Contract Law and the Social Contract: Rethinking Law Reform in the Field of Contract Law from the Perspective of Social Contract Theory

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I. Introduction

Recently, a number of EU jurisdictions have embarked upon landmark reforms of their laws of obligations, albeit to a different extent and in a different form.[1] Hungary, for instance, enacted a new civil code in 2013 (Hungarian Act V of 2013).[2] The UK enacted its Consumer Rights Act 2015 which introduced significant changes to its consumer law and which entered into force on October 1st, 2015. After decades of fierce debate,[3] France overhauled its law of obligations with *Ordonnance* n° 2016-131 of 10 February 2016. The aforementioned legislation enacted the 'controversial,' from a French perspective, concept of *imprévision*[4] but attempted to delete[5] cherished notions of French law such as the *cause* (basis of contract) which has been embraced by many jurisdictions which built their law of obligations on the basis of the *Code civil.* It is also worth mentioning that these changes have occurred in the context of a largely stagnated attempt by EU institutions to harmonize the law of obligations of EU Member States by introducing common principles.[6]

As Serbia is on the verge of implementing a large-scale reform in its law of obligations—Book II of the draft proposal for a civil code put forward in 2014 purports to introduce 'significant' changes

[1] Note there was a prior surge in law reforms in the 1990s: former-communist countries, which are now part of the EU, modified their legislation to adapt it to a market economy post-1989, the Netherlands implemented a new civil code in 1992, Germany amended its *Bürgerliches Gesetzbuch* (BGB) in 2001, etc.

[2] It replaced the Hungarian Act no IV of 1959.

[3] It is not thus surprising that France implemented the reform via an ordonnance as this special piece of legislation does not pass through Parliament.

[4] French courts have been long divided about the merits if this principle which allows the modification or termination of agreements when performance becomes excessively onerous through no fault of either party due to unforeseeable events. In the leading decision Canal de Craponne (1876), the *Cour de cassation* held that courts, no matter how equitable it seemed, could not consider the time and circumstances in order to modify agreements between parties and substitute freely negotiated clauses with new ones. Contrast with the approach of French judges to onerous performance in administrative contracts: with its *arrêt* Gaz de Bordeaux (1916), the *Conseil d'Etat* decided that the city of Bordeaux owed an indemnity to a concessioner which maintained the public lights in the city because the price of coal had increased five times since the time of entry, the price in the contract was no longer relevant to the new circumstances, and the change could not have been foreseen. See Yves Lequette, François Terré and Henri Capitant, *Les grands arrêts de la jurisprudence civile* (12 edn, Dalloz Bibliothèque 2008) 183-92.

[5] While the *ordonnance* removed the explicit references to the cause, the principle seems to have remained in spirit: for instance, the new article 1128 defines 'licit content' as a condition of validity of contract and the new article 1169 voids agreements in case counter-performance is 'illusionary' or 'derisory.'

[6] For the past 30 years EU scholars and politicians alike have debated the merits of harmonization. While once the European Commission even considered the idea of implementing a European Civil Code, the initiative at this point is confined to piecemeal consumer directives. For an overview of the development of the initiative, see Chapter 1 in Radosveta Vassileva, 'Change of Economic Circumstances in Bulgarian and English Law. What Lessons for the Harmonization of Contract Law in the European Union?' (Doctoral Thesis, University College London 2016).

to the current legislative framework,[7] it seems interesting, from a comparative perspective, to consider to what extent Serbia can benefit from the experience of others, having in mind that there are some negative lessons to be learned as well. Notably, when one examines the evolution of debates regarding both recent national and supranational initiatives for law reform, one notes a key similarity. Law reform is persistently portrayed as a *technical* matter involving two decisions: 1) what instrument should we use? 2) which are the better principles to include in that instrument? To illustrate, the European Commission has been traditionally preoccupied with the form that harmonization of the law of obligations in the EU should take.[8] Moreover, it consistently calls for the selection of the common, better, balanced and simple legal principles.[9] One could observe somewhat similar concerns in France regarding the choice of principles—French scholarship was so divided about the merits of *l'imprévision*,[10] that it is not surprising that the French President opted to implement the reform via an *ordonnance*, as mentioned above, possibly to preclude such dead-end debates from continuing in Parliament.

Without underestimating the importance of discussing technical matters, it is relevant to stress that immersed in discussions over wordings and necessity of specific principles, commentators often ignore deeper questions—this issue has already been raised by some academics particularly in light of the on-going initiative to implement common principles of the law of obligations in the EU. It has already been asserted that the rule-based approach to drafting harmonization instruments lies on the assumption that 'common rules equate with common solutions to legal problems,' thus ignoring context and the values these rules incarnate.[11] Moreover, it has been emphasized that the fact that a common core of European private law exists does not imply the superiority of that solution: the choice

[7] See the introduction to Book II of the proposal.

[8] In 2009 the Commission published the so-called Draft Common Frame of Reference (DCFR) which has the scope and purpose of a civil code. In 2010, it published a green paper proposing seven options for DCFR's future among which a regulation on a European Civil Code, a regulation on European Contract Law, a toolbox, etc.; The text has remained an academic undertaking; Subsequent debates involve the choice between directives which have to be transposed and regulations which are immediately applicable in Member States.

[9] In its 2003 Communication, the Commission emphasizes with regard to the then future Common Frame of Reference: 'Advantage should be taken of existing national legal orders in order to find possible common denominators, to develop common principles and, where appropriate, to identify best solutions,' COM(2003) 68 final, page 17; In the Common European Sales Law (CESL) proposal, the Commission also maintains that CESL 'should identify well-balanced solutions,' COM(2011) 635 final, page 21; In the recent proposals for directives on contracts for the supply of digital content and contracts for the online and other distance sales of goods, the Commission emphasizes the necessity of 'simple and modern rules,' COM(2015) 634 final, page 6 and COM(2015) 635 final, page 8.

[10] This is particularly evidenced by prior scholarly initiatives for the recodification of the French law of obligations. The avant-projet Catala (2005) does not accord the judge the right to modify agreements in case of impracticability while the avant-projet Terré (2009) does.

[11] Lucinda Miller, 'Specific Performance in the Common and Civil Law' in Paula Giliker (ed), *Re-examining Contract and Unjust Enrichment* (Nijhoff 2007) 285.

of rules depends on whether one adopts efficiency or morality as a guiding principle.[12] Yet, others have underlined that selecting principles of contract law for the EU involves political choices[13] and that principles could be qualified as 'leftist' if they promoted solidarity (altruism) and 'rightist' if they promoted autonomy.[14]

This paper attempts to contribute to the debate on the disadvantages of a rule-focused rhetoric concerning law reform in the field of obligations by showcasing the possible, yet complex links that exist between contract law and social contract theory.[15] Although the social contract is a rational concept and not an historical event, the prominence of particular ideas about governance in a jurisdiction, especially at the time key principles of contract were formulated, may provide insights regarding the function that has been attributed to contract and the role assigned to the judge. By examining the 'social contracts' embedded in the contract laws of two jurisdictions, which have different paths of historical and social development—England, an established market economy, and Bulgaria, a former-communist State which only joined the EU in 2007, the paper highlights why contract law is not merely a set of technical rules, but forms part of a jurisdiction's social model.

Why might this issue be of concern for Serbian law reform? The question has primarily theoretical and symbolic importance: what 'social contract' is embedded in the draft proposal for a civil code? Nonetheless, one may also speculate that it has practical significance. As will be argued, national judges interpret contractual principles from the perspective of their understanding of what the national 'social contract' is or should be. In other words, if judges believe that a new legal principle imposed by the legislator violates the terms of the 'social contract' of their jurisdiction, they may engage in legal creativity to circumvent it.

II. Contract Law and the 'Social Contract'

In the 1930s the Bulgarian jurist Lyuben Dikov published a series of articles dedicated to the relationship between contract law and social theory in prestigious journals and editions in Bulgaria, Germany, France, and Italy.[16] The originality of his articles consists in highlighting the usefulness of

[12] Jan Smits, 'European Private Law and the Comparative Method' in Christian Twigg-Flesner (ed), *The Cambridge Companion to European Union Private Law* (CUP 2010) 36.
[13] Martijn Hesselink, 'Five Political Ideas of European Contract Law' (2011) 2 ERCL 295.
[14] Martijn Hesselink, 'The Politics of a European Civil Code' (2004) 10 ELJ 675, 676.
[15] With some exceptions, literature on the possible, yet complex links between contract and social contract is largely missing. Valcke has recently suggested that social contract theory may be helpful in understanding the differences between French and English contract law, Catherine Valcke, 'On Comparing French and English Contract Law: Insights from Social Contract Theory' (2009) IV JCL 69.
[16] 'Il Diritto civile dell'avvenire' (1931) 11 Rivista internazionale di filosofia del diritto 153-180; 'Norma giuridica e volontà privata' (1934) 14 Rivista internazionale di filosofia del diritto 681-706; 'The Evolution of Contract' (1938) 33 Annuaire de l'Université de Sofia 437-52, published in France as 'L'évolution de la notion de contrat' in *Etudes de droit civil à la mémoire de Henri Capitant* (Dalloz 1939) 201-18; 'Die Abänderung von Verträgen den Richter' in *Hedemann-*

social theory in *explaining and redefining* contract. While Dikov's articles have been ignored and forgotten,[17] they may prove helpful in exposing fundamental conceptual differences between jurisdictions which go beyond the divergences of legal principles and values.

Dikov emphasized that concepts such as will, legal norm, contract, etc. were simply 'incarnations of the leading social-philosophical systems during a given historical period.'[18] Dikov maintained that law had a historical, a political, and a philosophical dimension.[19] Yet, he believed that the philosophical dimension had the strongest influence. The scholar distinguished two main types of social-philosophical theories that explained the relationship between the individual and society—individualism and universalism. He also differentiated two subtypes of individualism—liberal and democratic. Dikov contended that each of these social systems had given rise to distinct notions of contract, private will, and legal norm.[20]

Before explaining these three distinct concepts, it should be emphasized that Dikov argued that law was in transition and one could find elements of all of these concepts operating simultaneously.[21] He also believed that individualist or universalist concepts of contract had to be invoked depending on the problem that had to be solved—the choice of concept and the timeframe of its operation depended on 'legal policy.'[22] In that light, Dikov was a proponent of a dynamic approach to legal certainty[23] (greater freedom of the courts) and believed that judges needed proper tools to address the issues they confronted.[24]

A. Individualist Notions of Contract

The central element and starting point of both liberal and democratic individualism is the human being: in both frameworks society is regarded as the total sum of individuals. However, the two social-philosophical systems differ in the authority they bestow upon the State. Dikov identifies as liberal individualists representatives of the Enlightenment from the 17th and 18th century—Hobbes, Locke,

Festschrift (Jena 1938), published in Bulgarian as 'Modification of Contracts by the Judge' in *Modification of Contracts by the Judge* (Feneya 2010) 15-31.

[17] The rise of communism in Bulgaria in 1944 was accompanied by purges. As a prominent scholar, Dikov was sent to concentration camp, stripped off his academic honors, and his work was deemed 'Fascist.' Throughout his life he had been district judge, Dean of the Law Faculty of Sofia University, Rector of Sofia University, Minister of Justice. Dikov had written the first Bulgarian textbooks on merchant law. His treatise on the law of obligations and family law as well as his numerous articles are some of the most sophisticated examples of Bulgarian legal writing.

[18] Dikov, 'The Evolution of Contract' (n 16) 438.

[19] ibid.

[20] ibid 444-47.

[21] Dikov, 'Norma giuridica e volontà privata' (n 16) 706; Dikov was writing in the interwar period, characterized by a clash of values and ideas of governance.

[22] Dikov, 'Modification of Contracts by the Judge' (n 16) 29.

[23] Dikov, 'Il Diritto civile dell'avvenire' (n 16) 173.

[24] Dikov was convinced that the *Code civil* whose rules on obligations and contracts Bulgaria had borrowed from the 1865 *Codice civile* were outdated and inadequate, Lyuben Dikov, *Morality and Law* (Imprimerie de la Cour 1934) 15-16.

Rousseau, and Kant.[25] Despite the differences in their social contract theories, all of them argue that men are born free and independent and dispose of natural rights. However, men enter into a social contract[26] and transfer *some of their rights* to the State, while preserving certain rights for themselves (what Dikov calls 'a private sphere of activity').[27] In this framework, the State creates legal norms applicable to all individuals. Nonetheless, in their private spheres of activity, individuals make their own 'private laws' known as contracts, which have the force of law only for the individuals entering into them.[28] Dikov contends that this logical consequence of the liberal individualist social contract is incarnated in article 1134 of the version of the *Code civil* at the time.[29]

By contrast, Dikov identifies as proponents of democratic individualism authors from the early 20th century—Kelsen, del Vecchio, Merkl, etc.[30] What is common between the theories of these authors is that individuals transfer *all of their rights* to the State, while in return the State allows them to act freely within limits. From this perspective, contracts between individuals cannot be equated to law. Rather, a contract is a tool for regulation of private legal relationships within the limits of freedom of contract delineated by the State through its laws. Contracts do not create law, but legal relationships giving rise to rights, which are recognized by the law.[31] While they differ significantly in their approach to the origin of contractual rights, both liberal and democratic individualism result in a natural opposition between the interests of the individual and those of society.

Although French authors have proposed to resolve this problem in the framework of liberal individualism by introducing the idea of contractual solidarity,[32] Dikov believes that solidarity only reduces, but does not eliminate the tension—solidarity simply constitutes a restriction in the name of public interest.[33] Furthermore, solidarity has found only limited application by the *Cour de*

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[25] Dikov, 'Norma giuridica e volontà privata' (n 16) 684.

[26] These philosophers held different views regarding the state of nature and the reasons for entering the social contract. For Hobbes, life in the natural state was unbearable for man because it was 'solitary, poor, nasty, brutish, and short,' Thomas Hobbes, *Leviathan* (1651) ch XIII; For Locke, while men in the state of nature were free, equal, and independent, enjoyment of property was unsafe and unsecure, John Locke, *Second Treatise of Government* (1690) ch VIII and IX; By contrast, Rousseau believed that men in the state of nature were physically unequal and enjoyed an unlimited right to everything. However, they entered into society to gain civil liberty, proprietorship and moral equality. Rousseau argued, nonetheless, that the institutions of his time promoted moral inequality. See Jean-Jacques Rousseau, *Du contrat social* (1762) ch IV and ch IX. Also Jean-Jacques Rousseau, *Discourse Upon the Origin and the Foundation of the Inequality among Mankind* (1754); For Kant and Hobbes, individuals may be coerced in the social contract, while for Locke they enter voluntarily. See John Locke, *Second Treatise of Government* (1690) ch VIII, Immanuel Kant, 'Theory and Practice' (1793), Thomas Hobbes, *Leviathan* (1651) ch XII.

[27] Dikov, 'The Evolution of Contract' (n 16) 443.

[28] Dikov, 'Norma giuridica e volontà privata' (n 16) 685.

[29] 'Agreements lawfully entered into take the place of the law for those who have made them.'

[30] On the differences between their theories, see Dikov, 'Norma giuridica e volontà privata' (n 16) 687-97.

[31] Dikov, 'The Evolution of Contract' (n 16) 444.

[32] In the early 20th century, Gény, Duguit and Gounot reacted against legal positivism and advocated contractual solidarity as a mechanism to correct the inequality of the bargain.

[33] Dikov, 'The Evolution of Contract' (n 16) 452.

cassation[34] which, for example, refuses to recognize changed economic circumstances (*imprévision*) in civil contracts to this day, as noted above.

B. A Universalist Concept of Contract

Dikov argued that the ultimate conflict between social and individual interests can be resolved through the prism of universalism—an organic theory of the relationship between the individual and society by the Austrian philosopher Othmar Spann who was inspired by German philosophical idealism. Spann was looking for an alternative to capitalism (individualism) and Marxian socialism. [35] In his frame of reference, the starting point is society rather than the individual. Individuals are perceived as cells of an organism (society). Just like cells, they cannot exist by themselves, but only make sense as parts of the whole. From this perspective, what is good for the organism is good for every individual cell as well as for groups of cells and vice versa.[36] Moreover, there is no social contract as society precedes the individual. In contrast to communism, which denies private will and promotes equality (in the sense of sameness), in an organic framework the members of the community have certain freedoms and stay united in difference.

Before explaining why Dikov thought that Spann's theory was fundamental for revolutionizing contract law, an important clarification should be made. Spann's theories were misused by the Nazis to defend their totalitarian regime and limit free will which is why universalism has a bad name in Germany. However, it has been argued that the bad reputation is not justified. Scholars have underlined the fundamental differences between Spann's theories and Nazi ideology.[37] Spann himself suffered from the Nazi regime: following the annexation of Austria to Nazi Germany, he was imprisoned by the Nazis and was banned from teaching at the University of Vienna.[38] Similarly to Bulgarian scholars during communism, academics in Fascist States at the time had to bow to the regime to avoid persecution.[39] Also, it has been emphasized that some of Spann's ideas are still 'prominent…in contemporary German political and legal culture'[40]

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[34] On the limited importance of contractual solidarity in French law, see Jean Cédras, 'Le solidarisme contractuel en doctrine et devant la Cour de cassation' in *Rapport 2003 de la Cour de cassation* (la Documentation française 2004) 186.
[35] For an introduction to his theories in English, see Bart Landheer, 'Othmar Spann's Social Theories' (1931) 39 J.Pol.Econ 239.
[36] Dikov, 'The Evolution of Contract' (n 16) 447.
[37] See Samuel Rosenberg, 'Three Concepts in Nazi Political Theory' (1937) 1 Science & Society 229-30; Tomas Riha, 'Spann's Universalism—The Foundation of the Neoromantic Theory of Corporative State' (1985) 31 AJPH 255-268.
[38] For a summary of his biography and a comparison of his intellectual contributions to those of rival Austrian scholars, see Tamara Ehs, 'The Other Austrians' (2011) 2 Journal of European History of Law 16-25.
[39] This of course does not mean that there were not scholars who were supportive and convinced in the virtues of these regimes. However, due to fear of 'witch-hunting,' many academics had to adapt their work to pass through censorship, which has also led to subsequent, often unjust labeling of their work.
[40] Anthony Carty, 'Alfred Verdross and Othmar Spann: German Romantic Nationalism, National Socialism and International Law' (1995) 6 EJIL 78, 97.

Dikov believed that universalism could fundamentally redefine contract. From an organic perspective, he argued, contract is a legal relationship between members of the legal community and can only exist within the legal community. Because of the dependence of all cells to one another and to the whole, contract is not isolated from the organism[41] (no private sphere of influence). Thus, contract is a *unity of subjective and objective will*—the will of the parties and the will of the community. The terms of contract are determined not only by the parties' will, but also by the will of the legal community as expressed in legislation and the concrete requirements for good faith and mutual trust.[42] Dikov clarified that the limitations that laws put on freedom of contract are not true restrictions, but unavoidable consequences of the dependencies that cells have upon one another and society. These dependencies result in relative freedom of self-determination.[43]

Dikov himself used the theory to justify judicial intervention in contracts. He argued that if the State is a party to a contract, it had to intervene when the enforcement of contract as written was harmful to the community. As the *speaker of the community*, the judge is the only figure of authority that can interfere in its name.[44] The requirement for contractual fairness is a natural consequence of the belonging of the individual units to a community, which precedes them.

III. Applying Dikov's Typology

Dikov's typology is helpful in expounding that contract law is socio-politically biased because, from a theoretical perspective, it forms part of the State's social contract. This section examines the 'social contracts' embedded in the contract laws of two jurisdictions, which have different paths of historical and social development—England and Bulgaria, to show that Dikov's typology can also serve as a lens delineating fundamental divergences between national contract laws.

Without any major political turbulence, England has witnessed a gradual development of its contract law within the same framework—liberal individualism. By contrast, Bulgaria's turbulent political past resulted into a major evolution of its social contract—thus, its current contract law is predominantly organic.[45]

A. The Private Sphere of the Individual in English Law

English contract law began developing in the late 18th and early 19th century which were dominated by liberal individualist thought and which had seen the industrial revolution and the rise

[41] Dikov, 'The Evolution of Contract' (n 16) 446.
[42] ibid 450.
[43] ibid 446.
[44] Dikov, 'Modification of Contracts by the Judge' (n 16) 25-28.
[45] Note unlike other former-communist countries, Bulgaria has not carried out a major reform of its law of obligations.

of capitalism. Freedom and equality between people, despite their social status, were embraced as key organizing principles as England moved away from feudalism.[46] In the same period, English courts borrowed the will theory from the writings of Pothier[47] which had informed the drafting of the *Code civil*[48] and assigned it a key role.[49] In the so-called 'classical model' of English contract, free dealing was synonymous to fair dealing.[50]

A brief overview of the modern English legal landscape demonstrates that English judges have largely remained committed to freedom of contract and refuse to intervene in agreements to avoid making contract for the parties. This approach is in line with the main idea of liberal individualism—citizens dispose of both inalienable rights and rights they transfer to the sovereign. The rights that parties keep for themselves are sacred and, consequently, so is their freedom to enter into agreements with one another. In their inalienable 'private spheres'—in the language of Dikov—they are free to make contracts which result in rights and duties only for them. The State's responsibility involves the interpretation and enforcement of the rights and duties that the parties have *explicitly* agreed upon. The State can neither make laws violating the citizens' inalienable rights nor can it intervene in their private spheres unless the parties unambiguously want it to.

In the instances common law judges have combatted issues of substantive unfairness in modern times, they have relied exclusively on the 'tools' permitted from a liberal individualist standpoint, thus preserving English contract law's internal consistency and focus on the individual. Traditionally, the English common law, unlike Bulgarian law, as discussed below, uses the will theory itself as an instrument to remedy unjust outcomes or as an excuse not to. In essence, judicial activism is confined to developing the will theory because the judge cannot enter the individuals' private spheres of influence. As noted above, in a liberal individualist framework, the individual has transferred only *some of his rights* to the State—based on this partial transfer, the judge may intervene only for public policy reasons. However, there are boundaries that he cannot cross.

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[46] See Peter Gabel and Jay Feinman, 'Contract Law as Ideology' in David Kairys (ed), *The Politics of Law* (3rd edn, Basic Books 1998) 497-510.

[47] His *Traité des obligations* of 1761 was translated into English in 1806 and served as inspiration for English judges: Pothier's version of the will theory impacted the analysis of the nature of the agreement, mistake, and assessment of damages in English law, David John Ibbetson, *A Historical Introduction to the Law of Obligations* (OUP 1999) 220-29.

[48] James Gordley, 'Myths of the French Civil Code' (1994) 42 Am.J.Comp.L. 459, 460.

[49] In *Printing and Numerical Registering Co v Sampson*, Sir Jessell MR famously said: '…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.' (1874-75) LR 19 Eq 462, 465.

[50] Roger Brownsword, *Contract Law: Themes for the Twenty-First Century* (2 edn, OUP 2006) 50.

One of the strategies, which the common law employs to achieve just outcomes, involves establishing vitiation of the agreement.[51] English law has developed various principles like mistake, misrepresentation, duress, etc. The purpose of all of them, nonetheless, is to demonstrate that the contract as written does not indicate the true will of the parties—by intervening judges do not make contract for the parties, but enforce their rights to 'legislate' in their private sphere of influence. In addition, these doctrines have rather narrow scopes[52]—a further illustration of English judges' concern not to lightly interfere with the individuals' private spheres.[53] Even Lord Denning's inequality of bargaining power principle enunciated in *Lloyds Bank Ltd v Bundy*,[54] which has not been subsequently retained, does not go beyond the limits of judicial discretion delineated by liberal individualism. Denning had emphasized: 'One who is in extreme need may knowingly consent to a most improvident bargain, solely to relieve the straits in which he finds himself.'[55] In other words, the agreement had been vitiated.[56]

Furthermore, while modern English law seems to have departed from the rigidity of literalist interpretation[57] notably with Lord Hoffmann's restatement[58] of the principles of construction in

[51] Traditionally, English judges show concern for substantive unfairness only if it is related to procedural unfairness. While judges diverge on how consideration should be established—factually or as a question of law—they are concerned about its sufficiency but not its adequacy. See Mindy Chen-Wishart, 'Consideration: Practical Benefit and the Emperor's New Clothes' in Jack Beatson and Daniel Friedmann (eds), *Good Faith and Fault in Contract Law* (Clarendon 1995) 139.

[52] For instance, in the leading decision *Bell v Lever Bros* [1932] AC 161, the House of Lords refused to recognize a mistake as to the loyalty of directors as fundamental enough to avoid a compensation agreement; Prior to the Misrepresentation Act 1967, English law granted relief only for fraudulent and negligent misrepresentation, which are difficult to prove. See, for instance, *Derry v Peek* (1889) 14 App Cas 337 and *Hedley Byrne* [1964] AC 465; Contradictory case law on duress demonstrates the difficulties judges face in formulating how much pressure is necessary to set aside an agreement. In *CTN Cash and Carry* [1994] 4 All ER 714, a threat to withdraw a credit line was considered legitimate while in *B&S Contracts* [1984] ICR 419 a threat to cancel a contract unless an additional sum was paid was deemed as evidence of duress.

[53] It is interesting to note that this concern has been embraced by common law scholars as well. Chen-Wishart, for instance, emphasizes that in a market economy a 'knowledgeable party should generally be allowed to take advantage of a less knowledgeable party' and that 'parties are under no obligation to help one another,' Mindy Chen-Wishart, *Contract Law* (5th edn, OUP 2015) 216 and 258.

[54] [1975] QB 326.

[55] ibid.

[56] *Laesio enormis* (extreme necessity) is one of the vitiating factors recognized in the Bulgarian LOC (articles 27 and 33); A similar idea is incarnated in article 1118 of the former version of *Code civil.*

[57] Common law doctrine distinguishes two schools of interpretation—the literalist and the purposive school. The literalist school (traditional approach) endorses the literal interpretation of contract. It seeks to identify the objective intention of the parties, abides by the ordinary meaning of language, and admits extrinsic evidence only in cases of ambiguity. The purposive school, by contrast, seeks to identify the meaning that the contract would convey to a reasonable person, prefers a common sense approach to the meaning of language, and does not recognize ambiguity as a precondition for the use of extrinsic evidence. Gerard McMeel, 'The Principles and Policies of Contractual Construction' in Andrew Burrows and Edwin Peel (eds), *Contract Terms* (2nd edn, OUP 2009) 39-41.

[58] At [1998] 1 All ER 98, 114, Hoffmann claims to have consolidated principles that were already stated by Lord Wilberforce in *Prenn v Simmonds* [1971] 3 All ER 237 and *Reardon Smith Line* [1976] 3 All ER 570; Scholars have observed that the principles defined by Hoffmann are 'widely applied by the courts and accepted by academic commentators,' See David McLauchlan, 'Contract Interpretation: What is It about?' (2009) 31 SLR 5, 6.

Investors Compensation Scheme Ltd,[59] the individual (and his will) have remained the points of departure for analysis. Lord Hoffmann defines interpretation as 'the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.'[60] There is certainly debate about the significance of this change of method of interpretation.[61] Nonetheless, it should be noted that in purposive construction, judicial discretion is limited to choosing the meaning which is deemed reasonable in the context—judges cannot impose interpretations which the words as written in the contract cannot bear.[62] Moreover, recent case law suggests judges are cautious to over rely on context, thus remaining focused on the language that parties themselves used.[63]

The peculiar doctrine of frustration also illustrates how careful judges are to restrain their activism within the limits imposed by English law's liberal individualist framework. In *Taylor v Caldwell*, the decision from which the doctrine of frustration emerged, Blackburn J grounded his conclusions on an implied condition.[64] In *Davis Contractors Ltd*, the decision which established frustration's modern test, the principle was grounded on the radical change of the promise[65]—Lord Radcliffe declared that a contract could be frustrated only if due to the radical change in circumstance, the party has to do something that it did not promise to do. In principle, judges encourage parties to include detailed force majeure/hardship clauses in their agreements to distribute risk and to determine the effects of supervening events by themselves.[66]

Finally, in modern times market individualism has been challenged by a rival ideology—consumer welfarism. Nonetheless, this transition to promoting fairness in certain agreements has not altered the underlying framework of English contract law. In Dikov's language, statutory instruments

[59] [1998] 1 All ER 98.
[60] ibid 114.
[61] McMeel emphasizes that the differences between the literalist and the purposive approach are, largely, differences of emphasis. McMeel (n 59) 39. Collins characterizes the opposition between the two schools as a 'fissure of legal reasoning.' Hugh Collins, 'Introduction: The Research Agenda of Implicit Dimensions of Contract' in David Campbell and others (eds), *Implicit Dimensions of Contract* (Hart 2003) 7.
[62] In *Burntcopper Ltd* [2014] EWHC 148 (Comm) [24], Judge Mackie QC declared: 'Where there are competing meanings the court will choose the more *commercially sensible* of rival interpretations of express terms.'
[63] In *Arnold v Britton* [2015] UKSC 36 at [17] Lord Neuberger explicitly emphasizes that 'the reliance placed in some cases on commercial common sense and surrounding circumstances…should not be invoked to undervalue the importance of the language of the provision which is to be construed.' In the said case, the UKSC upheld a clause providing for yearly indexation of service charges in lease agreements which had detrimental consequences for the lessees: by 2072 the lessees will have to pay £550,000 a year.
[64] (1863) 3 B & S 826, 833.
[65] [1956] AC 696, 729.
[66] In *Joseph Constantine* [1942] AC 154, 163, Viscount Simon LC declared: 'There can be no discharge by supervening impossibility if the express terms of the contract bind the parties to performance, notwithstanding that the supervening event may occur'; See also William Swalding, 'The Judicial Construction of Force Majeure Clauses' in Ewan McKendrick (ed), *Force Majeure and Frustration of Contract* (2nd edn, Lloyd's Press 1995) 18.

like the Consumer Rights Act 2015 can be interpreted as attempts to mitigate the injustices of liberal individualism—restrictions in the name of public interest. Essentially, such acts protect the private sphere of influence of individuals who are unable to defend their inalienable rights themselves—consumers. Nonetheless, from an English perspective, fairness and freedom of contract are still perceived as rival values and the tension between them has neither been eliminated in theory nor in practice. This is particularly visible in decisions like *Office of Fair Trading v Abbey National*[67] and *Cavendish Square Holding BV v Talal El Makdessi, ParkingEye Limited v Beavis*[68] in which the UK Supreme Court ruled against consumers.[69]

B. The Individual and Society: Two Reference Points with Equal Weight in Bulgarian Law

The radical, yet piecemeal revisions of Bulgarian law due to the drastic political changes in the country have resulted into a strange paradox—the coexistence of the individualist and the universalist concept elaborated by Dikov in modern Bulgarian contract law. Unlike English law, Bulgarian law endorses two reference points that have equal weight—the individual and society.

1. The Transition from Liberal Individualism to 'Organic' Socialism

Until 1950 Bulgaria had a Law on Obligations and Contracts (LOC)[70] based on the *Codice civile* of 1865 which was largely a replica of the *Code civil*. This LOC reflected a liberal individualist approach to contracts. Parties were free to determine the content of the agreement, which had the force of law for them.[71] However, the agreement needed to have a lawful cause—not to be contrary to the law, good morals or public order.[72] When Bulgaria became a communist country, nonetheless, the 1892 LOC was abolished and a new LOC reflecting communist ideology was enacted in 1950. The communist LOC abandoned the notion that contracts have the force of law. Rather, contracts were regarded as mere tools facilitating the completion of the state economic plan.[73]

While freedom of contract was allowed, it was limited by both the economic objectives and the standards of moral behavior (socialist coexistence) endorsed by the State. Article 9 of the communist

[67] [2010] 1 AC 696.
[68] [2015] UKSC 675.
[69] In *Abbey*, the court declared that overdraft charges by banks form part of the core terms of a contract to avoid subjecting them to fairness review pursuant to Regulation 5 (now Section 62 of the CRA); In *ParkingEye,* the court held that a £85 charge for overstaying the two-hour parking limit by almost an hour was not unfair.
[70] Enacted in 1892.
[71] Article 28, para 1 of the first LOC corresponds to article 1134, para 1 of the *Code civil.*
[72] Article 27 of the first LOC corresponds to article 1133 of the *Code civil.*
[73] Article 8 of the first version of the 1950 LOC: 'Contracts are concluded and performed on the basis of the socialist political framework, socialist ownership of the means of production, and the people's economic plan. They serve the development of socialism, the fulfillment of the people's economic plan, and the defense of the material and cultural interests of socialist organizations and citizens according to the principles of socialism.'

version of the 1950 LOC stipulated: 'Parties are free to determine the content of their agreement as long as it does not contradict the law, the national economic plan and the rules of socialist coexistence.' The consequence for violations of these restrictions was invalidity. Article 26, para 1 (LOC) stated: 'Void are contracts that contradict the law or the state economic plan, contracts that circumvent the law or contracts that violate the rules of socialist coexistence…' Moreover, state entities could be forced to enter into a contract to fulfill the state economic plan in certain circumstances.[74]

What looks surprising, however, is that these restrictions can be reasoned from the perspective of the universalist approach described by Dikov—what is good for the State is good for groups of individuals (for instance, State-owned entities) and individuals themselves. Since the state economic plan is approved by the State, it is not a restriction, but a natural consequence of the fact that individuals belong to the socialist community and are building a socialist future together. Likewise, the members of the community (cells) could not violate the rules of socialist coexistence because this would impact negatively the social organism.

One of the contributions of my doctoral thesis was to demonstrate a peculiar paradox—contrary to convenient myths propagated by the Bulgarian government[75] and scholars[76] that the 1950 LOC was an original Bulgarian piece of legislation inspired by the principles of socialism, my research has shown that while the LOC is a creative compilation, it is primarily based on Book IV (and partially Book II) of the *Codice civile* of 1942, which was drafted during the rule of Mussolini.[77] In that light, it has to be emphasized that it is known that Spann, whose organic theory was mentioned above, had an important influence on Italian corporatism,[78] the philosophy that underlay the 1942 *Codice civile*. In a chapter dedicated to the motivation and character of Italian codification, Filippo Vassalli, the head of the working group that drafted the 1942 version as well as the group that defascized the code

[74] Article 11 of the communist version of the LOC; On this peculiarity of socialist law, see Stephen Szaszy, 'The Duty to Conclude a Contract in East European Law' (1964) 13 The International and Comparative Law Quarterly 1470.

[75] According to the verbatim report of the sitting of 3 November 1950, at which the LOC was enacted, the law was inspired by the Soviet Civil Code of 1922, Poland's Draft of a Bill on the General Part of Civil Law (1947) as well as Soviet doctrine.

[76] Tokushev maintains that the 1950 LOC is based on 'the principles of socialist law and planned economy.' Dimiter Tokushev, *History of the New Bulgarian State and Law 1878-1944* (Sibi 2008) 182; Kalaidjiev claims that the LOC is an original Bulgarian normative act created in accordance to the classical solutions of the continental (French-German) tradition,' Angel Kalaidjiev, *The Law of Obligations: General Part* (5th edn, Sibi 2010) 26.

[77] On the reasons which may have led to this legislative choice, see Chapter 2 in Radosveta Vassileva, 'Change of Economic Circumstances in Bulgarian and English Law. What Lessons for the Harmonization of Contract Law in the European Union?' (Doctoral Thesis, University College London 2016).

[78] On the origin, development and current state of corporatism in Italy, see Mariucca Salvati, 'The Long History of Corporatism in Italy: A Question of Culture or Economics?' (2006) 15 Contemporary European History 223; On the complex links between Spann's universalism and Mussolini's leading theoreticians, see Chiara Spinsante, 'Il corporativismo fascista: Il dibattito italiano sulla riforma corporativa dello Stato durante gli anni Venti e la sua recezione da parte del conservatorismo tedesco nella Repubblica di Weimar' (Doctoral Thesis, University of Macerata 2012).

following the fall of Mussolini in 1943, clarifies: 'The regime of obligations and individual rights is constantly adapted to the needs of the national economy either by regulatory action of the corporate order expressly referred to in the [civil] code, or by a number of criteria, such as the protection of production…the duty to act honestly and in good faith, the duty of corporate solidarity, which…tend to place the rights of individuals in an organic link with the economic life and morality of the nation.'[79] As a result of the organic influence which played a role in the code's genesis, the document provides for a larger degree of State control of agreements' contents. This organic dimension appealed to leading Bulgarian jurists at the time who were influenced by organic social theory, including Spann's views.[80]

2. From 'Organic Socialism' to a Hybrid Approach

After the fall of communism, Bulgarian legislators chose simply to amend the 1950 LOC rather than to draft a new one from scratch. They reintroduced the classical liberal individualist idea that contracts have the force of law for the parties into the LOC.[81] They also deleted the references to the state economic plan and socialist economic structures.[82] However, they did not alter the LOC's underlying organic framework. The LOC is permeated with diverse open norms[83] and principles which permit judicial intervention into agreements to enforce substantive fairness (also known as equivalence of performance[84]) and which continue to be applied in practice.[85]

For instance, article 266, para 2, applicable to manufacturing contracts, stipulates: 'If in the course of the performance of the contract the duly determined prices of materials or labor change, the compensation shall be adjusted accordingly, even where it was agreed upon as a total sum.' While Bulgarian courts have enforced this rule on a number of occasions,[86] one of the most interesting cases is Decision 1/2013 on com.c.921/2011 by the Supreme Court of Cassation which (SCC) concerns an agreement for construction between a company and a local municipality at a fixed price supposed to be paid in tranches. The company had delayed performance because of increased costs and the municipality withheld its last tranche to enforce a liquidated damages clause. While the lower courts

[79] Filippo Vassalli, *Studi Giuridici. Volume III* (Giuffrè 1960) 615.
[80] See footnote 77.
[81] Article 20a, para 1 (current LOC).
[82] Article 9 currently states: 'Parties are free to determine the content of the contract insofar as it does not contravene the mandatory provisions of both the law and good morals.'
[83] Good faith, fairness, interests of society, good morals, etc.
[84] The idea that what the promisor gives should be equivalent to what he receives.
[85] Note Bulgarian law disposes of these tools in addition to the vitiating factors such as mistake, threat, etc. as well as the subjective theory of interpretation to which it adheres.
[86] See the following decisions by the Supreme Court of Cassation: Decision 169/2003 on civ.c.2520/2002, Decision 671/2008 on com.c.290/2008, Ruling 763/2013 on com.c.1106/2012.

had stipulated that the clause was enforceable, the SCC quashed their decision because it violates article 266, para 2. Since the price of materials and labor had increased, the municipality owed the company an additional payment, which it did not make, so it caused itself the delay. Not only the liquidated damages were unenforceable, but also the municipality was ordered to pay the last tranche with interest.[87]

Moreover, organic reasoning also informs Bulgaria's legislative culture. In addition to amending the LOC in the early 1990s, Bulgarian legislators re-established the dualism of Bulgarian private law[88] by enacting a Law on Commerce (LC). Essentially, the LC contains rules applicable to merchant contracts.[89] Many of them are striking from a liberal individualist perspective. Article 300, for example, allows the judge to supplement the agreement in certain instances.[90] Article 307 allows the judge to modify/terminate a contract due to supervening onerousness upon a unilateral request by one of the parties.[91] Such legislative choices are emanations of the organic approach to contract, which has been internalized by the Bulgarian legal community. As noted above, English judges deliberately refuse to intervene in agreements and to make contract for the parties. In addition, as mentioned above, they are often reluctant to rely on legislation to enforce substantive fairness in consumer agreements. In Bulgaria, however, judges apply these interventionist principles in commercial agreements in which there is equality of bargaining power.

Finally, recent examples of judicial activism demonstrate that Bulgarian judges reason organically even when confronted with rigid legal norms. For example, unlike the LOC which allows courts to modify liquidated damages clauses in civil contracts,[92] article 309 of the LC explicitly forbids judges to scale down[93] agreed damages in merchant agreements: 'The liquidated damages due

[87] Contrast with *Davis Contractors* [1956] AC 696, a case with similar facts, in which the House of Lords refused to grant the builders an award for recovery of extra costs in *quantum meruit*. The costs were primarily incurred due to increase in the price of labor.

[88] Dividing private law into civil and commercial law. Dualism of private law has been embraced by continental jurisdictions like France and Germany. However, it is not universally accepted: Italy and Switzerland do not have autonomous commercial law. See *International Encyclopedia of Comparative Law* (1981) vol VIII, ch 2, para 167-70; Dualism does not exist in England.

[89] The LC and LOC are subsidiary.

[90] 'Where the parties agree to supplement the contract upon the occurrence of certain circumstances, and should they fail to reach agreement in the event of such occurrence, either party may petition the court to do so. When rendering its decision, the court shall take into consideration the objective of the contract, the remainder of its contents and commercial custom.'

[91] 'A court may, upon request by one of the parties, modify or terminate the contract entirely or in part, in the event of the occurrence of such circumstances which the parties could not and were not obliged to foresee, and should the preservation of the contract be contrary to fairness and good faith'; This principle has recently been applied to terminate lease agreements entered into in 2007 which had become subsequently imbalanced due to an economic crisis. See Decision 50/2010 on com.c.10/2010 of the Varna Appellate Court and Decision 240/2013 on com.c.259/2011 of the Supreme Court of Cassation; Official statistics demonstrate that the inflationary change which imbalanced the agreements was 6% (inflation was estimated at 6.5% in 2006 and 12.5% in 2007).

[92] Article 92.

[93] They can scale them up, nonetheless.

under a merchant transaction concluded between merchants may not be reduced on grounds of excessive amounts.' In the key Decision on Interpretation[94] 1/2010, nonetheless, the SCC relied on article 9 of the LOC mentioned above to declare that agreed damages clauses in any agreement are to be avoided if they contravene good morals. Because of the cosmetic amendment of article 9, the LOC preserved the organic approach to freedom of contract which characterizes Bulgarian communist law—contractual content is subjected to moral review by the judge who is society's lawful speaker. In other words, unlike English judges, Bulgarian judges dispose of larger discretionary powers and their creativity is not confined to stretching the will theory.[95]

IV. What 'Social Contract' Underlies or Should Underlie the Serbian Law of Obligations?

The previous discussion demonstrates that from a theoretical perspective contract law forms part of a jurisdiction's social model. Hence there are no 'good,' 'bad' or 'balanced' legal principles—there are principles which are compatible or incompatible with the social model of the jurisdiction in which they are supposed to operate. It thus seems that Dikov's typology of contracts may serve as a starting point for conceptual debate regarding Book II (Obligations) of the draft proposal for a Serbian civil code. Notably, what 'social contract' underlies or should underlie the Serbian law of obligations? This question is interesting from a theoretical point of view, but may also affect the application of a future Serbian civil code, particularly if the 'social contract' embedded in the legislation is in dissonance with the 'social contract' as understood and internalized by Serbian judges.

A brief overview of the Law of Obligations (LO) of 1978, which is still in force in Serbia, demonstrates that Serbian law already has 'organic' character (and is much closer in spirit to Bulgarian law) as it embraces a number of principles allowing a significant degree of judicial intervention in agreements—see articles 133-136 on changed circumstances, article 274 allowing to decrease agreed damages clauses, article 63 on mistake, etc.[96] It is interesting, however, that when one compares Book II of the draft proposal for a civil code to the LO, one notes that the drafters have not only preserved but, at times, advanced the organic framework by providing judges with further discretion regarding agreements. For instance, the draft proposal provides Serbian judges with an additional tool to control the content of agreements. By virtue of articles 39 and 42 of the proposal,

[94] These special decisions of Bulgarian courts are primary sources of law.
[95] The Bulgarian approach lies in stark contrast with the UKSC's concern that '[the] penalty rule is an interference with freedom of contract' and that it is 'based on public policy' in *Cavendish Square Holding BV v Talal El Makdessi, ParkingEye Limited v Beavis* [2015] UKSC 67 at [33] and [243]; In addition, unlike English judges, Bulgarian judges are not concerned about equality of bargaining power when qualifying an agreed damages clause as excessive.
[96] Note English law refuses to extend frustration to extremely onerous performance, as visible by cases such as *Tennants (Lancashire)* [1917] AC 495. As noted above, they generally refuse to strike out excessive liquidated damages clauses and have severely limited the scope of mistake too.

judges can void agreements whose scope or basis contravene mandatory provisions, good morals, and morality.[97] This should be contrasted with articles 49 and 51 of the current LO, which mention good morals and mandatory provisions as grounds for invalidation, but not morality. A second example involves the interpretation of contracts—article 68 of the proposal which does not have an equivalent in the current LO allows the judge to examine diverse surrounding circumstances to determine the intention of the parties like pre-contractual negotiations, good business practice, the agreement's purpose, etc., which may further subjectivism.[98]

Is the enhancement and strengthening of the organic framework of the Serbian law of obligations desirable? As a foreign scholar who has only begun to discover the richness and complexity of the Serbian legal tradition, I can only make several comparative observations. Firstly, both the liberal individualist and the organic model of contract exist in Europe and there is little sign of convergence. In that light, the introduction to Book II indicates that one of the goals of the draft is to align Serbian law to the standards embedded in EU documents pertaining to the development of a European Civil Code—a project that is now discarded for diverse political and cultural reasons including, in my humble opinion, the clash of liberal individualist and organic models.[99] By staying committed to an organic model, Serbia is making a choice which needs to be debated more openly, especially if it intends to develop a market economy. Secondly, and this can only be affirmed via discussion with judges as well as examining future case law on the civil code if it is implemented, do Serbian judges support the organic model? Is it interventionist enough for their taste or does it go too far? As demonstrated by my discussion in the previous section, English judges traditionally refuse to apply EU legislation which allows intervention in agreements. By contrast, Bulgarian judges not only find excuses to apply interventionist principles by molding their criteria of application, but also rely on creativity to avoid norms which preclude intervention. If judges do not support new rules which have been implemented, they do what they believe is right and only then seek the means to justify their solution.

[97] Contrast with the approach of English judges who traditionally refuse to strike out clauses for moral reasons such as substantive unfairness even in consumer agreements. See footnote 69.

[98] Contrast with English law which has an overt preference for literal interpretation. Also, as mentioned above, judges advocating a contextual approach refuse to examine pre-contractual evidence.

[99] The traditional opponents of harmonization in the EU are the UK, France, Belgium, the Netherlands, Austria and Germany. These jurisdictions blocked the implementation of the Common European Sales Law which was the last chance for revival of a harmonization in the law of obligations in the EU going beyond consumer law. The laws of the first three reflect liberal individualist values as they were shaped primarily in the 18th-early 19th century. The laws of the last three are well-known for their interventionist principles.

Summary/Abstract

As Serbia is on the verge of reforming its law of obligations, it seems interesting to consider the implications of such reform from a comparative perspective. In line with the theme of this year's Kopaonik School of Natural Law, this paper endorses a theoretical approach. It showcases the possible, yet complex links that exist between contract law and social contract theory by building on the work of Lyuben Dikov—an established Bulgarian authority prior to communism. Although the social contract is a rational concept and not an historical event, the prominence of particular ideas about governance in a jurisdiction, especially at the time key principles of contract were moulded, may provide insights regarding the function that has been attributed to contract law. Then, the paper examines the 'social contracts' embedded in the contract laws of two jurisdictions, which have different paths of historical and social development—England and Bulgaria, to provide concrete examples of the usefulness of Dikov's theory as a lens of analysis of contract law and to highlight why contract law is not merely a set of technical rules, but indeed forms part of a jurisdiction's social model. Hence it seems relevant to encourage debate on the 'social contract' embedded in the current proposal for a Serbian civil code as the issue has both conceptual and practical implications.