrister W.D. Evans. In one of his appendices giving English illustrations of Pothier's principles, Evans put the point thus:

> As every contract derives its effect from the intention of the parties, that intention … must be the ground of every decision respecting its operation and intent, and the grand object of consideration in every question with regard to its construction (Pothier 1761-1764, appendix 5, p. 35).

The objective doctrine of agreement

The will theory has the enormous virtue that it recognises the freedom of choice that is of the essence of Pareto optimisation. However, it does so only very imperfectly, for it is, to put the point as strongly as the case demands, worthless as a legal technique for giving expression to the parties' choices. Whatever its previous importance, the will theory now really functions only as a spur to theoretical reflection in the law of contract, for its manifest shortcomings make it abundantly clear that any workable doctrine of agreement must be objective: 'It is not the subjective thing known as meeting of the minds, but the objective thing, manifestation of mutual consent, which is essential to the making of a contract' (Benedict v. Pfunder, p. 4). The subjectivity of the will theory assumes a direct access to the minds (and therefore preferences) of the parties whereas, of course, this is just what we do not have. In one of the most famous phrases of the common law, Brian CJ put it thus: 'the intent of a man cannot be tried for the Devil himself knows not the intent of a man' (Anon v. Anon). All we ever have is the physical behaviour (including speech) of the parties, some of which signifies meaningful action which must be understood by reference to a social framework. Exchange is a reciprocal commitment of the parties established through their bargaining, that is to say, it is a social relationship manifested in the external signs of action.

The point I am trying to make emerges clearly from Weber's famous use of exchange as an example of exactly this sort of understanding of the meaning of action from its observable signs:

> Let us suppose that two men … meet and "exchange" two objects. We are inclined to think that a mere description of what can be observed during this exchange – muscular movements and, if some words were "spoken", the sounds which, so to say, constitute the "matter" or the "material" of the behaviour – would in no sense comprehend the "essence" of what happens. This is quite correct. The "essence" of what happens is

> constituted by the "meaning" which the two parties ascribe to their observable behaviour, a "meaning" which "regulates" the course of their future conduct. Without this "meaning", we are inclined to say, an "exchange is neither empirically possible nor conceptually imaginable. Of course! The fact that "observable" signs function as "symbols" is one of the constitutive presuppositions of all "social" relations (Weber 1907, p. 109).

In the most thorough work by a contract scholar on the normative constitution of contract, Ian Macneil has identified three levels of social relationships necessary for contractual agreement to be possible. The first level which emerges from analysis of such agreement is this level of the ontologically fundamental social relations within which all human action is constituted, the 'social structure' of shared signs, language and meaning within which all action is framed. This is the basic sense in which society 'is the fundamental root, the base, of contract' (Macneil 1980, p. 1). We shall turn to the other two levels below.

Though the law of contract exists to guarantee the expectations generated by a contractual agreement, it is, then, denied direct access to the intentions which motivate that agreement and is obliged to work with the observable behaviour which signifies that intention. This is not, however, the main point that separates the subjective from the objective in the law of contract.[3] The interest of the substantive law of contract is not principally explanatory and it does not occupy itself with hermeneutic problems.[4] Its interest is the normative one of deciding whether to enforce or to refuse to enforce contracts and the way it must set about this is, in a sense, quite the opposite of sociological method. For what is enforced as a contract is <u>not</u> the subjective meaning of the party intending to make, say, an offer, but rather the objective meaning of the sign. The law of contract must, of course, pay attention to the behaviour which signals the intention, but it is quite wrong to say that that behaviour functions merely as evidence of intention:

> Doubtless the law is generally expressed in terms of subjective assent, rather than objective expressions, the latter being said to be "evidence of the former" … but when it is established that this is no rule of evidence but a rule of substantive law, the whole subjective theory which is sometimes rather ludicrously epitomised by the quaintly archaic expression "meeting of the minds" falls to the ground (Williston 1957, vol. 13, pp. 32-4; cf. vol. 1, p. 42).

The law of contract sets up an objective standard of agreement with which the parties must comply. This standard was described thus by Blackburn J. in Smith v. Hughes:

> If, whatever a man's real intention may be, he so conducts himself that a reasonable man would believe that he was assenting to the terms proposed by the other party, and that the other party upon that belief enters into the contract with him, the man thus conducting himself would be equally bound as if he had intended to agree to the other party's terms (p. 607).

The meaning of a statement made in the course of negotiations is assessed from the objective perspective of a reasonable person in the situation of the party to whom the statement was made, and a party who acts in such a way as to signify agreement to such a reasonable person will be held to have agreed, whatever his actual subjective intention. (An example will be given shortly.) This is to say, in the passage from subjective to objective theories of agreement, the law of contract makes the determination of agreement a matter not of delving into the subjective will or preferences of a party but of the imposition of an objective, normative standard.

Though the objective theory of agreement in this way remedies the basic shortcoming of the subjective theory, by doing so it itself immediately gives rise to a problem which threatens to undermine the legitimacy of agreement as a means of allocating goods. The separation of the objective sign from the signified subjective agreement creates the possibility of communication of intention, but by doing so creates the possibility of distortion of that communication. There are two possible types of such distortion of relevance here which raise very different issues. First, a

party may fail in his attempt to communicate his intention and agree by mistake. This, we will see, is not really a problem for contract; in fact it is important that a party should be able to make a mistake. But, second, a party may be deceived or coerced into entering a contract, manifesting the objective signs of agreement to which he does not actually agree, and this is a major problem, for it vitiates the essential implicit condition of agreement, that choice is expressive of the economic actor's freely determined preferences.

The consequences of a subjective mistake

If follows from what we have already seen of the objective doctrine of agreement that a 'mistake' in the common sense of the word is no defence to contractual liability. Were it such a defence, the law of contract would be unable to function, for a party faced with liability would simply be able to say that he intended to contract on terms which evade that liability. As Baggallay J. put it in Tamplin v. James:

> The defendant cannot be allowed to evade … performance by the simple statement that he has made a mistake. Were such to be the law the performance of a contract could rarely be enforced upon an unwilling party who was also unscrupulous (pp. 217-218)[5].

To this it is necessary only to add that were the party sufficiently scrupulous to allow the law to work, then the law would not be needed. In Tamplin v. James the purchaser bid at auction for a plot of land. The purchaser 'had known the property from [the time he was] a boy' (p. 216) and made his bid without consulting the plans which the vendor had made available at the auction. The purchaser thought the plot being sold was twice as big as it actually was, and, presumably for this reason offering more than other bidders, was successful at auction. When he found out that the plot was half the size he believed, he refused to complete the purchase because, in essence, he had made a mistake. It was accepted that he had made a subjective mistake, but as that

mistake, caused by his failure to consult the plans, was unreasonable, it was given no objective weight, and the contract was enforced.

Though subjective mistake is given no objective force in contract, this does not, of course, make the imposition of liability upon those who made the mistake any less onerous. However, that the law of contract takes this attitude to subjective mistake is a necessary (but not sufficient) condition of the claim that allocations by a market are just, for it is only through this attitude that the market is able to allocate goods according to desert. Within contract scholarship, the justice of desert has received its most persuasive statement from Charles Fried (1981, p. 7):

> It is a first principle of liberal political morality that we be secure in what is ours, so that our persons and property not be open to exploitation by others, and that from a sure foundation we may express our will and expend our powers in the world. By these powers we may create good things or low, useful articles or luxuries, things extraordinary or banal, and we will be judged accordingly – as saintly or mean, skilful or ordinary, industrious and fortunate or debased, friendly and kind or cold and inhuman. But whatever we accomplish and however that accomplishment is judged, morality requires that we respect the person and property of others, leaving them free to make their lives as we are left free to make ours. This is the liberal ideal.

There is achievement and, as a necessary condition of achievement, the possibility of failure in the liberal conception of justice as desert. The point that has been stressed so powerfully in Nozick's 'entitlement theory of justice' (Nozick 1974, pp. 150-153), which turns on the deliberately provocative slogan '[f]rom each as they chose, to each as they are chosen' (p. 160), is that allocation through desert requires that the economic actor must not only benefit from his correct choices but also must abide by his mistaken ones. An economic actor who realises during or after performance that he has failed to profit or has done relatively poorly out of a contract will always have made a subjective mistake, but a law of contract which seeks to allocate goods according to desert must not recognise such mistakes as defences to liability.

This attitude to mistake is the legal institutional foundation of the most successful argument in modern liberal political theory, the rejection of 'patterned principles' (Nozick 1974, pp. 155-60) of distribution in favour of the 'pure procedure' (Rawls 1999, pp. 73-78) of the market on the ground that any state imposition of the 'ideal outcome' (B. Barry 1990, pp. 35-52) of a politically determined fair distribution of goods must prevent (approximations to) the perfectly efficient distribution which would be voluntarily reached at general competitive equilibrium. This argument has made it almost axiomatic that we must reject 'fairness' in order to gain the efficiency and justice of Pareto optimisation.

We are, of course, faced here with the basic notion of 'freedom of contract', which was given one of its most famous legal expressions in 1875 by Sir George Jessel MR:

> [I]f there is one thing 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. Therefore, you have this paramount public policy to consider – that you are not lightly to interfere with this freedom of contract (Printing and Numerical Registering Co v. Sampson, p. 465).

As part of an argument for resisting the temptation to, in the public interest, revise a possibly onerous contract because of the trumping public interest in freedom of contract, Sir George held that freedom of contract has two aspects. The first is that economic actors should be able to contract for as wide a range of goods as possible. The second, of relevance here, is that their contracts should be left alone, the doctrine of sanctity of contract as it is known in the English law (Parry 1959). Freedom of contract is represented wholly negatively as freedom from regulation, and specifically from the imposition of fairness, in the belief that efficient and just outcomes will be produced spontaneously (Bastiat 1850, pp. 65-66). Something like this position is, of

course, at the heart of neo-classical economics, and, indeed, to its claims to be able to pass purely ordinal welfare judgements which avoid, and require the economist to avoid, value judgements of fairness. As Manne (1970, p. 3) has put it when claiming that economics 'is perhaps the most scientific of the social sciences':

> Here the word scientific must connote objectivity and moral detachment … The question for an economist is rarely one of the mutual fairness of a transaction between the parties.

The point I wish to stress is that this attitude follows from a conception of economic action as, in a sense, amoral:

> Actions motivated by the possibility of taking advantage of others seem to merit the shirking, agency cost or opportunism labels. These actions would be absent not only if monitoring cost were zero but even if this cost were positive, as long as persons attach no value to gains secured in this way. Ethical beliefs matter here. But we must be careful in economics when ethical beliefs are brought into the analysis. Economic analysis neither makes nor needs an ethical presumption regarding motivation. Analysis depends only on the assumption of rational maximisation (Demsetz, 1995, p. 28).[6]

I write this paper from the position of one who essentially accepts the efficiency of Pareto optimality, who believes that desert is the most just available basis on which to allocate economics goods, and, a linked but not wholly entailed point, who generally dislikes patterning in itself. Nevertheless, I believe that the equation of the correct disregard of subjective mistake with a commitment to freedom of contract negatively understood as the absence of regulation and disregard of fairness is wholly wrong. Leaving aside other grounds on which I believe this to be so, as a matter of practical institutional engineering it is, I will argue, impossible to have contractual agreement which does not have fairness (and therefore normative concern) at its heart. My fundamental reason for holding this belief is as follows.

It has been noted that the language of the 'revelation' of preferences has something of a mysterious, indeed ethereal, quality (Robertson 1952, p. 19), and, from

the point of view of institutional engineering, this language is wholly misconceived. The economic actor does not reveal his preferences; he attempts to express them in an exchange. Though an economic actor enters into an exchange to maximise his individual utilities, the exchange is immediately a social relationship and the success of the maximisation is conditional on accuracy of the social expression of the individual preferences.[7] The economic actor's capacity to express his preferences is determined in that relationship; that is to say, from the outset that capacity is determined by the nature of the relationship, which is a function of his own powers, the other party's powers, and the quality of the legal institution which brings them together. The point of view of institutional engineering has to have at its heart regard to the social dimension of choice which (N.) Barry (1990, p. 37) acutely describes:

> [L]iberty is not a subjective choice – individuals responding to the dictates of desire and aversion – but the exercise of a power and capacity to act in concert with others.

To see what this regard for the social dimension entails, let us return to the law of agreement and mistake. Though there are, as we shall see, as a legacy of the will theory, categories of objective mistake which the law of contract does recognise as excusing performance because they nullify consent, this recognition is not a direct recognition of the subjective mistake of the defendant, and the use of the language of mistake to describe it has led to abiding confusion because what actually is at issue is the objective regulation of agreement.

The consequences of objective mistake

The English doctrine of mistake is the most unsatisfactory doctrine in the law of contract, a distinction it maintains against a great deal of severe competition. The reason it is so unsatisfactory is that, though it makes no sense to allow that mistake is

an excuse for failure to perform, if one accepts the subjective doctrine of agreement,. one is obliged to allow just this, for a mistake must vitiate the consensus ad idem. At the cost of repetition, the sale in Tamplin v. James could not have been enforceable were a consensus ad idem required. We have seen, however, that this is the reason for rejecting the subjective doctrine rather than allowing mistake to be an excuse. Nevertheless, as the law of contract has by no means come to terms with its degenerating classical principles (Campbell 1992), mistake remains as a largely redundant, notoriously complicated area of the law. One has to be desperate before one looks to the doctrine of mistake to help one with one's disputes, but understanding the doctrine's shortcomings is a valuable exercise.

Four types of mistake have been recognised as possibly excusing non-performance: common mistake, mutual mistake, unilateral mistake and personality mistake, the fourth being a variant of the third. The classification of the first three turns on how mistake presents itself if one accepts the subjective doctrine, for it proceeds by purporting to be classify the states of mind of the parties. A common mistake is the same mistake shared by both parties, a mutual mistake is when different mistakes are made by both parties, and unilateral mistake is when only one party is mistaken (Cheshire 1944). We shall ignore common mistake, which is now recognised to raise issues wholly unrelated to the existence of an agreement which I cannot enter into here, but look at the other three. We shall see that the subjective doctrine has no power to make the necessary distinctions between the cases in which problems have arisen.

In a unilateral mistake, as I say, one party is mistaken. In Hartog v. Colin and Shields, for example, a seller made a clerical error when communicating an offer and quoted a price that was absurdly low. The buyer purported to accept that price but the

seller was excused performance because of his mistake. How can this case be distinguished from Tamplin v. James? In fact, it cannot be distinguished on the basis of the subjective doctrine. The defendants in both cases were subjectively mistaken in the same unilateral way. The distinction between the cases is that in Hartog v. Colin and Shields the offer was so absurdly low that it would have been obvious to a reasonable third party that it was made in error, and the law will not allow advantage to be taken of egregious mistakes. In Tamplin v. James (p. 221 per James LJ) the possibility that the seller had 'snapped at' an obviously mistaken offer was considered and rejected, leading one to conclude that the offered price, though high, cannot have been startlingly high. The point is that it is not the defendant's mistake that fundamentally matters. It is the seller's attempt to take advantage of the defendant's mistake that matters.

In Scriven Bros and Co v. Hindley and Co a consignment of tow, a textile, was sold at auction. The buyer bought the tow thinking it was hemp, a more valuable textile, but on finding it was tow, sought to escape the contract, and was allowed to do so. This case obviously needs carefully to be distinguished from Tamplin v. James, to which it seems identical. It is identical on the facts of the defendant's mistake. It is distinguished in that the defendant's mistake about the tow was induced by the seller's negligence in the way he (or rather the auctioneer as his agent) conducted the auction, which would have misled a reasonable person about the goods for sale and did so mislead the buyer. The seller and the buyer are, however, mutually mistaken in this case in that the buyer makes a mistake but the seller does not know this. This is to say, the seller's mistake is not to know the buyer is mistaken, whereas in a unilateral mistake the party seeking to take advantage obviously does know of the other party's mistake. Nevertheless, the excuse again stems from the seller's conduct, which is

what is at issue. The distinction between this situation and Tamplin v. James is even more clear in Denny v. Hancock, a sale of land at which the purchaser made a mistake about the extent of the land for sale exactly as in Tamplin v. James, but was excused performance because the mistake was caused by an error in the information made available by the claimant vendor.

The last type of mistake which we shall consider is the personality mistake. This arises when a fraudulent buyer makes a purchase on credit terms by impersonating a creditworthy person and then, of course, does not satisfy the debt. In the leading case, Lewis v. Averay, the buyer paid for a car by a cheque which was accepted because the buyer impersonated a famous television actor, and the cheque was dishonoured. Let us leave it aside that the mistake is about the 'personality' of the buyer and why this matters, circumstances of no intrinsic importance which only some silly and, as they have caused hardship, deplorable aspects of the English law of mistake throws up. Behind this, personality mistake is a sort of unilateral mistake in that only one party is mistaken, but whereas in unilateral mistake as such there is no deliberate attempt to induce the mistake, in personality mistake cases there is. These are, of course, cases of fraud, and it has never been contested that a contract induced by fraud (or similar behaviour raising different legal pleas) should be enforceable. Of course, unilateral mistake is a sort of constructive fraud.

The point I am trying to make, at a length for which I apologise, is that understanding the treatment of different subjective mistakes on the basis of the consensus ad idem understanding of agreement is impossible. All mistakes should vitiate a contract were a consensus ad idem necessary, but it would not be right (nor even possible) for the law of contract to function on this basis. What necessarily happens is that a party's wish to escape liability because he entered into a contract by

mistake is respected when the mistake is the product of unfair conduct by the other party. The shortcomings of the doctrine of mistake fundamentally show us that the law cannot, should not and does not directly turn on a party's mistaken subjective intention, though the idea of direct perception of that intention that informs the idea of the consensus ad idem and the revelation of preferences leads one to believe it should. Rather, mistakes are objectively evaluated and those parties making unreasonable mistakes are obliged to abide with them. Objectively reasonable mistakes do excuse non-performance, but this reasonableness is not a property solely of the individual will but emerges by assessment of the fairness of the negotiating relationship with the other party that led to the mistaken agreement. The crucial role of fairness becomes clear when we consider the doctrine of duress, the principal way the law of contract has addressed coercion, one of the sources of distorted communication of agreement, to which we now turn.

Duress and fairness

Weber defines economic action as 'any peaceful exercise of an actor's control over resources which is in its main impulse oriented towards economic ends', action being 'economically oriented' in so far as 'it is concerned with the satisfaction of a desire for "utilities"' (Weber 1925, p. 63). The qualification 'peaceful' is essential. The desire to increase one's sum of utilities that drives Pareto optimising exchange is by no means enough in itself to produce welfare optimising outcomes. Rational utility maximisation through exchange works on the basis that every increase of pleasure is won only at the cost of the pain of the expenditure of (ultimately) labour (Gossen 1854, ch. 2). It therefore implies some sort of reciprocity. But, of course, the truly pure individual utility maximiser must resent the reciprocal performance which

exchange requires of him and logically would prefer deceitful or coercive acquisition. As Pareto himself recognised: 'the efforts of man are utilised in two different ways: they are directed to the production or transformation of economic goods, or else to the appropriation of goods produced by others' (Pareto 1906, p. 341). In order to ensure that utility maximisation takes the form of economic action, and thus be the basis of 'rational' rather than 'non-rational' capitalism (Weber 1904-1905, pp. 17-25; 1919-1920, p. 334), it must take place within conditions of 'peacefulness' (von Mises 1922, p. 36).

The provision of peace is, of course, in the first place a political matter. The solution of 'the Hobbesian problem of order' (Parsons 1968, pp. 89-94) to deal with the chaotic tendencies of 'possessive individualism' (Macpherson 1962, pp. 9-106) is the political precondition of economic action (Gauthier 1986, p. 85). The guarantee of the sanctity of contract certainly is one reason Hobbes gives for the necessity of the social contract in order to leave the state of nature:

> If a Covenant be made, wherein neither of the parties performe presently, but trust one another, in the condition of meer Nature, (which is a condition of Warre of every man against every man,) upon any reasonable suspition it is Voyd: But if there be a common Power set over them both, with right and force to compell performance; it is not Voyd. For he that performeth first, has no assurance the other will performe after; because the bonds of words are too weak to bridle mens ambition, avarice, anger, and other Passions, without the feare of some coercive Power; which in the condition of meer Nature … cannot possibly be supposed (Hobbes 1651, p. 196).

In Macneil's description of the three levels of the normative foundation of contract which has been mentioned above, the provision of peacefulness is rightly described as the '[s]overeign imposition of norms' by the 'external god' Leviathan (Macneil 1983, p. 370); that is to say, it is a matter of <u>confining</u> maximisation within a normative framework which channels it into the form of rational economic action:

> contract between totally isolated, utility-maximising individuals is not contract, but war … contractual solidarity - the social solidarity making exchange work … at a minimum holds the parties together so that they will not kill and steal in preference to exchanging [This is a matter of the] external god providing social stability, enforcement of promises, and other basic requirements. Within these rigid confines, the parties are free to maximise their individual utilities to their hearts' content (Macneil 1980, pp. 1, 14).

The law of contract obviously exists within such externally imposed confines, residing within a space provided by the criminal law's prohibition of, say, robbery. It is not, however, possible to confine the way the law of contract itself deals with the problem of maximising behaviour which defeats rather than promotes welfare enhancing exchange to the imposition of confining norms. There is, rather, a complex structure of norms which have arisen within contracting behaviour itself to deal with duress understood broadly in a way I shortly shall describe. Macneil describes the common sociality essential for all human activity and the political limits to self-interest which prevent competition from decaying into war or parasitism as the two levels of norms which compose the background 'social matrix' of contract (Macneil 1974, pp. 710-712). He then goes on to argue that 'law contributes more than general stability, it is directly facilitative in [that] it provides for the accomplishment of co-operation [and the] continuation of interdependence' (Macneil 1980, p. 93) through external and internal (Macneil 1980, pp. 36-37; 1983, p. 367; 1987, pp. 31-32) 'values of contract behaviour … generated … in billions of contractual relations' (Macneil 1983, p. 351). This third level of contract norms arises within contract behaviour.

The most obvious of these third level norms are those statutory provisions limiting, say, the terms on which goods may be sold or credit extended to consumers. There is no need to give a comprehensive description of these here as their broad nature (Scott and Black 2000, ch. 3) is well enough known. It is necessary to make

only one point in passing. These are, in a sense, external norms imposed by the welfare state, but it must be noted that in liberal democratic societies the mechanisms of welfarist policy formulation give great weight to the relevant business interests. This weight indeed is so great that it tends to undercut the legitimacy of the economic policy formulation process (Miliband 1969), but, of course, any such process must give due weight to those interests and much regulatory failure is the product of not doing so (Ayres and Braithwaite1992). The point of relevance to us is that it is only when viewed from the illusory perspective of untrammeled freedom of contract that these norms can appear wholly external to contract behaviour.

More than this, norms which are external in this sense are imposed not only, nor even necessarily (Macneil 1980, p. 37), by 'the positive law of the sovereign, but also [by] many other sources [including] private law, such as that imposed on … businesses by trade associations.' As well as such relatively 'vertical impositions', there is also the 'more horizontal imposition of external values, such as those arising from … customs of a trade' (Macneil 1983, pp. 367-368). These foster co-operation by reducing the 'choice of a party which is reciprocating too little, is too powerful, is terminating relations, or is following arbitrary or other procedures viewed as inadequate' (Macneil 1983, p. 379). Finally, and most importantly, internal norms intimately linked to the external ones orient 'both [the] actual behaviour and [the] principles of right action' (Macneil 1980, 38) of contracting parties.

Though Macneil derives these norms from the most authoritative legal scholarship, the principal concern of his later work is to describe, in a sociological metalanguage, the (in the last formulation) ten common contract norms (Macneil 1980; 1983) which underpin all contracting by generating a (to various degrees, as will be seen below) co-operative attitude which respects 'solidarity and reciprocity'

(Macneil 1983, p. 348). This description is, as I have put it elsewhere, 'a most substantial modern contribution to the economic and social theory of the capitalist economy' (Campbell 1990, p. 82), a legal equivalent to Alfred Chandler's work on business structure (Campbell 2001b). However, Macneil's normative metalanguage has obscured the relationship to the actual legal doctrines which express the norms he describes. I have in my own earlier work (Campbell 1996b) tried to show how immanent critique of the actual common law (i.e. non-statutory) doctrines of the law of contract yields the co-operative normative orientation Macneil essentially describes. Without going over that all work here, let us take up the doctrine of duress.

The basic case of duress is of actual or threatened violence to the person, and so in Barton v. Armstrong, the claimed duress was a threat by Armstrong to kill Barton unless Barton bought Armstrong's shares in a company. The point at issue was whether the purchase, which there was evidence Barton thought a sensible commercial decision, was made, at least in part, as a result of the threat. If it was, the accepted position is that such duress vitiates the consent of the party to the 'agreement' made so that 'the contract entered into was not a voluntary act' (Pao On v. Lau Yiu Long, p. 636 per Lord Scarman), and so excuses the party subject to the threat from performance. Though we will see that there is extreme difficulty about this basic point, one can see how it arose as an implication of the concept of agreement. Subsequently, the use of duress as an excuse has come to cover many situations, and it is obvious why it should do so. If one accepts that a threat to life is duress, can it consistently be denied that a threat of imprisonment (Mutual Finance Co Ltd v. John Wetton and Sons Ltd), or of injury to reputation (Thorne v. Motor Trade Association, p. 822 per Lord Wright), or of violence to goods (The Siboen and the Sibotre, p. 335 per Kerr J) might also be duress? In the surely correct belief that it

cannot, the English law now recognises that any illegitimate act (The Universe Sentinel, pp. 400-401 per Lord Scarman), including bringing illegitimate commercial pressure to bear (D and C Builders v. Rees), by one party which coerces another party into a contract gives the coerced party an excuse not to perform.

Given this recognition of the legitimacy of recognising duress, the extension of the underlying argument that consent is being undermined to cases of the abuse of fiduciary relationships under the doctrine of undue influence (Royal Bank of Scotland plc v. Etridge (No 2)), and to cases of manifest inequality of bargaining power under the doctrines of unconscionability (Lloyds Bank Ltd v. Bundy), the incapacity of incompetents (Imperial Loan Co v. Stone), and economic duress (Dimskal Shipping Co SA v. ITWF, p. 165 per Lord Goff), has proved impossible to resist. In, for example, The Atlantic Baron, shipbuilders threatened to discontinue building a ship for a shipowner unless the shipowner agreed to pay an extra 10 per cent of the agreed price. The shipbuilders had no lawful reason to terminate but knew that the owner had chartered the ship to a third party at extremely favourable rates and were likely to lose that charter if the vessel were not delivered (and consequently themselves be exposed to liability and to deterioration in their relationship with a major client). The owner therefore agreed to pay under protest, but this agreement was recognised to have been secured by economic duress and would have been unenforceable but for other reasons not relevant here.

Now this type of opportunistic behaviour by the defendants is not consistent with a welfare optimising law of contract, but to say that a major shipowning corporation was subject to coercion of its will is absurd, and indeed all the principal cases of economic duress involve major corporations which it is very strained to say have had their will coerced (even if one accepts that they have a will). Recognising

this makes the real principle underlying these cases more clear, for the claim that duress vitiates consent is not a serviceable rationale for the rule against securing acceptance by duress in contract cases (Hale 1943; Unger 1986, pp. 69-71),[8] and what is at issue is not really the actual absence of consent but the fairness of the means by which the consent was obtained. As Durkheim (1890-1900, p. 207) put it when analysing the binding force of contract:

> any contract in which pressure has a part becomes invalid. It is not at all because the determining cause of the contract is exterior to the individual who binds himself. It is because he has suffered some unjustified injury; in a word, because the contract is unjust.

Ultimately this is because the very idea of exchange always involves a sort of duress. A party coerced into a contract by duress has nevertheless consented in the sense of choosing between one of two evils in the way that we have seen is central to utility maximisation through the reciprocity of exchange. As this always is so, one cannot draw an at all workable line between voluntary or involuntary consent, one can say only whether the consent was, in the circumstances, fairly obtained, the fairness being a matter of how adequate was the bargaining relationship of the parties. One could, of course, perfectly well say as an abstract point that the shipbuilder's behaviour in The Atlantic Baron was permissible, but contracts made through recourse to that sort of behaviour do not in fact bind because the highly opportunistic means by which it was secured undermines the moral force which a contract has when it is the product of fair competition (Cook and Emerson 1978). Of course, if we eliminate all competition in negotiation, we eliminate the market, for it turns on competition of this sort (Eisenberg 1982). But equally if we have no regulation at all, we are in the state of nature or, if we stubbornly stick to some very minimal regulation, we will end up with bad contracts in very many cases indeed. That we

must eschew these extremes has been convincingly argued by Kennedy (1982, p. 582):

> without doing violence to the notion of voluntariness as it has been worked out in the law, [we] could adopt a hard-nosed, self-reliant, individualist posture that shrinks the defences of fraud and duress almost to nothing. At the other extreme, [we] could require that the slightly stronger or slightly better-informed party give away all his advantage … If we cut back the rules far enough, we would arrive at something like the state of nature – legalised theft. If we extended them far enough, we would jeopardise the enforceability of the whole range of bargains that define a mixed capitalist economy … In either extreme case, we would have departed from freedom of contract.

All contracts in fact are composed of a mixture of competitive and co-operative orientations to the bargain, for complete competitiveness and complete co-operation both destroy the idea of contract. The crucial task for the contract lawyer as transaction cost engineer is to design the contracting framework which provides the appropriate mixture of orientations for a particular contract as the institutional form of a particular exchange. It is not at all desirable to regulate in order to stipulate specific 'fair' terms for the parties' exchange.[9] But it is absolutely essential to regulate to ensure that the parties' bargaining is fair in the sense that it allows both of them to express their individual preferences and therefore qualities through their agreement (Collins 1999). This is a matter of designing appropriate institutions.

It is, as Macneil has indicated, possible to locate all the possibilities along a 'spectrum of contracts' ranged between competitive and co-operative poles (Macneil 1978, p. 12). As an example of the co-operative pole of the spectrum, let us take the sale of a pension investment, which has to be conducted on a fiduciary basis because inevitable, pronounced asymmetries of information mean that the seller has to have the interests of the customer in mind if reasonable outcomes are to be produced. This is the rationale of the concept of the 'protection' of small investors (Page and Ferguson 1992, ch. 1).[10] The reform of pensions law in the UK in the 1980s (Rider et

al. 1989) created a wholly ineffective regulatory regime which allowed far too competitive a relationship between agent and customer to emerge (Consumers' Association 1993), with the resulting pension mis-selling taking place on such as scale as to amount to 'the biggest financial scandal in British history' (Dowd and Hinchliffe 2001, p. 167).

At the other pole, we might place the valuation of corporate securities by methods derived from the Black-Scholes (1973) model, which works only by the adoption of a very narrow view of financial returns to an investor, though the securities traded are in economic institutions of enormous social significance. Whilst I do not wish to enter into detail, securities' prices can be determined according to the 'fundamental theorem of asset price' on which the 'efficient stock market hypothesis' is based only on radically simplifying maximising assumptions (Black 1989) and, by implication, by allowing trade on this basis. But, leaving aside any weaknesses in the model itself, this system works only by reliance on a system of communication of information the integrity of which is the product of the most exhaustive regulation, and therefore dealing should be seen as normatively constituted behaviour, albeit that it is constituted as an unusually narrow (but clearly limited) self-interest.[11] The point is that both types of contract rest on institutionalised normative foundations, a point obvious in the first case and which drawing a parallel to Coase's (1988, pp. 9-10) description of commodity exchanges makes obvious about the second:

> commodity exchanges and stock exchanges...are normally organised by a group of traders (the members of the exchange) which owns (or rents) the physical facility within which transactions take place. All exchanges regulate in great detail the activities of those who trade in these markets (the times at which transactions can be made, what can be traded, the responsibilities of the parties, the terms of settlement, etc), and they all provide machinery for the settlement of disputes and impose sanctions against those who infringe the rules of the exchange. It is not without significance that these exchanges, often used by economists as examples of a perfect market and perfect competition, are markets in which

> transactions are highly regulated (and this quite apart from any government regulation that there may be). It suggests, I think correctly, that for anything approaching perfect competition to exist, an intricate system of rules and regulations would normally be needed.

As it has been developed without self-consciousness of the social relationship it regulates, the contractual doctrine of agreement has posited the 'social' aspect of agreement through a set of apparent restrictions on agreement, popularly understood as restrictions on freedom of contract, which misunderstand their own nature (Macneil 1990, p. 154). As we have seen, the pure rational utility maximiser would like to ignore the reciprocal obligations of contract, and that he does not do so is, in the first instance, a question of the external imposition of peacefulness. But, more than this, an efficient because just law of contract is essentially composed of rules internal to the agreement process which seek to encourage fairness in that process, because fairness is a condition of the parties' expressing themselves in their exchange.

How one can make a mistake in agreement

In an important sense, the regulatory issue is to make it possible for parties to make a mistake. We have seen that a subjective understanding of mistake cannot be the basis of a workable doctrine of mistake in the law of contract. Were contract really to rest on subjective agreement in the way expressed by the requirement of consensus ad idem, then there would be no way of visiting the consequences of poor decisions on economic actors and therefore no allocation of goods according to desert. (Indeed, there would be no way of enforcing contracts at all, but that is beside the point). We must, then, have an objective concept of agreement, but this makes the welfare outcomes of an exchange dependent on the legal relationship between the parties as well as on their individual qualities (Scanlon 1988). If we are to identify the merit of their individual qualities, as desert requires we must, we must try to make the

relationship which expresses those qualities carry out its work of expression as transparently as possible (Collins 1992).

This brings in all the issues clustered around the doctrine of duress. For if an economic actor entered into a contract in circumstances of illegitimate pressure which made it unreasonable to say that he consented, then it cannot be held that the disadvantageous bargain was the result of his mistake, and therefore it cannot be just to hold him to the contract. The possibility of making a mistake to which one is held is conditional on one having a reasonable opportunity to not make a mistake, and the existence of this opportunity is largely a function of the quality of the exchange relationship which leads to the agreement. In the course of his description of contract as the legal institutional expression of organic solidarity, Durkheim (1893, pp. 318-319) again put it very clearly:

> for the obligatory force of [a] contract to be entire, it is not sufficient for it to have been the object of express assent. It must also be fair, and it is not fair by the mere fact that it has been agreed verbally. A mere statement cannot of itself engender the power to bind that inheres in agreements. For the consent to possess this power, it must itself at least rest upon some objective basis. The necessary and sufficient condition for this equivalence to be the rule governing contracts is that the contracting parties should be placed externally under equal conditions. As the assessment of matters cannot be determined a priori, but arises from the exchange itself, in order to have their labour appraised at its precise worth the individuals involved in the exchange must dispose of no other force than that which they draw from their social merit. In this way the value of objects corresponds exactly to the services that they render and the toil that has been expended … Doubtless their unequal merit will always leave men unequally placed in society. But these inequalities are only apparently external, for they merely interpret internal inequalities from the outside It is no longer the same if some receive some additional power from some other source … Every form of superiority has repercussions on the way in which contracts are arrived at. If therefore it does not depend upon the person of individuals and their services to society, it invalidates the mental conditions of the exchange.

All agreements, then, must take place within a normative negotiating framework composed of amalgams of Macneil's three levels of norms, including internal contract

norms (though different types of agreement require normative support of different degrees of elaboration), and these are expressed in various doctrines of the law of contract. As these developments have occurred *ad hoc* and under the sway of a belief in the will theory's subjective understanding of agreement, they have produced a monstrous legal pleonasm obscuring the basically simple point of fairness. The law of contract cannot consistently distinguish between agreements in which consent is vitiated by duress (or the like) and those in which pressures do not vitiate consent. If one acknowledges this but is faced with the necessity of enforcing some and not enforcing other contracts, which becomes acute in the case of mistake, one has to fall back on fairness. To do this one has to give up a lot of conventional thinking about the nature of markets.

When addressing questions of institutional design, we are obliged to do exactly this. For, quite contrary to the claim that freedom of contract is a matter of having no regulation of agreement, there is, in fact, a very large set of common law and statutory rules which have arisen because regulation is necessary to constitute that agreement. These rules presently obtain but, understood in the inadequate individualistic terms of the classical law and the equally inadequate non-institutional terms of neo-classical economics, they are poorly expressed and applied. In particular, an amphiboly between freedom of contract and fairness, itself based on an amphiboly between freedom of contract and regulation, is thought to be a regrettable but ineluctable feature of an efficient market. Nothing could be further from the truth. Self-consciousness of the institutional conditions of exchange puts fairness at the heart of agreement.

The lesson which must be learned from the contractual doctrine of agreement is that, from the perspective of institutional engineering, an economic actor's

preferences are of no direct relevance. An actual market which seeks to establish the liberal ideal of justice as desert cannot be based directly on the subjective intentions of the parties to contracts. Enforceable agreements can, must and do arise in the absence of a consensus ad idem, and this leads to the possibility of opportunistic behaviour which the law has tried to address through, inter alia, its development of duress and related pleas as excuses for non-performance. An economic actor's preferences can be the basis of welfare optimising exchange only if they are rationally formed and clearly signalled which in part – the part which it is necessary to regulate if the exchange is to take place at all – is a function of the quality of the relationship with the other party to the exchange.

In what is perhaps the most influential of the modern avocations of the market economy, Milton Friedman (1962, p. 13) has described the virtuous core of that economy in this way:

> Fundamentally, there are only two ways of co-ordinating the economic activities of millions. One is central direction involving the use of coercion … The other is voluntary co-operation of individuals – the technique of the market place. The possibility of co-ordination through voluntary co-operation rests on the elementary … proposition that both parties to an economic transaction benefit from it, provided the transaction is bilaterally voluntary and informed. Exchange can therefore bring about co-ordination without coercion. A working model of society organised through voluntary exchange is a free enterprise exchange economy … competitive capitalism.

The voluntariness of choice is identified as a condition of the competitive capitalist economy being efficient and just, and the transaction being bilaterally voluntary and informed is identified as a condition of voluntariness. But voluntariness is conceived as wholly the property of the individual participant in the exchange rather than in part a property of the exchange relationship, and this leads to a serious mistake about the nature of the state which will support the market.

Friedman, of course, is committed to the most thoroughgoing notion of freedom of contract and in particular thinks that:

> The existence of a free market does not of course eliminate the need for government. On the contrary, government is essential both as a forum for determining the rules of the game and as an umpire to interpret and enforce the rules decided upon (p. 15).

Friedman evidently believes that the market requires the type of, as Nozick (1974, pp. 26-28) has it, 'ultra-minimal' state which has characterised liberal political theory. I would not wish to mislead readers by allowing them to imagine that I find the ultra-minimal state attractive in terms of political theory. My point here is, however, that, writing as one who wishes to defend the liberal conception of justice as desert, the ultra-minimal state just is not a practical legal institution. It avoids 'the hard work facing any legal system based on entitlements [of] determining what constitutes … "consent"' (Barnett 1986, p. 307).[12] Even if one is anxious not to tell the parties what their contracts should be, one must collectively set the bounds to the ways they can agree if one is to make their negotiating relationships lead to optimising exchanges. To provide that transactions are '<u>bilaterally voluntary and informed</u>' is always a matter of extensive regulation of contracts. (Or rather, when we neglect it, the result is inefficient and unjust markets, exploited by those who enjoy superior bargaining power, which are illegitimate and do not bind). We simply have to come to terms with this necessity if we are to have efficient and just markets.

Conclusion: transaction costs and facilitative social structures in law and economics[13]

The problem of dealing with the necessity of regulation in pursuit of fairness can be stated in transaction cost terms as dealing with the existence of bargaining costs as the costs of establishing a market:

> In order to carry out a market transaction it is necessary to discover who it is that one wishes to deal with, to inform people that one wishes to deal and on what terms, to conduct negotiations leading up to the bargain, to draw up the contract … and so on (Coase 1960, p. 114).

In Dahlman's (1979, p. 148) classification, the specific costs of the law of contractual agreement would be treated as 'bargaining and decision costs'.[14] But confusion is introduced as the design of governance structures in transaction cost economics in general is conceived as a problem of 'reducing transaction costs...in relationships' (Goetz and Scott 1983, n. 5), for these costs are regarded as a type of friction obstructing the transactions: 'Friction, the economic counterpart for which is transaction costs, is pervasive in both physical and economic systems' (Williamson 1989, p. 87). Transaction cost engineering should be directed towards the 'perfectly frictionless' assumptions on which neo-classical analysis is based (Walras 1874, p. 84).

In new institutional economics it is (almost) always allowed that these 'frictionless ideals' are unachievable (Williamson 1979, p. 124), that zero transaction costs (and therefore general competition) is 'a very unrealistic assumption' (Coase 1960, p. 114), and indeed the best institutional economics, by 'always keep[ing] an eye open that to the fact that transaction costs are here to stay' (Dahlman 1979, p. 161), generates a most welcome caution about what we can hope to achieve through the mechanisms we create. Coase has also given real insights into the legal constitution of markets as well as public regulation. Good institutional economics, then, centrally urges the recognition that transactions at zero cost will never empirically obtain, but, nevertheless, the point is to approximate towards that ideal. However, this is a paradoxical and confusing goal because it is not properly understand why the goal is unrealisable.

I hope that this discussion of contractual agreement shows that the negotiating, information gathering, organising, etc within which transactions take place cannot be regarded only as costs, they are also the social relations which are essentially facilitative of the transaction. Negotiation is a cost, but what contract could be made without language? Information gathering is a cost, but what contract could be made in complete ignorance? All actions, including all transactions, can take place only within constitutive social relations. The stress on the reduction of transaction costs certainly should have a technical function in guiding mechanism design in appropriate cases. But it inevitably is carried too far if that technical function is confused, as it typically is in the law and economics characterised by too much traffic from economics to law, with a basic analysis of the ontological character of economic action. If one really took away all the costs of exchanging, the exchange would not take place cost free; it would not take place.

In my opinion, the argument I have made about contractual agreement in this paper should be generalised to tell us that though the transaction cost approach certainly has a very important technical function, it cannot begin to stand as an understanding of economic actions. That action is fundamentally normative, and if we are to utilise something like individual utility maximising assumptions, it can be only within a normative framework. I have my own views on how this should be done which most resemble, in the contemporary economic literature, Sen's (1979) 'basic capacity equality', but I do not wish to say anything about this here. It has not been my aim to show how this should be done but to show that it must be done and that, despite the individualism of the language of consensus ad idem, freedom of contract, revealed preference, individual utility maximisation, choice, etc, it is being done. Of course, that it is being done without being known to be being done means that it is

being done badly. But the fact that it is being done is the best ground we can have for thinking that, done self-consciously, it might be done better.

Arrow (1969, p. 151) concluded his principal contribution to the transaction costs literature by driving towards something like the point I am trying to make:

> It is mistake to limit collective action to state action; many other departures from the anonymous atomism of the price system are observed regularly. Indeed, forms of any complexity are illustrations of collective action, the internal allocation of their resources being directed by authoritative and hierarchical controls. I want, however, to conclude by calling attention to a less visible form of social action: norms of social behaviour, including ethical and moral codes. I suggest as one possible interpretation that they are reactions of society to compensate for market failures. It is useful for individuals to have some trust in each other's word. In the absence of trust, it would become very costly to arrange for alternative sanctions and guarantees, and many opportunities for mutually beneficial co-operation would have to be foregone.

This indication that there is a role for trust <u>in</u> markets seems to give a larger role to it than is typical of the way that trust features in institutional economics, as a sort of alternative to markets. This obviously is the case in non-market situations, such as Arrow's example of the firm, where 'trust' features as a corporate culture of belief in the authority of the executive (Williamson 1993, sec. 3.6). But even when a contract is being analysed, trust features as a sort of fall-back when normal economic orientations are thought not to work because, say, of asset specificity (Williamson 1983). However, Arrow's is a perception that 'there is an element of trust in every transaction' (Arrow 1984, pp. 104-5) and this perception leads him to say:

> In many ways the prevailing neo-classical "paradigm"...is deficient because it ignores the social-structural basis (Arrow 1972, p. 183).

I am not competent to say a great deal about the fundamental issues of the sociological character of the nature of economic action which this observation raises. I wish to say only that, from the point of view of practical institutional engineering, what Arrow calls the neo-classical paradigm <u>is</u> deficient in ways which both law and

economics and new institutional economics after Coase have not properly taken onboard (Campbell 1996a). Rational economic action has a normative aspect which cannot be reduced to amoral individual maximisation with any results other than an increase in the theoretical complexity and a decrease in the empirical plausibility and moral attractiveness of our accounts of such action.[15] In order to establish a welfare optimising market, the law of contract therefore has to constitute that market in such a way that it expresses and promotes that normative aspect.[16] In contract, the actualisation of reciprocity is fairness. In law and economics, a preponderance of 'economic' criticism of 'law' has generated an uncritical respect for freedom of contract and perpetuated the unhelpful amphiboly between that freedom and regulation in pursuit of fairness. However, I think it right to say that the regulatory constitution of the market (Collins 1999) and the importance of norms in economic action are beginning to be fully appreciated. An attempt to give 'social norms' (Symposium 1996, 1997, 1998) a major place in a more sophisticated anaysis of the behavioural aspects of economic action (Sunstein 1999) characterises what has been called the 'second wave' of law and economics (Richardson and Hadfield (eds.) 1999). If it is to develop real force, this second wave will, if I may be excused some execrable mixing of metaphors, have to very markedly reverse the one way traffic law and economics has so far displayed. It can do so only if theoretical developments in new institutional economics allows a more positive attitude to be taken to the facilitative social relationships which so far have been entirely negatively described as costs.

Notes

[1] I will avoid directly addressing the abstract philosophic criticisms of the relationship of Pareto optimality and fairness (Sen 1970). From the perspective of practical institutional design taken here, Sen's paralysing theoretical argument is, in fact, weak to the point of triviality (B. Barry 1986).

[2] The argument of this paper is that a subjective law of contractual agreement is impossible, and it is implicit in this that the common claim that the law of agreement initially was subjective but became objective must be wrong, for there can never have been an (other than a fleeting) law, as opposed to commentary on the law, that was subjective (Perillo 2000). The English law of agreement is currently being subjected to pointless turmoil by appeal court judges who not only are keen to give extra-judicial statements of their views but see fit to give judgments which expand to fill theoretical categories rather than being narrowed to, so far as possible, confine themselves to the case at hand, and so have issued *dicta* supporting an impossible subjective theory: e.g. Lord Steyn (1997, p. 433): 'It is a defensible position for a legal system to give predominance to the subjective intentions of the parties. Such a policy can claim to be committed to the ideal of perfect individualised justice'; cf. Trentham (G Percy) Ltd v. Architral Luxfer Ltd (p. 25).

[3] The point I am about to make is found in Hume (1751, sec. 159 n. 1): 'It is evident, that the will or consent alone never transfers property, nor causes the obligations of a promise (for the same reasoning applies to both) but the will must be expressed by words or signs, in order to impose a tie upon any man. *The expression being once brought in as subservient to the will, soon becomes the principal part of the promise*;

nor will a man be less bound by his word, though he secretly give a different direction to his intention, and withold the assent of his mind'.

[4] The rules of civil procedure are, of course, more concerned with these problems.

[5] For modern authority see Storer v. Manchester City Council (p. 828).

[6] The specific context in which Manne put forward his views was a criticism of insider dealing regulation, and I have dealt with this particular instance of the general argument about normative regulation of economic action which I wish to make here elsewhere (Campbell 1996c). These views of Manne's are, of course, part of his contribution to the agency theory of the firm, which is the context in which Demsetz put forward the views quoted. I have criticised the amorality of that theory in Campbell (1997b).

[7] Welfare economics of course recognises a social dimension to the revelation of preferences when it makes such revelation subsequently conditional upon effective demand. This, as it were, two stage analysis allows questions of distributive justice to be eliminated from the first theorem of welfare economics and confined to a second theorem which considers the initial allocation of endowments. It is an implication of the argument of this paper that I do not believe that this separation ultimately is sustainable, but I do not want to take up this issue here. I am here directing my comments at a social dimension of Pareto efficiency itself, such efficiency being, of course, a necessary if not, in the two theorem structure of welfare economics, a sufficient condition of market allocations being just. There arguably are other social influences on the formation and revelation of preferences which a welfare assessment of market exchange is obliged to address but which I shall not address here.

[8] It may well be the case that a rationale along these lines has to be pursued in the criminal law, which takes up the issue of duress with a different purpose, though an analogy to the law of contract has played an important part in the development of the criminal law of duress (Lynch v. DPP of Northern Ireland). The fact that contract does not in fact deal with issues of the ultimate reality of consent in situations of duress allows us to avoid the extremely difficult philosophical problems about the nature and extent of the freedom of the will which criminal law is obliged to face. In Lynch the issue was determining responsibility for participation in murder under very present threat to one's own life.

[9] The abandonment of this doctrine of 'just price', is taken to be the principal sign of the establishment of the modern law of contract (Atiyah 1979, pp. 61-65, 169-177).

[10] It is highly arguable that the customer can never be sufficiently competent to allow of a market in this industry, and that, inter alia, in the interests of security, pensions should be directly provided by the state (Hudson 2000). Even if this is so, I believe it merely emphasises the point I am trying to make.

[11] Of course, one this was recognised the system would become open to general evaluation of its welfare effects, which is precisely what thinking it is a free market outside of regulation prevents. This is, in my opinion, a very serious mistake (Campbell and Picciotto 2000).

[12] I should point out that Barnett, whom I quote here, is a very radical libertarian who would disagree with the use I am making of his argument against Nozick.

[13] Much of the conclusion of this paper is a revision of Campbell (1997a).

[14] Danzig (1978) is a most striking general illustration of these costs by use of actual legal cases.

[15] This is, in essence, how I would describe the results of game theoretic accounts of the fundamental moral constitution of exchange. Game theory does, of course, have its place within delimited moral boundaries for which it cannot itself plausibly account. The issue, into which I cannot go here, is what B. Barry (1995, pp. 39-46) describes as the inadequacy of conceiving of justice as mutual advantage and the necessity of appreciating justice as impartiality.

[16] I have analysed the dreadful results of the failure to do this in the neo-classical strategy for the development of former second and third world countries in Campbell (1999; 2001a).

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