

Module 1

Purpose and Theories of Contract Law

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1. Introduction

Do you remember the last time when you downloaded the latest app on your smartphone and a little window popped up saying “*Please click to accept our terms and conditions*”, when you borrowed money from your friend with a promise to return the money after a month, or when you entered into a rent agreement with the Landlord? If yes, that was a contract you had entered into!

Almost every day, we are exposed to contracts; be it signing a lease agreement to move into a new apartment, downloading software, or even ordering a meal through the food delivery apps. These contracts formalize our relationships, by adding ‘enforceability’ into our arrangements and without contracts, our lives would indeed be full of frenzy and chaos. However, before we delve into understanding what is a contract and how to draft a good contract, let us pause and understand the purpose of a law that governs these contracts.

2. Purpose of Contract Law

The primary purpose of a contract is to enable parties to enter into legally enforceable agreements. Contract law also provides safety valves in such agreements so that if the parties are in dispute or one of the parties defaults, appropriate resolutions can be sought. In a nutshell, the purpose of contract law is to smoothen the functioning of any transaction, commercial, or otherwise. A contract also provides a transaction **certainty, predictability, and enforceability** which otherwise would not exist if the parties were to simply shake hands on a matter. As J. Beatson writes, “*a contract has an important function of securing that expectations created by a promise of future performance are fulfilled, or that compensation will be paid for its breach*”. (If you didn’t understand this in the first read, read again, please. Reading convoluted texts is a skill all law students and young lawyers should develop).

Think: While we’ll discuss contract drafting in later modules, please keep *certainty, predictability, and enforceability* in mind as a draftsman. Is your contract certain, predictable, and enforceable? Is each clause in your contract certain, predictable, and enforceable?

By executing a contract, the parties to the contract who invariably have conflicting needs can align their common interests and carry out their obligations.

3. Theories of Contract Law

Over the years, several theories have emerged to understand contract law from a philosophical perspective. These theories have also helped explain, to an extent, the aspect of enforceability of a contract. Alan Schwartz, who is a leading authority on contract law, notes that contract law does not have a completely descriptive theory (a descriptive theory of law which explains what the law “is”) or a complete normative theory (a normative theory of law tells what the law “should be”). (Sometimes what the

law is, is not what the law should be). It is perhaps due to this reason there are so many different ways to look at the theoretical foundations of contract law.

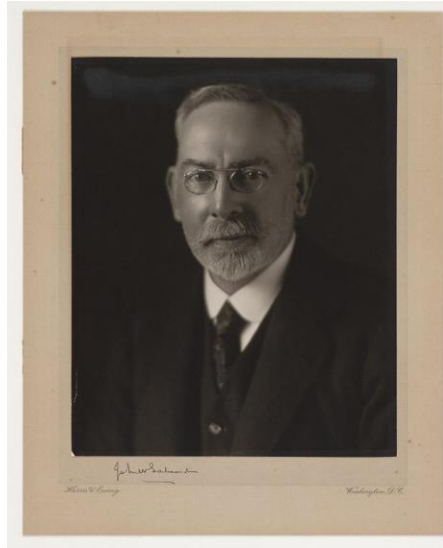
Why should you worry yourself with the ‘theories’ of contract law? Well, a ‘theory’ of contract law is a **particular lens** from which you view the ‘contract law’. Viewing or seeing things from one lens gives us one perspective; changing our lens shows us another perspective. Having various lenses through which you look at the contract law will help you understand, analyze, and critique the subject of contract law, and even contracts in a more nuanced manner. That’s why we say, good theory feeds into good practice and good practice feeds into good theory.

Of the several theories, we will briefly look at the four key theories:

- **Classical theory or the will theory:**

The ‘Classical Theory’ or the ‘Will Theory’ is regarded as the oldest theory of contract. According to this theory, a contract is enforced to **respect the will of the parties** who have entered into the contract.

Renowned jurist Salmond is a proponent of the will theory. Will theory also sets the ball rolling for one of the essential elements of the formation of a contract: **meeting of the minds or consensus ad idem**. The will theory also emphasizes on freedom of parties to enter into a contract: this is a jurisprudential concept which states that contracts are based on mutual agreement and **free choice** of the parties. Accordingly, contracts should not be hampered by external control.



John Salmond

Therefore, a *contract between parties who are free and willing to contract* and agree to do or not do something should be enforced unless the consideration for such a contract is unlawful. The will theory also throws light on the aspects of liability of parties to a contract: as the parties have willingly decided to enter into a contract, they must also suffer the liabilities arising out of such a contract. Interesting, right?

However, the will theory has been criticized by several jurists, mainly on the ground that there is no yardstick to measure the intention of the parties and intention can only be conferred through conduct.

- **Promise Theory**

The cornerstone of this theory is, yes you got it right, it's a **promise!** If there is a promise made which is valid and supported by a lawful consideration, then it is enforceable by law. Promise theory works on the concept of **reciprocity**: everyone in society expects that the person for whom he has done something, will also do something useful to him.

Kant, who is one of the supporters of the promise theory, stipulates that the duty to uphold the promise made to another person is what leads to a **rational society**. According to Roscoe Pound,¹ promises are equivalent to modern wealth and it is important to uphold the enforcement of such promises to maintain 'wealth' as the basis of civilization. Any promise made during a commercial transaction must be enforced.



Immanuel Kant

One flaw in this doctrine is that it does not take into account the concept of privity of contract² as the sole assumption of this theory is, if a promise has been made, it should be enforced, even if the enforcement is initiated by a third party.

The primary criticism against the promise theory stems from the glorification of the individual autonomy over everything else: promise theory operates on the premise that once a promise has been made and fulfilled by the promisor, the purpose or objective behind the promise loses sight. Secondly, promise theory

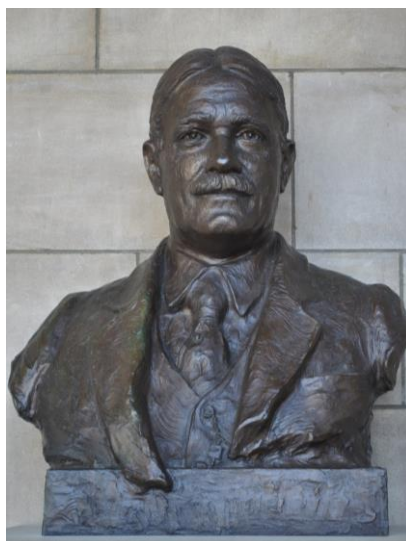
¹ Pound emphasized on the importance of social relationships in the development of law. He is famous for his theory of law as a tool of social engineering.

² The doctrine of privity of contract says that a contract cannot confer rights or impose duties upon a person who is not a party to the contract.

also does not respect the freedom of parties to enter into a contract. Under the promise theory, the promisor will not be in a position to change or rescind the original contract at a later stage. The problem with the promise theory is that it does not respect the free will of the parties. It would be unimaginable for people to live in a rigid society which makes it mandatory for every person to fulfill the promise made, irrespective of the nature or illegality of the promise.

- **Social Theory**

This theory has been propounded by renowned jurist **Roscoe Pound**. Pound's theory of '**social engineering**' endeavors to strike a balance between competing interests in society by securing satisfaction of the maximum wants with minimum friction. The 'social theory' finds its roots in the sociological school of law. Once again, the privity of contract is not paramount for this theory as it advocates enforcement of the claims of a stranger to a contract. The motivation behind doing so is to provide the promised relief and also promote a good, responsible economy.



Roscoe Pound

Once a contract is enforced from the viewpoint of social interests, **a third party** that seeks to derive the benefit from this contract is allowed to sue based on such

a contract. This theory is criticized because it puts too much emphasis on social interests at the cost of the interest of the individuals.

- **Economic theory**

Contracts can also be viewed from the lens of economics. According to **Richard A. Posner**, whose seminal work is titled, *An Economic Analysis of Law*, contract law performs three significant economic functions:

- It provides economic incentives for individuals to exchange goods and services efficiently.
- The costs of economic transactions are reduced as the terms and conditions of a contract and are spelled out.
- It alerts the parties involved against any impending troubles - if the parties discover the issues that have arisen in the past, it becomes easier to avoid potential pitfalls and execute the transaction smoothly.



Richard Posner

4. The development of contract law

While contracts are extremely commonplace in the present day, the formal evolution of the law around contracts took considerable time. The relationship among people in Feudal Europe was through well-defined roles; traditionally, duties were spelled out that made each person responsible to the family or the tribe, or the king. The need for a formal contract was not necessary.

According to **Henry Maine**, the development of contracts and the law around it was a direct result of the **emerging industrial order**. That '*necessity is the mother of invention*' came into play as England became a booming industrial hub with flourishing trade and a capitalistic economy - the law of the contract was, thus, a product of necessity. In an industrial, trade-led economy it was important to spell out the roles and responsibilities of each party who had to perform a task. And how would you do that? Through the instrument of a contract!

Self-reflective exercise: Individual will, promise, society's interests, and the economy's interests are the buzzwords behind each of the theories listed out here. These theories were propounded by philosophers/scholars, and we'd like to tell you too that you too are a philosopher/scholar. The 'bigger' questions of life, law, and contracts are the domains of everyone. So, here's a challenge for you: try coming up with your 'theory' of contract law and post it on the discussion forum.
